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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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SIGNIFICANT ENVIRONMENTAL LITIGATION

Trio of Recent Decisions Create Uncertainty for Franchisors and Equipment Manufacturers

While courts will generally impose liability under the federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) on manufacturers or distributors for personal injuries and property damage caused by products placed into the stream of commerce, courts have established the "useful product exception" doctrine that insulates equipment or product manufacturers or distributors from liability as a CERCLA "arranger" or generator when hazardous substances contained in the products are subsequently released while the product is put to productive use. This doctrine is intended to prevent parties from avoiding generator liability by characterizing transactions as sales of products when they are in fact arrangements to dispose of hazardous substances. However, what happens if the vendors provide advice or technical services that facilitate the disposal of hazardous substances? Moreover, what is the impact when the services or advice is provided as part of a franchise agreement? Two federal courts recently allowed operators of dry cleaner businesses to seek contribution from their equipment manufacturers on two different theories of liability, while the Texas Supreme Court rejected a lawsuit because of insufficient evidence.

In *Berg v. Popham*, 2005 U.S.App. LEXIS 12412 (9th Cir. 06/24/05), the United States Court of Appeals of the Ninth Circuit reversed a district court ruling and allowed former operators of a dry cleaner business to proceed with a contribution action under the state superfund law against the successor of the manufacturer of its dry cleaning equipment. In this case, the plaintiffs owned and operated the "Boni-Park" laundry and dry cleaning business under a franchise agreement with Norge Corporation (Norge). The dry cleaning equipment plant used perchloroethylene (PERC or PCE) as a cleaning solvent that was mixed with water during the cleaning process. A "water/PERC separator that captured the dirty PCE was installed so that the separator water was discharged through a floor drain into the sewer system. The plant also contained a still where the PCE was heated to separate it from oil and dirt residue. This process generated a PCE-contaminated sludge that was also flushed into the sewer system. At some point, PCE escaped from the sewer lines and into soils near the Boni-Park facility.

In 1988, the State of Alaska notified the plaintiffs that they were potentially responsible parties (PRPs) under the state version of CERCLA. After incurring over $1 million in cleanup costs, the plaintiffs sought contribution from Maytag Corporation (Maytag) as the

successor to Norge. The district court granted Maytag's motion to dismiss on both CERCLA and the state superfund law. On appeal, the Berg's did not contest the dismissal of the CERCLA claim but argued that the district court had misinterpreted the state superfund law claim because of a slight difference in language between the two statues. The Ninth Circuit then certified the interpretation of the state superfund law to the Alaska Supreme Court.

The Alaska Supreme Court ruled that the state legislature had inserted an "or" in front of the phrase "by any other party or entity" in the state superfund law. The court said that the state superfund law was amended after the 1989 Exxon Valdez incident to create a fifth category of PRPs who own or have control over hazardous substances at the time of the release. The court said that to be liable as a generator under the state superfund law, a PRP must have actual or substantial involvement in decisions over disposal of wastes. Examples of such substantial involvement, the court went on, could include designing, installing or connecting a system that disposes of waste on behalf of a third party. Because Norge had designed and connected the plant at the Boni-Park facility to the sewer system, the Alaska Supreme Court found that Norge had actual involvement in the disposal of the PCE. The state court also found that while the state superfund law did have a useful product exception, it was narrower than the CERCLA exception. Moreover, the court said the exception did not apply in this case where machines and services were specifically designed to release hazardous substances as part of their routine operation. Based on the Alaska Supreme Court interpretation, the Ninth Circuit ruled that the plaintiffs had pled sufficient facts to support a claim under the state superfund law and remanded the case back to the district court for further proceedings on the state contribution claim.

California Department of Toxic Substances Control v. Payless Cleaners, 2005 U.S. Dist. LEXIS 7873 (E.D.Ca. 3/4/2005) also involved a contribution claim brought against Maytag as the successor to Norge. There, the state Department of Toxic Substances Control (DTSC) brought a cost recovery action against various businesses and property owners in connection with a two-mile wide plume of PCE located near the central business district of Chico, California. One of the defendants was the Peters Family Trust (Peters) that owned property where the Norge Village Cleaner had formerly operated. The Peters brought a third-party claim against Norge/Maytag, arguing that Norge was liable under CERCLA as an arranger because it had controlled the layout of the dry cleaner plant and floor drains, and installed the plant so that it would discharge PCE into the sewer system. On Maytag's motion to dismiss, the court agreed that Maytag was not liable as an arranger under the useful product exception, but allowed Peters' operator claim to proceed under a controller theory. The court said that in Ninth Circuit, a party that did not actually possess or own hazardous substances at the time of disposal

could nevertheless be liable if it had the authority or duty to control the disposal and actually did dispose of the waste. The court found that the manual instructions were akin to recommendations and did not constitute actual exercise of control over ultimate disposal because the dry cleaner was free to choose a different method of disposal. However, because Maytag selected the location of the floor drains, installed the floor drains and then annually inspected to ensure that the wastewater was in fact being disposed as designed under its franchise agreement, the court found that there were sufficient facts pled to suggest that Maytag had at least shared in the decision-making over the disposal of the PCE if not actually authorized or approved the discharge into the sewer system.

The Texas Supreme Court reached a different conclusion in In *R.R. Street & Co. Inc. v. Pilgrim Enterprises, Inc*., 2005 Tex. LEXIS 437 (June 10, 2005) when it ruled that a manufacturer of dry cleaning equipment and chemicals was not liable as a generator under the Texas Solid Waste Disposal Act (SWDA). In this case, family-owned Pilgrim Enterprises, Inc. (Pilgrim) operated a chain of dry cleaner businesses for 50 years in Houston and San Antonio. In 1994, the owners of Pilgrim decided to sell the businesses and discovered PCE contamination at 16 of its 20 facilities. Pilgrim then entered into a voluntary cleanup agreement with the Texas Natural Resources Conservation Commission (TNRCC) and incurred $7 million in remediation costs. The company then sought recovery of its costs from various manufacturers under the Texas SWDA and common law theories.

All the defendants except R.R. Street & Co., Inc. (Street) reached settlements prior to trial. Pilgrim claimed that Street should be liable as a generator under the SWDA because Street instructed Pilgrim how to dispose of PCE-contaminated wastes. Street had sold Pilgrim filters that recycled dirty PCE through cartridge filters that had to be periodically replaced. Following industry practice, Pilgrim disposed of used filters in dumpsters. Street also sold stills to Pilgrim that were used to evaporate and separate PCE from water. Pilgrim disposed of the sludges at the bottom of the stills in the dumpsters and said it was instructed by Street to dispose of the separator water into the sewer system. Pilgrim also charged that the principal of Street periodically visited its facilities to test the concentration of the detergents in the dry cleaner plant and then disposed of vials of PCE-contaminated water in the sinks or toilets. After a trial court found in favor of Street, an appeals court reversed and held Street liable for $1.5 million in cleanup costs. However, the state Supreme Court found that the facts did not establish that Street was a generator under the SWDA because there was no evidence that Street actually controlled disposal practices or owned the chemicals. Under the circumstances, the court said that merely providing advice was insufficient to impose generator liability since Pilgrim was under no obligation to follow the advice.

Commentary: *These cases have implications not only for vendors and franchisors, but also for environmental contractors who design remediation systems and perhaps even businesses that emit hazardous air pollutants that may be deposited in surface waters and soils near a plant. There are numerous lessons and cautions that can be drawn from these cases.*

First, the Pilgrim case can be distinguished from the Berg and Payless cases since Pilgrim only involved a vendor who provided technical assistance and did not actually install the system. Moreover, the Berg and Payless cases involved franchisees that seemed to have less control over some aspects of their operations. Thus, it would appear that manufacturers and vendors who limit themselves to the sale of physical goods and technical manuals should continue to avail themselves of the useful product exception.

Second, these cases also reflect the importance of carefully reviewing state superfund laws in transactions. The Berg and Street cases had different results partially because of the different language of the statutes. The Payless case was also influenced by the precedent in the Ninth Circuit that does not require actual ownership of hazardous substances for imposition of arranger liability.

Third, an increasing number of CERCLA contribution actions are being filed against franchisors. Most of these cases have involved gasoline service stations where the dealership either disposed of waste motor oil and the plaintiff seeks to impose liability on the oil company as an arranger or where there has been a release of gasoline at the dealership and operator liability is sought to be imposed on the oil companies. In the typical franchise relationship, the franchisor sells the right to operate under its name to a franchisee in exchange for some form of consideration. The franchisee operates much like a business since it invests its own capital in the business, incurs the expenses, and retains the net profits generated by the business; however, the franchisor retains a certain degree of operational control over each franchisee. Lawsuits have been filed against franchisors over the years on the grounds that the franchisor's control over the franchise business, either by actual exercise over the day-to-day operations or through the inherent authority contained in the franchise agreement created an agency relationship for which the franchisor was vicariously liable. Other courts have also imposed liability on an apparent agency theory where it was reasonable for a third party to believe that the relationship between the franchisor and franchisee was as master/servant. Another possible theory of liability is the tort principle of non-delegable duty for inherently dangerous activities. If a court finds that the disposal of waste oil is inherent in the service station business and is also an inherently dangerous activity, then the court could conclude that the franchisor could still be liable for the acts of its franchisee, even if it is considered an independent contractor since the disposal of waste oil would be a non-delegable duty.

Factors that courts have used in determining whether a franchisor should be held liable for the damages caused by its franchisee include whether the franchiser is involved in the hiring and firing of employees, setting of wages and benefits, selection of uniforms, control over promotions, establishing pricing and size of products, such as meals, hours of operation, requiring use of forms and supplies, and mandating certain methods of financial reporting or recordkeeping. The difficulty in practice has been that courts seem to attach different weight to different factors. For example, the right to specify hours of operation has been dispositive in some jurisdictions but not in others. Further complicating the task of delineating a clear test for franchisor liability is the variety of franchising relationships and agreements. For example, not all franchisors offer training and continuing assistance to their franchisees nor do all franchisors sell or lease equipment or inventory. Some franchisors charge franchise fees while others also take commissions or royalties on sales or some combination of both. In some ways, the franchiser cases are similar to the parent/subsidiary cases since there is some degree of mutual interdependence yet at the same time both entities retain a level of independence.

There are no reported cases of a franchisor being held derivately liable by virtue of its control over the operations of the franchisee. These decisions are extremely fact-sensitive. For example, in ACME Printing Ink Co. v. Menard, Inc., 812 F.Supp. 1498 (E.D. Wis. 1992), the court found no evidence that Texaco had been responsible for waste oil disposal but because no discovery had been conducted, the court ruled the motion was premature. However, the Indiana Supreme Court affirmed a lower court ruling that the oil company was liable for contamination caused by USTs at a franchisee location because a commissioned fuel deliverer or "jobber" hired by Shell from 1946 to 1963 could be considered an operator of the USTs. In Shell Oil v. Meyer, 705 N.E.2d 962 (Ind. 12/6/98) landowners whose properties were impacted by a former gasoline station sought $ 2,743,660.21 in corrective action costs from Shell Oil and Unocal. The oil companies argued that they were simply gasoline wholesalers who were not responsible for the USTs. The Indiana Supreme Court agreed with the lower courts that the Shell fuel deliverer was responsible for checking the tanks, determining how much gasoline to dispense and filling the tanks. Since these actions were essentially all that was required during that time period for operators of tanks, the court found Shell not liable for the acts of its agent from 1946 until Shell sold its storage plant in 1963 when the new storage terminal owner retained the jobber. For the same reasons, Unocal which began supplying fuel to the storage terminal in 1971, was also found not liable.

Finally, because the Payless Cleaner decision premised Maytag's arranger liability under its control over disposal decisions, it is not too hard to imagine government agencies or private plaintiffs using this language to seek to liability

under state laws with similar wording on property owners who install underground storage tanks for a prospective tenant or landlords who fail to enforce lease terms that require tenants to comply with environmental laws.

Actual Contamination Not Required to Maintain CERCLA Contribution Action

May a property owner seek recovery under CERCLA for investigation costs if it turns out the property was not in fact contaminated? In *Doyle v. Town of Litchfield*, 2005 U.S. Dist. LEXIS 10860 (D.Ct. 5/31/05), the U.S. District Court for the District of Connecticut ruled that contamination of a property was not a condition predicate to seeking recovery of response costs. In this case, the plaintiff acquired a parcel of property approximately a quarter-mile from a former municipal landfill. After noticing an orange sheen on a pond on the property along with dead fish and pollywogs, the plaintiff learned that the former landfill had been the subject of enforcement actions and that leachate had been migrating from the landfill. The plaintiff conducted an investigation to determine if the former landfill had impacted the property and filed an action in state court which found no evidence of contaminants above applicable state standards. The plaintiff then filed a cost recovery action in federal court. The defendant municipality argued that the plaintiff could not maintain its action because there was no evidence that the former landfill had impacted the plaintiff's property. However, the court held that a plaintiff was not required to demonstrate actual contamination, but simply that the response costs were incurred as a result of a release at a facility. Since there had been a release at the former landfill and the plaintiff had responsible belief that its property could have been impacted, the court denied the defendant's motion for summary judgment.

Bankruptcy Court Rules Debtor Not Required to Fund Long-Term Groundwater O&M

A bankruptcy court has ordered that a debtor is not required to comply with a consent decree requiring it to pay for 13% of the long-term monitoring and maintenance program for a groundwater treatment system at two disposal facilities. In *In re FV Steel and Wire Company,* 2005 Bankr. LEXIS 724 (Bankr. E.D. Wisc. 2005), the debtor was notified in 1990 that it was a PRP for two disposal facilities where it had arranged to dispose hazardous substances. In 1992, the debtor entered into a partial consent decree where it agreed to make payments to the PRPs performing the remediation, reimburse EPA and the State of Indiana for certain past response costs and payment of civil fines. At the time that the debtor filed a Chapter 11 bankruptcy petition in 2004, the only remaining tasks were long-term operations and maintenance of the groundwater treatment system.

EPA requested a ruling from the bankruptcy court that the automatic stay would not operate to prevent the agency from enforcing the consent decree against the debtor under policy and regulatory exception of section 362 of the

Bankruptcy Code. Because the remediation was already completed and the only obligation of the debtor under the consent decree was to make payments equal to 13% of the costs for operating the groundwater system, the court said EPA was seeking to collect a money judgment. Therefore, the automatic stay barred the collection effort.

Commentary: *This case could have implications for enforcement of engineering controls. Approximately 80% of CERCLA cleanups now have some form of institutional or engineering controls. The cleanup decisions are predicated on the assumption that future parties will comply with the restrictions. Unless a funding mechanism is established for the estimated long-term maintenance costs, the PRPs may find themselves ordered to perform additional remediation. Indeed, as discussed in our last issue, EPA will be implementing an institutional control tracking system (ICTS) for its Superfund program where it will begin reviewing nearly 900 Construction Complete (CC) sites to evaluate the effectiveness of institutional controls (ICs) at those sites.*

Federal Appeals Court Rules Purchaser Did Not Contractually Assume Liability

In *Honeywell International, Inc. v. Phillips Petroleum Co.,* 2005 U.S. App. LEXIS 13112 (5th Cir. 6/30/05), the federal Court of Appeals for the Fifth Circuit held that the defendant had no contractual obligation to indemnify for remediation costs associated with a refinery that the plaintiff acquired and subsequently sold.

In this case, The Signal Companies sold a refinery to Lone Star in 1968. Later that year, Signal reorganized itself as a holding company with three subsidiaries under a master agreement. Signal transferred its natural resources assets owned by Signal on the effective date of the agreement to Signal Oil & Gas that provided for the subsidiary to assume liabilities associated with those assets. In 1974, a supplemental agreement provided that Signal Oil assumed all liabilities and assets related to the natural resources business as of January 1, 1970. In 1992, Lone Star brought a contribution action against Honeywell, the successor of Signal. Honeywell, in turn, sought contractual indemnity from Phillips, the successor of Signal Oil.

The district court ruled that the master agreement limited the scope of Signal Oil's liability to the assets received and that the 1974 agreement did not alter this arrangement since it applied to the assets referenced in the master agreement. Since Signal had sold the Lone Star refinery two years before the master agreement, that refinery was not included in the assets for which Signal Oil had agreed to assume liability. The Fifth Circuit affirmed, finding that Signal could have required Signal Oil to assume all liabilities associated with its natural resources business for assets presently or formerly owned.

Nevada Supreme Court Declines To Hold Consulting Firm Liable As

Successor

The Nevada Supreme Court declined to apply the continuity of enterprise theory of successor liability in *Village Builders 96, LP v. U.S. Laboratories, Inc.*, 2005 Nev. LEXIS 29 (Nev. 2005). The court then found that a purchaser of the assets of an environmental consulting firm was not liable in connection with a Phase I performed by the seller under the traditional state tests for successor liability.

In this case, the principal of Buena Nevada (BN) sold 100% of the stock to Geofron, Inc. (Geofron) in December 1996. Geofron renamed the acquired business as Buena Engineers, Inc., a division of Geofron, Inc. (Buena Geofron). As part of the sales agreement, the former principal of BN reserved the right to repurchase the shares of Buena Geofron. He never acted as an officer of Buena Geofron, but served as a sales manager.

In 1997, Buena Geofron performed a Phase I environmental site assessment and a limited subsurface investigation for the plaintiff on a property that contained a car wash and gas station. Buena Geofron did not find any impacts to the property from the gas station and plaintiff proceeded to purchase the property for $2.8 million in September 1998. However, the plaintiff learned the site was contaminated three months later and advised Buena Geofron, who performed additional investigation and submitted a site characterization report to the Nevada Department of Environmental Protection (NDEP) in March 1999. The plaintiff then retained Buena Geofron to perform the remediation.

Meanwhile, the former principal of BN was in the process of negotiating a sale of Buena Geofron to the defendant. In May 1999, the former principal exercised his right to purchase the stock of Buena Geofron, placed them back into BN, and then sold the assets and the goodwill of BN to the defendant for cash. The defendant placed the assets in a new subsidiary, Buena Delaware. The new company retained many of the same employees, used the same company facilities and logo for over a year, performed the same services and did not alter the contracts it assumed under the purchase agreement. The purchase agreement did provide that the defendant would not assume liability for litigation matters commenced after the closing but arising out of actions that occurred prior to the sale.

In August 1999, the plaintiff filed an action to recover its cleanup costs against the former owners of the property. After learning that the defendant had acquired BN, the plaintiff amended its complaint to add claims for negligence and breach of contract against the defendant. The trial court granted summary judgment to the defendant as well as attorney costs.

On appeal, the Nevada Supreme Court declined to find the defendant liable under the *de facto* merger exception for imposing liability on purchasers of corporate asset. The court ruled that there was no continuity of shareholders between BN and Buena Delaware because the principal never owned any of the Buena Delaware stock. In

addition, the court said there could not be a *de facto* merger when the selling corporation continues to exist after the transaction, no matter how meager its existence. The court also refused to apply the mere continuity exception because there was more than one corporation surviving the closing.

Commentary: *The general rule for successor liability is that (unlike purchasers of corporate stock) purchasers of corporate assets do not assume liabilities associated with the business unless one of four exceptions exist. The exceptions are: the purchaser expressly or impliedly assumed the liabilities; the transaction was fraudulently entered into to avoid liabilities; the transaction amounted to a de facto merger; or the purchaser is a mere continuation of the seller.*

As witnessed in this case, these exceptions are difficult to establish because they generally require that there be continuity of ownership (i.e., at least one stockholder). Thus, as in this case where there was a cash transaction, the plaintiff could not show there was a continuity of shareholders.

Due to the difficulty of satisfying these traditional exceptions to the general rule of non-liability for asset purchasers, federal courts began adopting the so-called "Substantial Continuity" or "Continuity of Enterprise" theory as federal common law in the 1980s and 1990s when addressing CERCLA liability claims. This test is a relaxed version of the "mere continuity" test since it focuses not on the survival of corporate entity but whether the purchaser continues the business in substantially the same form. The idea is that if the purchaser holds itself out as a continuation of the business to take advantage of the goodwill of the predecessor, then it should also be held accountable for the liabilities associated with that enterprise. Another rationale was that applying a uniform federal common law would promote consistent enforcement of federal laws like CERCLA.

It appears that the high-water mark of this theory occurred in the 1998 after the United States Supreme Court ruled indicated in United States v. Bestfoods (524 U.S. 51) that the a parent corporations could only be liable as a CERCLA operator if the state common law rules for piercing the corporate veil were satisfied or if the corporation could be shown to have directly operated the facility. While Bestfoods only addressed the liability of parent corporations, it is slowly but surely serving as the impetus for reversing the line of cases that imposed liability on successor corporations under a federal common law analysis. In 2003, the United States Court of Appeals for the Second Circuit ruled that the substantial continuity test was no longer valid for determining successor liability under CERCLA, New York v. National Service Industries Inc., No. 02-9227, 12/17/03). Both the First and Ninth Circuits have rejected the substantial continuity test in the wake of Bestfoods.

In this case, the Nevada Supreme Court first observed that there was a trend away from use of the Substantial Continuity test and since there were no CERCLA claims

involved in the litigation, the court did not have to address the issue.

Federal District Court Silicosis Ruling May Have Broad Implications For Mass Tort Cases

In a highly critical 249-page decision, a federal district court judge accused plaintiff law firms, screening companies and doctors of manufacturing a "phantom epidemic" of silicosis claims. As a result, Judge Janis Graham Jack concluded that most of the 10,000 individual claims should be remanded to state court for further proceedings. *In Re: Silica Products Liability Litigation, No. 1553 (S.D. Tex. 6/30/05)*. In the one case for which she retained jurisdiction, Judge Jack excluded the testimony of the plaintiffs' medical experts. As a result of the testimony in this case, a federal grand jury has been convened in New York.

Silica, which is also known as silicon dioxide, is the second most common element in the earth's crust. It is the primary ingredient in sand and 95% of the earth's rocks. Silica dust may be generated when sand or rocks are chipped, cut, drilled or ground. The silica particles can be inhaled and trapped within the lungs, causing swelling and scarring. Over time, the impacted area will become swollen, making breathing difficult. Eventually, the lungs will fail. The disease is progressive and incurable with the only treatment being a lung transplant. Chronic silicosis usually results from 15-20 years of low exposure to silica while acute silicosis can occur after as soon as six months after exposure to high levels of respirable silica particles.

According to the Centers for Disease Control and Prevention (CDC) as well as the National Institute for Occupational Safety and Health (NIOSH), there has been a steady decline in the incidence and mortality of silicosis during the past 30 years, with deaths decreasing from 1157 in 1968 to 187 in 1999. Although Mississippi had one of the lowest rates of silicosis, the number of silicosis cases filed in the state skyrocketed between 2002-04 suggesting there might be a silicosis epidemic. Indeed, more silicosis claims were filed per day during the two-year period than had been filed each of the preceding two years. Some suggested that the flood of silicosis filings was related to the looming effective date of tort reform legislation in Mississippi.

In September 2003, the Judicial Panel on Multidistrict Litigation (MDL) transferred the 111 silica cases to United States District Court for the Southern District of Texas. After nearly two years of pre-trial proceedings and discovery, the MDL case took a dramatic turn in October 2004 when one of the screening doctors withdrew his silicosis diagnosis during a deposition. When two other doctors testified that the screening company had inserted diagnostic language in their reports and had stamped their signatures without providing the doctors with the opportunity to review the final report, the judge ordered a Daubert hearing and court deposition for the remaining diagnosing doctors and screening companies.

In her order, Judge Jack found that a "small cadre of non-

treating physicians, financially beholden to lawyers and screening companies rather than to patients, managed to notice a disease missed by approximately 8,000 other physicians." In fact, nine non-treating doctors accounted for 99% of the silicosis diagnoses. The court said that the diagnoses failed to meet minimum, medically-acceptable criterion for diagnosing silicosis. Among the deficiencies the court noted was that law firms had prepared the occupational histories, the pulmonary function tests had been manipulated and that approximately 60% of the plaintiffs had previously filed asbestosis claims. The court noted that it was extremely rare for asbestosis and silicosis to occur in the same patient.

Commentary: *This decision could dramatically alter the landscape for approximately 750,000 asbestosis cases because many of these cases involve the same screening companies and doctors who repudiated their silicosis diagnoses. Defense counsel often have been reluctant to challenge the veracity of the medical claims. However, Judge Jack established a relatively high medical standard for the screening process that could embolden defendants to forcefully use the discovery process to challenge diagnoses or force plaintiffs to produce medical evidence that will satisfy this higher threshold.*

The decision and the grand jury investigation could also unleash a new wave of litigation over claims that have already been paid. More than 70 companies have filed for bankruptcy because of their asbestos liability and it is not inconceivable that plaintiffs who were truly injured but received less compensation because of the false claims could bring claims against the law firms that brought the false claims. It is also possible that we may see more objections to asbestos settlements in bankruptcy proceedings to ensure that money is preserved for those who actually suffer from asbestosis.

Purchasers Not Liable as Successors for Asbestosis Claims

Building on the preceding case discussions, two New York state courts held that asset purchasers did not assume the asbestos liabilities of their predecessors under a successor liability theory.

In re: New York City Asbestos Litigation, N.Y. App. Div. LEXIS 1542 (1st Dept-App. Div. 2/15/2005), involved a plaintiff/decedent that had allegedly been exposed to asbestos in products manufactured by Hardie-Tynes Manufacturing Company (Hardie) during his military service from 1957-1972. In December 1997, Hardie sold substantially all of its operating assets for $1 million cash to H-T Acquisition, Inc. (New H-T). In 2002, the plaintiff's estate sought to recover damages from, New H-T as the successor to Hardie on a *de facto* merger theory after Hardie's insurance carrier became insolvent.

The trial court granted the defendant's motion for summary judgment that it could not be liable as a matter of law under the *de facto* merger exception. The appeals court affirmed the dismissal. The court found there was no continuity of shareholders, which the court said was essential to a de facto merger

finding. While Hardie had ceased ordinary business operations, the court found it had not been dissolved. The court noted that the asset purchaser agreement required Hardie to retain various corporate records and to maintain its corporate existence for at least two years, subject to a right to convert to a limited liability corporation. The appeals court did acknowledge that the requirement that the seller be dissolved to satisfy the *de facto* merger test could be met if the selling corporation continues to exist simply as a shell corporation shorn of any assets. In this case, though, the court said that Hardie had a meaningful post-closing existence. The court observed that the agreement provided that Hardie would retain substantial assets after the sale and would have to perform certain obligations including reimbursing New H-T for warranty repair work, bearing half the cost of product liability insurance coverage claims and indemnifying New H-T for third party claims arising out of the conduct of the business prior to the sale. The court also found that Hardie's lack of insurance coverage was not a result of the transaction, but due to the insolvency of the insurance company that provided liability coverage during the relevant period as well as that the coverage it did subsequently obtain had an absolute exclusion for asbestos-related claims.

In re Seventh Judicial Dist. Asbestos Litigation, 788 N.Y. S.2d 579 (Sup. Ct-Ontario Cty. 1/12/05) involved claims for personal injury and death against a distributor of auto parts containing asbestos. In this case, the plaintiff's estate alleged that the plaintiff had purchased replacement brakes for several trucks during the 1960s from Finn of Canandaigua, Inc., d/b/a Finn's Auto Parts (Finn). In May 1997, Hahn's Automotive Warehouse, Inc. (Hahn) entered into an asset purchase agreement with Finn to acquire all of the fixed assets, inventory of auto parts, goodwill, customer list and "relate files and records as are reasonably necessary for the continuation of the business." The agreement also provided that Hahn could use the Finn name, an employment contract for a store employee and a covenant not to compete from the seller. Hahn did not assume any liabilities under the agreement. Hahn replaced the store supervisor within a short time, began using its own invoices and eventually moved the store to a new location. Finn did not conduct any business after the sale, but failed to file a certificate of dissolution until 17 months after the closing.

The plaintiff argued that Hahn should be liable as a successor under the "mere continuity" exception or alternatively under the "substantial continuity" test. The court found that the defendant was not liable under the "mere continuity" exception because Finn continued to survive for neatly one and one-half years after the closing.

For the "substantial continuity" test, the court noted there was some confusion whether the New York Court of Appeals (the state's highest court) had rejected the use of this doctrine. Even if the doctrine could be used in New York, the court found that none of the public policy

considerations applied to this case.

Some of the factors cited by the court were that Hahn changed the nature of the business from retail to primarily wholesale and changed the physical location. Most importantly, the court held that "substantial continuity" has been invoked to prevent plaintiffs from having their rights extinguished by a transaction. Here, because the defendant was simply a distributor of products, the plaintiff could still pursue a remedy against the manufacturer of the products. As a result, the court said there was no basis for applying the doctrine against Hahn and dismissed the claim.

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DISCLOSURE/AUDITS

Owners of Elderly Housing Projects Agree to $3.6 Million Settlement

Two limited partnerships that own elderly housing complexes in North Providence, RI, have agreed to pay $3.6 million and turn over 75% of any insurance proceeds to EPA to resolve their potential liability for response costs and natural resources damaged arising from contamination that pre-dated the construction of the Section 8 residential housing. *United States v. Brook Village Associates Limited Partnership and United States v. Centerdale Manor Associates (D.R.I.).* Because the only significant assets of the partnerships were the apartment buildings that provide affordable housing to the elderly, the partnerships will raise the settlement proceeds by refinancing their mortgages with Rhode Island Housing and Mortgage Finance Corporation. The $3.6 million mortgage represents the maximum equity that could be realized from the property. The partnerships will also be required to continue providing affordable housing to the elderly for the next 40 years. In exchange for the payments and other commitments, the two partnerships, their current and former general and limited partners, and their officers, directors, heirs, successors and assigns will receive a covenant not to sue from EPA and Rhode Island but only to the extent that their liability arises solely as a result of their status as and in their capacity as a partner, officer, director, heir, successor, or assign of Brook Village or Centerdale Manor. The settlements also provide a covenant not to sue and contribution protection to the Rhode Island Housing and Mortgage Finance Corporation.

Prior to the construction of the residential complexes, a chemical manufacturer and drum reconditioning facility that operated an incinerator had occupied the site. After a fire destroyed most of the structures in 1971, the Rhode Island Department of Environmental Management (RIDEM) conducted a number of investigations and performed a limited cleanup. Brook Village apartment complex was constructed in November 1977 to provide affordable elderly housing. In 1982, RIDEM removed approximately 400 drums from the site and required sampling prior to the construction of the Centerdale Manor complex. Approximately 6,000 cubic yards of contaminated soil were removed during the construction of the complex. After additional contamination was detected in 1999, EPA issued a series of unilateral orders to the partnerships and other responsible parties that required installation of an interim soil cap and certain flood control measures to minimize impacts to the Woonasquactucket River.

Commentary: *Many lenders, especially those participating in the Fannie Mae Delegated Underwriting and Servicing (DUS) program, do not require comprehensive*

environmental due diligence for multi-family projects because these properties are viewed as not likely to have significant environmental liability. This tendency is often exacerbated where elder housing or nursing homes are involved because children are seldom expected to be present. Where due diligence is conducted and reveals that a cleanup has been performed in the past, it is important to evaluate the comprehensiveness of that cleanup, especially when the remediation was performed in the early stages of the federal or state cleanup programs.

Oops! Residential Phase I Fails to Detect Property was Formerly Used As WWII Bombing Range

An environmental consultant recently performed a Phase I environmental site assessment (ESA) on a multi-family complex for a lender participating in the Fannie Mae Delegated Underwriting and Servicing (DUS) product line. Because the residential complex was constructed in 1970 and the property appeared to be undeveloped prior to that date, the consultant did not research historical sources past that date.

Lender's environmental counsel advised the consultant that the bank's scope of work required compliance with ASTM E1527-00, requiring consultant to review historical sources back to 1940 or first use, whichever was later. Upon reviewing additional historical sources, environmental consultant learned that the United States Army had formerly owned the property during World War II and that a portion of the property had been used as a training range for aerial gunners. Fortunately, the portion of the property where the residential development was located was not part of the actual training range and did not present a risk to the property.

Commentary: *This incident illustrates the importance of performing comprehensive historical environmental due diligence on properties that may appear to currently have benign environmental uses. This includes researching historical sources back to 1940 or first use, whichever is later and using intervals of no more than five years. For older shopping centers, it would also be advisable to review tenant directories to determine if dry cleaners and gasoline stations may have operated in the past at the site. To protect the lender or borrower when the consultant is unable to trace the historical sources back to 1940 or first use, the consultant should be required to indicate in the report that data failure as defined by section 7.3.2 of the ASTM E1527-00 has occurred, but that the data failure is not significant and does not alter the conclusions of the report.*

Shareholders Ask SEC to Compel Greater Disclosure from Dupont

DuPont Shareholders for Fair Value (DSFV) has asked the Securities and Exchange Commission (SEC) to investigate if company executives have failed to adequately disclose potential liability associated with perfluorooctanoic acid (PFOA) which is used in the manufacture of non-stick coatings such as Teflon. The coalition of shareholders, which owns more than 28,700 shares of DuPont stock, said

the company should have disclosed in its Management Disclosure and Analysis an emerging trend to restrict the use of products containing PFOA. The petition also asks the SEC to clarify when a company's assertions that its products do not harm human health may constitute illegal and "materially misleading communications" under Rule 10(b)(5) when there is credible evidence to the contrary. In its May 24th letter, DSFV also charged that the company has never disclosed in its shareholder reports the data it had collected showing evidence that its Parkersburg, WV, facility had impacted area drinking water wells. The company recently entered into $108 million settlement of a class-action lawsuit brought by West Virginia and Ohio residents whose water supplies were contaminated. In April, DSFV sponsored a shareholder resolution asking the company to disclose attorney fees, expert fees, lobbying, public relations and other hidden costs associated with PFOA.

The action follows a grand jury subpoena that was served on DuPont by the United States Department of Justice (DOJ) to turn over documents related to PFOA. In July 2004, EPA charged that the company had violated the Toxic Substance Control Act (TSCA) by failing to advise the agency of the risks associated with PFOA and failed to comply with RCRA reporting requirements. DuPont recently said it has set aside $15 million to resolve the EPA action. In its 10-K for 2004, DuPont reiterated its belief that there are no known health effects associated with PFOA.

EPA Region I To Launch Health Care Compliance Initiative

EPA Region I will soon launch a voluntary compliance program for hospitals and other health care institutions similar to the program underway in EPA Region II. The New England program will likely include nursing homes as well as hospitals.

The voluntary compliance program will have significant implications for health care facilities that have been required to perform environmental compliance audits to qualify for health care facility financing. For example, hospitals in Connecticut that have obtained financing from the Connecticut Health Education Facilities Authority (CHEFA) are required to conduct environmental compliance audits and Phase I environmental site assessments. If these disclosed evidence of violations and the facilities failed to take action, the institution may not only be disqualified from the voluntary compliance program, but also become subject to fines and penalties for failing to correct known violations.

Commentary: *Hospitals also generate a wide variety of hazardous waste, such as chemotherapy and antineoplastic chemicals, solvents, formaldehyde, photographic chemicals, radionuclides, and waste anesthetic gases. Indeed, hospitals constitute the fourth largest source of mercury discharged into the environment and generate 1% of the total municipal solid waste in the United States. The EPA Region II office implemented its program in 2002 after recognizing that it had*

issued over $1 million dollars in fines and penalties.

IRS Rules Property Owner Cannot Expense Cleanup Costs

The Internal Revenue Service ruled on June 20th that costs incurred by a manufacturer that contaminated its own land through its own operations should be allocated to the products produced in the year the cleanup costs are incurred (Rev Ruling 2005-42, July 11, 2005). The ruling builds on a 2004 revenue ruling that said the cleanup costs to remediate the contamination caused by the manufacturer were expensed since it did not appreciably add to the value of the land, appreciably prolong its useful life or adapt the land for a new or different use. As a result, the costs must either be included in the cost of goods sold during the taxable year or capitalized to the products that remain in inventory at the end of the taxable year under Section 263A of the tax code.

Commentary: *In a 1994 revenue ruling (94-38), the IRS said that costs to remediate contamination caused by the taxpayer's business were not capital expenditures and were deductible as expenses under section 162. However, the cost of the groundwater treatment system was considered a capital expenditure under section 263. Many state brownfield programs allow property owners to claim tax credits in the year the cleanup costs are incurred. If a taxpayer elects to deduct the costs as expenses, this taxpayer will likely lose the ability to capitalize certain cleanup costs for federal taxation purposes.*

CERCLA/BROWNFIELDS

Supreme Court Kelo Decision Could Have Implications For Brownfield Development

On June 23rd, the United States Supreme Court ruled in *Kelo v. New London, Conn*., (U.S., No. 04-108, 6/23/05) that local governments could exercise their power of eminent domain to take private property to promote economic development pursuant to a comprehensive economic revitalization plan. However, the Court cautioned that its ruling would not apply to takings that were designed to benefit a particular class of identifiable individuals, such as properties that are taken simply to transfer the land to another private party.

At issue was the scope and meaning of the takings clause of the Fifth Amendment that only allows taking of property for "public use." The plaintiffs argued since the city contemplated transferring the property to a private developer, the property was not being taken for "public use." However, the sharply divided Court ruled that economic revitalization served a public purpose and therefore satisfied the "public use" requirement. The Court found that the taking was part of a comprehensive redevelopment plan and that a court should not second-guess an economically distressed city's determination that its comprehensive economic revitalization plan would serve a public purpose by bringing more jobs to its residents and more tax revenue to its coffers.

Commentary: *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. Local governments and redevelopment agencies can assemble small parcels of contaminated sites into larger developable tracts using their power of eminent domain. Under CERCLA § 101(20)(D), the condemning authority would not be liable for the cleanup, but only be required to exercise "due care" with respect to the contamination. In many states, a city simply has to make an effort to reach consensual agreement to purchase land and if this effort is unsuccessful, can then proceed under its power of eminent domain. The city would tender an offer that will be refused by the property owner or its representative and then pass a resolution or ordinance authorizing the government to acquire the property through condemnation.*

One limiting condition to this strategy may be if state constitutions only allow governments to exercise eminent domain to eliminate blight. Depending on how that term is defined, though, it could prevent governments or redevelopment agencies from assembling individual brownfield parcels that might have active businesses on them and therefore not be considered blighted. Some states have tried to navigate around the "blight" limitation by designating brownfield

redevelopment areas so that individual parcels could be assembled to further the purposes of advancing brownfield redevelopment in those areas.

At last count, bills have been introduced in about 28 state legislatures that would limit to varying degrees the circumstances when eminent domain may be exercised. In addition, two proposals have been introduced in Congress that would preclude the Department of Housing and Urban Development (HUD) from providing financial assistance such as Brownfield Economic Development Initiative (BEDI) grants for projects that result from the exercise of eminent domain.

Boston Redevelopment Agency Not Liable For Cleanup Costs

In another illustration of the viability of using eminent domain for brownfield redevelopment, the Supreme Judicial Court of Massachusetts ruled that the Boston Redevelopment Authority (BRA) and the Massachusetts Convention Center Authority (MCCA) were not liable for delays in remediating contamination at the site of the Boston Convention Exhibition Center and could pursue a cost recovery action against the responsible parties.

In *Commonwealth v. Boston Edison Company*, 2005 Mass. LEXIS 224 (May 25, 2005), the site of the convention center had been used as a junkyard from 1947 to 1992. In December 1987, the then state Department of Environmental Quality issued a notice of responsibility (NOR) to the defendant alleging that it had arranged for the disposal of hazardous substances at the site. In 1992, the owner of the junkyard sold the property to the Sak Recycling Corporation (Sak) that moved piles of scrap around the site until 1997 when the state legislature authorized the BRA to take the property by eminent domain to construct the new convention center. In 1999, the BRA received a NOR. The state brought a cost recovery action against the defendant. Boston Edison, in turn, sought a ruling that the Commonwealth, including the BRA and MCAA, were liable as persons who "otherwise caused or is legally responsible for a release" under the catchall provision of the 21E state superfund law. Boston Edison argued that by failing to require the Sak defendants to remediate the site, the agencies had allowed conditions to be exacerbated. The trial court agreed with Boston Edison and ruled that the agencies could only seek contribution and not their full costs of remediation from the defendants.

On appeal, the court ruled that the Commonwealth could not be liable for failing to act. In addition, the court ruled that BRA and MCCA were not liable as an owner or operator because of the liability exclusion for government entities that take title pursuant to its exercise of eminent domain.

The defendants also alleged that the agencies were liable under the 21E catchall provision for failing to comply with the NOR. However, the court held that simply receiving an NOR is insufficient to impose liability. Since the defendants did not point to any actions taken by the agencies that caused the

contamination, the court found that the agencies were not liable and could therefore bring a cost recovery action against the defendants.

EPA Announces NRD Settlements

Kerr-McGee Chemical entered into a settlement with the federal government and the State of Illinois to remediate radioactive wastes and restore natural resources at two Superfund sites in and around the city of West Chicago, IL. Under the consent decree, which is valued at $74 million, Kerr-McGee will excavate approximately 77,000 cubic yards of radioactive contamination in the West Branch DuPage River and Kress Creek. Kerr-McGee will pay approximately $8 million in past response costs related to overseeing natural resources work. The company will also restore nearly eight miles of the West Branch DuPage River and Kress Creek as well as the DuPage County Forest Preserve at a cost of up to $800,000. The sediments and soils of the banks and waterways were contaminated with thorium residues from the 1930s through the early 1970s as a result of the production at the Rare Earths Facility of thorium materials for use in defense and other applications. The West Branch DuPage River and Kress Creek are the last areas of radioactive contamination in the vicinity of the Rare Earths Facility remaining to be cleaned up. Under prior EPA orders, Kerr-McGee spent approximately $115 million cleaning up radioactive contamination in residential areas, West Chicago's Reed-Keppler Park, and West Chicago's Sewage Treatment Plant from approximately 1995 to 2004. Kerr-McGee is decommissioning the Rare Earths Facility under a state license issued by the Illinois Emergency Management Agency, Department of Nuclear Safety.

New Jersey Announces Additional NRD Settlements

The New Jersey Department of Environmental Protection (NJDEP) recently announced additional settlements under its natural resources damages (NRD) enforcement initiative. SP Industries agreed to pay NJDEP $65,641 to resolve the company's liability for a 1.2-acre plume of volatile organic compound (VOC) at its laboratory glassware site in Vineland. NJDEP will use the settlement money for an as yet to-be-determined restoration project, pooling this money with other settlements toward the purchase of land protecting groundwater in Vineland's watershed. Earlier this year, SP Industries had agreed to a $56,586 NRD settlement for a 2.5-acre plume of chromium-contaminated groundwater at its Wilmad Glass site in Buena Vista, Atlantic County.

Commentary: *In the past three years, DEP and the New Jersey Attorney General's Office have filed NRD complaints against more than 50 companies alleged to have polluted more than 300 sites involving 2,200 acres*.

Asbestos Debris At Residential Complex Could Lead to Potential Criminal Liability

EPA is considering relocating approximately 60 residents of a Klamath Falls, OR, subdivision after determining that the complex was constructed on an asbestos waste burial site. In the meantime, the Oregon Department of Justice has brought a $3 million racketeering lawsuit against the developer, MBK Partnership, Mel Stewart, his wife and his partner, Dr. Kenneth L. Tuttle, a Klamath Falls surgeon, and other family members for knowingly hiding the existence of asbestos debris from prospective buyers of North Ridge Estates properties.

The asbestos debris came from buried pipe insulation and materials such as siding and roofing that were used in more than 80 buildings when the site was a World War II Navy barracks. The asbestos-containing materials were buried when the buildings were demolished. In 1979, EPA ordered the MBK Partnership to file deed restrictions on any lot containing asbestos burial sites; however, MBK never filed any of the required deed restrictions.

In 2002, a worker discovered a buried asbestos pipe. Workers have removed tons of debris from the properties but more pieces surface each winter after the ground freezes. Thirteen families filed a federal lawsuit in 2003 alleging MBK committed fraud by failing to disclose the presence of asbestos. After filing for bankruptcy in December 2004, the company sued the state, arguing that the state was liable for part of the cleanup costs because it had formerly owned the site.

Commentary: *Naturally occurring asbestos (NOA) is also turning out to be a problem at some residential properties, especially in California. NOA minerals occur naturally in rock and soil as the result of natural geologic processes and are found in 44 of California's 58 counties. NOA usually does not pose any health threat if asbestos fibers remain undisturbed in the rock or soil. However, the asbestos fibers can be released into the air when the NOA is weathered by natural processes or human activity. For example, EPA recently issued a report finding elevated levels of a naturally occurring Tremolite at playing fields, a popular bike trail and a playground for toddlers; however, the agency did not quantify the risk to residents for exposure to these intermittent high levels.*

HAZARDOUS WASTES/USTS

New Jersey Conducts Compliance Inspections of Photo Processors

The New Jersey Department of Environmental Protection (NJDEP) recently announced that it would conduct a compliance and enforcement inspection of photo processing centers in Hudson County. The enforcement sweep will include any entity that processes photographs on site including drug stores, department stores, photographic studios, photo centers, schools, colleges, businesses/ medical offices performing x-ray services, and photocopying and duplicating service providers. The DEP wants to ensure that photo processors are properly managing the waste generated during the photograph-developing process.

Commentary: *Shopping centers and commercial office buildings often have tenants such as photo processors and health care facilities that generate small quantities of hazardous wastes. It is important during due diligence to ensure that these operations are properly managing their wastes such as sending waste to an appropriate disposal facility and properly treating wastewater prior to discharge into the sewer system.*

Consultant Delay Makes UST Owner Ineligible for UST Reimbursements

During replacement of its USTs, an owner of a gasoline station in Billerica, MA, discovered that the former USTs had contaminated soils. The owner retained a consultant who qualified as a licensed environmental professional (LEP) to complete the cleanup and seek reimbursement from the state UST Petroleum Cleanup Fund (UST Fund). However, the LEP failed to inform the UST owner that it had to obtain a certificate of compliance from the state Department of Environmental Protection. As a result, the owner failed to obtain the certificate in a timely manner and $45,000 of its cleanup costs became ineligible for reimbursement. The owner then sued the consultant for negligence.

The statute creating the state UST Fund provides that an UST owner or operator may not delay cleanups or avoid responsibility because of any failure or delay of reimbursement. In addition, it provides that no person may assert a claim or defense because of a failure or delay in reimbursement. The LEP argued that this latter clause precluded the station owner's negligence and contract claims. However, the court in *Williams Auto Electric Services, Inc. v. Sandra M. Hebert and 21E, Inc.,* 2005 Mass. App. LEXIS 262 (App. Ct. 3/24/05) ruled that the clause applied to government agencies and did not apply to the consultant. Therefore, when the owner failed to obtain the certificate in a timely manner, $45,000 of its cleanup costs became ineligible for reimbursement.

Bankruptcy Code Extended Time for Filing For UST Reimbursement

The federal Court of Appeals for the Second Circuit ruled that a bankrupt convenience store chain that failed to file 22 claims for reimbursement to the Kentucky Petroleum Storage Tank Environmental Assurance Fund (UST Fund) within the statutory time period was eligible for reimbursement because the bankruptcy code automatically extends regulatory deadlines. In *In re: Dairy Mart Convenience Stores, Inc.,* 2005 U.S.App. LEXIS 11069 (2nd Cir. 6/15/05), Dairy Mart filed a petition for reorganization on September 24, 2001. The company then submitted its claims for reimbursement to the Kentucky UST Fund on October 13, 2001. Because the claim was submitted four days after the statutory period for seeking reimbursement, the UST Fund denied the claim. The company then filed an adversary proceeding. The state argued it was immune from being sued in federal court by the doctrine of sovereign immunity set forth in the Eleventh Amendment. However, the court ruled that Section 108 of the Bankruptcy Code automatically extended the filing deadline by 60 days to November 23, 2001. Since the claim was submitted within the grace period, the state was in violation of federal law so the doctrine of sovereign immunity did not apply. Therefore, the state was required to process the claim as if it had been timely submitted.

NY UST Owner Barred From Bringing Indemnity Action

A state court denied a motion for summary judgment of an owner of a gasoline station to recover costs to remediate leaded gas contamination from Sunoco even though the owner had never used leaded gasoline. In *State of New York v. Passalacqua*, 2005 N.Y. App. Div. LEXIS 6163 (App. Div. 6/9/05), Sunoco operated a gasoline station from 1959 to 1983 when it sold the station to the defendant Passalacqua. In 1981, Sunoco had replaced three 4,000-gallon USTs. In the process of investigating the extent of contamination associated with an adjacent gasoline station in 1988, the plaintiff identified free-floating product around the tanks owned by Passalacqua. When the defendant removed the USTs in 1992, the plaintiff determined that soil contamination was a mixture of a recent spill and pre-1980 leaded gasoline. The plaintiff then spent $439,026 to remediate the contamination and filed a cost recovery action against both Passalacqua and Sunoco. The trial court determined the Spill Fund was entitled to $281,900 because of the statute of limitations. Passalacqua then brought an indemnification action against Sunoco under the state Navigation Law, arguing that he never used leaded gasoline. Sunoco argued that while it may have manufactured leaded gasoline during the time it owned the gasoline station, there was no evidence of a discharge of leaded gasoline during the time it owned the tanks. Because dischargers are not entitled to bring indemnification claims under

Navigation Law and Passalacqua had failed to establish as a matter of law that it was not a discharger, the court denied his summary judgment for statutory indemnification.

Commentary: *One of the more vexing issues for developers or owners of property is whether they may be liable as dischargers because of the presence of current or former USTs at a site that they do not operate or have not operated in the past. Like many states, New York does not impose liability based solely on ownership of contaminated land. However, New York state courts have held that a landowner, who can control activities occurring on its property and who has reason to believe petroleum products will be stored there, could be liable as a discharger for the cleanup costs.*

In New York, a property owner with a tenant who operated USTs generally will usually be considered responsible for a discharge because the owner as landlord exercised or could have exercised control over the tenant's operations through lease covenants or by other means. In a similar vein, one might ask what happens if a tenant abandons tanks when it vacates the premises. Purchasers and developers have argued that tanks remain the property of the tenant and are not part of the real estate. However, there have been a number of cases that have held that the USTs are trade fixtures appurtenant to the real estate, thereby making the purchaser/developer the owner of the tanks and thus, responsible for contamination from that tank system. After considering two damage claim applications with similar facts, the Oil Spill Fund denied the claims because, in part, the tanks installed by prior operators/owners were, by the terms of the lease, deemed part of the real property and were, by the terms of the lease, owned solely and absolutely by the landlord.

Less clear is what happens if a tank system with tanks that were properly closed in place under requirements in effect at the time and when a subsequent purchaser discovers contamination from that tank system. Some cases have held owners or buyers liable as dischargers where they could have known about the existence of contamination through the exercise of reasonable diligence or should have known about the presence of the tank system from the use of the property. In any event, the uncertainty in the law highlights the importance of performing comprehensive due diligence prior to taking title to identify the possible existence of tank systems, and to determine if there is an ongoing discharge at the property. As with most oil spill cases, there are a number of factors to be examined in determining liability for a discharge such as when the discharge began, if knowledge of the discharge could have been discovered through adequate due diligence, and whether the purchaser/developer has any relationship to the former property owner/operator, to the former system owner/operator or to a supplier of petroleum to the property. It is possible in certain very limited circumstances that a subsequent purchaser/developer could be found to be a "faultless" landowner.

New Jersey Announces UST Inspection Initiative

The NJDEP recently announced that it had established a group of 18 state and county inspectors to conduct compliance inspections every three years at the 8,000 UST facilities operating in the state. In the first wave of inspections, the NJDEP imposed penalties of $41,750 against Haskell Gulf Station, $38,000 against Captan Auto Repair and $36,750 against AEZ, Inc., of Denville for disabling overfill protection equipment on their UST systems. NJDEP also fined Acocella Automotive Group $66,000 for failing to properly register and insure its USTs as well as failing to provide and test leak detection equipment for USTs and product piping; First Oil was fined $30,000 for failing to register its USTs and for failing to perform release detection monitoring on product piping; the G & N Partnership was fined $76,000 for failing to register its tank and failing to have acceptable release detection monitoring; Pompton Plains Mobil was fined $30,000 for failing to perform release detection monitoring.. The agency also fined Prospect Transportation $35,000 and R & R Bulk Transport $15,000 for delivering fuel to unregistered USTs.

Commentary: *We have previously reported on the investigations that have revealed that a significant portion of UST systems that comply with the 1998 performance standards have suffered releases of petroleum into the environment. As demonstrated by the NJDEP enforcement action, some of the causes are due to poor operation of the USTs.*

Another source of contamination for new or upgraded USTs is damaged spill overflow equipment known as "spill buckets". This equipment is designed to collect fuel in a fill line after a tank has reached its capacity. However, this equipment is often damaged during the winter months during snow removal.

There is also growing evidence of releases involving MTBE (with no other petroleum constituents) where the UST systems pass tightness tests. One theory is that tanks with vacuum-assisted Stage II Vapor Recovery Systems are causing the tank systems to come under pressure that allows MTBE vapors to escape into sumps below dispensers or into the spill buckets. As a result of these trends, purchasers and their lenders should not assume that new UST systems are properly operating but should conduct tightness tests and consider sampling from the spill buckets and under the dispensers during due diligence.

INSURANCE

Federal Court Rules Purchaser May Not Obtain Coverage for Predecessor's Liability

The complex transactions involving former manufactured gas plants (MGP) continue to spawn insurance coverage litigation. In a recent decision involving corporate parent liability and non-assignment clauses, the United States District Court for the Middle District of Florida ruled that insurers were not obligated to pay the costs for remediating an MGP plant that had operated in Saint Augustine, FL, from 1886 to 1947.

In *Atlanta Gas Light Company v. UGI Utilities,* No. 3:03-cv-614-J20MMH (M.D. Fla. 3/22/05), UGI had developed a certain process known as the "Lowe" water gas process. The company licensed the process to dozens of MGPs across the country and acquired investment interests in the plants. In 1887, UGI took a minority investment interest in the Saint Augustine Gas & Electric Company (SAGELC) that owned and operated the MGP. While SAGELC maintained its own board of directors, UGI officials were always present either as officers or directors of the company. During the 1910-1928 period, UGI personnel occupied a majority of the office positions of SAGELC. The companies had overlapping directors; UGI formed oversight committees; a UGI employee served as plant superintendent at one point and refurbished the plant; UGI served as purchasing manager and consulting engineer and was paid a fee for supervision of the MGP. After all of the stock of SAGELC was sold to American Commonwealths Power Company (ACPC) in 1928, UGI's relationship with the MGP ceased. SEGELC became a subsidiary of ACPC's subsidiary, American Gas & Power (AGP). From 1928 to 1935, SEGELC entered into management and engineering contracts with AGP and there was significant overlap in directors and officers. In 1944, AGP sold all of the SEGELC assets to an individual who merged the assets into a new corporation, Savannah-St. Augustine Gas Company which changed its name to South Atlantic Gas Company in 1945. In 1966, the company merged with the plaintiff. As part of this transaction, the plaintiff acquired the assets to the MGP.

The plaintiff argued that the predecessor companies were liable as CERCLA operators. The district court ruled that the existence of overlapping officers and directors, the use of oversight committees, and the review and approval of capital budgets was consistent with traditional parent/subsidiary relationships and therefore did not cause UGI or AGP to be liable as an operator under the *Bestfoods* analysis. The court also found that the management contracts were simply consulting arrangements where UGI only made recommendations or provided advice that SEGELC was free to ignore.

The plaintiff also asserted that it qualified as an insured under

insurance policies issued between 1940 and 1947. The court said that the non-assignment clause was ineffective for statutory mergers, but that the clauses would generally apply to asset purchase agreements. Because the first two policies were transferred by purchase agreements, the court said the plaintiff could not obtain the benefits of those policies in the absence of a written assignment or consent from the insurer. The court found that the plaintiff did succeed to the benefits of the third policy because of the 1944 and 1966 mergers. However, the third policy only covered the period of February 1946 to February 1947 and the court found that there was insufficient evidence to show that a release had occurred during that one-year period. As a result, the court ruled that the policy was not triggered.

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