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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.

Editor's Note: There have been an extraordinary number of interesting developments during the past few months time that may significantly impact transactions, environmental litigation and the cleanup of contaminated sites. As a result, in this issue we are dispensing with our usual format to focus on environmental remediation issues. We are also experimenting with a shorter format. As always, we welcome and encourage input and suggestions from subscribers on this and other changes or features that you would like to see.

LITIGATION ROUNDUP

Review of Recent Post-Aviall Decisions

The United States Supreme Court decision in *Cooper Industries v. Aviall, 125 S.Ct. 577 (2004)* has led to a plethora of motions by defendants seeking to cut off previously commenced contribution actions. While the cases are highly fact specific, we are also beginning to see some trends emerge.

Aviall held that a potentially responsible party (PRP) may not bring a contribution action under §113(f) (3) of CERCLA unless it was subject to a civil action brought under §106 or §107 of CERCLA, or if the PRP had resolved its liability in an administrative settlement.

A number of decisions grappled with the issue of what constitutes an "administrative settlement." In *City of Waukesha v. Viacom International, Inc.,* 2005 U.S. Dist. LEXIS 5560 (March 23, 2005), the city had entered into a cost share pilot program with the Wisconsin Department of Natural Resources (WDNR) to remediate a landfill. The city filed a contribution action against successors to companies that had allegedly arranged to dispose of hazardous substances at the landfill in the past. In 2002, the federal district court ruled the city could maintain a contribution action. Following *Aviall*, though, the defendants filed a motion to dismiss the earlier ruling. The city also filed a motion for leave to file an amended complaint to add a contribution claim under §113(f) (3) (B), arguing that its cost share pilot program with the WDNR was an "administrative settlement." The city also submitted a separate administrative settlement agreement to the WDNR that explicitly resolved the city's liability under state law and CERCLA. The court ruled the WDNR contract was not an administrative or judicially approved settlement that resolved the city's liability to Wisconsin. The court noted that the contract did not refer to CERCLA and that the statute authorizing the WDNR to enter into the contract provided that it did not affect any common law or other liability under other statutes for damages arising from a site. The fact that the city filed the unsigned administrative settlement also suggested to the court that the city had not resolved its CERCLA liability to the state.

The harder case was the unreported decision in *W.R. Grace & Co. v. Zotos International*, Decision and Order, 98-CV-838S(F) (W.D.N.Y. May 3, 2005). Here, the plaintiff entered into administrative orders on consent in 1984 and 1988 with the New York Department of Environmental Conservation (NYDEC) to perform a remedial investigation/feasibility study (RI/FS). After implementing the remedy at a cost $1.7 million, the plaintiff filed a contribution action under §113(f) (1). After a non-jury trial, the Supreme Court issued its *Aviall* opinion, prompting a round of post-trial supplemental briefings where the plaintiff filed a motion to amend its complaint to add a claim under §113(f) (3). In entering a judgment in favor of the defendant, the federal

district court for the western district of New York found it significant that the consent orders did not contain any reference to CERCLA, but simply cited the state Superfund law known as the Inactive Hazardous Waste Disposal Site Act. Moreover, the court noted that the consent orders did not indicate that NYDEC was exercising any authority under CERCLA, did not indicate that EPA concurred with the selected remedy and did not provide for any release of CERCLA liability. As a result, the court found that the consent orders only resolved Grace's liability under state law and that Grace could therefore not bring a contribution claim against the defendant.

Not to be discouraged, the state of New York has gone on the record that it believes its orders on consent constitute an administrative settlement under §113(f)(3) in *Senaca Meadows, Inc v. ECI Liquidating, Inc.,* a case pending in the federal district court for the western district of New York. Here, the defendants filed a motion to dismiss, arguing that a series of orders on consent entered into between the NYDEC to investigate and remediate the Tantalo Landfill in Seneca Falls, NY did not constitute a "settlement agreement" under §113(f)(3) because the consent orders only resolved state claims. Attorney General of the State of New York filed an amicus curiae memorandum of law opposing the motion to dismiss. The state argues that a core element of the CERCLA framework is to allow states to perform cleanups and then recover their response costs from PRPs, and that CERCLA is the core authority that the state of New York relied upon to recover its response costs. The memorandum of law goes on to say that the NYDEC settled both CERCLA and state claims under the consent orders. Specifically, the state noted that a the second consent order provided contribution protection to the plaintiff under §113(f)(2) for matters addressed by the order; the third consent order released the plaintiff from all claims that NYDEC might have under statutory or common law involving the investigative or remedial activities at the site related to disposal of hazardous wastes. In addition, the 2004 consent order specifically provided that to the extent authorized by the §113(f) (3), plaintiff was entitled to seek contribution from any person except those entitled to contribution protection under §113(f) (2). Moreover, the state noted that the federal district court for the western district of New York had previously ruled that similar orders of consent issued by NYDEC constituted "administrative settlements" under §113(f)(3).

Pharmacia Corporation v. Clayton Chemical Acquisition LLC, 2005 U.S. Dist. LEXIS 5286 (N.D.Ill. 3/8/05) illustrates how narrowly a court may interpret what constitutes an “administrative settlement.” In this case, the plaintiff along with 18 other PRPs entered into an Administrative Order by Consent (AOC) under §106 to undertake a remedial investigation/ feasibility study (RI/FS) for an second operable at the Sauget Superfund site known as Sauget Area 2. EPA subsequently issued a Unilateral Administrative Order

(UAO). After incurring nearly $3 million to implement the AOC and the UAO, the plaintiffs brought a contribution action against other PRPs who had not been named under the UAO or executed the AOC. In holding that the AOC was not an "administrative settlement" entitling the plaintiffs to bring a contribution action, the court noted that CERCLA §122 authorized EPA to enter into "administrative settlements" but that the AOC was issued under §106. If the AOC was intended to be an administrative settlement, the court concluded, the document would have stated in the caption that it was issued pursuant to §122(d) (3). The court also said that the AOC did not mention anywhere in its 25 pages that it was a "settlement" but instead always referred to an "order." Also significant to the court was that the AOC contained a provision for stipulated penalties that were based on §106 and that the AOC contained the standard boilerplate disclaimer that AOC did not constitute an admission of liability by any of the parties. The court also ruled that neither the UAO nor the AOC qualified as civil actions under §113(f) (1). The court pointed out that §106 authorized bringing an action in district court or taking "other action…including such orders…." Since Congress clearly delineated between bringing a civil action and an order, the court found that the UAO did not constitute a civil action under §113(f) (1)

Plaintiffs facing dismissal of their §113(f) contribution actions are resurrecting the right of contribution. Both *Vine Street LLC v. Keeling,* 2005 U.S. Dist. LEXIS 4653 (March 24, 2005) and *Metropolitan Water Reclamation District of Greater Chicago v. Lake River Corp,* 2005 U.S. Dist. LEXIS 6948 (April 12, 2005) addressed the issue and ruled that there is an implied right of contribution under §107(a)(4)(B). These courts distinguished earlier decisions holding that potentially responsible parties (PRPs) could not bring contribution actions under §107(a)(4)(B) of CERCLA. According to *Vine Street* and *Metropolitan Water Reclamation,* the earlier cases denied the §107(a) claims because the PRPs could bring an §113(f) action. In contrast, the plaintiffs in *Vine Street* and *Metropolitan Water Reclamation* were precluded from bringing 113(f) claims because they had performed voluntary cleanups. Thus, the courts ruled that the plaintiffs could bring a contribution action under §107.

If a plaintiff does not have a CERCLA right of contribution, there may be a remedy under a state Superfund statute since the state laws may not necessarily track CERCLA. A good example was *Johnson v. City of San Diego,* 2005 Cal. App. Unpub. LEXIS 1979 (Cal. App. March 4, 2005). In this case, the plaintiffs purchased a vacant lot where they planned to operate a recycling business. After taking title, the plaintiffs discovered the site was contaminated. They then sued the City of San Diego under the state Carpenter-Presley-Tanner Hazardous Substance Account Act (HSAA), alleging that the city and its contractors had disposed hazardous materials. In rejecting the City's claim that the plaintiff did not have a

right of contribution under HSAA, the court ruled that *Aviall* was not applicable because HSAA did not contain language requiring that HSAA contribution actions must be brought only during or after a civil action. Instead, HSAA only requires that a plaintiff incur "removal or remedial costs in accordance with this chapter or [CERCLA]."

Commentary: *As the administrative settlement cases illustrate, simply claiming that an agreement is an administrative settlement does not mean that a court will necessarily agree. Plaintiffs should expect defendants to vigorously challenge the validity of the agreement as an "administrative settlement." State voluntary cleanup agreements (VCA) may be particularly vulnerable to attack since they usually refer to an agency's authority under a state law to enter into the agreement and, thus, have an even more tenuous link to CERCLA. Some states have agreed in the past to insert language in their VCAs that the agreement constituted an administrative settlement for purposes of contribution protection under §113(f)(2). In those states, it would probably make sense for a purchaser contemplating entering into a state VCA to request that the state insert a reference to 113(f)(3) in the agreement. An example of such an agreement is the two model forms developed by the WDNR. The forms state it is the intention of the parties that the agreement constitutes an administrative settlement for purposes of §113(f) (3). In any event, the settlement agreement should be subject to public comment to satisfy procedural due process concerns.*

Another possible avenue for preserving contribution rights may be the federal enforcement bar provision of CERCLA §128. Under this section, a party who performs a cleanup at an "eligible response site" in compliance with a "state response program" will not be subject to federal administrative or judicial enforcement action except in limited circumstance. This option will be explored in more detail in a later issue.

The implied right of contribution seems to be gaining traction in certain situations. When faced with a plaintiff who has performed a voluntary cleanup and did not cause the release that led to the contamination, many courts may be hard-pressed to find that the remediator cannot recover its costs from the PRP who actually contributed to the problem.

State Cleanup Order Invalidated Because of Cleanup Guidance

Many states such as New York administer and enforce their remedial programs through internal guidance policies and use informal cleanup standards that have not been promulgated through rulemaking. Many responsible parties and volunteers interested in remediating contaminated sites are often frustrated by the amount of time and money they spend negotiating cleanups under this informal regime. This approval process frequently creates a perception that cleanups standards are being established on an ad hoc basis and the lack of certainty can serve as a strong disincentive to redeveloping contaminated sites.

Most parties have simply resigned themselves to this process. However, the owner of an auto parts salvage company in Florida decided to draw a line in the sand and successfully challenged a cleanup order issued by the Florida Department of Environmental Protection (FDEP) pursuant to informal agency guidance. In *Kerper v. Dept. of Environmental Protection*, 894 So.2d 1006 Fla. (Ct. App., 5th Dist., 1/14/05), the plaintiff had planned to purchase the property he was leasing until he discovered it was contaminated. During a dispute over the enforceability of the purchase agreement, the FDEP became aware of abandoned drums, discarded oil filters and battery casings, a burn pile and contaminated soil. The agency issued a notice of violation to the landlord and the plaintiff/tenant. The landlord settled with the FDEP, but the plaintiff requested an administrative hearing. After the administrative law judge held the plaintiff liable for failing to clean up an oil spill, the FDEP issued a final order directing the plaintiff to conduct further assessment and remediation of the petroleum contamination consistent with the agency's "Corrective Actions for Contaminated Site Cases," (CACSC) guidelines for contaminated sites. The plaintiff appealed the order, arguing, *inter alia*, that the guidelines were invalid as an "unpromulgated rule." The appeals court agreed, noting that the legislature had directed FDEP in a 2003 state law authorizing the use of risk-based cleanups for all contaminated sites to adopt regulations by July 1, 2004 for remediation of contaminated sites. Because the agency had failed to promulgate the new rules, the court said FDEP had no authority to issue an order under the CACSC policy. The court not only invalidated the order, but also awarded him attorney fees and court costs.

Sloppy Drafting Forces Sellers to Assume Greater Liability

Nothing can be more frustrating for a party in a transaction than to finally reach an agreement in principle after protracted and heated contract negotiations but only to lose the benefit of its bargain because of imprecise drafting. Unfortunately, the scenario played out in two recent state court decisions.

In Alternatives *Federal Credit Union v. Olbios, LLC*, 2005 N.Y.App. LEXIS 42 (App. Div. 1/6/05), the plaintiff agreed to purchase a parcel of property in Ithaca, NY in March 1999. Prior to signing the contract, the plaintiff learned during its due diligence that a 1961 map had depicted an underground storage tank (UST) at the property. Concerned about potential contamination associated with the former UST, the purchaser/plaintiff negotiated a clause in the contract that provided that if the UST identified in the Phase I environmental site assessment (ESA) required remediation or removal, the seller/defendant would be responsible for the remediation or removal.

After the contract was executed but before the closing, the seller/defendant excavated the area where the UST had been depicted on the historical maps but did not

find any tank. The purchaser then acquired the property. One year later, the plaintiff discovered petroleum-contaminated soil while excavating the site to build an office building. The plaintiff notified the seller who initially selected a consultant to remove the contaminated and place clean fill at a total costs of approximately $116,000. The plaintiff promptly paid the invoices in full and requested reimbursement from the defendant who expressed concerns over the reasonableness of the costs and the quality of the work. Eventually, the defendant refused to pay, claiming that because no tank had been discovered, its remedial obligation had not been triggered.

The trial court found for the defendant and dismissed the complaint but the appeals court reversed. The appellate court found that while the contract clearly linked the defendant's liability to the former tank, the agreement was ambiguous as to whether the defendant had a remedial obligation where the tank had been previously removed. This allowed the court to look beyond the express terms of contract to determine the intent of the parties. Because a 1971 map had shown the tank crossed out, the court said the parties contemplated the possibility that the tank had been removed when they agreed to the ambiguous language. Moreover, because the defendant knew that the tank was not present before the closing and the contaminated soil was found where the tank had been located, the court concluded that the defendant was responsible for the reasonable costs of the remediation. The court then remanded the dispute over the costs of the cleanup back to the trial court.

The stakes were larger in *Goodrich Corporation v. Autoliv Asp, Inc.,* 2005 Cal. App. Unpub. LEXIS 2109 (Ct. App. March 8, 2005). In this case, the plaintiff purchased the assets of a business that had operated in Fairfield, CA. The plaintiff's subsidiary, Universal Propulsion Company, Inc (UPCO) then entered into a lease with the owner of the property, OEA Aerospace, Inc. (OEAA) that included an option to purchase. Prior to the commencement of UPCO's lease, the Regional Water Quality Control Board (RWQCB) issued a cleanup order for the OEAA property and an adjacent property that OEAA leased from the United States Air Force. In 2001, UPCO exercised its purchase option, but OEAA refused to convey title until UPCO agreed to assume all of the environmental liabilities for the OEAA parcel as well as the adjacent Air Force parcel.

After the parties filed various claims against each other, they agreed to mediate their dispute, which resulted in a memorandum of settlement. According to the terms of this agreement, OEAA was required to pay "all environmental remediation costs associated with the subject property and the Air Force Property….UPCO [was required to] contribute to the remediation of the environmental liabilities on the subject property to defray the costs thereof on a dollar for dollar basis up to and not to exceed the following amounts: $300,000 in 2003, $300,000 in 2004 and $400,000 in 2005."

The parties then found themselves in a dispute as to how much UPCO was required to pay towards the remediation. The defendant claimed that UPCO had to pay the designated amounts each year regardless of how much was spent that year on remediation and that UPCO's $1 million share could only be reduced if the final cleanup costs were below $2 million. The plaintiff, meanwhile, argued the annual limitations were for the amount of cleanup costs incurred each year and that the amounts due should not be carried over to the following year. The trial court found in favor of the plaintiff. However, the appeals court concluded that the agreement was susceptible of more than one interpretation and could not be enforced because it the material terms were unclear.

Commentary: *Contract drafting like fiction writing or journalism is an art. Just as a reporter needs to understand a subject before they can explain it to a reader, lawyers drafting an environmental provision need to understand environmental liability. Lawyers without environmental backgrounds often try make up for their lack of environmental expertise by drafting around the issue with lots of verbiage and complex, run-on sentences. They often use vague references, do not utilize defined terms and the language may conflict with other sections of the contract. Such unclear language not only can lead to confusion between the contracting parties, but also if a dispute ends up in court, the parties will be placed in a position of having a judge try to guess how the parties intended to allocate certain environmental liabilities. One of the best ways to reduce ambiguities in contracts and reduce the possibility of litigation arising out of confusion or misunderstandings from unclear language is to draft careful definitions. By using definitions, parties can also avoid excessive verbiage in the rest of the contract.*

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

Definition of "Premises" in Lease Limits Liability of Tenant

New York's highest court recently ruled that IBM was not required under a lease to remediate contamination caused by a former UST because the lease limited the defined premises to the building and the contamination was outside the building.

In *South Road Associates, LLC v. International Business Machines,* 2005 N.Y. LEXIS 502 (March 29, 2005), IBM leased space in two buildings located in Poughkeepsie, NY. During its occupancy, IBM installed a UST outside the buildings to hold waste solvents. After contamination was discovered at the site, the NYSDEC placed the property on the state Superfund list. IBM then entered into a separate agreement with the plaintiff to “abate” the contamination to the satisfaction of the NYSDEC. IBM removed contaminated soils and the UST, installed a groundwater treatment system and NYSDEC delisted the site. Upon termination of the lease, the parties entered into an access agreement so that IBM could maintain and operate the long-term groundwater monitoring and treatment system.

Because the groundwater and bedrock remained contaminated, the plaintiff filed a breach of contract, arguing that IBM had failed to return the “the premises in good order and condition” and to “repair all damage to the premises.” In its motion for summary judgment, IBM argued that the lease defined the demised premises as the interior portions of the buildings. As a result, IBM asserted it was not responsible under the lease for remediating the land outside the building. The trial court found the lease terms ambiguous and allowed the plaintiff to introduce extrinsic evidence to support its view that the lease conveyed to IBM rights and obligations beyond the interior space of the buildings. The plaintiff pointed to the fact that IBM occupied the entire property, paid all the real estate taxes and that it installed the UST outside the building.

The trial court agreed with the plaintiff, but the intermediate court reversed, granting summary judgment to IBM dismissing the complaint. The intermediate panel held that the “clear and unambiguous” language of the lease demonstrated that the “premises” consisted of the buildings’ interior space. The Court of Appeals agreed, noting that the lease stated that the premises was the space shown on the floor plan expressed in square footage of the buildings. The Court of Appeals also observed that the lease repeatedly mentions the term “premises” separately from the water tower, land, parking lot and building. Interpreting “premises’ to include these exterior portions of the property, the Court said, would have the effect of rendering the language in those other provisions superfluous. Since the plaintiff did not allege that IBM had failed to return the interior space in “good order and condition.” the Court held that IBM had not breached the lease and affirmed the dismissal of the complaint.

Commentary: *The provisions of the IBM lease requiring the tenant to return the premises in good condition less normal wear and tear as well as to repair damage to the premises are typical for commercial leases. Arguably, these provisions should extend to leaking USTs and PCB transformers that are not technically part of the demised premises, as well as the associated subsurface or groundwater contamination,*

particularly where the tenant occupies the entire property under a triple net lease. However, because landlords have had trouble using the traditional lease provisions to compel tenants to remediate contamination, commercial leases should contain environmental provisions that clearly allocate the responsibilities of the tenant and the landlord for environmental liability.

These narrow interpretations also have implications for contribution actions brought under CERCLA or state environmental laws. A tenant may be liable under CERCLA or a state Superfund as an operator to the extent it exercises control over the property. A lease confers right of possession over some or all of a property, and hence control over the demised premises. Like the New York Court of Appeals, many courts will rule that a tenant cannot be a CERCLA operator beyond the confines of the premises since the tenant has no right to control those areas. Other courts, though, will take a more pragmatic view and find a tenant liable as a CERCLA operator for any portions of the property that it actually exercise control regardless of the lease terms. Under this line of authority, it would not be stretch to view IBM as a CERCLA operator since it exercised control over the outside portion of the building when it installed and used the UST.

A lessee can also be deemed to be an owner for CERCLA purposes despite the absence of legal title if it exercises sufficient control over the property. This kind of result most often occurs where there is a long-term, triple net lease, an absentee landlord, and the tenant occupies the entire property. In such situations, some courts have found those tenants to have indicia of ownership and that they are acting as de facto owners.

Since this case was commenced in 2002, it is unclear why the landlord did not bring a CERCLA action. It may be that the cleanup agreement provided that the only remedies available to either party was those set forth in the document and that the parties waived whatever statutory or common law rights that were available to them. Of course, in the wake of Aviall, the landlord would have faced a motion to dismiss unless it was subject to an civil action, entered into an administrative settlement or could convince the court to allow it to bring a contribution claim under §107.

SUPERFUND/BROWNFIELDS

EPA Plans to Re-Evaluate 900 Completed Superfund Sites

EPA has begun implementing an institutional control tracking system (ICTS) for its Superfund program under which it will begin reviewing nearly 900 Construction Complete (CC) sites to evaluate the effectiveness of institutional controls (ICs) at those sites. CC sites are facilities where physical construction of the remedy has been completed, all immediate threats have been addressed and long-term threats are under control. EPA guidance requires use of ICs when residual contamination does not allow for unrestricted use (UU) or unrestricted exposure (UE).

EPA has launched this initiative after initial tracking data reports found potential problems at the approximately 150 sites that had been deleted from the National Priorities List (NPL). The action also follows a January GAO report that concluded that EPA did not have sufficient mechanisms in place to determine if ICs had been implemented at Superfund and RCRA corrective action sites or if the ICs in place remained protective of human health and the environment. According to "*Improved Effectiveness of Controls at Sites Could Better Protect the Public*", many ICs implemented between 2001-2003 do not comply with current EPA IC guidance. Part of the problem, the report said, was that the decision documents do not specify when controls should be implemented, how long they should be in place and who should be responsible for enforcing them. Another problem was that ICs often were not implemented until after the cleanup was completed. Moreover, many of the five-year reviews conducted by EPA or states did not verify if ICs were implemented and effective.

The report also found that the vast majority of ICs at older sites were established as covenants in consent decrees instead of instruments recorded in land records, which made the ICs difficult to enforce. At older sites, ICs may have not been required even though the residual contamination exceeded unrestricted use (UU) standards or simply may not have been implemented. In other cases, the ICs may simply be informational devices (deed notices) that are not sufficiently protective.

Under its ICTS program, EPA will perform expedited reviews over the next year at priority sites. Criteria for identifying priority sites will include sites that have been deleted from the NPL and CC sites with potential/actual breaches or that are going to be redevelopment. EPA may contact PRPs as well as owners or developers of CC sites requesting information about ICs or request their assistance to promptly correct deficiencies. If necessary, EPA may exercise reopeners or use other enforcement authority to correct flaws with ICs.

Commentary: *In April, EPA issued its "Institutional Controls: A Citizen's Guide to Understanding Institutional Controls at Superfund, Brownfields, Federal Facilities, Underground Storage Tanks, and Resource Conservation and Recovery Act Cleanups" (OSWER 9255.0-98). The guidance, which is intended to complement existing EPA IC guidance, discusses the different types of ICs, explains when they are used, and identifies the entities that may be involved in the implementation, monitoring and enforcement of ICs.*

Another complicating factor in establishing and enforcing ICs is that states may use different definitions and instruments to create ICs. Nineteen state programs adopt the EPA definition that limits ICs to legal mechanisms. However, ten states define ICs to include both legal mechanisms and physical controls. The remaining 15 state programs use terms like land-use restriction, land use control, activity and use limitation, or environmental use restriction. States may also use different types of instruments to create ICs such as restrictive covenants, easements, deed restrictions, and equitable servitudes. Some states have created specific written instruments to control residual contamination. The National Conference of Commissioners for Uniform State Laws with their Uniform Environmental Covenant Act, which has been enacted in seven states with 13 states pending, will assist in the implementation, monitoring and enforcement of Institutional controls.

EPA Announces Latest Round of Brownfield Grants and Loans

EPA announced that it will award $75.9 million in brownfield financial assistance to 218 applicants in 44 states. The four categories of awards include 172 assessment grants totaling $33.6 million, 106 cleanup grants worth $19.3 million, 13 revolving loan fund grants of $20.8 million and 11 job-training grants valued at $2.2 million.

The agency also announced that it planned to award $1.65 million under its Community Action for A Renewed Environment (CARE) Program to help communities understand and reduce risks from toxics from all sources through voluntary actions. The term "toxics" is meant to apply to broad categories of chemicals and will not be limited to a particular class of substances regulated by a particular statute or regulation. The CARE Program grants will be awarded pursuant to EPA research and demonstration authorities under the Clean Water Act, Clean Air Act, Resource Conservation and Recovery Act, Toxic Substances Control Act, Safe Drinking Water Act, Federal Insecticide, Fungicide and Rodenticide Act and the Marine Protection, Research and Sanctuaries Act. Under CARE, EPA will provide two types of two-year grants. EPA will award six Level I grants that will range from $60,000 to $90,000. The goal of the Level I cooperative agreements is to help communities understand toxic risks, set priorities for reducing those risks and identify actions to address those risks. The four Level II grants may range from $150,000 to $325,000,

but EPA anticipates the awards will be funded at $275,000. The Level II cooperative agreements will be used to implement the risk reduction actions through voluntary actions. The grants may not be used to facilitate inventorying, assessment or remediation of brownfield sites or other activities that are authorized under the CERCLA Technical Assistance Grants (TAGs).

Meanwhile, the federal Housing and Urban Development announced that will award $24 million in Brownfields Economic Development Initiative (BEDI) grants. The deadline for BEDI applications is June 17, 2005. Currently, BEDI grants may only be used for projects or activities also supported by HUD Section 108-guaranteed loan program. However, bills are circulating in Congress to decouple the BEDI program from the §108 program.

Pennsylvania Establishes Site Assessment Grants for Small Businesses

The Pennsylvania Department of Environmental Protection (PADEP) is accepting applications for its Site Assessment Grant Program until June 30th. The program will fund up to 80% of the cost of the site assessment up to $5,000 for any small business and up to a maximum of $15,000 for small businesses holding three qualifying permits. The site assessments are conducted by private consultants and will evaluate a company's business or manufacturing processes, operational procedures, systems, energy consumption and costs, raw material uses, waste streams and disposal costs. PADEP maintains a list of assessors who have completed a DEP training workshop specifically designed to support the program, but applicants are not required to select an assessor from the list.

New York State Department of Health Issues Draft VI Guidance

The New York State Department of Health (NYSDOH) has issued a draft "Guidance for Evaluating Soil Vapor Intrusion in the State of New York" for public comment. The NYSDOH proposed guidance follows draft guidance issued this past fall by the New York State Department of Environmental Conservation (NYSDEC) where the agency announced it would be screening approximately 400 sites that were closed prior to 2003 that have been impacted with chlorinated solvents. NYSDEC intends to screen these sites to determine if they exhibit a completed vapor intrusion pathway. If soil gas sampling identifies impacts to indoor air or groundwater contaminated with chlorinated solvents is detected within a 100 foot radius (vertically or horizontally) of an occupied building, NYSDEC will presume there is an indoor impact and may require more extensive sampling and mitigation measures. For more information about the NYSDEC vapor guidance, readers should refer to the January/ February 2005, Vol. 8, Issue 1 of the *Schnapf Environmental Journal.*

The vapor intrusion (VI) guidance establishes a comprehensive and rigorous framework for investigating soil

vapor and implementing remedial/mitigation measures. The NYSDOH guidance leaves little room for flexibility while performing investigations and implementing remedies since it proscribes vapor testing depths based on basements, sealing ground surface to determine surficial influence rather than just low flow, using inert gases, and not allowing passive mitigation.

The NYSDOH guidance proposes a single-tier approach for vapor intrusion investigation. It applies to current and potential human exposures to contaminated subsurface vapors in residential, commercial and industrial buildings. However, if the exposures are occupational (e.g., exposures from chemicals used at the workplace or in commercial/industrial process) as opposed to environmental exposures (vapors migrating from a subsurface source), then OSHA standards will apply to the investigation and the target workplace levels would be the OSHA permissible exposure levels (PELs). VOCs are defined as volatile organic chemicals, some semi-volatile chemicals and elemental mercury.

NYSDOH states the soil vapor intrusion pathway must be investigated at *any* site where there is known existing subsurface sources or likely subsurface source (based on previous land uses) of VOCs in groundwater or subsurface soil above their appropriate standard, criteria or guidance concentration. In addition, the vapor pathway must be examined at existing buildings or when buildings may be constructed near a subsurface source of VOCs. The VI guidance requires vapor assessment of potential exposures in unoccupied buildings as well as vacant sites where buildings are to be constructed.

The NYSDOH goes on to state that soil vapor results alone cannot be used to rule out the need for further sampling or addressing exposures. Under the VI guidance, sub-slab vapor will be the primary mechanism for evaluating exposures with indoor and outdoor air sampling results as well as soil vapor results used to guide these investigations. The VI guidance does not provide for numeric screening levels for subsurface media. As a result, it appears that a full panoply of indoor air, sub-slab and ambient air testing would be required once a VI investigation is required.

Modeling will not be allowed as a sole means of evaluating potential exposures. If subsurface vapor contamination is detected, the draft NYSDOH guidance provides that owners will have to evaluate current and potential exposures to contaminated subsurface vapors, take mitigation actions to prevent or mitigate exposures and implement an approved subsurface remediation program. The agency seems to assume that the mere presence of vapors in the subsurface will cause human exposures. However, the agency said that where the extent of the vapor contamination is understood, parties could avoid further time-consuming investigation and risk assessment by proposing a "blanket mitigation" approach where mitigation systems will be installed regardless of what actions might be eventually be required. However, it seems like indoor sampling would be

required to verify the effectiveness of the mitigation measures instead of other surrogate measurements such as pressure readings. Moreover, NYSDOH appears to limit VI investigations to the heating season.

The draft VI guidance emphasizes that New York does not have any subsurface vapor standards. The agency proposes indoor air guideline values (AGVs) for five compounds, including 5 micrograms per cubic meter (mcg/m3) for trichloroethylene (TCE) which translates roughly into 1 ppb of TCE in soil.

NYSDOH proposes two decision matrices for addressing potential exposures from vapor intrusion based on sub-slab soil vapor and indoor air concentration matrices as risk management tools. The matrices have different concentration levels for determining when no action, reasonable steps to reduce exposure (when other sources are contributing to the presence of VOCs in a building), monitoring or mitigation is required. Chemicals will be assigned to either of the matrices. NYSDOH proposes to assign TCE to soil vapor/indoor air matrix 1, and PCE and TCA to soil vapor/indoor air matrix 2. It would appear that the decision matrices would require mitigation at concentrations that would not require action under the default residential settings of the Johnson and Ettinger Model. Based on the parameters suggested for the decision matrices, it appears that NYSDOH would require mitigation where the ratio of sub-slab to indoor air concentrations was as low as 10. It appears that the sampling and mitigation costs under the proposed NYSDOH guidance will be substantial and that investigation/mitigation could be required for workplaces with VOC concentrations that would be considered acceptable under the OSHA PELs.

Meanwhile, a report issued by the New York State Assembly Environmental Conservation Committee recommended NYSDOH and the NYSDEC establish consistent and strict standards for TCE. The report is entitled, "*Vapor Intrusion of Contamination from Soil and Groundwater Into Indoor Air: Viewpoints from a Public Hearing.*" The committee received testimony that the NYSDOH TCE air guidance of 5 mcg/m^3 was significantly higher than levels proposed in other states and was insufficient since the TCE maximum contaminant level (MCL) of 5 parts per billion (ppb) resulted in lower levels of TCE in air. The Committee recommended that NYSDOH revise its TCE air guideline to 0.17 mcg/m3 since this was the provisional standard adopted by a number of EPA regional offices. Other key recommendations in the report include that vapor mitigation systems should only be used as short-term solutions and that NYSDEC should focus on eliminating the sources of the contamination. The report also urged that agencies should test the indoor air of any residents living near contaminated sites who requests such tests and that long-term monitoring and mitigation should be required at any sites that are to be redeveloped and that have potential vapor intrusion problems.

The Assembly Committee became involved after different screening levels were established at two high profile vapor intrusion sites. At the IBM Endicott facility and Hillcrest sites, NYSDOH applied its TCE air guidance of 5 mcg/m3 for determining when monitoring systems should be installed at homes at those sites. The limit was about 13 times greater than the exposure limit of 0.38 mcg/m3 established by EPA at Hopewell Junction. The vapor intrusion problems at the Endicott site caused the NYSDEC to reclassify the facility from a Class IV (delisted) to a Class II site, which is New York's equivalent to an NPL site.

Bankruptcy Settlement Facilitates Brownfield Development

The federal government, Illinois, Outboard Marine Corporation (OMC) and the City of Waukegan entered into a series of innovative settlements where OMC's bankruptcy estate will make a $2.6 million payment and Waukegan will assume responsibility for operation and maintenance of the engineering controls.

The settlements resolve nearly two decades of litigation. After widespread PCB contamination was discovered in Waukegan Harbor in 1984, EPA and the state filed a civil action against the OMC that resulted in a consent decree requiring OMC to implement a $20 million harbor cleanup. OMC performed the cleanup during 1992-93, and then placed the contaminated sediment and other waste in containment cells located at Plant 2. OMC declared bankruptcy in 2000 and sold off most of its assets. However, the estate was not able to sell Plant 2 and petitioned to abandon the facility under section 554 of the Bankruptcy Code. EPA and the state eventually reached a settlement in 2002 where the estate agreed to implement a limited removal action at Plant 2 and to pay EPA $221,250 to fund future remedial actions in exchange for allowing the estate to abandon the facility. In a separate action, EPA and the state filed a civil complaint in 2002 seeking the cleanup of chlorinated solvents in the ground water beneath Plant 2. In October 2004, EPA and the state settled with four private parties for remediation of soil and groundwater contamination at the Coke Plant site, a 36-acre parcel of land next to Plant 2 in the harbor complex. The city agreed to assume responsibility for operation and maintenance in exchange for a covenant not to sue (CNTS).

Under the first settlement, the OMC estate will place $2.6 million in a Superfund special account to be used toward cleanup of the ground water beneath Plant 2. In addition, the agreement grants EPA and Illinois EPA unsecured claims against the estate totaling approximately $2 million. In addition, Waukegan will assume responsibility for operating and maintaining the containment cells and buildings at the now vacant site.

The city's assumption of the operation and maintenance obligations at these two sites together with CNTS that applies to successors and assigns are part of the city's broader strategy for redeveloping its formerly industrial lakefront area. The city has

designated the lakefront area as a brownfield redevelopment district providing mixed use development. The city has also enacted a special ordinance for this area that establishes minimum construction code requirements for residential structures built on contaminated parcels. The city plans to sell parcels within the brownfield district to developers. The settlement reserves EPA's right to dedicate any windfall funds from the sale of the parcel to future cleanup that may be required at the former OMC site.

Commentary: *The Department of Justice is continuing to file claims and pursue settlements in bankruptcy proceedings. In In re Armstrong World Industries, Inc., et al., Case No. 00-4471 (Bankr. D. Del.), the United States filed a proof of claim against the debtor seeking the recovery of response costs incurred at seven Superfund sites. Under the proposed Settlement Agreement, the government claims for 19 ``Liquidated Sites'' were resolved for a total of $8,727,738.80. In addition, EPA was allowed to recover costs from the debtor at any "Additional Sites'' (e.g., presently unknown sites), following the effective date of a confirmed reorganization plan. However, any settlements or judgments for the Additional Sites will be paid as general unsecured claims, which are paid at 59.5%. In addition, EPA claims at 18 other sites would be discharged upon confirmation of the Plan.*

EPA received an allowed unsecured claim of $744,523 for the Skinner Landfill Superfund Site and an allowed unsecured claim of $4.1 million for the Pristine Superfund Site as part of a Stipulation and Agreed Order ("Agreed Order'') in In re Formica Corp., et al., Case No. 02-10969 (Bankr. S.D.N.Y.). Under the proposed Agreed Order, EPA's allowed claims would be deposited in special accounts for the Skinner and Pristine sites for the benefit of the PRPs performing the remedies for the two sites.

EPA entered into a settlement agreement with Reorganized Polaroid Corp. where the agency received an allowed general unsecured claim in the amount of $11 million for the Peterson/ Puritan, Inc. Superfund Site, located in the towns of Cumberland and Lincoln, Rhode Island in In re: Polaroid Corporation, et al., Case No. 01-10864 (Bankr. D. Del). In exchange for the settlement, Reorganized Polaroid received a covenant not to sue for future response costs at the site.

DUE DILIGENCE/ AUDITING/ DISCLOSURE/ ENFORCEMENT

SEC Issues Guidance on Disclosure of Material Contract Terms

In March, the Securities and Exchange Commission (SEC) issued a Report of Investigation (Release No. 51283) in connection with the settlement of an enforcement action that addressed the potential liability that public-traded companies may face for materially misleading disclosure of contractual provisions. Although the underlying enforcement action and the related Report of Investigation did not involve environmental issues, it may be applicable to contract provisions that allocate environmental liability of issuers.

In Release No. 51283, the SEC indicated that issuers have a responsibility to ensure that public disclosures of material contractual provisions, such as representations are not misleading. The Commission also said that an issuer could not avoid this disclosure obligation simply because the published information was not contained in the disclosure document itself, but in an agreement or document that is incorporated by reference or attached to the disclosure document. Where a document containing a representation is disclosed, the SEC said that the issuer is required to determine if additional disclosure is necessary to put the information into context so that it is not misleading. Under Release 51283, if management has knowledge of additional material facts such as qualifications to representations in the unattached schedules, failure to disclose that contradictory information would make the disclosure misleading. Likewise, an issuer must disclose new information that would make the facts described in the representation no longer true. The SEC also explained that general disclaimers regarding the material accuracy and completeness of disclosures may not be sufficient when the issuer has material information contradictory to the representation. Issuers who publish false or misleading material disclosures may be liable under section 10b of the Securities Exchange Act of 1934 (Exchange Act). The SEC also cautioned that issuers could also be liable under the Exchange Act not only for deliberately making material misleading disclosures, but also for recklessly or negligently failing to know and disclose the material facts. Release 51283 is not intended to change the way issuers negotiate or draft contracts and does not apply to representations, covenants or other contract provisions that are not public or disclosed to shareholders.

Commentary: *Because issuers filing merger or acquisition agreements with their public filings often do not include the disclosure schedules referenced in the agreements,*

investors may be unable to verify whether there are exceptions to the representations contained in such an agreement. As a result, issuers should exercise care when disclosing the terms of any contracts filed with the SEC or otherwise described in SEC filings. Issuers should carefully review the accuracy of representations or warranties in contracts filed with the SEC to ensure that the statements therein are not materially misleading absent supplemental disclosure or sufficient cautionary language that puts investors on notice. Issuers should determine if anything in the related disclosure schedules reaches a level of materiality requiring supplemental disclosure.

SEC To Begin Releasing Comment Letters to Filings

The SEC staff recently announced it will begin the process of publicly releasing comment letters and response letters relating to disclosure filings made after Aug. 1, 2004. This action is in response to the July 2004 report "*Environmental Disclosure: SEC Should Explore Ways to Improve Tracking and Transparency of Information."* where the Government Accountability Office (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 (See September 2004 Issue).

Under the new policy, comment and response letters will be released on a filing-by-filing basis through the EDGAR system at *www.sec.gov*. The process will commence with some of the oldest eligible filings. However, SEC eventually hopes to release letters 45 days after the Division of Corporation Finance and the Division of Investment Management.

FASB Releases Interpretation Statement for Asset Retirement Obligations

The Financial Accounting Standards Board (FASB) recently issued Financial Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations," (FIN 47 or Interpretation), which clarifies certain requirements set forth in FASB's 2002 Statement No. 143 "Accounting for Asset Retirement Obligations" (FASB 143 or Statement). FIN 47 will become effective no later than December 15, 2005 for companies using fiscal year accounting and December 31, 2005 for companies with calendar accounting.

FASB 143 was developed in 2001 because the variety of accounting practices that were used for asset retirement obligations (ARO) liability made it difficult to compare financial positions and results of companies with similar obligations. For example, some companies estimated an amount that would satisfy the costs to retire the assets and then accrued over time the incremental costs that the company anticipated to expend, while others delayed recognizing the obligation until a specific retirement date for the asset is known or when the asset is actually taken out of service.

Both FASB 143 and FASB Statement No. 5 "Accounting for

Contingencies" (FASB 5) deal with uncertainty, but have difference objectives. FASB 5 addresses how an entity should evaluate uncertainty when determining if a loss should be recognized. In contrast, FASB 143 requires entities to consider uncertainty about the timing and measurement of a liability. While FASB 5 requires entities to recognize losses when they are "probable", FASB 143 requires entities to recognize AROs fair value of the liability when it may be reasonably measured.

FASB 143 applies to "legal obligations" associated with the "retirement" of tangible long-lived assets. As used in the Statement, retirement means the sale, abandonment or disposal of a long-lived asset. The term does not apply to the temporary removal or idling of the asset. A legal obligation is "an obligation that a party is required to settle as a result of an existing or enacted law, statute, ordinance, or written or oral contract, or by legal construction of a contract under the doctrine of promissory estoppel."

The Statement indicates that liability has three characteristics. The first characteristic is that the entity has a "*present duty"* or responsibility to one or more entities that must be settled at a specified or determinable date, by the occurrence of a specified event or on demand. The second characteristic is that the duty or obligation must obligate the entity so that it has little or no discretion to avoid the future liability. Finally, the obligating event must have *already occurred.* FASB 143 acknowledges that it may be difficult to identify an obligating event in some situations. For example, an entity may obtain a license or permit that contains closure or decommissioning obligations. However, while the underlying law or permit may create a duty, the obligating event is the contamination since there would not be any closure obligation in the absence of the contamination.

Under FASB 143, ARO liability must be recognized when the liability is incurred, which is generally when the long-lived asset is acquired, constructed, developed or through normal operation provided the company can make a reasonable estimate of the "fair value" of the liability.

FASB 143 also applies to partial settlements of AROs. For example, an entity that owns or operates a landfill is required to periodically cap waste cell as they become full but does not have to perform closure or post-closure until the entire landfill ceases operation. In this scenario, the capping obligations fall within the scope of FASB 143 and must be included in the measurement of the asset retirement obligation. Likewise, an entity that acquires an operating landfill will have to comply with FASB 143 for the remaining obligations associated with the landfill. Similarly, decommissioning costs associated with nuclear power plants are legal obligations resulting from normal operations and therefore subject to FASB 143.

Remediation costs resulting from the improper operation of a long-lived asset do not fall within the scope of FASB 143. Thus, because leaks from fuel storage facilities are inherent in these operations, FASB

143 said these types of remediation liabilities fell within the scope of the Statement. In contrast, remediation costs associated with a catastrophic accident or spill are not covered by FASB 143. Instead, those costs fall within the scope of AICPA Statement of Position 96-1, "*Environmental Remediation Liabilities.*" Also, a past history of lax enforcement by regulatory authorities is not a justification for deferring the recognition of an asset retirement obligation.

A long-lived asset that has an indeterminate useful life and therefore an indeterminate settlement date also falls within FASB 143. According to the Statement, the uncertainty about the timing of the settlement would simply affect the measurement of the liability for that obligation. Since settlement dates are necessary for using present value technique for estimating fair value, the liability would be recognized when sufficient information exists to estimate a potential range of potential settlement dates.

FASB 143 does not apply to obligations of lessees in connection with leased property so long as the obligations meet the definition of minimum lease payments or contingent rentals as set forth in FASB Statement No. 13. It also does not apply to maintenance obligations or the cost of replacement parts. For companies that delayed recognition, FASB 143 had the effect of increasing liabilities while other companies may have experienced lower recognized since FASB 143 allowed discounting when developing fair value estimates.

After the initial recognition of an ARO liability, FASB 143 provides that entity should also recognize period-to-period changes in the asset retirement obligation from either the passage of time or revisions to the timing and amount of the original estimate. FASB 143 also stated that an entity will not extinguish its ARO liability by establishing a financial assurance for that ARP (such as an acceptable RCRA financial assurance mechanism for closure or post-closure).

FIN 47 clarified a number of key issues, including when liability should be recognized for a conditional ARO, which is a legal obligation to perform an asset retirement activity, but where the timing or method of settlement are conditioned on some future event that may not be within the control of the entity. FIN 47 also provides instructions on when fair value for a conditional ARO may be reasonably estimated and when an entity should be deemed to have sufficient information to reasonably estimate fair value.

Thus, if there is an ARO where the asset retirement activity is unconditional (e.g., closure obligation) but the timing and method of settling the liability may be conditioned on a future event, FIN 47 indicates that the entity shall recognize a liability for fair value of the conditional ARO if the fair value can be reasonably estimated. FIN 47 suggests that a fair value may be reasonably estimated if the ARO is reflected in the acquisition price of the asset, an active market exists for the transfer of the asset or sufficient

information exists to apply expected present value techniques. On this last point, FIN 47 indicates that an entity would have sufficient information to reasonably estimate the fair value if the settlement date and method of settling the obligation has been specified by others such as by law or pursuant to a contract. FIN 47 clarified that determining a settlement date may sometimes depend on judgments based on specific facts or circumstances such as if a liability may be extended through a contract renewal. However, an entity cannot defer recognition of the ARO where the only uncertainty is whether the performance will be required.

The Interpretation also states that the entity would also have sufficient information to reasonably estimate if there is information to estimate the settlement date or a range of settlement dates, the method or potential methods of settlement and if there is a reasonable basis to assign probabilities to the potential settlement dates or settlement methods. Examples of information that is expected to provide a basis for estimating potential settlement dates includes information from past practice, industry practice, management's intent or the asset's estimated economic life. FIN 47 emphasizes that the narrower the period of time that the entity may settle its obligations and the fewer the methods of settlement available, the more likely that the company will have sufficient information to reasonably estimate the fair value of the ARO.

FIN 47 contains a number of illustrations that all involve environmental scenarios. One example involves a telecommunications company that uses chemically treated poles. There is no requirement to remove the poles from the ground, but the entity may periodically replace them for operational reasons. Once the poles are removed, they must be properly disposed. The Interpretation indicated that at the time the entity purchased the poles, it had enough information to estimate the potential range of settlement dates, the potential methods of settlement and the probabilities associated with the settlement dates and methods based on industry practices. While the timing of the ARO is conditional on removing and disposing the poles, the existing legal requirements for disposing the poles constitutes an obligating event at the time of purchase. Although the entity may defer settlement by not removing the poles or by reusing them, FIN 47 stated that the ability to defer settlement does not relieve the entity of its obligation since the poles will eventually have to be properly disposed. Selling the poles will also not extinguish the obligation since the sales price will reflect the party’s view of the timing and amount of the costs to extinguish the obligation.

The second example illustrates that an ARO may also exist for a component part of a larger system. An entity buys kilns that are lined with special bricks that must be replaced periodically. Because the bricks become contaminated with hazardous substances, they must be properly disposed under RCRA. FIN

47 indicates that the performance of the ARO is conditional on removing the bricks from the kiln and that the existing hazardous waste requirements do impose an unconditional duty to properly dispose the bricks. The ARO is the requirement to dispose of the bricks in an RCRA-licensed facility, so the obligating event does not occur until the bricks become contaminated from use. Therefore, the entity has no obligation at the time of purchase. Once the bricks become contaminated, FIN 47 said that entity would have to recognize the ARO even though there is uncertainty as to when the bricks will actually be removed. However, the cost to replace and install new bricks is not part of the ARO and should be accounted for as a maintenance or replacement activity.

The third example involves a company that acquired a building with asbestos-containing materials (ACM) before the ACM rules for renovation and demolition were adopted. The company has no plans to renovate the plant. Although the timing of the ARO is conditioned on the plant undergoing renovation, FIN 47 indicated that an obligating event occurred when the ACM rules were issued. The entity would have to recognize the ARO upon implementation of the ACM rule if it can reasonably estimate the fair value. However, because the time period when the liability may actually be settled is unknown or cannot be estimated (the company has no plans to renovate the plant), FIN 47 said the entity cannot reasonable estimate the fair value of the liability. While the entity does not have to recognize an ARO liability when the ACM regulations become effective, FIN 47 stated that the company should describe the obligation, explain that an ARO liability has not been recognized because the fair value cannot be reasonably estimated and the reasons why it cannot reasonably estimate the fair value.

The final example also involves purchasing a plant with ACM but this time the ACM rules are in effect at the time of the purchase. Here, the obligating event is the acquisition of the plant since the regulations were in effect, but because the settlement period is indeterminate, the purchase price does not reflect the fair value. At this point in time, the ARO would not be recognized because the purchaser cannot reasonably estimate the fair value for the reasons set forth in the third example. Ten years later, though, the plant has to change product lines that will require modifications to the plant. Now, the entity has information to estimate a range of settlement dates, the potential methods of settlement and the associated probabilities. Thus, the entity is now able to estimate the fair value of liability for special handling of the ACM using an expected present value technique.

Some Banks Withdraw Loan Commitments Because of Wyle Labs Contamination

Washington Mutual and World Savings recently withdrew loan commitments from two prospective purchasers of homes located on Raquel Road in Norco, CA, after the appraiser included information about

contamination associated with the Wyle Labs. While no contamination has been found along Raquel, volatile organic compounds (VOCs) associated with the laboratory have been detected in surface water and an irrigation well as far as a half-mile from the lab at four times the state drinking-water standard. Area residents have blamed the contamination from the lab for a cluster of thyroid cancers and other thyroid-related ailments.

In addition, more than 400 residents have filed a class-action lawsuit against their developer claiming the contamination from the lab is impacting property values in the Hidden Valley neighborhood south of Wyle after indoor air samples from three homes along El Paso Drive detected elevated levels of the same VOCs found in the groundwater at the Wyle property. Previously, the state Department of Toxic Substances Control had focusing on the neighborhood northwest of Wyle. The lawsuit alleges that Western Pacific failed to adequately disclose the existence of the contamination when it began selling the homes.

Florida Expanded Notice May Complicate CERCLA Defenses

The Florida Department of Environmental Protection (DEP) recently proposed a rule that would require persons responsible for site rehabilitation (PRSR) to promptly notify the agency of any off-site contamination within ten days of discovery. The agency then will determine whether to provide notice to neighbors, including adjacent property owners and residents. The proposed version of the rule would have required the PRSR to directly notify neighbors.

Commentary: *One of the requirements for satisfying the CERCLA Bona Fide Prospective Purchaser (BFPP) and Contiguous Property Owner (CPO) defenses is for the party to comply with all required notice and reporting obligations. Thus, property owners who fail to comply with the PRSR would be jeopardizing their BFPP and CPO defenses. While it is possible that government regulators may exercise their enforcement discretion and overlook a technical violation of a notice obligation (failing to strictly notify within the mandated time period or only notifying one agency where multiple agencies must be contacted), parties in contribution or cost recovery actions will certainly argue that any violation of a notice obligation no matter how minor should operate to preclude a party from asserting the BFPP or CPO defenses. Thus, it is important for purchasers and their lenders to identify all applicable reporting and notice requirements, and to make sure that notices are provided to all required agencies within the applicable time periods.*

Washington Enacts Superlien Legislation

Washington became the first state in over a decade to enact a superlien law when Governor Christine Gregiore signed into law Senate Bill 5449 (chapter 211 of the Laws 2005) on April 28th. The legislation is actually a hybrid of a diluted superlien law and windfall lien law. It does not apply to property

owned by a local government or special purpose district. The law also does not apply to residential property with four or less residential units unless the exempt residential property is used to manufacture or store illegal drugs.

Under the state Model Toxics Control Act (MOTCA), the state Department of Ecology (DOE) may recover its response costs from responsible parties. However, the legislature was concerned that DOE often has difficulty recovering its costs from absent or bankrupt parties, and that DOE claims for reimbursement have lower priority in bankruptcy proceedings than those of secured creditors.

As a result, the legislation authorizes the DOE to file a lien for the full amount of its unrecovered cleanup costs against property where the agency has performed remedial actions. Under the initial version of the law, the DOE's lien would have subordinated existing security interests. The version that was signed into law, though, provides that the lien would have priority after local and special district property tax assessments and mortgages that were recorded prior to the time that a notice of the intent to perform a response action is recorded.

However, if the property is considered abandoned, then DOE would have a super-priority lien for the increase in the fair market value of the property attributable to the DOE response action up to the amount of DOE's unrecovered costs. This windfall lien will subordinate all existing and recorded liens on the property. The law defines an "abandoned property" as land where there has not been "significant business activity" for three years or there are unpaid property taxes in the three years preceding the time that DOE incurs its response costs. The increase in fair market value will be determined by subtracting the county assessor's value of the property for the most recent year prior to the initiation of the response action from the value of the property after the remedial action is completed. The post-remedial action property value shall be determined by either the bona fide purchase price of the property or a DOE real estate appraiser.

The law contains a number of procedural safeguards that mitigate the impact of the lien on secured creditors. First, when DOE notifies a party that it may be potentially liable under the MOTCA, DOE must include a notice stating that the agency may file a lien against the property if it incurs response costs that are not recovered.

In addition, at least 30 days prior to initiating a cleanup, DOE must provide a notice to the property owner, mortgagee and lienholders of record that the agency plans to commence a cleanup and that it has the authority to impose a lien for unrecovered remedial action costs. If DOE must perform an emergency cleanup, the agency must provide the notice within 30 days of the start of the emergency cleanup. If the property owner consents to the filing of the lien, DOE only has to notify the mortgagee and lienholders of record.

Before actually filing the lien, the DOE must provide the owner, mortgagee and lienholders of record with a notice of intent to file a lien by

certified mail. The notice must specify the purpose of the lien, the description of the property, the costs incurred by the agency, a statement of facts showing the probable cause that the property is the subject of the remedial action that caused the response costs, and a 30-day time period to respond to the notice. If the DOE does not receive any comments or determines that there is still probable cause despite the comments, the agency may then file the lien. The law does permit DOE to file a lien prior to the 30 day period if "exigent circumstances exist" such as an imminent bankruptcy filing or property transfer. The lien shall take effect when it is filed with the county auditor where the property is located.

An owner or lender holding a mortgage on property that is subject to a lien may petition to have the lien removed or reduced. If DOE denies the request, the law then gets a little murky. The statute says that the person may file a suit within 90 days of the DOE's decision to remove or reduce the amount of the lien. The law states that the lien will be removed if the person can show by a preponderance of the evidence that it is not a liable party. It is unclear if the owner is considered a liable party but the lender is not, if the lien has to be removed.

The same person is also entitled to seek a reduction of the lien by filing suit within 90 days of the DOE's decision provided the person can show by a preponderance of the evidence that the amount of the lien exceeds the remedial action costs incurred on the property. For the windfall lien, the person must show that the amount of the lien exceeds the unrecovered remedial costs or exceeds the increase in fair market value that it solely attributable to the remedial actions performed by DOE.

Commentary*: The superliens of other states vary considerably from state to state. Some of the Superlien statutes merely impose a priority lien on the property that is subject to the cleanup, while others may attach to all of the assets of the responsible party, including personal property and business revenues located or derived from within the state. Most state superliens only become effective after the lien has been recorded, but some states permit the lien to relate back to the initial date that the costs are incurred so that this essentially creates a "secret" superlien. States that have some form of superlien include Connecticut, Illinois (municipalities only to encourage brownfield development), Louisiana, Maine, Massachusetts, Michigan, New Hampshire, New Jersey and Wisconsin. Ohio and Rhode Island do not have superlien laws but have quirky general lien laws that can be problematic to lenders.*

Despite the importance of superlien laws, cleanup liens are not usually reviewed during due diligence. Most consultants take the position that these liens are not "reasonably ascertainable" under ASTM E1527-00 and that searching for cleanup liens are the responsibility of the user. It is important for lenders to be familiar with the states that have superlien laws and to make sure the liens are searched either as part of the Phase I ESA or title search.

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