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SIGNIFICANT ENVIRONMENTAL LITIGATION

Federal Courts Continue to Struggle with Avail Decision

Federal courts are issuing what appears to be conflicting decisions interpreting the scope of the United State's Supreme Court 2004 holding in *Cooper Industries v. Aviall Services*, 540 U.S. 1099 (Aviall). These inconsistent decisions are complicating efforts by states to preserve incentives for responsible parties to perform voluntary cleanups.

What is an Administrative Order?

Section 113(f)(3)(B) of CERCLA authorizes parties to bring contribution actions if they resolve their CERCLA liability through an "administrative or judicially approved settlement." Since this issue was not before the Supreme Court, the *Aviall* decision did not address this issue. To incentify parties to remediate contaminated sites, the New York State Department of Environmental Conservation (NYSDEC) recently added specific language to its "administrative orders on consent" stating that the orders constitute "administrative settlements" under section 113(f) and that the settling parties are resolving their CERCLA liability under the agreement. This language reflects the time-honored NYSDEC practice of relying on CERCLA as the principal mechanism for addressing cleanup of contaminated sites in New York. The agency has used CERCLA as the principal enforcement mechanism for cleanups because the agency has limited authority to compel cleanups under the state superfund law.

Notwithstanding this long-standing agency practice, the express reference to CERCLA in its orders and recent briefing by the state attorney general that the NYSDEC administrative orders constitute CERCLA administrative settlements, a three-judge panel of the Court of Appeals for the Second Circuit recently ruled in *Con Edison v. UGI Utils., Inc.*, 2005 U.S. App. LEXIS 19477 (September 9, 2005), that NYSDEC administrative orders do not qualify as "administrative settlements" for purposes of section 113(f). Earlier this year, a district court for the western district of New York ruled that a NYSDEC administrative order that referred to section 113(f) allowed a party to bring a contribution action in *Benderson Dev. Co. v. Neumade Prods. Corp.*, 2005 U.S. Dist. LEXIS 14943 (W.D.N.Y. June 13, 2005). This case was a relief to purchases or volunteers under the New York voluntary cleanup program who were understandably concerned following a decision in *W.R. Grace & Co. v. Zotos Int'l, Inc.*, 2005 U.S. Dist. LEXIS 8755 (W.D.N.Y. May 3, 2005) rejecting a contribution claim based on an old-style NYSDEC administrative order that did not refer to CERCLA liability. Now, though, the holding in the Benderson case is in doubt.

More troubling are the implications that the Con Edison case has for contribution protection afforded by administrative orders and other remediation agreements issued by the NYSDEC. Since the 1990s, NYSDEC has inserted language in its agreements that they constituted administrative settlements for purposes of providing contribution protection to the settlors under CERCLA section 113(f)(2). However, under the reasoning of the Con Ed decision, these agreements do not qualify as administrative

settlements, thereby exposing volunteers or purchasers of contaminated property performing cleanups to liability to other PRPs.

Meanwhile, in *Montville Twp. v. Woodmont Builders, LLC*, 2005 U.S. Dist. LEXIS 18079 (D.N.J. August 12, 2005), the federal district court for the district of New Jersey ruled that the state form of voluntary cleanup agreement known as a memorandum of agreement ("MOA") did not qualify as an administrative settlement or a civil action. As a result, the remediator was not allowed to maintain a contribution action. This case has potential far-reaching consequences because the New Jersey MOA is similar to agreements used by other states under their state brownfield or voluntary cleanup agreements. These agreements are usually issued under state authority and do not refer to CERCLA.

In *Ferguson v. Arcata Redwood Co., LLC*, 2005 U.S. Dist. LEXIS 18015 (N.D. CA. August 4, 2005), the federal district court ruled that an exchange of letters between the property owner and a state agency where the agency threatened enforcement action unless the owner implemented remedial actions was not an "administrative settlement" for purposes of section 113(f)(3)(B) of CERCLA. In this case, the plaintiff purchased the Property in 1993 and entered into a contract for sale to sell the parcel to a developer five years later. However, during its environmental diligence, the developer uncovered a disposal pit that had contaminants consistent with the prior use as a wood treatment facility. The California Regional Water Quality Control Board (CRWQCB) then issued a letter to the plaintiff requesting that it conduct further investigation and remedial activities. The letter also warned that failure to comply with this request in a timely manner may result in "elevated enforcement." In dismissing plaintiff's contribution claim, the federal district court noted that the letters from the CRWQCB did not specifically reference any threatened legal or administrative proceeding, did not contain the word "settlement" or "CERCLA" and that the CRWQCB never asserted that it was exercising authority under CERCLA. Finally, the court held that the no further action letter stating that "this agency finds that no further action on this site is required" did not constitute a settlement agreement.

What is a "civil action"?

In *CadleRock Properties Joint Venture, L.P. v. Schilberg*, 2005 U.S. Dist. LEXIS 14701 (D.CT. July 18, 2005), the plaintiff was issued two cleanup orders by the Connecticut Department of Environmental Protection (CTDEP) and sought contribution from prior landowners on grounds that the state orders were functionally equivalent to civil actions under CERCLA §106 or administrative settlements. The federal district court first noted that the CTDEP orders were issued solely under state environmental laws and that the CTDEP had not brought the enforcement actions pursuant to a §104 cooperative agreement with EPA. The court then ruled that a state cleanup order was not the equivalent of a "civil action" under CERCLA § 106." Since the contribution action was not brought "during or following a civil action under § 106 or § 107(a), the court held that the plaintiff was not entitled to bring a contribution action under §113(f)(1). The court also rejected the argument that filing a declaratory judgment for determining the future potential liability of the parties could satisfy the pre-requisite for bringing a contribution action "during or following a civil action" under § 106 or § 107. Finally, the court ruled that the plaintiff could not be deemed to be a settling party that resolved its liability pursuant to judicially approved federal settlement because the plaintiff had vigorously litigated and resisted its state

obligations and responsibilities.

At the other end of the spectrum was *Boarhead Farm Agreement Group v. Advanced Environmental Technology Corp*., E.D. Pa., No. 02-3830, 7/20/05) where the District Court for the Eastern District of Pennsylvania ruled a party bringing a contribution action under §113(f)(1) did not have to be actually a named party in the prior civil action. Here, EPA brought an action under both §§ 106 and 107 against three PRPs who subsequently entered into two consent decrees to perform a cleanup. The three PRPs and two other PRPs who had not been sued by EPA but agreed to help fund the cleanup then formed an unincorporated PRP association for implementing the work. The PRP group then sought to recover their costs from other non-settling PRPs. One of these newly named defendants asserted that the PRP Association could not bring a contribution action because the individual PRPs and not the association had entered into a consent decree. Moreover, the defendant argued that the two PRPs who had not been sued by EPA could not bring contribution actions. The court held that such a reading would torture the plain meaning of CERCLA and discourage PRPs who were not sued by EPA from cooperating with settling PRPs.

In *Honeywell Intl Inc. v. Phillips Petroleum Co*., 415 F.3d 429 (5th Cir. 2005) in 1968, the Signal Companies, Inc. ("Signal") sold a former oil refinery site to Lone Star (the "Lone Star Site"). Approximately a year later, Signal reorganized as a holding company and transferred its natural resources business to Signal Oil & Gas ("Signal Oil"), a previously inactive subsidiary. Under the transfer agreement, Signal Oil assumed certain liabilities associated with Signal's oil business. In 1992, Lone Star sued Honeywell, as successor to Signal, for costs associated with the former Lone Star facility. In 1993, Honeywell filed a contribution action against Phillips, as successor of Signal Oil, in the event that Honeywell was found liable to Lone Star. In 1998, the federal district court ruled that Signal had conveyed the Lone Star facility before the corporate reorganization. The district court also granted a motion for summary judgment in favor of Phillips ruling that it was not liable to Honeywell because the Lone Star assets had not been included in the 1970 transaction. Since the underlying lawsuit was resolved, Honeywell then argued that the district court had no jurisdiction to hear the Phillips claim since Aviall precluded Honeywell from bringing a CERCLA action since there was no longer a civil action under 113(f)(1). However, the 5th circuit said that at the time of the lawsuit, Phillips might have had successor liability so the claim was not frivolous. Moreover, since the claim was brought "during or following," it was not precluded by *Aviall.* Accordingly, the appeals court affirmed the dismissal of Honeywell's complaint against Phillips.

Is There An Implied Right of Contribution?

In *Viacom Inc. v. U.S.*, 2005 U.S. Dist. LEXIS 16877 (D. D.C. July 19, 2005), the plaintiff's corporate predecessor incurred $26.76 million cleanup costs under the supervision of the Nuclear Regulatory Commission ("NRC") and the New Jersey Department of Environmental Protection (NJDEP) to decommission at facility and estimated it would spend an additional $1.8 million. The plaintiff maintained that the contamination was related to work performed for the United States Army during World War II and sought to recover its costs from the United States on the grounds that it was a CERCLA arranger or operator of the plant. The United States brought a motion to dismiss because the contribution action was not brought following a lawsuit or pursuant to an administrative settlement. Because the United States

was the party most able to trigger any of the § 113(f) triggers for contribution actions, the court said it would be manifestly unjust if the United States could insulate itself from PRP liability by simply deciding not to invoke its powers to settle with, sue, or issue an administrative order requiring plaintiff to act. The court said that prohibiting a PRP that had voluntarily undertaken a cleanup from recovering its costs from other PRPs would have contravened the statutory purpose of CERCLA. As a result, the court concluded that a PRP that cannot sue for contribution for voluntary cleanup costs under § 113(f) could seek to recover its costs under § 107(a).

In *Kotrous v. Goss-Jewett Co. of N. Cal., Inc.*, 2005 U.S. Dist. LEXIS 18013 (E.D.Ca. June 16, 2005) a federal district court declined to reach the availability of a contribution action under §113(f) for a state cleanup order. Here, the plaintiff discovered soil contamination shortly after acquiring the property in 1996. In 1998, the defendant agreed to conduct a well survey that identified 35 water wells within 2,000 feet of the Site, including one private well used for domestic water supply that contained elevated levels of PCE. The well was removed from service but CRWQCB issued a letter to the defendant in 2000 requesting a work plan for additional investigation, including installing off-site groundwater monitoring wells. After the defendant refused to perform any further work, the CRWQCB issued a Cleanup and Abatement Order directing the plaintiff to complete the work. The plaintiff then commenced its action asserting claims for contribution under CERCLA and the California Hazardous Substance Account Act as well as a declaratory relief under CERCLA §113(g)(2). The defendant brought a motion to dismiss the contribution claims, because the plaintiff had not been sued or had not resolved its CERCLA liability pursuant to an administrative settlement. Unlike the CastleRock Properties case where the district court had felt constrained by earlier decisions of the United States Court of Appeals for the Second Circuit prohibiting responsible parties from bringing actions under §107, the court in this case was under no such precedent. Because of the equities of the case, the court held that it did not have to rule on the §113(f) contribution action because the plaintiff had an implied right of contribution under §107.

Commentary: *In an attempt to continue to encourage PRPs to agree to perform cleanups and to minimize the impact of the Aviall decision on settling PRPs, EPA recently announced interim revisions to the model language for its CERCLA AOCs for removal actions, remedial investigations/feasibility studies ("RI/FS") and remedial designs. In addition to adding language specifically providing that the agreements constitute an administrative settlement for purposes of §113(f)(3)(B), the title of each order has been changed to "Administrative Settlement Agreement and Order on Consent" (ASOC).*

1958 Judgment Against Prior Owner Precludes Innocent Purchaser Defense

A federal district court ruled that a property owner could not qualify as a innocent purchaser because of the existence of a 1958 judgment recorded in the real estate records that prohibited a prior owner from "further dumping of waste materials" on the land. As a result, a federal district court ruled in *Kaladish v. Uniroyal Holding Inc.*, D.C. Conn., No. 00 CV 854, 8/9/05) that the current owner was not entitled to bring a private cost recovery action under section 107.

In this case, a farmer had leased a portion of his pig farm during the 1950s to a waste hauler who disposed of approximately 1.5 million pounds of

waste per month that had been generated by the Footwear Division of the United States Rubber Company (USRC). Most of the waste, which primarily consisted of rubber scraps, trimmings, shoes, rubber-coated canvas, rubberized aircraft components, and cafeteria garbage, was buried, but some of the waste was burned. During the mid-1950s, 2000 gallons of methyl ethyl ketone (MEK) was disposed at the site. In 1957, neighbors successfully brought a nuisance action in state court prohibiting further dumping or burning of waste on the pig farm. In 1970, the farmer sold the property to the waste hauler who used the land for his fuel oil business. The property changed hands several times until it was acquired by the plaintiff in December 1976. One year later, the Footwear Division of the USRC ceased operations.

EPA and the CTDEP performed site investigations during the 1980s and CTDEP informed the property owner in 2000 that the property was under consideration for placement on the National Priorities List (NPL) because of contaminated groundwater. The property owner then brought an action against the defendants as corporate successors to USRC. The court found that the plaintiff was not entitled to bring a contribution action under §113(f)(1) because it had not been sued under CERCLA. The court also held that the plaintiff could not proceed under §107 because it was a PRP.

The plaintiff asserted that it was not liable under CERCLA because of the innocent purchaser or third party defenses. However, the court noted that the plaintiff had admitted that it made no inquiries regarding the property before purchasing it, did not examine any court records pertaining to the property before purchase and either failed to perform a title search or could not remember conducting one before his purchase. As a result, the court held the plaintiff had not conducted the requisite appropriate inquiry necessary to establish the innocent purchaser defense. Moreover, because the 1958 judgment was a part of the land records at the time of his purchase, the plaintiff had reason to know that hazardous substances could be present at the site.

On the third party defense, the court found that the plaintiff had at least an indirect contractual relationship through the chain of title with the former property owners who were responsible for waste disposal on the property. In addition, because the property owner admitted that he had not taken any actions to contain, remove, or prevent the release of any hazardous substances on the property since taking title, he also did not satisfy the requirements of the third party defense that he exercise due care with respect to the hazardous substances concerned and took all precautions against the foreseeable consequences of the prior dumping.

The court acknowledged that the combination of the *Aviall* decision and the Second Circuit's decision in *Bedford Affiliates v. Sills*, 156 F.3d 416 (2d Cir. 1999) created a perverse incentive for PRPs to wait until they are sued before incurring response costs. However, the court said that *Bedford* remained good law in the Second Circuit and that the majority of circuit courts agreed that a PRP may not sue another PRP under CERCLA § 107. Accordingly, the court granted the defendant's motion for summary judgment.

Innocent Purchaser Defense Precluded by Reliance on Third Party Report

A federal district court held in S.S. & G. and Nevada City Hotel, LLP v. California, No. 02:02-CV-2514 (E.D.Ca. August 22, 2005) that there was a triable issue of fact whether a developer could rely on a Phase I environmental site assessment prepared by a former landowner to assert the innocent purchase defense.

In this case, plaintiff S.S. & G. LLP (SSG) retained an environmental consultant in 2000 in connection with its purchase of a 1.7 acre parcel of land in Nevada City, California. At the same time, SSG was in negotiations with other individuals to finance the construction of a hotel on the site. The Phase I indicated that the purpose of the report was to assess the suitability of the property for construction of a hotel. The report also contained a limitation of liability equal to the fee for the work. The Phase I identified that the site contained fill material but that there was no evidence that former uses of the property would have resulted in the presence of hazardous substances on the property. As part of the Phase I investigation, the environmental consultant was provided a copy of a geotechnical report prepared that identified purple-brown soil in trenches cut to evaluate to soil compaction.

In 2002, the property was conveyed to Nevada City Hotel partnership (NCH) to construct and operate the hotel. During grading operations, NCH identified a layer of purple soil that turned out to be contaminated with a number of heavy metals. The hotel project was halted while NCH investigated the extent of the contamination. NCH found that the property had formerly been used to process gold ores and that the cleanup of the site would cost $3 million.

The plaintiffs then brought cost recovery claims against a variety of defendants. Third-party Newmont Mining filed a motion for summary judgment arguing that NCH was not an innocent purchaser under CERCLA because NCH did not conduct its own environmental site assessment when it purchased the site and was aware of the contamination by virtue of the geotechnical report. In response, the third-party plaintiff stated that NCH could rely on the Phase I because SSG and NCH were related or affiliated entities since they shared common partners. The court held that the geotechnical report was not designed to identify environmental liabilities and, therefore, could not be used to show that NCH knew or should of known of the contamination. However, due to the inactivity that occurred between 2000-2002 at the site and the seemingly contradictory conclusions of the geotechnical and Phase I reports, the court concluded that there were genuine issues of material fact as to whether NCH's reliance on the conclusions in the Site Assessment were reasonable.

Newmont also argued that the Phase I did not constitute "all appropriate inquiry" since the plaintiffs had brought a claim for damages against the consultant H&K for negligently conducting the site assessment. In their action against the consultant, the plaintiffs claimed the consultant did not review Sanborn maps and failed to review topographic maps that would have revealed that extensive mining operations had been conducted at the property in the 1890s. Because there was conflicting deposition testimony whether consultant had deviated from generally accepted and customary standards for performing due diligence for property transactions, court said there was a genuine issue of material fact regarding the adequacy of the site assessment.

Commentary: *Interestingly, the revised ASTM E1527-00 now ASTM E1527-05 will permit reliance on reports prepared by third parties, in some situations.*

Delay In Obtaining NFA Letter Results in Damage Award

The United States Court of Appeals for the Third Circuit ruled in *Jaasma v. Shell Oil Company*, 412 F.3d. 501 (3rd Cir. 2005) that a landlord could recover damages from its tenant for loss of use during the time after the property was cleaned up, but before the state agency issued a No Further Action (NFA) letter. In this case, Shell Oil Company (Shell) entered into a lease with the plaintiff landlord in 1988. The lease required Shell and its assignee, Motiva Enterprises (Motiva), to remove all gasoline, waste oil and fuel oil tanks from the premises upon termination and to restore the property to its original condition. In addition, Shell covenanted to comply with all applicable environmental laws and indemnify the landlord for any claims arising out of violations of environmental laws or any contamination attributable to Shell. One week before the lease was to terminate in October 2001, Shell removed the USTs and discovered petroleum contamination. After removing 6,500 tons of contaminated soil, Shell submitted a closure report to the NJDEP in January 2002, three months after the lease termination. NJDEP acknowledged receipt of the report in April 2002 and requested additional sampling because of technical deficiencies but did not require any further cleanup. In June 2003, NJDEP requested that Shell/Motiva conduct additional groundwater monitoring. Shell submitted the supplemental sampling report to NJDEP in September 2003 which confirmed that contaminants were below NJDEP cleanup levels. The agency issued a final NFA letter in February 2004.

The landlord then commenced an action against Shell/Motiva under a variety of theories including breach of lease, and as a holdover tenant, and sought damages for loss of use of her property from the lease termination date to the issuance of the NJDEP NFA letter. The plaintiff acknowledged that the physical cleanup had achieved state cleanup standards in October 2001 but claimed that because of the absence of regulatory signoff, she was not able to sell or rent the property at fair market value. The plaintiff proffered evidence that three different realtors advised her that she would not be able sell her property at fair market value until a NFA and that several prospective buyers had made the NFA a condition for sale.

After removing the action to federal district court, the defendants moved for summary judgment. The district court granted summary judgment on the holdover tenant and negligence claims. On the breach of contract claim, the court first concluded that the proper measure of damages was diminution of value or cost of remediation. Finding that the market value was not affected, the court ruled that the plaintiff had not proved any damages and ruled in favor of the defendants.

On appeal, the Third Circuit reversed, finding that New Jersey recognized damages for loss of use from temporary impairments, including uncertainty following environmental contamination. The court said even in the absence of contamination, New Jersey would recognize a claim for damages for the period of uncertainty following a pollution event particularly where the uncertainty was due to an ongoing review or investigation by a state environmental agency.

The court also found that Shell had breached the lease provision requiring compliance with environmental laws because this obligation included producing reports and evidence necessary to allow a state agency to

issue an NFA letter. Moreover, the court held that obtaining an NFA letter was a crucial part of the obligation of returning property to its "original state." The Court said that a fact finder could reasonably find that the property was not fully marketable prior to the issuance of the NFA.

Commentary: *The Third Circuit relied partially on an opinion issued by the Court of Appeals for the Seventh Circuit in NRC Corp., v. Amoco Oil, 205 F.3d. 1007 (7th Cir. 200). Now that two federal appeals courts have endorsed the view that loss of use damages may be available for temporary environmental impairments of property, it is quite possible that other state or federal courts will adopt this reasoning. If so, this could bode bad news for tenants. Given the long time it takes to obtain NFA letters or regulatory closure letters and the pace of real estate deals, landlords may begin to seek damages from tenants for the period of time that they have to keep the property off the market because of ongoing cleanups. In addition, parties who may be tempted to perform self-directed cleanups without oversight of state environmental agencies may find themselves subject to damages if it turns out that future purchasers or tenants insist on formal regulatory closure before agreeing to purchase or occupy the property.*

Third Circuit Rejects Continuity of Enterprise Doctrine

The United States Court of Appeals for the Third Circuit became the latest federal appeals court to reject the use of the substantial continuity test for imposing CERCLA liability on successor corporations. In *United States v. General Battery Corp. Inc.*, Price Battery Corporation (Price) manufactured lead acid batteries from the 1930s to 1966 at a plant in Hamburg, PA. During this time, the company disposed of battery casings at various sites in the area. In 1966, the sole shareholder of Price sold most of the company's assets to General Battery Corporation (General) in exchange for $2.95 million in cash and General stock valued at approximately $1 million, which represented 4.537% of General's outstanding equity and was roughly equivalent to the amount of stock held by each of General's co-founding shareholders. As part of the transaction, General assumed Price's contractual obligations and assumed all of the liabilities appearing on Price's balance sheet. General agreed to indemnify Price for claims other than future tort claims and agreed to retain Price's three senior executives. After the sale, General continued to operate the plant, retained middle management, union employees as well as the sales and office personal. Meanwhile, Price was required to change its name to Price Investment Company and retain $150,000 in cash pending completion of an audit. Price Investment Company did not conduct any operations and was formally dissolved one year later after the audit was completed. In 2000, General was merged into Exide Corporation (Exide). EPA incurred response costs at sites where Price had arranged to dispose of its battery casings and filed a cost recovery action against Exide as the successor to Price. The district court found Exide liable under both a de facto merger and substantial continuity analysis.

Because the Third Circuit had endorsed the view of using a federal common law approach to ensure uniform enforcement of CERCLA, many district courts within the jurisdiction of the Third Circuit had concluded that the substantial continuity test should be used in lieu of state corporate law. However, the appeals court had never actually ruled on the appropriateness of the test until this case. In this decision, the Third Circuit dismissed the viability of the test in little more than a

paragraph, concluding that the doctrine was inconsistent with the United States Supreme Court in *United States v. Bestfoods*, 524 U.S. 51 (1998).

Most of the opinion was devoted to assessing if Exide should be liable as a successor under the *de facto* merger exception. The Court noted its precedent of requiring a uniform federal rule was still valid after Bestfoods but then concluded that Pennsylvania generally tracked the majority rule that required there be a (1) continuation of the enterprise, (2) a continuity of shareholders, (3) the seller had to have ceased operations and (4) the purchasing corporation assumed the obligations of the seller. In the view of the Court, the only issue in dispute was whether the fact that the Price transaction involved a combination of cash and shares satisfied the second prong that there be continuity of ownership. Exide argued that the *de facto* case law required that the transaction be "primarily" for stock or a certain percentage of stock in the acquiring company. The Court found that while the law was somewhat unsettled, the "continuity of ownership" inquiry did not mandate that there be identify of ownership but instead required that the owners of the selling enterprise retain some ongoing interest in their assets so that they become a "constituent" part of the successor. Since the sole shareholder of Price acquired an amount of shares that were roughly on par with the co-founders of General, the Court concluded that the sale of Price was a *de facto* merger and affirmed the district court's holding that Exide was liable under CERCLA for the waste disposed by Price.

The Third Circuit's opinion followed a decision of the Eastern District of Pennsylvania in *Action Manufacturing Co. Inc. v. Simon Wrecking Co.,2005 U.S.Dist. LEXIS (E.D.Pa. 18671 August 31, 2005)* that also declined to apply the substantial continuity test. The plaintiff argued that defendant Marcegaglia was liable as a successor of Bishop Tube Co. The district court noted that the Third Circuit had ruled in *Smith Land & Improvement Corp. v. Celotex Corp.*, 851 F.2d. 86 (3rd Cir. 1988) that federal common law should be used when resolving successor liability under CERCLA. The court then went on to conclude that all four appeals courts considered the doctrine after *Bestfoods*, and had rejected the substantial continuity test. Thus, the court concluded that the substantial continuity test was not a part of the federal common law. The court also observed that six of its sister district courts that had endorsed the substantial continuity test had issued their decisions prior to *Bestfoods*.

"No Hunt" Clause in Purchase Agreement Complicates Breach of Contract Action

In 2000, Shan Industries (Shan) entered into an asset purchase agreement with Tyco Industries (Tyco) to acquire a division of Tyco's A&E Product division which included Accurate Forming division (Accurate). With $8 million in sales, the manufacturer of small metal parts seemed like a perfect turnaround candidate for Shan, especially since Tyco represented that Accurate was in compliance with environmental laws and agreed to indemnity Shan for any inaccuracies of any of its representations. Tyco also agreed to continue to comply with remediation obligations under the New Jersey ISRA to obtain a No Further Action (NFA) letter for the groundwater remediation that was reportedly nearly completed.

However, the agreement also contained what is commonly known as a "no hunt" or "no look" provision whereby Shan covenanted not to perform any environmental audit within three years of the closing and not to encourage any third party to initiate an audit or action

that would reasonably likely lead to a claim or obligation for the New Jersey plant. However, Shan was allowed to conduct "reasonably non-intrusive environmental inspections, compliance audits and assessments" as part of a corporate-wide compliance plan If Shan felt it required additional information, the contract provided that Tyco would be responsible for conducting the investigation.

After acquiring Accurate, Shan learned that the company's New Jersey plant was in widespread non-compliance with federal and New Jersey environmental laws. To take advantage of the EPA audit policy, the company conducted an environmental compliance audit in 2003 that revealed at least eight emission sources including its lacquer-spraying machinery, degreasers and chrome electroplaters were emitting excessive levels of TCE. The company estimated that it faced environmental compliance costs of at least $2 million and potential fines of $1 billion. The violations were voluntarily reported to EPA and the agency fined the company $101,000 that was payable in installments. However, in April 2004, the NJDEP issued a cease and desist order that would have required the company to shut equipment producing 40% of the plant's production. The company entered into a compliance order with NJDEP that requires compliance by January 2006.

After discovering the non-compliance, Shan requested that Tyco indemnity the company. Tyco agreed to permit Shan to retain a Tyco subsidiary, Earth Tech, to evaluate the environmental compliance of the plant. When the company became dissatisfied with Earth Tech's work, it retained its own environmental consultant that identified the widespread environmental violations. After settlement negotiations were unsuccessful, Shan brought a multi-count complaint against Tyco in federal district court seeking damages for breach of contract, fraudulent inducement, recission, common law indemnity as well as RICO violations. However, it is unclear how the interplay of the indemnity and the "no hunt" clause will impact the lawsuit. Federal and state authorities have reportedly launched civil and criminal investigations into Tyco's operation of Accurate.

Commentary: *A "no hunt" provision prohibits a buyer from performing voluntary investigations or cleanups unless ordered to do so by a governmental agency. In many ways, these clauses operate like the conditions in environmental insurance policies that define a pollution condition as an investigation or cleanup mandated by a governmental agency.*

These clauses are being used with increasing frequency in corporate transactions, usually where the parties have carefully negotiated an environmental risk allocation formula and the seller has agreed to provide some form of partial indemnity for a limited period of time. The reasoning of the seller is that the buyer had a period of time to evaluate environmental liabilities and should not be allowed to cause or accelerate liabilities that might not normally fall within the life of an environmental indemnity or cost-sharing agreement. Of course, a seller cannot prevent the buyer from complying with environmental laws. However, if the buyer takes voluntary steps like Shan did in the Tyco case, those actions might cause the buyer to forfeit or waive its contractual rights.

Contract negotiations are usually influenced by the relative bargaining powers of the parties. Unless a buyer is negotiating with a highly motivated seller, a buyer's principal contractual strategy may be to negotiate longer environmental due diligence periods to more carefully evaluate environmental liabilities or to explore some form of

environmental insurance or other risk transfer mechanism for unforeseen environmental liabilities that might arise in the future.

Florida Court Creates "Superlien" For Surplus Tax Sale Proceeds

A Florida state court essentially created a superlien in favor of the state Department of Environmental Protection (DEP) when it allowed the agency to receive surplus proceeds from a tax sale instead of the assignee of a perfected mortgage holder.

In *Penzell v. M&M Construction*, 2005 Fla. App. LEXIS 14057 (Ct. App-3rd Dist 09/7/05), Bank of America (BOA) held a mortgage on contaminated property. DEP obtained a judgment against the owner of the contaminated property in February 2003 requiring the owner to commence remedial activities at its property. The DEP implemented remedial actions when the owner defaulted and recorded a final judgment of approximately $53,000 in April 2003. After the owner also defaulted on its property taxes, a tax auction was held in December 2003. After the property taxes were paid, excess proceeds of approximately $123,000 remained. In January 2004, BOA assigned its rights and interests in the mortgage to the plaintiff.

The successful bidder filed an action to resolve title and the plaintiff intervened, seeking to have the excess proceeds distributed to her as assignee of BOA. After the court issued an order to show cause why the proceeds should not be distributed to the plaintiff, DEP asserted that it was entitled to all excess proceeds due to its recorded judgment and lien. The trial court ordered that the excess sales proceeds be distributed to DEP and the plaintiff appealed, arguing that the mortgage had priority to the judgment lien .

Relying on a state statute providing that liens of record held by a government unit against property shall be given priority to excess proceeds from tax sales, the appeals court affirmed the trial court decision. The court said the lien held by DEP was a government lien under the statute and that it had been duly and timely recorded. The court also noted that the plaintiff had actual notice of the judgment and the lien prior to the assignment of the mortgage. Therefore, the DEP lien had priority over the mortgage.

Commentary: *While only a handful of states have enacted "superlien" laws that will take priority over previously recorded security interests, most states have non-priority liens that may be filed against property to secure repayment of response costs. As illustrated by the Penzell case, there may be circumstances where even non-priority liens may be allowed to jump ahead of more senior liens.*

Under the All Appropriate Inquiry rule, parties seeking to assert one of the landowner defenses are required to search for environmental cleanup liens. One of the hotly contested issues in the revisions to ASTM E1527 was whether environmental consultants should have the obligation to search for cleanup liens as part of their Phase I responsibilities. Many in the consulting industry felt that they did not have the expertise or the resources to perform these searches since states vary in how they file and perfect these interests. As a result, the Final AAI Rule and the ASTM standard provide that this task is the obligation of the client/user. Prior to commencing due diligence, it is important for the parties to determine who will be responsible for searching for cleanup liens. Sometimes, an environmental agency may have not yet recorded it or it may not have been properly recorded. An indirect way to protect against a misfiling is to determine if a government agency has incurred response costs at the property.

Tenant Not Liable for Holdover Rent Because of Contaminated Slab

Commercial leases typically contain surrender clauses that require tenants to return the leased premises to substantially the same condition that existed at the commencement of the lease and to remove all of their equipment and property. If the tenant fails to comply with these requirements, many leases also have holdover tenant provisions that provide the tenant will continue to be obligated to pay rent beyond the expiration of the lease until it complies with the surrender clause.

In *Prospect Hill Acquisition, LLC v. Tyco Electronics Corp.*, 2005 U.S. App. LEXIS 13579 (1st Cir. 2005), the Court of Appeals for the First Circuit determined that concrete flooring contaminated with cyanide from on-site operations was not a violation of the surrender clause. Therefore, the tenant was not liable for holdover rent. In this case, the plaintiff acquired a commercial building in 2001 from the defendant pursuant to a "as is" agreement. The plaintiff knew the metal plating operations had had been conducted at the premises since at least 1975 and that the defendant had operated at the site since 1999. Contemporaneous with the purchase, the plaintiff entered into a six month lease with the defendant. The surrender clause required the tenant/defendant to remove all of its equipment, fixtures, materials or other property that was or might be contaminated, hazardous or otherwise regulated under environmental laws.

Three months before the expiration of the lease, the tenant proposed procedures for complying with the surrender clause. At the request of the plaintiff/landlord, the tenant agreed to sample the concrete floor for the presence of cyanide even though the tenant felt it was not obligated to do so under the lease. The sampling detected trace levels of cyanide that did not require any remediation but cautioned the plaintiff that the concrete might have to be managed as a hazardous waste if the building was demolished. In response, the plaintiff insisted that the tenant remove the concrete flooring. The tenant initially objected but eventually agreed to remove the concrete floor. Because the removal of the floor was not completed until three months past the expiration date of the lease, the plaintiff sought holdover rent charges of approximately $424,000.

The federal district court granted summary judgment to the tenant, ruling that the surrender clause applied to movable property and not to building structures or contaminants imbedded in building structures. The appeals court agreed that the contaminants in the concrete floor did not constitute "materials of other property" subject to the surrender clause. The court was also influenced by the fact that the most of the contamination was from the historical operations at the premises since the tenant had only operated at the premises for two years. Since the tenant had occupied the premises for only seven months under the lease and the plaintiff had agreed to purchase the property "as is," the court concluded it would be inequitable to hold tenant liable for the contamination. Since it had already incurred considerable costs that it was not obligated to incur under the lease, the court declined to find the tenant liable for holdover rent.

Commentary: *This case illustrates the importance of ensuring that the environmental provisions in all documents pertaining to a particular transaction are consistent and conform to each other. A purchaser accepting premises "as is" should not be able to draft around those limitations by inserting provisions in a lease with the same party that imposes environmental liabilities greater than those in the purchase agreement.*

State Consent Order Does Not Preclude State Common Law Claims

A board of education sought damages under state law for the cost of vacating a school building because of the presence of contamination migrating from an adjacent site. The adjacent property owner who had entered into a consent decree with the Ohio EPA to address the contamination filed a motion to dismiss the lawsuit, arguing the lawsuit constituted a challenge to the remedial action and therefore the court had no jurisdiction to hear the case under ban on pre-enforcement review under CERCLA.

In *Board of Education of the Gorham Fayette Local v. D.H. Holdings Corporation,* 2005 U.S. Dist. LEXIS (N.D. Ohio 2005), a federal district court denied the defendant's motion noting that consent decree expressly provided that it should not be construed to limit the authority of the state to take any action to eliminate or mitigate conditions that might present an imminent and substantial harm as well as costs for such action. Since the plaintiff's lawsuit was based purely on state law claims such as negligence and trespass, and the school board took action to protect students and teachers from the harm posed by the contamination, the court concluded the lawsuit was not a challenge to the investigation or remedy to be implemented under the consent order. Thus, the plaintiff was allowed to maintain its action for property damages and its relocation expenses.

Commentary: *With the growing use of risk-based cleanups and reliance on land use controls, property owners located near contaminated sites that are dissatisfied with the scope of a cleanup or feel their property values have been damaged by the presence or proximity of the contamination are increasingly bringing state common law claims. Once a remedy is selected, CERCLA §113(h) prohibits federal courts from hearing cases that involve challenges to remedial actions or could interfere with the selected remedy. To avoid this prohibition, plaintiffs have tried to bring claims in state courts either using common law causes of action or state environmental laws. Since CERCLA does not address tort claims, plaintiffs will generally be free to bring claims for property damages.*

A closer question is whether they could bring the claim under a state cleanup statute. If the lawsuit essentially seeks to address the same contamination covered by the selected remedy, §113(h) should bar that claim. However, if plaintiffs seek to address contamination or damages not covered by the remedy, a court may feel that it has jurisdiction to hear the case, especially if the case is filed after the remedy is selected but before the responsible party enters into a consent decree to perform the remedial design and remedial action (RD/RA). Once a court approves an RD/RA consent order, it will be loathed to interfere with its orders and state courts will likely feel similarly constrained.

Of course, if parties dissatisfied with the selected remedy have information that they feel was not considered or known at the time that the record of decision (ROD) was issued, another option could be to request that EPA modify the ROD using its Explanation of Significant Differences (ESD) process. For example, if a community subsequently re-zones an area for residential use, a ROD that provided for cleanup to commercial cleanup standards with institutional controls may no longer be appropriate. Such an effort to revise or alter the cleanup to a more stringent standard will undoubtedly encounter stiff opposition from the responsible parties. In addition, there may be institutional reluctance on the part of an agency to review a

previously approved cleanup plan. Thus, community groups seeking such a challenge will have to be prepared to expend considerable resources and should try to garner as much political support as possible.

Property Owner Unable to Prove Damages From Migrating Contamination

In *Equity Asset Corp. v. B/E Aerospace, Inc.*, 2005 U.S. Dist. LEXIS 21961 (D.Kan. 9/29/05), the plaintiff acquired property in 1996 and constructed a commercial building. The Phase I did not identify any environmental conditions associated with the property. Sometime after taking title, the plaintiff discovered that the groundwater beneath its site was impacted from solvents that had escaped from a UST located at the adjacent property that had been installed in 1969.

In 1999 the defendant acquired the property that was the source of the contamination in 1999 through an asset purchase agreement. Upon learning of the contamination, the defendant implemented remedial actions to remove the source of the contamination and treat the groundwater.

Plaintiff then commenced a lawsuit for damages for negligence and trespass and the defendant filed a motion for summary judgment asserting that it had not intentionally or negligently caused any contamination and that the plaintiff had not demonstrated any damages. The plaintiff also claimed that it had to purchase an environmental insurance policy due to the inability to refinance the property because of the contamination. In response to the summary judgment, the plaintiff also contended that the defendant was liable under a successor liability theory.

In granting defendant's motion, the federal district court ruled that the plaintiff could not maintain its successor liability claim because it had not made that claim before the pre-trial order. The court also found that the plaintiff has not established any facts to support a finding of negligence and had not established any damages. The plaintiff had introduced an unauthenticated letter regarding its inability to refinance but the court held this was not adequate proof. The court also found that since the plaintiff had not disclosed the contamination to its tenants and had not lost any rents, it could not demonstrate any damages. On the trespass claim, the court said that since the defendant could not be liable as a successor, the plaintiff had to show the defendant had intentionally discharged contaminants onto the plaintiff's property. Since the plaintiff could not even show that the defendant had caused the contamination, the court said there was no evidence that the defendant had intentionally contaminated the plaintiff's property.

Commentary: *An interesting issue that was not before the court was that the plaintiff had relied on a two-year old Phase I that had been performed by an affiliated entity. Because the plaintiff's CERCLA claim was deemed not to be ripe because the plaintiff had not incurred any cleanup costs, the court did not have to address if the plaintiff's reliance on a two-year old report prepared by another entity would allow it to qualify as innocent landowner.*

Insurer Not Required To Defend Builder Of Contaminated Development

Purchasers of homes in an upscale multi-use planned residential development filed a lawsuit against their builder claiming that the builder/defendant failed to conduct geographic and environmental surveys and failed to discover that the property had previously been used by the United States Department of Defense as a training site for aerial bombing and

contained Ordinance and Explosive Wastes (OEW), Unexploded Ordinances (UXO) or Munitions and Explosives of Concern (MEC).. As of result, plaintiffs alleged that the builder failed to disclose the presence of the OEW and the value of their property was substantially less than represented. The plaintiffs sought damages for loss of use. The builder then filed a third party declaratory action against its Comprehensive General Liability (CGL) demanding the insurer provide a defense and indemnity.

In *Auto-Owners Insurance Company v. Essex Homes Southeast*, 2005 U.S. App. 12945 (4th Cir. 2005), the federal district court had held that the underlying complaint had not alleged an occurrence during the policy period that caused the property damage. The court said that the only two occurrences were the bombings that occurred prior to the policy and the negligent misrepresentation which did not cause the loss of use.

The Fourth Circuit affirmed the trial court's decision but for different reasons. The appeals court first concluded that the essence of the underlying complaint was that the builder's negligence caused their damages. The court said that negligence is an occurrence under South Carolina law and that the insurer's duty to defend would be triggered even if the district court was correct that the claim was without merit. Thus, the district court had erred when it ruled the complaint did not allege an occurrence.

Nonetheless, the appeals court held that the insurer was relieved of its duty to defend by the "your work" exclusion, which applies to representations and failure to provide warnings. The builder claimed that this clause could not apply to work that was not done (*i.e.,* failure to perform the surveys). However, the court said that builders' failure to investigate and remove the OEW constituted defects, deficiencies or inadequacies in the performance of its work, which was the development of the site. Because of the "your work" exclusion, there was no possibility that the insurer would be obligated to cover the losses of the insured builder. Thus, the court held that the insurer had no obligation to defend the builder.

SUPERFUND/BROWNFIELDS

EPA Reopens Cleanup at New Jersey Superfund Site

In our May issue, we discussed that EPA will be re-examining over 900 Construction Complete (CC) sites where the agency has determined that a cleanup has been completed. Recently, EPA entered into an administrative order on consent (AOC) with Ford Motor Company where the company agreed to perform supplemental investigation at the Ringwood Mines/Landfill Superfund site that had been delisted from the National Priorities List (NPL) in 1994. The agreement also requires Ford to reimburse EPA for over $226,000 in past costs. EPA determined that further investigation was necessary after additional wastes were found at the site.

The approximately 900-acre site operated as an iron mine from the 1700's through the 1930's and encompasses approximately 50 residences, abandoned mine shafts and pits, an inactive municipal landfill and forested land that includes a portion of the Ringwood State Park. The United States Defense Plant Corporation acquired the mines and associated property during World War II and refurbished Peters Mine in case it was needed for wartime production. However, the mine was not needed. The government sold the land to Pittsburgh Pacific Company in 1958 who then sold it to Ringwood Realty Corp. (RRC), a former Ford subsidiary in 1965. RRC hoped to develop low-cost housing for its Ford's Mahwah assembly plant employees but dropped those plans after encountering local opposition.

During the late 1960s and early 1970s, Ford disposed of car parts, paint sludge and solvents generated from its Mahwah plant at the site in volume that could fill two tubes of the Lincoln Tunnel. RRC began conveying portions of the contaminated land in the late 1960s, including 209 acres to a utility for transmission line right of way and 227 acres to a local home developer. In 1970, RRC donated approximately 290 acres to the Borough of Ringwood (Ringwood) Solid Waste Management Authority, which operated a municipal landfill on a portion of this property from 1972 until it was ordered closed by the New Jersey Department of Environmental Protection ('NJDEP') in 1976. In 1973, RRC donated 109 acres to the state that was added to the Ringwood State Park and another 35 acres to a local non-profit organization.

EPA added the site to the NPL in 1983 after heavy metals, volatile organic compounds (VOCs) and low levels of polychlorinated biphenyls (PCBs) were detected in the soil and groundwater. In 1984, Ford entered into an AOC to perform a remedial investigation (RI/FS). In 1987, EPA issued a unilateral administrative order demanding Ford to remove the paint sludge. The company also agreed to a third AOC to perform a feasibility study. Following the RI/FS, EPA issued its record of decision (ROD), which required Ford to implement certain additional chemical analysis of tailings, soil and groundwater. In 1990, the agency also identified the Borough of Ringwood (Ringwood) as a PRP because it had knowingly acquired contaminated property and also had operated a municipal landfill on a portion of the property. After Ringwood and Ford agreed to reimburse EPA for its past response costs, the agency formally removed the site from the NPL in 1993.

Despite the delisting, Ford has been required to perform additional cleanups four times since the site was deleted from the NPL to remove

additional paint sludge and drums that were found by the residents in lawns, along hiking and brooks feeding the Wanaque reservoir, which provides drinking water to 2.5 million people. While residents in the area have complained of high incidences of lung and bladder cancer as well as non-Hodgkins lymphoma, no link has been established between the wastes and the illnesses. In December 2004, Ford began a site-wide field reconnaissance survey to locate additional deposits of paint sludge. Since the beginning of the year, 3,600 tons of sludge have been removed. Because of the community distrust over Ford's commitment to remediate the site, NJDEP will perform additional cleanup at 48 residential properties. NJDEP expects Ford to pay for the additional costs. If the company refuses, the agency will issue an injunctive order under the Spill Act seeking treble damages.

As a result of the problems identified at the Ringwood site, Ford is now coming under scrutiny for several disposal sites in New York that adjoin the state boundary. Ford entered into a voluntary cleanup agreement with the NYSDEC in 2002 and the agency is coming under increasing political pressure to require Ford to perform a more extensive investigation.

Commentary: *Because of the Construction Complete Initiative, it is important for purchasers, investors and lenders of corporate assets to verify the status of sites where the target company has been named as a PRP and has supposedly resolved its liability. It would be prudent to review EPA or state records to confirm that the cleanup is still considered effective, confirm that institutional controls have been implemented and remain effective, and perhaps even do an internet search to see if there are any newspaper articles discussing current site conditions.*

EPA Announces ER3 Initiative

Under its Environmentally Responsible Redevelopment and Reuse Initiative (ER3 Initiative), EPA will provide liability relief to developers who agree to implement energy-efficient or green building design in their projects, or create or restore natural wildlife habitat on a site.

Under the ER3 Initiative (70 Fed. Reg. 20,901), EPA anticipates that a property transaction would come to the attention of the Office of Site Remediation Enforcement because there are liability issues either with a current owner or with a potential developer. The agency will issue a 'letter of certainty" to or enter into a PPA with developers as incentives for sustainable development on the site. Under another incentive of the program, EPA would agree to reduce penalties for non-compliance with environmental requirements if the party implements a supplemental environmental project (SEP) that would support sustainable development near the facility. The sustainable development project might include the construction of energy-efficient "green buildings" that promote environmental conservation or use open space on an industrial site to protect a natural habitat on the path of a migratory bird. EPA plans to enter into partnerships with governmental and nongovernmental entities to serve as a source of general information to redevelopers about the ER3 initiative. The agency also hopes to expand the initiative to other EPA program offices and federal agencies.

EPA Announces Good Samaritan Initiative

According to EPA, 500,000 abandoned mines may be impairing 40% of western headwater streams. Many of these abandoned mines are on private land and the responsible parties are no longer in existence. While conservation organizations and local

communities have been willing to restore the watersheds, the specter of CERCLA liability has discouraged them from taking any action. EPA hopes the Good Samaritan will remove these disincentives by providing the volunteers with immunity from future liability as an owner or operator of the abandoned mine site.

Under the Good Samaritan Initiative, the volunteer will submit an application for a permit to EPA that will include a detailed plan describing the cleanup actions that the Good Samaritan will take to improve water quality and habitat. EPA will approve the application if no responsible parties are available and if the application can reasonably demonstrate the plan will improve water quality. After the permit is approved, the Good Samaritan will implement the cleanup and receive a covenant not to sue and contribution protection from further liability.

EPA hopes that an agreement with Trout Unlimited (TU) will serve as a model to help restore abandoned gold, silver, and other hard rock mines where there is no known potentially responsible party. Under the Good Samaritan Initiative agreement, TU will clean up the abandoned mines that pose the greatest risk to fisheries and water quality at a cost of approximately $300,000. The cleanup is expected to take two to three years.

EPA also plans to continue to use its funding authority under section §319 of the Clean Water Act and Targeted Watersheds Grants to facilitate cleanup of abandoned mines and to protect fishable waters.

EPA Region 4 Launches Prospective Purchaser Response Team Initiative

Because of the hectic pace of real estate development and the need to lock in low long-term interest rates, developers are increasingly loathe to contact state or federal agencies to determine appropriate cleanup measures out of concern that the regulatory process may increase construction costs or delay start of construction. At the early stage of a project, the developer is usually less concerned about liability and more focused on losing a low interest rate or having the real estate bubble burst before the development can be completed or sold. Unless a lender insists that the developer obtain regulatory signoff, many developers are implementing self-directed cleanups where they rely on the professional judgments of environmental consultants in the field.

To meet the needs of developers and to ensure that development properly addresses risks that may exist at contaminated sites. EPA Region 4 recently announced the formation of a Prospective Purchaser Inquiry (PPI) Response Team Approach to facilitate revitalization of superfund and brownfield sites. Since May 2005, the Region 4 PPI team has conducted thirty meetings with parties who are interested in redeveloping superfund sites and has been averaging two meetings a week.

The PPI team provides prospective purchasers with information on EPA policies and has produced two fact sheets: "*So You want to Buy a Superfund Site*" and "*Top Ten Questions To Ask When Buying a Superfund Site."* The PPI team has also drafted hybrid comfort letters that purchasers have used to assuage concerns of lenders. Region 4 emphasizes that prospective purchasers are not required to contact the PPI to qualify for the various CERCLA landowner liability defenses but suggests that the PPI service could help purchasers obtain accurate information in a timely manner before they make critical business decisions about their projects.

After receiving an inquiry from a

prospective purchaser, the PPI team will schedule a meeting usually within three days of the inquiry. To ensure that the PPI team can address development and revitalization issues, the meeting will be attended by an EPA technical staff person, cost recovery staff attorney, the regional lead attorney for reuse and revitalization and the regional Superfund Redevelopment Initiative (SRI) coordinator. At the meeting, the PPI team will address four key issues: what is the current status of the cleanup and what are the anticipated future actions; is the proposed development compatible with the proposed remedy and any existing or proposed institutional controls; does the prospective purchaser understand the applicability of landowner liability protections; and how will EPA resolve any section 107(l) non-priority liens or section 107(r) windfall liens?

To maximize the effectiveness of the meeting, the PPI team suggests that the prospective purchaser provide copies of development plans, engineering maps or other information in advance of the meeting that could assist the PPI team to evaluate the compatibility of the project. The PPI team may be able to modify certain aspects of the remedy to accommodate the redevelopment plans, such as moving well locations to accommodate buildings or incorporating parts of the development as institutional controls (e.g., parking lots, building foundations). The PPI team can help the developer understand the nature of the continuing obligations it may have to comply with to ensure that it maintains its landowner liability defense.

EPA Announces PPAs

Other EPA regions continue to use the various tools available to them to facilitate redevelopment of brownfield sites. The PA Region 2 office recently entered into a proposed prospective purchaser agreement (`PPA'') with the Suffolk County, the State of New York and an as-of-yet unnamed Auction Purchaser for a 0.9-acre parcel of real property located within the Circuitron Corporation Superfund Site at 82 Milbar Boulevard in East Farmingdale, Suffolk County, New York. Under the terms of the PPA, Suffolk County would market the Property at auction, with a portion of the proceeds to be paid to EPA for reimbursement of response costs. In exchange for the payment, the United States and the State of New York would covenant not to sue or take administrative action against Suffolk County and its departments and agencies, and the Auction Purchaser. EPA also agreed to release the CERCLA Section 107(l) lien it had filed against the Property, and to waive any windfall lien or right to perfect any windfall lien it may have now and in the future.

The Region 2 office also announced that it had entered into a PPA with The Stop & Shop Supermarket Company LLC for a ground lease of approximately 9-acre parcel of real property (the ``Property'') included within the Liberty Industrial Finishing Superfund Site in the Village of Farmingdale, Town of Oyster Bay, Nassau County, New York. Stop & Shop plans to construct and operate a shopping center including a supermarket and fueling facility. EPA agreed to provide a covenant not to sue if the company becomes an operator of the Property. In exchange, the company agreed to perform work at the Site that EPA has valued at approximately $100,000 and will also pay to EPA the amount of $12,500.

The Region 7 office entered into an agreement with AGP Grain Marketing, LLC (AGP) and Garvey Elevators, Inc. (Garvey) involving the Garvey Elevator Site located in Hastings, NE. Under the agreement, AGP Grain Marketing, LLC will pay

$2,050,000 into an escrow account following the sale of the Site property to AGP that will be used by Garvey to implement response actions at the Site. In addition, AGP will be required to provide access to the Site, refrain from any activity that would interfere with the response actions or exacerbate the existing contamination at the Site, and comply with certain use restrictions. The Escrow Agreement also requires that Garvey execute a security agreement in favor of EPA. In exchange, EPA agreed to provide AGP with a covenant not to sue under CERCLA and section 7003 of RCRA.

Meanwhile, EPA Region 6 issued a “ready for reuse” certificate and entered into a PPA to facilitate the purchase of approximately 140 acres of Operable Unit One of the Tex Tin Corporation Superfund Site by Phoenix International Terminal, LLC. The site is currently owned by the Tex Tin Site Custodial Trust. The Purchaser intends to construct a freight and storage facility to support Texas City deep-water terminal at Shoal Point, approximately 1.5 miles from the Site. In exchange for a covenant not to sue, the Purchaser agreed to pay $1,000,000 to the Trustee of the Tex Tin Custodial Trust. The Trustee will then pay any outstanding liens on the property and any other expenses required by the Custodial Trust Agreement, and pay the balance of the purchase price left after payment of Trust expenses to EPA. In addition, the Purchaser agreed to provide an irrevocable right of access to representatives of EPA.

DUE DILIGENCE/ AUDITS/DISCLOSURE

EPA Issues All Appropriate Inquiry Rule

EPA issued its long-awaited All-Appropriate Inquiry (AAI) Rule on November 1, 2005 (70 FR 66069-66113). The rule will take effect in a year. There were four major changes to the Final Rule under its Preamble. Among the changes from the proposed rule was the expansion of the definition of an Environmental Professional to include those without bachelor's degree but who have at least 10 years of relevant experience. The grandfather clause was also eliminated. Another change allows information contained in previously conducted assessments to be used even if the information was collected more than a year prior to the date on which the subject property is acquired. The other shelf life time lines remain the same—one year and 180 days. However, the final rule does require that all aspects of a site assessment, or all appropriate inquiries investigation, completed more than one year prior to the date of acquisition of the subject property be updated to reflect current conditions and current property-specific information. Compliance with the new ASTM E1527-05 will satisfy the requirements of AAI. The third and major change involves government searches. Institutional Controls need only to be determined on the subject property and no one-half mile from the subject property. The fourth change deals with "additional inquiry." In the Final Rule, EPA delineated responsibilities for particular aspects of the "all appropriate inquiries" investigation between the environmental professional and the prospective landowner/grantee. EPA also defined "additional inquiries" that must be conducted by the prospective landowner. The Final Rule does not require the prospective landowner to provide information collected as part of the "additional inquiries" to the environmental professional. A more detailed discussion of the rule will appear in the next issue.

Bank Survives Claim of Fraudulent Non-Disclosure Involving Phase I

In prior issues, we have reported on cases where defaulting borrowers have brought claims against their lenders claiming the bank had not advised them of environmental issues associated with their contaminated property. A New York state court recently rejected a similar claim filed by a guarantor of a loan.

In *Bank of New York v. Bram Manufacturing*, 2005 NY Slip op. 51130U (Sup. Ct-Rockland Cty. 7/20/05), the defendant borrower entered into a series of loans with a predecessor of Bank of New York (BONY), Nanuet National Bank. In 1998, the borrower learned that its property was contaminated with TCE from a former operation when a potential purchaser conducted a Phase II on the site. Because it could not sell the property, the borrower consolidated its loans with BONY and entered into a $504,000 mortgage with the plaintiff in January 2000. As part of the restated mortgage, the borrower's principals executed a guaranty. In January 2002, the borrower defaulted on its loan, which had an outstanding balance (principal

and interest) of approximately $475,000. Instead of foreclosing on the property, BONY opted to sue on the mortgage note and the guaranty.

In response to BONY's motion for summary judgment, the guarantors claimed that the bank was not entitled to recover under the note or the guarantee because it had concealed the extent of the contamination. The defendants argued that BONY had an obligation as a secured creditor to perform an environmental assessment and that this failure relieved the defendants of any liability under the guarantee. However, the court ruled that a bank had no such obligation to perform an environmental assessment to maintain its defense to liability. Moreover, the court noted that the defendants had not performed their own due diligence when they first acquired the property in 1985 and that BONY did not have any superior knowledge or unique information in its possession concerning the environmental conditions of the property that it would have been obligated to disclose to the defendants. Indeed, the ct noted that the defendants were aware of the contamination as a result of the 1998 Phase II and had equal access to investigate the environmental conditions of their property. Thus, the court granted BONY's motion for summary judgment.

FASB Preparing Exposure Draft for Business Combinations

Earlier this year, the Financial Accounting Standards Board (FASB) issued an Exposure Draft for a proposed new standard for accounting for business combinations. The new accounting standard would replace existing FASB Statement No. 141 and could significantly impact the way environmental liabilities are recognized and measured in mergers and acquisitions.

Perhaps the most significant change will be that the Exposure Draft would require that assets acquired and liabilities assumed in business combinations be measured and recognized at their fair values as of the acquisition date. As a result, the new standard would eliminate the approach of FASB Statement No. 5, Accounting for Contingencies for recognizing contingencies.

Other significant changes to current practices for accounting for business combinations include the following:

Scope—The standard would apply to business combinations between mutual entities, business combinations achieved without a purchase of net assets or equity interests, and the initial consolidation of variable interest entities.

Definition of a Business—The Exposure Draft would provide a definition of a business and nullify the definitions provided in EITF Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business," and FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities.

Measuring the Fair Value of the Acquired Entity—Business combinations would be measured and recognized as of the acquisition date at the fair value of the acquired entity. This would apply to step acquisitions and partial acquisitions (those in which less than 100 percent of the equity interests in the acquiree are owned at the acquisition date).

Measurement Period—Any measurement period adjustments to the provisional values recognized for the assets acquired and liabilities assumed would be recognized as if the accounting for the business combination had been completed at the acquisition date. Therefore, comparative information for prior periods would be adjusted.

Measuring and Recognizing

the Assets Acquired and the Liabilities Assumed—The assets acquired and liabilities assumed would be measured and recognized at their fair values as of the acquisition date, with limited exceptions. Costs associated with restructuring or exit activities that are not liabilities at the acquisition date would not be recognized as liabilities assumed in the business combination.

Step Acquisition—In a step acquisition, the acquirer would remeasure its preacquisition noncontrolling equity investments to fair value at the acquisition date and would recognize any gain or loss in income.

Commentary: *The proposed standard is the second phase of a project on business combinations that FASB is conducting jointly with the International Accounting Standards Board (IASB). The objective of this project is to develop a single high-quality standard for accounting for business combinations that can be used for both domestic and cross-border financial reporting.*

Property Owner Fined for Failing to Comply With Institutional Controls

Northampton Investments II, LLC of Holyoke (Northhampton, MA) was fined by the Massachusetts Department of Environmental Protection (MADEP) after the agency determined that deed restrictions had not been properly recorded on two properties. In 1998, Northampton acquired property that had been contaminated from a leaking fuel oil storage tank; the contamination had been discovered by a prior owner. The remedy implemented by Northhampton under the state licensed site professional program provided for deed restrictions prohibiting excavation of soils on the property as well as on an impacted adjacent property. During the audit, MADEP determined that the deed restrictions did not adequately describe the activities and uses that must be restricted. In addition, a number of legal requirements for the deed restrictions had not been met. In August 2004, DEP issued a Notice of Noncompliance requiring Northampton to correct the filings on record with the Registry of Deeds. When Northhampton failed to comply by the deadline, the agency commenced its enforcement action.

In another enforcement action, MADEP fined J.W.P. Realty Trust and Charles G. Padula $17,000 for failing to properly implement a cleanup. On April 6, 1998, the agency received an Initial Site Investigation Report. When the final cleanup report was submitted by the April 6, 2003 deadline, the agency initiated its enforcement action. In addition to the fine, the property owner must complete the cleanup under an accelerated time frame.

Meanwhile, the Rhode Island Department of Environmental Protection (RIDEP) fined DB Marketing Company, Inc. $17,250 for failing to maintain groundwater cleanup systems at the company's former stores in Greenfield and East Longmeadow. During inspections conducted by the RIDEP in September 2004, the agency determined that the soil vapor extraction and air sparging (SVE/AS) systems were not operating and had been shut down without notification or prior explanation to the DEP.

Consultant Not Liable To Building Owner for Violations of Asbestos NESHAP Where No Claims Filed by Third Parties

Contractors working on renovation or demolition projects that disturb quantities of asbestos-containing materials (ACM) that exceed the thresholds established under EPA’s asbestos NESHAP are strictly liable for complying with the notification and work

practices requirements of the rule. However, what happens if EPA or the local regulatory authority do not take any action and there is no evidence that the violations resulted in any actual exposure to building occupants? Can a property owner still seek indemnity from the contractor for potential future claims?

According to the federal district court for the eastern district of New York, the answer is no. In *Solow Building Company, LLC v. ATC Associates, Inc. and Safeway Environmental Corp.*, 2005 U.S. Dist. LEXIS 21600 (E.D.N.Y. 9/28/05), a tenant of the plaintiff hired defendant ATC to monitor indoor air and defendant Safeway to perform asbestos abatement work in connection with the renovation of its leased spaces in a building on 57th Street in Manhattan in 1998. During the performance of the work, Safeway allowed asbestos fibers to be released into the air while removing duct tape and by not properly wetting asbestos debris.

The plaintiff argued that there was a probable likelihood that injuries would arise from the defendants' failure to comply with the asbestos NESHAP and sought a declaratory judgment for indemnification against potential claims that may be brought by persons injured by the asbestos or for violations of the asbestos NESHAP. The court said that federal courts generally decline to award declaratory judgments for indemnification before any claims are filed. Since the plaintiff had not been sued in the six years since the work was completed and three years of discovery had not identified anyone who had been exposed to asbestos, the court held that the plaintiff's complaint amounted to a conjectural leap that there was a probable likelihood that someone had been exposed to asbestos fibers. Since the plaintiff fell far short of showing any immediate liability, a declaratory judgment was not appropriate.

Commentary: *In what probably amounted to dicta, the court said that the plaintiff had not produced any authority to show how it could be held liable for any injuries to persons exposed to asbestos since it was the tenant and not the plaintiff that had hired the defendants. This was an interesting statement by the court since as the owner of the property, the plaintiff could have been found strictly liable for violations of the asbestos NESHAP. In many jurisdictions, a violation of a statute or regulation constitutes either per se negligence or can be used as evidence to show that the plaintiff had a duty of care and had breached that duty.*

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