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BROWNFIELDS

Federal Brownfield Tax Incentive Extended and Expanded

On December 20, 2006, President Bush signed into law the Tax Relief and Health Care Act of 2006. The legislation extends the federal brownfield tax incentive to December 31, 2007. Taxpayers that incur eligible cleanup costs prior to that date will be able to deduct the costs in the year incurred rather than capitalized over time. In addition, the legislation expands the definition of eligible costs to include expenses for the cleanup of petroleum contamination. Taxpayers seeking the accelerated tax treatment of their eligible remediation costs must receive a certification of eligibility from the applicable state environmental agency certifying that the costs were incurred at a site that qualifies as a brownfield.

New York State Court Upholds Another NYSDEC BCP Application Denial

We continue our coverage of the emerging body of brownfield law with the recent decision *377 Greenwich LLC v. New York State Department of Environmental Conservation*, No. 101617/06 (N.Y. Sup. 11/15/06), in which the owner of property located in Manhattan sought to overturn a decision by the New York State Department of Environmental Conservation (NYSDEC) denying its application to participate in the New York Brownfield Cleanup Program (BCP).

In this case, the owner/petitioner acquired a 10,080 square foot parcel that was currently being used as a parking lot to construct an 80-room hotel and 100 seat restaurant. In July 2003, a consultant retained by a prior owner uncovered the presence of two unregistered 500-gallon USTs associated with a former use and a limited area of soil contaminated with semi-volatile organic compounds (SVOCs). A petroleum spill was reported to the NYSDEC.

In April 2004, the NYSDEC approved a work plan calling for excavation of the contaminated soil. Because the property was also subject to the New York City Department of Environmental Protection (NYCDEP) "e" designation program, the petitioner also had to get approval from the NYCDEP. In June 2004, the NYCDEP issued a Notice to Proceed to the NYC Department of Buildings (NYCDOB) authorizing NYCDOB to issue a construction permit for the project. However, the NYCDOB could not issue a certificate of occupancy until the NYCDEP received a closure report and issued a Notice of Satisfaction to the NYCDOB.

The petitioner acquired the property on June 29, 2004 and submitted a BCP application to the NYDEC the next day. Two weeks later, the petitioner submitted a work plan calling for the excavation of

newly discovered mercury contaminated soils and fill material that was present over roughly half the property to a depth of 14 feet.

During the period that the petitioner's BCP application was under review by the NYSDEC, the agency issued new guidance that tightened the eligibility criteria for the BCP. The NYSDEC did not render a decision on the petitioner's application until 15 months later. Given the extraordinary administrative delay and its need to maintain its construction schedule, the petitioner proceeded to implement its proposed work plan and incurred approximately $1 million in remediation costs.

In October 2005, the NYSDEC denied the application on the basis that the site had relatively low levels of contamination and that the costs attributable to the contamination were not significant when compared to the total cost of development and the value of the property. In addition, the agency indicated that the contamination was not a result of past uses of the property. Based on these facts and the other criteria set forth in its guidance, the NYSDEC concluded that the reuse or redevelopment of the property was not complicated by the presence or potential presence of contamination.

The petitioner then challenged the denial, arguing that the NYSDEC had too narrowly interpreted the definition of what constituted a brownfield site, that the agency could not enforce its eligibility criteria because the guidance document had not been promulgated pursuant to formal rulemaking procedures and that the guidance document was inconsistent with prior agency interpretation of the BCP law.

The court ruled that NYSDEC acted rationally in considering various factors in this case, including the hazardous level of the contaminants, the issue of comparative cost, the steps already taken toward facilitating the underlying project (such as obtaining the construction loan in determining if the contamination had complicated reuse. The court said the agency's interpretation was consistent with the overall objective of the BCP law which was to restore brownfield sites to productive use. Since the construction of the project proceeded without the benefit of being admitted into the BCP, the court held, then it was is entirely rational for NYSDEC to conclude that the contamination had not complicated the redevelopment.

The court also found that the NYSDEC had acted rationally when it determined that the contaminants at the site did not rise to the level of making it a brownfield site. The court noted that the agency had particular expertise in this area, and had persuasively argued that a certain amount of contaminants are ubiquitous and that the mere existence of low levels of contaminants is not sufficient to trigger automatic acceptance into the BCP. The court noted that the presence of contamination above state cleanup goals was just one factor that NYSDEC considered

when determining if remediation is necessary for any particular site. The judge also found noteworthy NYSDEC's conclusion that since the development plans called for excavating the site to a depth of 25 feet, a large part of what the petitioner called remediation cost was excavation costs that were otherwise necessary for the petitioner to construct the building foundation.

In support of its denial, the NYSDEC argued that the proceedings had been rendered moot because the petitioner had already remediated the site and completed construction of the hotel project before a final decision was made on its BCP application. The petitioner countered that the matter is not moot, because this court could find that the application should have been accepted into the BCP and therefore, the petitioner would be entitled to significant tax benefits. Moreover, the petitioner argued that it was placed into the conundrum by the NYSDEC's delay in processing its application.

The court rejected the petitioner's analysis because acceptance into the BCP was only the first step in establishing entitlement to the tax benefits. The court said that the petitioner would also have had to perform a cleanup according to a cleanup plan approved by the NYSDEC as well as with appropriate community input. By moving forward with the remediation and the hotel project before being accepted into the BCP, the court rules the petitioner could not satisfy these requirements and therefore could not be entitled to the tax benefits.

Regarding the delays, the court said the petitioner had remedies available to it, including the right to file a writ of mandamus to compel NYSDEC to render a decision on its application. In deciding to go forward with remediation and other aspects of the hotel project without DEC approval, the court said the petitioner either did or should have made its own cost /benefit analysis of the risks involved. The consequences of its own decision cannot be attributed to the DEC, the court concluded.

Michigan Developer To Retain Brownfield Tax Credits Despite Absence of Significant Contamination

Meanwhile, in Michigan, the state Economic Development Corporation has decided to allow a developer to retain $4.5 million in brownfield tax credits even though sampling has determined that the site had very little contamination.

The $60 million Petoskey Pointe development is slated to take up an entire city block downtown. Petoskey Pointe developers hired environmental consultant AKT Peerless to conduct soil samples in May 2005. Three of the 10 soil borings showed high concentrations of tetrachloroethylene (PCE). Peerless estimated that up to 10,000 cubic yards of contaminated soil would have to be removed from the site. The Emmet County Board of Commissioners approved the report but the state Department of Environmental Quality questioned

the sampling results. Peerless responded in April that the PCE detected in the soil was attributable to laboratory contamination and did not accurately reflect PCE concentrations in the soil on the property. Approximately six weeks later, the erroneous information was used in the brownfield application to the MEDC. In addition to the tax credit, the developers asked the state to reimburse the estimated $450,000 in remediation costs using statewide school funds to be captured through the county brownfield authority. The MEDC approved the tax credit on May 30th along with a press release.

One month later, Peerless submitted a revised soil removal estimate to DEQ that indicated the total contaminated soil to be removed would be less than 1,000 cubic yards. In August, the volume of contaminated soil was reduced again to less than a few hundred cubic yards.

Despite the dramatic reduction in the amount of contamination, MEDC indicated it would not rescind the brownfield tax credit. Agency officials indicated that it deciding whether to approve the tax credit, the MDEC considers several factors such as public benefit, job creation, the area's level of unemployment in addition to the extent of the contamination. Since the Petoskey Pointe project is estimated to create 115 full-time jobs, the agency concluded the project should still qualify for the brownfield tax credit.

Florida Amends Brownfield Tax Credits

Florida Governor Jeb Bush recently signed legislation amending the Voluntary Cleanup Tax Credit program and the Florida Brownfields Redevelopment Program (HB 7131 and HB 209). The new legislation expands the financial incentives for developers of brownfields and establishes enhanced tax credits for developers of affordable housing.

A developer is now eligible for tax credits equal to 50% of its cleanup costs per year up to a maximum of $500,000. In the final year of cleanup, a developer may be able to claim 25% of its total cleanup costs for all years of the project up to a maximum of $500,000 provided an NFA letter is issued in the final year. Developers of affordable housing projects may claim an additional 25% of their costs up to the maximum amounts.

In addition, costs incurred prior to execution of a brownfield agreement may be counted towards the amount of eligible costs provided the brownfield agreement is executed in the same year that the remediation costs are incurred.

HB 7131 also increases the amount of the limited state loan guaranty available to lenders that finance certain redevelopment projects. The loan guaranty for redevelopment projects in brownfield areas is increased from 10% to 50%. If the redevelopment project involves affordable housing, the loan guaranty is increased from 10% to 75% of the loan amount.

HB 209 repealed the Intangible Personal Property Tax that allowed tax credits to be applied

to corporate income tax or intangible personal property tax. Now the tax credits may only be applied to corporate income tax.

Restaurant Chain Declines to Develop Contaminated Connecticut Site

Texas Roadhouse Inc. has decided not to open a restaurant on two brownfields parcels located near a Home Depot in Waterbury, CT. In January, the Louisville, Kentucky-based company had announced it planned to build a 7,135-square-foot restaurant on the site with 235 seats that would employ about 80 mostly full-time workers. The Waterbury Development Corporation's Business Development Group had been working on obtaining state and federal financing to help pay for the estimated more than $3 million remediation costs. Texas Roadhouse will build the restaurant in another location in Waterbury.

Wal-Mart Declines to Take Full Title

Meanwhile, Wal-Mart Stores Inc. declined to be named on a deed in connection with an agreement for parcel of contaminated land owned by Lehman Brothers in Birmingham, AL. In 2005, Wal-Mart entered into a six-month option to purchase the Eastwood Mall. Built in 1960, the mall had once been the third largest mall in the country but was now nearly vacant. During its due diligence, Wal-Mart discovered that the mall was contaminated from a former dry cleaner and gas station.

In February 2006, the City of Birmingham adopted an ordinance whereby the City agreed to accept an assignment of an option held by Wal-Mart. The City would then contribute $11 million towards the $21.4 million purchase price. After the city acquired title, it would convey the entire 50 acre parcel to Wal-Mart Stores East LP. Wal-Mart East Stores LP agreed to demolish the old shopping center and planned to build a 200,000 square foot superstore and other retail buildings that would result in 770 full-time jobs and generate an estimate $3.7 million in additional sales taxes.

Wal-Mart subsequently decided that it did not want to take title to all of the property. The city recently passed ordinance 06-72 that approved an amendment to the redevelopment plan. Under the new structure, the City agreed to take title for the entire parcel from the seller and then convey only 23 acres to Wal-Mart for its store with the remaining 27 acres conveyed to Map Eastwood LLC to develop 150,000 square feet of retail space in seven out-parcels. Wal-Mart Stores East LLC submitted a voluntary cleanup agreement with the state Department of Environmental Management (ADEM). The demolition was completed in August and ADEM has approved the VCP cleanup plan.

EPA Enters Into First BFPP Agreements

In the first to be officially called a Bona Fide Prospective Purchaser (BFPP) Agreement, the University of Portland entered into an agreement to purchase a parcel located within the Portland Harbor Superfund Site. Under the Bona

Fide Prospective Purchaser Agreement and Order On Consent For Removal Action (No. CERCLA-10-2007-0027), the respondent agreed to perform a non-time critical removal action at the upland portions of the Triangle Park Property where it planned to relocate its athletic facilities. In exchange for a covenant not to sue and contribution protection under both CERCLA and the Oil Pollution Act (OPA), the university agreed to establish a $3 million trust fund in three installments over a four-year period and use the fund to perform an Engineering Evaluation and Cost Analysis (EE/CA), implement an EPA-approved CERCLA removal action and undertake actions that may be required under the Clean Water Act or OPA to abate petroleum discharges from the site. If the trust fund is insufficient to complete the removal action, the university may cease implementing the required work and not be required to complete or expend any further funds towards the cleanup. If the trust fund is not depleted when the removal action is completed, the university may use any remaining trust funds to implement post-removal action site controls. The agreement contained a specific provision where the university represented that it was a BFPP, that it has and will continue to comply with all continuing obligations the BFPP defense. The contribution protection section also provided that in the event of a claim alleging that the university was not a BFPP or lost its status as a BFPP, the agreement constituted an administrative settlement under CERCLA sections 113(f)(2), 113(f)(3) and 122(h)(4), and that the university was entitled to contribution protection from the effective date of the agreement.

Earlier this year, EPA had entered into an Agreed Order on Consent and Covenant Not To Sue for the Many Diversified Interests, Inc. (MDI) Superfund Site that served as a BFPP agreement (No. 06-12-05). In this agreement, Clinton Gregg Investments, Ltd. ("Respondent") was the successful bidder in an auction conducted by a bankruptcy trustee for an inactive foundry in Houston, TX. The Respondent, who planned to develop the 36-acre site into a residential or mixed residential/commercial complex, agreed to implement the approved remedy. The Respondent represented that it was a BFPP, intended to take steps to maintain its BFPP status, represented that it had no prior involvement with the site and had performed all appropriate inquiry prior to purchasing the property. As part of its obligation to complete the work, the Respondent agreed to establish financial assurance in the amount of $6.642 million. If EPA subsequently determined that the costs of the work would increase by more than 10% than that estimated in the 2003 RI/FS as a result of changed circumstances arising after the effective date of the agreement, the Respondent would be required to increase the financial assurance. If after submitting the remedial action workplan, the Respondent demonstrated that the estimated cost

to complete the work would be less than the estimated cost, the financial assurance could be reduced. In consideration for EPA agreeing not to seek reimbursement of oversight costs in excess of $210,000, the Respondent agreed not to contest or dispute any oversight costs demanded by EPA. The *force majeure* provision also contained a definition of best efforts. EPA also agreed that after it certified completion of the Soil Remedial Action and the Interim Ground Water Remedial Action, it would covenant not to sue or take any action against future third party transferee, lessee, or sublessee of any portion of the site, and provide a letter or other satisfactory form of documentation of the covenant not to sue for the respondent to make available to such third parties.

DV Luxury Resort LLC ("Settling Respondent") also entered into an Agreement and Covenant Not to Sue in connection with a long-term lease of a portion of the Empire Canyon Site in Park City, UT (CERCLA-08-2007-001). The site was historically used as a dump for mine waste. In 2003, the owner of the property entered into an administrative order on consent (AOC) to conduct a non-time critical removal action that involved re-routing surface water away from the contaminated mine waste and covering the site with clean fill material. The Settling Respondent planned to construct a hotel, spa and condominium complex on the Property. The development would require excavating contaminated material, re-using some of the material on-site and exporting the balance of the contaminated materials. In exchange for the covenant not to sue and contribution protection, Settling Respondent agreed to safely manage soil and groundwater during construction, implement a stormwater pollution prevention plan, install a cover of clean fill material over all impacted areas of the property not within the footprint of the buildings, construct a storm water diversion system and monitor or treat these discharges to avoid violation of applicable water quality standards, incorporate certain "green building" features into the design of the buildings and maintain these green building systems. The Settling Respondent was also required to maintain financial assurances in the amount of $1.2 million to complete the work. However, the Settling Respondent will not be required to maintain separate financial assurances to cover the costs of its long-term operation and maintenance obligations. Except for the sale or transfer of individual condominium units, all future transferees or assignees must agree to be bound by the terms of the agreement.

EPA proposed to enter into an Agreement and Covenant Not To Sue with Kanani LLC ("Purchaser") to facilitate the purchase of the former location of the Chem-Wood Treatment Company site in the Campbell Industrial Park, Ewa Beach, HI (RCRA 09-2006-003, CERCLA 09-2006-09). The purchaser is an assignee of VIP Sanitation that had entered into a contract for the purchase of the property in September 2005. The seller had acquired the property from Chem-Wood. The purchaser plans to use the property to store supplies and materials as well as park vehicles. In exchange for a covenant not to sue under CERCLA and RCRA as well as contribution protection, the Purchaser agreed to implement the requirements of a corrective action order issued against the prior owners of the property. Upon completion of the corrective action, the Purchaser could be reimbursed from the balance remaining in the Corrective Action Trust

Agreement established by Chem-Wood in 1988. However, the agreement states that the costs of the corrective action are expected to exceed the amount of any reimbursement from the trust fund.

HAZARDOUS WASTES/USTS

Member of LLC Held Liable for UST Violations

The Commissioner of the New York State Department of Environmental Conservation (NYSDEC) affirmed a $60,000 penalty assessed against an officer of a limited liability corporation for the declining company's failure to register petroleum and chemical storage tanks.

In "*In the Matter of 125 Broadway LLC and Michael O'Brien,"* DEC Case No. R4-2005-0214-18 (December 15, 2006), 125 Broadway LLC entered into an order on consent (Order) in May 2005 to resolve violations alleging the owner of a building located in Menards, NY had failed to register and close the petroleum tanks as well as perform hazardous waste characterization on the liquid in the chemical storage tank. The Order suspended $20K of the $25K penalty and required the company to register and permanently close the tanks within 30 days. When the company failed to comply with the Order, the NYSDEC entered into modified consent order (Modification) imposing a penalty of $50K of which $45K was suspended provided the company complied with the modified order. The president of the company signed both orders but was not named as a respondent.

When the company also failed to comply with the Modification, the NYSDEC issued a Notice of Hearing and Complaint (Complaint) against both the company and its president. The Complaint alleged that the president exercised control over the site and had the sole power to cause compliance with the orders. The Complaint further stated that an officer of a corporation, who has the authority and responsibility to effect changes that will bring a facility into compliance, to be held personally liable. The Complaint requested that the Administrative Law Judge (ALJ) find the president and the company individually and jointly liable for failing to comply with the orders. The company failed to appear at the hearing and the NYSDEC made a motion for a default order, requesting that the company and its president be jointly liable for $60K for failing to comply with the modified order as well as the $45K penalty in the modified order.

The ALJ found that it was well-settled law that corporate officers may be held civilly and criminally liable for environmental liabilities without piercing the corporate veil. Noting that none of the orders issued by NYSDEC commissioner had considered if this line of well-settled law applied to members and/or managers of limited liability companies, the ALJ then went on to analyze if these concepts could be applied to situations involving limited liability companies. The ALJ said that the state limited liability company law combines the corporate limitation on personal

liability of the owners (who are called members) with the operating and management flexibility of partnerships. The LLC law also provided that unless the articles of organization of a LLC provide that management shall be vested in a manager or managers, every member is an agent of the LLC. While finding that the LLC law provided that members or agents of an LLC may not be liable for the debts or obligations of the LLC solely by reason of their status as a member, manager or agent of the LLC, this shield did not apply to specific acts or omissions of a member.

The ALJ also found that the concept of officer liability differed from the concept of piercing the corporate veil and that corporate officers have been held personally liable when the corporate veil was not pierced. The ALJ also found persuasive the fact that several state courts have held the doctrine of piercing the corporate applied to limited liability companies. Thus, the ALJ held that the concept of holding corporate officers liable for acts or omissions that caused violations of the state Environmental Conservation Law applied to members of limited liability companies.

Turning to the specific facts of the case, the ALJ noted that since Michael O'Brien had failed to appear at the hearing, he did not dispute the NYSDEC allegations that he had exercised total control over the site and had the sole power to cause compliance with the Order and Modification and had signed the orders as president of the LLC, and that all documents attached to the motion for the default order demonstrated that he was a member of the LLC (indeed the sole member) and was managing the company's business with the NYSDEC. However, since he had not been named as a respondent in the Modification, the ALJ ruled that he could not be liable for the $45K suspended penalty.

The commissioner affirmed the ALJ decision and ordered that the company and O'Brien were jointly liable for $60K, of which $30K would be due within 30 days of the service of the order, with the remaining $30K suspended contingent on compliance with the order.

NYSDEC Seeks $212K From NYC Apartment Building Owner For UST Violations

In December 1996, 134 Plus 37 Maple Realty Inc. (Maple Realty) acquired an apartment building in Flushing, NY that contained an unregistered 4,000-gallon heating oil tank. Following a September 2004 inspection, the NYSDEC issued an administrative complaint seeking a total of $212K in penalties for a variety of violations dating back to 1985 when NYSDEC promulgated its regulations implementing the state Petroleum Bulk Storage Act.

The first cause of action in the complaint sought penalties for failing to register the tank. The ALJ ruled that Maple Realty could not be liable for failing to register the tank prior to December 1996 since it did not own

the tank prior to the time it acquired the building.

The NYSDEC also sought penalties involving the breached fuel line that allowed fuel oil to flow onto the ground near the building. A resident of the building had reported a petroleum spill in January 2004. Because Maple Realty had failed to report and cleanup the spill, the ALJ ruled that Maple Realty was liable as a matter of law.

The NYSDEC also alleged that Maple Realty had failed to perform tightness tests and inventory monitoring on the tank. The complaint alleged that Maple Realty stored No. 6 fuel oil but an affidavit of the NYSDEC inspector indicated that she observed what appeared to be No. 4 fuel oil leaking from a breach in a fuel line. The NYSDEC regulations do not require tightness testing or inventory monitoring for tanks that store No. 5 or No. 6 fuel oil. The ALJ determined that because there was a material question of fact on the kind of fuel that was stored in the tank, a hearing was necessary and he denied the motion for an order without a hearing. Because additional hearings were required, the ALJ reserved a recommendation on the appropriate civil penalty.

The NYSDEC also sought to hold the chief corporate officer of Maple Realty liable for the alleged violations. However, the ALJ ruled that the NYSDEC staff did not allege any facts that would warrant either piercing the corporate veil or imposing direct liability based on the personal participation of the officer in the alleged violations.

Commentary: *Heating oil tanks are frequently used in the northeast and upper Midwest states. While heating oil tanks used for on-site consumptive use are not subject to the federal UST program, many states do regulate these tanks under their UST programs. The particular requirements of these state programs can vary significantly. During due diligence it is important not only to determine if current heating oil tanks are in compliance with applicable requirements but also to determine how former tanks may have been closed. Often times, these tanks may not have been closed in accordance with state closure requirements.*

This case also illustrates the importance of complying with applicable spill reporting and cleanup requirements. The NYSDEC and the state Oil Spill Fund have been aggressively enforcing cases against owners of USTs that have failed to report petroleum spills, even those that occur in building basements where the spill may flow to a drain that discharges to the sewer system. A number of apartment buildings in Manhattan have been fined over $1 million for failing to timely report and respond to petroleum spills.

Franchisors Held Liable for Fuel Deliveries

In *W.R. Grace & Co. and Ecarg, Inc. (Ecarg) v. WEJA, Inc*, No. A-5527-03T1 (App. Div. 11/30/06), the plaintiffs sought recovery of cleanup costs associated with petroleum

contamination at a site formerly used as a gas station and car wash from the former operators and the oil companies that had supplied gasoline to the gas station.

Like many environmental cases, the facts are complicated. Amy Joy Realty leased the site in 1970 to G.E. 440 who constructed a gas station and car wash. In 1981, defendant Richards and his company, Sunrich, purchased the stock of G.E. 440 along with the gas station and car wash business. At the time of the sale, the gas station had steel and fiberglass piping but Sunrich replaced the steel piping with fiberglass lines as part of a UST system upgrade financed by Sunoco. Later in 1981, Amy Joy Realty sold the property to Louis Feil, who then sold it to Grace Retail Corporation, a subsidiary of W. R.Grace. In September 1982, defendant WEJA purchased the gas station and car wash business, and entered into a five-year lease with Grace. WEJA ceased operating the gas station in 1986.

In June 1994, the Hudson Regional Health Commission (HRHC) ordered WEJA to register and remove the USTs. WEJA forwarded the HRHC letter to plaintiffs, claiming that plaintiffs were responsible for registration and removal of the tanks. Plaintiffs contended that WEJA was responsible but began removal of the USTs. After extensive soil excavation, the plaintiffs submitted a closure report to the NJDEP.

The trial court granted summary judgment dismissing plaintiffs' claims against Shell, Sunoco as well as former operators, Richards and Sunrich. After the trial, the court ruled that the plaintiffs owned the UST system and were responsible for 60% of the cleanup costs with WEJA responsible for the remaining 40%. The court also held that WEJA was responsible for $39,000 of plaintiffs' pre-trial attorneys' fees and 40% of the reasonable attorneys' fees and costs incurred during trial and post-trial.

The appellate division reversed the grant of summary judgment to the oil companies and ordered a new trial. Plaintiffs' alleged that spills and overfills during gasoline deliveries caused site contamination. Shell and Sunoco assert that plaintiffs never presented any proof of overfills or spills such as eyewitness accounts. The defendants argued that the mere possibility of overfills was not sufficient to raise a genuine issue of material fact, and, therefore, the trial court properly granted summary judgment dismissing plaintiffs' claims against them.

However, the appeals court held that the pattern of the soil contamination, the notes and first-hand observations of the field technicians coupled and the expert's interpretation was sufficient to create an inference that Sunoco and Shell had caused contamination at the site. The court explained that direct proof of leakage was not necessary and could be established through circumstantial evidence such as evidence showing significant contamination in the soil around a number of the fill ports on the western end of the tanks as well as

the strong gasoline odor at those locations. The panel noted that plaintiffs' experts also testified that the USTs did not have any holes when they were removed in 1995 and that the contamination was likely a result of overfills and leaking piping or loose fittings or joints. The court said that there was no dispute that Sunoco and Shell had delivered gasoline to fill ports that did not have any spill or overfill containment system. Because there was a genuine issue of material fact if the contamination was caused by overfills and spills during gasoline deliveries, the appeals court ruled that the trial court had erred when it had granted summary judgment to Shell and Sunoco.

The plaintiffs had argued that the former operators were liable under the New Jersey Spill Compensation and Control Act (Spill Act) as persons "in any way responsible" for the discharge of gasoline. The appeals court concluded that the plaintiffs had produced sufficient evidence to raise a genuine issue of material fact showing that discharges of gasoline had occurred during the period of time that Richards and Sunrich operated the gas station. The court found that there was ample evidence in the record that due to the hydraulic effect of the high water table at the site, the joints in the UST system's fiberglass piping failed, which contributed to gasoline contamination in 1981 and 1982.

The court acknowledged that there was no direct evidence of any leakage from the tanks during the period that Richards and Sunrich controlled the property. However, the panel said the plaintiffs' fingerprinting and geochemistry expert had identified the presence of gasoline that was consistent with Sunoco gasoline distributed prior to 1984 and Shell gasoline sold prior to 1981. The court also noted that inventory discrepancies existed while Richards and Sunrich controlled the property that plaintiffs claimed showed leakage. While the daily inventory discrepancies could have been due to many factors, the court held that after viewing all the evidence in the light most favorable to plaintiffs, the plaintiffs had established sufficient inferences to raise material issue of fact concerning leakage from April 1981 to September 1982. Thus, the court ruled the plaintiffs had erred in granting summary judgment against Richards and Sunrich.

The plaintiffs also argued that the trial court had incorrectly ruled that they owned the tanks when it had dismissed the common law claims for breach of the 1982 lease and negligence against defendant WEJA and its sole shareholder Wallace Teich. The parties agreed that the trial court had correctly concluded that G.E. 400 had owned the tanks under the 1970 lease and had transferred ownership of the tanks to WEJA as part of the sale of the business. However, WEJA had argued and the trial court had agreed that paragraph 8.C. of the lease had effectively transferred ownership to the plaintiffs. This paragraph provided that all alterations, additions, improvements, repairs, fixtures, underground tanks,

and all machinery and equipment other than car wash equipment that were permanently attached to the property would become property of the landlord upon installation. The trial court had ruled that the paragraph applied to tanks that had already been installed and therefore the plaintiffs were owners of the tanks. The appeals court, though, held that when viewed in the historical context of the property, the only logical interpretation was that paragraph 8.C. was prospective in nature. The court noted that WEJA had assumed the debt that Richards owed Sunoco for putting in new tanks or a new UST system. Since the parties agreed that WEJA had not made any modifications or installations to the UST system, the court held that paragraph 8.C did not operate to transfer title to the plaintiffs. The court also pointed out that other provisions of the October 1982 triple net lease supported this view. They noted that Section 6 of the lease required WEJA to operate in compliance with law, section 7 imposed a duty on WEJA to conduct maintenance and repairs at the site, and that section 9 imposes an indemnification obligation on WEJA in favor of Grace for all of WEJA's operations, and that operation of the tanks was clearly within the scope of WEJA's operations..

On the allocation of liability, the appeals court agreed with the plaintiffs that the trial court had incorrectly used ownership as the primary criterion for assigning the costs of the UST cleanup. The court noted that owners and operators may be liable under both the Spill Act and the Underground Storage of Hazardous Substances Act. Because WEJA had abandoned the USTs without complying with NJDEP requirements and had refused to comply with the 1994 HRHC order, the appeals court ruled that the trial court should have apportioned liability under the equitable analysis required by the Spill Act. Even if the plaintiffs were owners of the UST system, the appeals court held it was not equitable to release from all responsibility the party that had possession and control of the tanks.

The appeals court also found that Teich as the sole shareholder had been sufficiently involved in the operation and control of the property to be held personally liable under the Spill Act.

Commentary: *One interesting aspect of this case is that the franchisors were held liable not because of any assertion of control over their franchisees but because they had directly delivered fuel to the USTs. The major oil companies typically now rely on independent companies known as "jobbers" to deliver fuel. During the past few years, some oil companies have decided to leave the retail gasoline market and have been selling their owned and leased gas stations to jobbers. Under the analysis of this case, lenders contemplating financing such acquisitions should ensure that the jobbers have adequate indemnification or insurance for pre-existing petroleum contamination at the sites to be acquired.*

The other important lesson in this case involves the lease. Many leases provide that improvements will become the property of the landlord

upon termination of the lease or if abandoned by the tenant. One of the purposes behind these clauses was that the improvements could be valuable to the landlord in re-renting the property. However, these clauses can also expose landlords to liability for cleanup of petroleum contamination abandoned by their former tenants. Landlords and their counsel should carefully review existing leases and consider modifying these provisions, especially during lease extensions.

INDOOR AIR

Lender Not Liable For LBP Exposure

In *Hanlan v. Parkchester North Condominiums*, Inc. 2006 N.Y. App. Div. LEXIS 11522 (N.Y. App. Div. September 28, 2006), the mother of a child who suffered from lead poisoning sought damages for an alleged lead paint hazard condition from the manager of a condominium complex as well as the lender of the condominium unit.

The court granted the defendants' motion for summary judgment. The court ruled that neither Citibank, the mortgagor of the condominium unit, nor the condominium manager owned or controlled the premises at issue, or had assumed any duty to the plaintiffs. Furthermore, the court held that neither defendant had the actual or constructive notice of the lead paint condition alleged to have caused injury as required by the New York City Lead Law.

New York State Court Rules Plaintiff May Not Introduce Evidence To Establish Mold Causes Personal Injury

In *Fraser vs. 301-52 Townhouse Corporation*, 2006 N.Y. Slip Op 51855 (U) (N.Y. Sup. Ct. September 27, 2006), the plaintiffs purchased a garden duplex apartment in August 1996. Shortly thereafter, the plaintiffs notified the co-op board that water leaking from an excavated patio had damaged their apartment and also lead to the proliferation of mold growth that caused a variety of respiratory problems, skin rashes and fatigue. After the board failed to remedy the conditions to their satisfaction, the plaintiffs moved to Woodstock in December 2002 where their health improved.

After the plaintiffs filed an action for personal injuries and property damage, the court ordered a "Frye" hearing to determine if there was sufficient scientific evidence to support the plaintiffs' claim that the mold was the cause of the health problems. After a ten-day hearing and reviewing more than 1,000 pages of expert testimony, the Supreme Court for the County of New York prohibited the plaintiffs from introducing testimony demonstrating that the presence of mold had caused their health problems because this theory was not supported by the scientific literature. Moreover, even if the plaintiffs could have established a link between the mold and their health complaints, the court said there were no generally acceptable standards for measuring mold in indoor air, for determining how much mold in indoor air was excessive, no standard scientific definitions for "dampness" or "moisture" and that the most reliable method for testing for allergies had not been used. Accordingly, the court dismissed plaintiffs' claims for personal injury.

Earlier this year, a California appeals court also excluded testimony seeking to establish that

the plaintiffs' symptoms were caused by exposure to mold. In *Geffcken v. D'Andrea*, 2006 Cal. App. Unpub. LEXIS 1681 (Ct. App. 2d Dist. 02/27/06), the plaintiffs alleged that they were exposed to mold spores and mycotoxins at their residence. One of the plaintiffs also alleged that she was exposed to mold while working as a caregiver at premises leased by her client. The plaintiffs filed a lawsuit in June 2001 seeking damages from the homeowners associations and the managing agents under nuisance, constructive eviction, breach of warranty of habitability and negligence.

To support their claim, the plaintiffs sought to introduce expert testimony that purported to establish that there had been mold spores in the indoor air of both residences, that enzyme and blood serology tests indicated that the plaintiffs had been exposed to mycotoxins. The defendants sought to exclude this evidence and after several days of testimony, the trial ruled that the plaintiffs could not introduce the expert testimony because the testimony would not pass the *Kelly-Frye* test adopted by California courts.

The appeals court affirmed the trial court's decision to exclude the plaintiffs' expert testimony. The court found that the indoor air sampling was limited to identifying the species of molds that were present in the residences and did not test for the presence of mycotoxins. The court found that the mere presence of mold spores was not generally accepted scientific evidence establishing the presence of mycotoxins. Moreover, the court noted that the owner of the laboratory had testified that the air samples had "pervasive chain of custody errors and deficiencies." Any minimal probative value that would be gained by introducing the results of the sampling, the court concluded, would be outweighed by the substantial danger of undue prejudice, confusion of issues or misleading of the jury.

The plaintiffs argued that the trial court had misapplied the *Kelly-Frye* test when it excluded the mycotoxin antibody and blood serum serology tests. The appeals court said that under *Kelly-Frye*, the proponent of the expert testimony must show that the reliability of the new technique has gained scientific acceptance in the relevant scientific community, the expert is qualified and the correct scientific procedures were used. The court observed that the defendants' experts had testified that the mycotoxin test used by the plaintiff's expert was not generally accepted by the scientific community as a valid technique for determining human exposure to mycotoxins and that peer-reviewed literature had invalidated the test. Moreover, the court noted that the plaintiffs' expert testimony was suspect because the expert was the owner of the only lab that performed the test and thus had a financial stake in the outcome of the case.

On the blood serum serology test, the court noted that the lab used by the plaintiffs was the only lab in the country that performed the test and the test had not been evaluated or approved by the federal

Food and Drug Administration. Moreover, a publication from the California Department of Health Services concluded that the particular blood serum serology test could not be used to imply the presence of black mold within a home or workplace and could not be used to prove exposure to the specific mold or its mycotoxins. The defendants' experts also testified that the test had no value in assessing mycotoxin exposure or any relevance in diagnosing mycotoxin-related illnesses. Thus, the court held that the trial court had not erred in excluding evidence derived from these tests.

The court also affirmed the ruling excluding the testimony of the plaintiff's principal expert witness on the basis that he was not qualified to express any relevant opinions and that there was no reasonable basis for his opinion that exposure to mycotoxins was the cause of the plaintiffs' ailments. The appeals court said it did not have to consider the expert's qualifications because the expert could not have reasonably relied on the test results to support his opinion since the data was invalidated under *Kelly-Frye.*

Commentary: *For years, the admissibility of expert testimony was determined using the test articulated in Frye v. United States, 293 F.1013 (D.C. App. 1923). Under Frye, expert witness testimony will be admissible if the person seeking to introduce the testimony can show that the theory and method on which it is based has achieved "general acceptance" in the scientific community.*

In 1993, the United States Supreme Court adopted a new test for determining admissibility of expert witness testimony in Daubert v. Merrell Dow Pharmaceuticals, Inc., 509 U.S. 579 (1993). To prevent the introduction of "junk science" into courtrooms, Daubert requires courts to act as a "gatekeeper" and make an initial determination if the testimony should be admitted into evidence. In making this determination, courts are to apply a variety of criteria including whether the testimony is based on reliable principles and methods, has the expert's concept been tested, the known error rate for the testing, whether the concept has been subjected to peer review and whether the witness reliably applied the theory to the facts of the case. Because this exercise can often turn into a mini-trial, well-financed defendants are increasingly using Daubert challenges in environmental lawsuits.

New York and several other large states have not adopted Daubert and continue to use the Frye for determining admissibility of expert testimony. Thus, while state court proceedings in such states will use the Frye general acceptance test, federal courts for those jurisdictions will follow the Daubert reliability test. However, even if Daubert will not be applied to an expert's testimony, the criteria can be a useful tool for parties to evaluate the strength of their own experts and can serve as a useful roadmap for challenging the other party's expert during cross-examination.

Co-op Board and Management Company Liable For Not Complying with NYC DOH Mold Guidelines

In *Dole v. 106-108 West 87th Street Owners Inc*, 2006 N.Y. Misc. LEXIS 3421 (N.Y. Civ. Ct. 11/22/06), the plaintiff/petitioner sought civil contempt and civil penalties for the failure of the defendants to comply with the terms of a stipulation agreement that resolved an administrative action before the NYC Department of Housing Preservation and Development (HPD).

In January 2005, the plaintiff/petitioner discovered approximately 140 square feet of water-damaged dry wall and associated insulation during renovations to create a loft apartment. The renovation work ceased and the plaintiff retained an environmental consultant to assess the presence of mold. The first study identified "heavy" *Chaetomium* mold growth and *Aspergillus/Penicillium* mold spores on the first floor, and excessive water moisture in the bricks and the mortar around the window. The petitioner soon became sick and vacated the premises in October 2005. A subsequent inspection found the elevated airborne *Aspergillus/Penicillium* and slightly elevated airborne *Stachybotrys* mold spores in the upper bedroom.

In January 2006, the petitioner initiated a proceeding before the HPD alleging that the defendants/respondents had failed to abate a hazardous mold condition. The parties then entered into a stipulation whereby the defendants/respondents agreed to remove all water-damaged sheetrock using safeguards to ensure any mold in or behind the sheetrock does not further contaminate the apartment, inspect and repair the sources of water intrusion, sample for mold and then implement mold abatement procedures in accordance with industry standards, including the New York City Department of Health "Guidelines on Assessment and Remediation of Fungi in Indoor Environments" ("DOH Mold Guidelines"). In March 2006, the petitioner filed an order to show cause seeking damages and penalties for the respondents failure to comply with the terms of the stipulation.

The respondents/defendants argued that they properly removed all sheetrock, conducted a visual inspection for the presence of mold and returned to conduct air testing. The respondents relied on a report prepared by their contractor indicating that while elevated *Penicillium* spores were detected inside the apartment, the concentration of spores was not high enough to indicate a microbial contamination condition. The report did recommend that an air purifier utilizing HEPA and carbon filtration be operated non-stop for two weeks to reduce and control the concentration of airborne fungal spores in the apartment.

The court noted that the report of the respondents' contractor did not indicate the results of a visual inspection, including whether any water/moisture and/or water

damage to the interior surface was observed or whether conditions exist that are favorable for future mold growth. Though the respondents had not identified the size of the mold-impacted area, the petitioner introduced evidence that the amount of mold-damaged sheetrock exceeded 100 square feet. Under the DOH Guidelines, this amount of contaminated area qualified as a Level IV remediation requiring trained abatement contractors. The court found that the respondents had failed to comply with the DOH Guidelines since the individuals retained by the respondents were not trained to perform mold abatements or were not supervised by a trained professional. In addition, the contractor did not use a HEPA vacuum and clean the area with a damp cloth/mop and a detergent solution. Based on these facts, the court determined that the respondents had violated the terms of the HPD stipulation warranting a finding of civil contempt.

As a result, the court held that the petitioner was entitled its costs and expenses in enforcing the HPD stipulation. The petitioner also sought recovery of her expenses associated with having to relocate,
including moving and broker fees, and the rent and utilities at the temporary residences. However, because the petitioner had not introduced any expert testimony establishing the petitioner's alleged illness, linking her alleged illness to the mold condition and showing that the alleged illness required her to relocate, the court ruled that she had failed to actual establish such damages.

The court also found that the mold condition constituted a Class "B" violation and ordered the respondents to correct this violation within 30 days of receipt of this decision/order. However, if the respondents failed to comply with the order, the court said the petitioner could bring another action to seek appropriate relief, including civil penalties and/or contempt.

WETLANDS

Ninth Circuit Finds Pond Satisfies Rapanos "Significant Nexus" Requirement

In the first federal appeals court decision following the Supreme Court's decision in *Rapanos v. United States*, 126 S.Ct. 2208 (2006), the Court of Appeals for the Ninth Circuit ruled that a pond was a jurisdictional wetlands because it had sufficient nexus to surface waters.

In *Northern California River Watch v. City of Healdsburg*, No. 04-15442 (9th Cir. Aug. 10, 2006), the City of Healdsburg discharged wastewater from its publicly-owned treatment works (POTW) into a pond that was a former rock quarry that had filled with water from the underlying gravel aquifer. The pond and its surrounding wetlands are separated from the Russian River by a levee which normally prevented a direct surface water connection between the river and the pond.

In 2001, the plaintiff filed a lawsuit charging that the POTW was required to obtain a National Pollutant Discharge Elimination System (NPDES) permit because the pond and its associated wetlands constituted waters of the United States. After a four day trial, the district court determined that there was a significant hydrologic connection between the pond and the river since water from the pond seeps through the gravel aquifer into the river. The trial court ruled that the pond and its wetlands were wetlands adjacent to a surface water and therefore waters of the United States. Accordingly, the court held that the POTW had to obtain a permit to discharge the wastewater into the pond.

On appeal, the Ninth Circuit observed that 26% of the pond's volume eventually drained into the river through the underlying aquifer. These discharges significantly affected the water quality of the river by increasing the chloride levels in the river. In addition to the subsurface hydrological connection, the court noted that the river and pond frequently overflowed during flood events. Moreover, the court found that the wetlands along the river and pond provided habitat for wide varieties of birds, mammals and fish and that the pond was essentially indistinguishable from the river from an ecological standpoint. Thus, the court found that there was a significant nexus between the pond and the river.

The City also argued that the wastewater discharges were not subject to NPDES requirements because of the waste treatment system exception. However, the court said that this exception was limited to self-contained treatment ponds. Since the pond water percolated into the aquifer, the court found the pond did not qualify for the exception.

The court also ruled that the pond was not subject to the excavation operation exception. While a surface mine reclamation

operation discharged slurry and sediment into the pond, there were no ongoing excavation or extraction operations at the pond. Thus, the court affirmed the district court ruling that the POTW had violated the Clean Water Act by discharging wastewater into the pond without an NPDES permit.

NYSDEC Commissioner Upholds ALJ Ruling that Wetlands Authorization Does Not Run With Land

In the early 1960s, Opal Investments (Opal) purchased a parcel of land in Staten Island. In 1981, the New York Department of Environmental Conservation (NYSDEC) prepared a tentative freshwater wetlands map for Staten Island that did not identify any wetlands on the property. Following public hearings, a second freshwater wetlands map was filed in 1986 that identified Class 1 wetlands at the bottom of a ravine that diagonally crossed the site.

In 1988, Opal filed an application for a wetlands permit related to the construction of a warehouse and light industrial complex. The NYSDEC would only approve a development plan that Opal Investments felt was economically infeasible. As a result, Opal petitioned the Freshwater Wetlands Appeals Board (FWAB) for relief pursuant to a temporary hardship exemption created by the state legislature for property owners whose land had not appeared on the initial 1981 wetlands map. In 1998, the FWAB determined that Opal had suffered an unnecessary hardship and ordered the NYSDEC to issue a freshwater permit to Opal.

Because of financial difficulties, Opal did not complete the permit application process. In 2003, Linus Realty acquired the property and filed a freshwater permit application to construct ten commercial buildings. In 2004, the NYSDEC denied the permit application because the project would severely reduce or eliminate the function and benefits of the wetlands on the property as well as negatively impact upgradient and downgradient wetlands.

Linus Realty sought review by the NYSDEC Office of Hearings and Mediation Services (OHMS), arguing that FWAB decision directing NYSDEC to issue a freshwater wetlands permit created a property interest like restrictive covenants, easements or zoning that ran with the land. The Administrative Law Judge (ALJ) determined that the FWAB decision did not run with the land and was not applicable to the proposed project.

Linus Realty then sought review by the NYSDEC commissioner, who upheld the ALJ decision in *In the Matter of the Application for a Freshwater Wetlands Permit pursuant to Article 24 of the Environmental Conservation Law and 6 NYCRR Part 663 To Construct Commercial Buildings in and adjacent to Freshwater AR-7 on a Site Located on Johnson Street (Block 7207, Lot 35), Staten Island (Richmond County), New York by Linus Realty,*

LLC, DEC Application No. 2-6405-99476/00001, 2006 N.Y. Env LEXIS 58 (9/20/06). The NYSDEC Commissioner held that FWAB decision was issued because of the unique hardship suffered by Opal and that Linus Realty was not entitled to such a hardship finding since it had acquired the property with notice of the revised wetlands map. Even if Opal had completed the permit process, the ALJ said that wetlands permit do not create property interests and are only transferable at the discretion of the NYSDEC. Moreover, the ALJ said that even if a permit had been issued to Opal, it would not be relevant to the proposed project which was significantly different from the development that Opal had contemplated and would result in more significant impacts to wetlands than Opal's project.

Farmer Ordered to Reimburse USDA $40K for "Swampbuster" Violations

A recent federal district court explored the scope of the so-called "Swampbuster" provisions of the Food Security Act of 1985 (FSA). This law prohibits farmers who convert wetlands to agricultural use from participating in a variety of federal farm-assistance programs.

In *Ballanger v. Johanns,* 2006 U.S. Dist. LEXIS 66765 (S.D. Iowa 9/15/06), the plaintiff purchased agricultural land in the mid-1990s. After conducting several inspections between 2002-2003, the Natural Resource Conservation Service (NRCS) of the United States Department of Agriculture (USDA) concluded that Ballanger had converted several acres of wetlands to agricultural use in 1996. The NRCS based its technical determination on the existence of several wetland hydrology factors, including the presence of oxidized root channels in the upper 12 inches of soil, local soil surveys and aerial photographs. The local USDA office sent a letter to Ballanger informing him of the NRCS determination and advised him that it would determine if a violation of the FSA had occurred. The letter also advised Ballanger that if he could produce written evidence that he had acted in good faith and had not intentionally violated the FSA, his could remain eligible for USDA benefits provided he restored the wetlands. Ballanger met with the local office and explained that he had been told by the prior owner that no wetlands had existed on the farm but never submitted the good faith determination form. In June 2004, the local USDA office formally notified Ballanger that he was not eligible for farm-assistance from 1996 and would remain ineligible until the wetlands were either successfully restored and mitigation completed. Since Ballanger had received USDA assistance between 2000 and 2002, he was ordered to refund $35,849.70 in principal and $4,466.53 in interest.

Ballanger then appealed to the USDA National Appeals Division (NAD), arguing that the acreage in question had not contained wetlands and that the NRCS had failed to determine if the removal of the hydrophilic vegetation had impeded

or impaired the flow of water. In March 2005, the NAD hearing officer upheld the NRCS determination that Ballanger had converted wetlands, that he was ineligible for benefits and that he had to refund the USDA benefits that he had improperly received. Ballanger then requested a review by the NAD deputy director. In May 2005, the NAD deputy director upheld the hearing officer's ruling. The Deputy Director held that the FSA did not require the NRCS to establish that removal of the vegetation had altered or affected the drainage or flow of water but that removal of the vegetation was sufficient to establish a violation. In addition, the deputy director found that the NRCS had ample evidence to support its conclusion that wetlands had been converted.

In his complaint seeking to overturn the USDA decision, Ballanger argued that (1) the NRCS wetlands delineation failed to comply with established NRCS delineation protocols because the delineation had been made in December after the growing season had ended, (2) that the agency had failed to collect data to show that the land was inundated for at least seven consecutive days during the growing season or saturated for at least 14 consecutive days during the growing season as required by the federal wetlands manual, (3) that the agency had failed to collect data to establish the prevalence of hydrophilic vegetation under non-altered hydrological conditions as required by the federal wetlands manual, (4) had failed to determine if the removal of the vegetation impaired or reduced the flow or circulation of water, and (5) had failed to consider if the removal of the vegetation had only minimal effects on function and value of the wetlands.

The court did not reach the merits of the first three and last issues because Ballanger had not specifically raised them during the administrative proceedings. On the sole issue before the court, Ballanger argued that the FSA required the NCRS to conduct a water flow impairment study because a converted wetlands was defined as a "wetland that has been drained, dredged, filled, leveled or otherwise manipulated (including the removal of woody vegetation or any activity that results in impairing or reducing the flow, circulation or reach of water) for the purpose or to have the effect of making production of an agricultural commodity possible…." However, the court found that the language referring to impairing water flow was an illustrative parenthetical that was not a necessary element of the definition. The court said the key to conversion was manipulating a wetlands so that it could produce an agricultural commodity.

Ballanger also argued that the USDA had improperly enlarged the definition of converted wetlands by inserting the phrase "removal of woody vegetation" into the regulatory definition of converted wetlands. Again, the court rejected this assertion, finding that the language was simply an illustrative parenthetical and was a permissible construction of the FSA. The court said that if a party manipulates wetlands by removing vegetation to

produce agricultural crops, the person has converted wetlands. Since Ballanger had admitted removing woody vegetation to make crop production possible and the regulatory definition was consistent with the FSA, the court held that Ballanger had clearly converted wetlands.

In a second case earlier this year, the United States Court of Appeals for the Fourth Circuit upheld a denial of farm benefits to a corporate farm operator in *Holly Hill Farm Corporation v. United States*, 2006 N.Y.App. LEXIS 11375 (5/8/06). In this case, the predecessor to the NRCS notified the Holly Hill Corporation (Holly Hill) in 1990 that several acres of wooden bottomland on the 650-acre farm may qualify as wetlands and suggested that Holly Hill seek a wetlands determination before clearing the land. In 1991 and 1994, the USDA received a whistle-blower complaint that Holly Hill had illegally converted wetlands. Holly Hill denied access to USDA inspectors in 1991 and the Farm Services Agency (FSA) automatically denied farm benefits to Holly Hill. In 1995, EPA issued a compliance order to Holly Hill instructing it to cease unauthorized filling of wetlands.

After Holly Hill applied for farm benefits for crop year 2002, the NCRS notified the company that it was ineligible unless it allowed NRCS officials to investigate the outstanding wetlands complaints and establish a conservation plan for the farm. Holly Hills eventually granted access to the NRCS in 2003. The NRCS subsequently concluded that an acre of land contained wetlands that had been converted after November 28, 1990 and the FSA formally notified Holly Hill that it was ineligible for program benefits. Holly Hill challenged the decision, arguing that the wetlands determination was not supported by the evidence. The NAD Hearing office, NAD Deputy Director and federal district court for the eastern district of Virginia upheld the USDA decision.

On appeal to the Fourth Circuit, Holly Hills argued that it was entitled to the minimal effects exception. The court noted that the provision provides that the NRCS "shall" determine if the effect of a conversion has a minimal effect on the function and value of a wetland but that the program benefit applicants had to request such a determination prior to any conversion. After any conversion, the court said, the applicant has the burden of demonstrating that the effect was minimal. Since Holly Hill had the burden of establishing the minimal effects and had failed to raise the issue during the administrative proceeding, the court ruled that USDA's failure to make a minimal effects determination did not constitute plain error and affirmed the USDA decision.

Commentary: *The Swampbuster provision does not make it illegal to convert wetlands for agricultural purposes but simply makes farmers ineligible for farm benefits for illegally converted wetlands. When Congress originally enacted the Swampbuster provision, it provided for a loss of proportional farm benefits. However,*

Congress expanded the scope of the prohibition in the Food, Agriculture, Conservation and Trade Act (FACTA) of 1990. For wetlands converted after November 28, 1990, FACTA provides that the farm will lose ALL USDA benefits on all land controlled by the farmer until the wetlands are restored or the loss mitigated. Moreover, while the 1985 provision applied to wetlands that were then converted to produce crops, the FACTA amendments expanded the prohibition to wetlands that are converted in a way that makes production of an agricultural commodity possible even if the land is not actually placed into production.

Ballanger and Holly Hill involved wetlands conversions that had occurred a decade ago. Because of the drastic consequences under the Swampbuster provision of the FSA as amended by FACTA, it is important that purchasers of agricultural land who plan to seek USDA benefits determine if wetlands are present or previous wetlands were illegally converted. If the purchaser determines that wetlands were converted for agricultural purposes, it should consider developing evidence to support a minimal effects determination.

City Prohibited From Enforcing Wetlands Banking Agreement

In *City of Green Isle v. Boelter*, 2006 Minn. App. Unpub. LEXIS 1120 (Ct. App. 10/3/06), Green Isle was required to replace wetlands that had been destroyed in connection with the construction of the Green Isle Industrial Park. The city decided to establish a wetlands bank that would be used to create wetlands mitigation credits for the current project and allow the city additional credits for future projects.

In 1999, the city entered into a wetlands banking and mitigation agreement to construct a wetlands bank on 13.5 acres of a 20-acre parcel owned by the defendants. The agreement provided that the defendants would provide the land at no cost, that the city would ensure that the defendants would have access to all areas of the property for "normal use," and that the city would prepare and pay the costs for preparing and recording all necessary documents for creating a permanent easement. The city then submitted a permit application to the soil and water conservation district that was approved. The approval required the city to record the Declaration of Restriction and Covenants (DRC) prior to commencing construction of the wetlands.

The city spent $97,000 excavating ponds to create wetlands. After the construction of the wetlands was completed, the city delivered the DRC and an affidavit for execution by the defendant. The DRC required the defendant to maintain a permanent "vegetative cover" for both the wetlands and non-wetlands areas as well as prohibiting using the land for producing agricultural crops, grazing livestock, haying, mowing, timber management, erecting structures or placing any materials, substances or other objects on areas specified in the wetlands replacement plan.

The Boelters refused to execute the documents because they had not been aware of the severe use restrictions that would be imposed on their property. The city then filed a breach of contract action. The defendants testified that they had believed the only use restriction would be that they could not drain the ponds that had been constructed on their property, and that they would not have entered into a contract had they been aware of such drastic restrictions on their land. The trial court dismissed all of the city's claims, finding that the city had breached the agreement by failing to obtain the signature of the defendants and to record the DRC prior to constructing the wetlands.

On appeal, the city argued that the meaning of "normal use" had to be construed in the context of the purpose of the wetlands mitigation and banking agreement. However, the court ruled plain and ordinary meaning of "normal use" was to conform to a regular or typical pattern of use, which in the case of the defendants' property was agricultural land. The court found that any damage suffered by the city was a result of its breach.

The court also rejected the city's argument that the defendants were unjustly enriched by the city's construction of the wetlands. Since the defendants had been willing to dig the ponds using their own equipment, the court said the defendants could have constructed the wetlands at little or no cost. In addition, the court found that the defendants were not enriched by the presence of the wetlands since the city was entitled to all wetlands credits created by the project.

Bankruptcy Injunction Bars Enforcement of Wetlands Administrative Order

In *NJDEP v. IT Group*, 2006 U.S. Dist. LEXIS 11345 (D.Del 3/17/06), a federal district court ruled that the New Jersey Department of Environmental Protection (NJDEP) was barred from enforcing an administrative order requiring wetlands mitigation to replace wetlands that the ordered party had improperly drained.

In 2002, the New Jersey Department of Environmental Protection (NJDEP) determined that Landbank, Inc. had drained approximately 19 acres of freshwater wetlands during construction of the Woodbury Creek Wetlands Mitigation Bank. The NJDEP then issued an administrative order to Landbank requiring it to create 57 new acres of off-site wetlands, re-establish financial assurances for the mitigation bank and pay a $9K penalty.

After Landbank filed a request for an administrative hearing, NJDEP filed a motion for summary judgment with the New Jersey Office of Administrative Law seeking to establish Landbank's liability for the violations. At the time of the administrative hearing, Landbank had already filed a bankruptcy petition and a liquidation plan had been approved. The IT Litigation Trust which was set up as part of the confirmed liquidation plan filed a motion with the bankruptcy court seeking dismissal of the

administrative action. The bankruptcy court concluded that the NJDEP administrative order seeking to enforce Landmark's mitigation claims was a pre-petition, general, unsecured claim that was subject to the confirmation order.

On appeal, the NJDEP argued that its administrative order was an affirmative injunction that was exempt from the automatic stay. However, the district court ruled that the automatic stay was terminated with the effective date of the liquidation plan and that the plan injunction prohibiting creditors from pursuing claims against the debtor was in effect. Since the debtor had ceased operations and the IT Litigation Trust was in the process of liquidating assets and making distributions to creditors, the court said the only way the debtor could comply with the order would be through a payment of money. As a result, the court found that the relief sought by NJDEP was compensatory in nature and not designed to prevent ongoing environmental harm. Because the administrative order more closely resembled a claim for monetary payment intended to compensate for past wrong acts as opposed to injunctive relief preventing future harm, the district court concluded that the bankruptcy court had properly enjoined NJDEP from enforcing the administrative order.

Commentary: *This case illustrates how courts may view wetlands violations differently than claims involving contaminated property. Section 362(b)(4) of the Bankruptcy Code provides that the automatic stay does not apply to enforcement of a government agency's police and regulatory powers. Many courts have allowed regulatory agencies to enforce administrative orders requiring debtors to remediate contaminated sites even where the state may have had the statutory right to take action and seek cost recovery. In this case, the court distinguished situations where releases of hazardous substances presented an ongoing risk of environmental harm from the past draining of wetlands. The NJDEP apparently did not introduce any evidence of the impact that the draining of the wetlands had on the environment. Because there was no evidence that the draining of the wetlands had caused any continuing environmental harm, the administrative order directed mitigation at another location and required creation of wetlands at a 3 to 1 ratio for every acre of wetlands allegedly destroyed, the court concluded that the NJDEP was simply seeking compensation for past wrongful acts.*