

SCHNAPF ENVIRONMENTAL JOURNAL

A Newsletter Covering Recent Environmental Developments and Caselaw

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Contents

DUE DILIGENCE/DISCLOSURE	3
FANNIE MAE WAIVES PHASE I ESAS FOR DUS REFINANCINGS	3
FREDDIE MAC ISSUES NEW RADON PROTOCOL FOR PHASE I ESAS	4
LENDER LIABLE FOR NOT DISCLOSING CONTAMINATION.....	6
COURT REFUSES TO DISMISS CONSULTANT FOR FAILING TO IDENTIFY USTs DURING PHASE I.....	9
CONSULTANT SETTLES MALPRACTICE CLAIM AFTER FAILING TO IDENTIFY FORMER DEGREASING PIT AS REC.....	10
COURT UPHOLDS LIMITATION OF LIABILITY IN HOME INSPECTION CONTRACT.....	11
STATE COURT REFUSES TO DISMISS TRUSTEE FOR CONTAMINATED PROPERTY	12
STUDY ASSERTS PETROLEUM-CONTAMINATED SITES POSE LOW VI RISK	13
PA VI LAWSUIT ILLUSTRATES DIFFICULTY OF ASSESSING VI PATHWAY	15
SUPERFUND/BROWNFIELDS	16
EPA INSPECTOR GENERAL LAUNCHES EJ INVESTIGATION OF RINGWOOD MINE CLEANUP	16
UPDATE ON WHITE SWAN SUPERFUND SITE	16
EPA IDENTIFIES MORE SITES IN SEVERAL STATES WITH VAPOR INTRUSION.....	18
ATSDR STUDY CONFIRMS INCREASED CANCER RATE AT ENDICOTT VI SITE	20
EPA ISSUES PCB BROWNFIELD GUIDANCE.....	20
EPA ANNOUNCES PROSPECTIVE PURCHASER AGREEMENTS	21
ROUNDUP OF SIGNIFICANT CERCLA SETTLEMENTS, BY STATE	22
BROWNFIELD BACKLASH IN NEW JERSEY	24
CONNECTICUT BROWNFIELD LAW GOES INTO EFFECT	25
NY LEGISLATURE AMENDS BROWNFIELD CLEANUP PROGRAM	26
CLEAN WATER ACT	28
SUPREME COURT UNABLE TO REACH CONSENSUS ON DEFINITION OF WETLANDS	28
INDOOR ENVIRONMENTAL ISSUES	31
ROUNDUP OF RECENT MOLD INSURANCE CASES	31

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

DUE DILIGENCE/DISCLOSURE

Fannie Mae Waives Phase I ESAs for DUS Refinancings

One of the early signs that a hot real estate market is getting a bit frothy is when banks begin relaxing their credit criteria. So we were intrigued to learn that Fannie Mae had recently announced that it had relaxed its environmental due diligence requirements for refinancing existing Delegated Underwriting & Servicing (DUS) loans (including 3Max Express and co-ops loans) that are in good standing. Loans involving senior housing or multifamily affordable housing properties are not eligible for the reduced environmental requirements.

The changes are part of the streamlined origination and reduced documentation requirements of Fannie Mae's Choice Refinance program. Under this program, a new or updated Phase I or Phase II will not be required if a Phase I was performed for the original loan and three conditions are satisfied. **First**, the borrower must certify in the General Certificate that there has not been any adverse change at the Property and the Borrower is not aware of any "proximate land uses" that pose an environmental risk. **Second**, the lender must perform a transaction screen that complied with the ASTM E1528 and the transaction screen does not reveal any adverse conditions that require further investigation. **Finally**, the borrower must certify in the General Certificate and the lender must confirm that the

borrower is implementing any operation and maintenance plans that were required as part of the original loan. If a Phase I was not performed for the original loan or if the three conditions are not met, the lender must comply with the environmental due diligence procedures set forth in Part X of the Fannie Mae DUS Guide.

Before lenders rush off to relax their environmental due diligence requirements for refinancings, it is important to point out the Choice Refinance program represents the minimum underwriting standards. The Choice Refinance program states that lenders should still exercise "prudent business judgment" in determining whether additional due diligence beyond the minimum requirements is warranted based on the facts and circumstances of the particular loan. In addition, under the Choice Refinance program, lenders must provide the same selling and servicing representations and warranties that Fannie Mae requires for non-refinance loans. Thus, if the lender elects to use the relaxed environmental underwriting option but environmental issues are subsequently discovered that impair the property that would constitute a breach of those selling and servicing representations, the bank may trigger its DUS Master Loss Sharing Agreement with Fannie Mae.

Commentary: *We do not see why any bank would take such a risk and relax its environmental underwriting*

standards when it still has to make the same underwriting representations and warranties. Lenders should exercise extreme caution in deciding to use the minimum underwriting standards of the Choice Refinance Program. Before deciding to adopt the relaxed environmental standards, lenders should make sure that the Phase I performed for the original loan was of very high quality and had thoroughly investigated the historic use of the property. In addition, in relying on certification of no adverse change, the bank should ensure that the person executing the certification is intimately familiar with the property and has been employed at the property for a sufficient period of time to have personal knowledge of any material changes to the property since the original Phase I report.

Freddie Mac Issues New Radon Protocol for Phase I ESAs

On June 7th, Freddie Mac announced detailed radon due diligence requirements for multi-family properties. The new requirements appear in Chapter 13 of the Freddie Mac finalized changes to its Multi-family Seller/Service Guide.

New section 13.14, requires environmental consultants to evaluate potential presence of radon gas for all properties, regardless of the EPA zone designation within six months prior to the Origination Date. EPA has divided the nation's counties into three radon zones. Zone 1 counties have a predicted average indoor radon screening level greater than 4 pico Curies per liter (4 pCi/L) and are identified with red marking on the EPA radon zone

map. Zone 2 counties have a predicted average indoor radon screening level between 2 and 4 pCi/L and colored orange on the on the EPA radon zone map while Zone 3 counties have a predicted average indoor radon screening level of less than 2 pCi/L and are colored yellow.

The new radon requirements are fairly prescriptive. An environmental consultant must screen a minimum of 10% of the lowest "habitable areas" of a property or one unit per building. The guide defines "habitable areas" as those suitable for occupancy that are or will potentially be used as living space. If the lowest habitable area of a Property consists of one basement, then the environmental consultant must screen the basement concentration. If the lowest habitable area consists of 20 rooms, then the environmental consultant must screen at least two of these rooms for radon. The initial radon screening must be conducted in rooms that are likely to be used regularly, such as family rooms, living rooms, playrooms, dens, or bedrooms. Screening in kitchens, bathrooms, laundry rooms, or hallways that are used only periodically will not be acceptable. Freddie Mac does not require radon screening for public areas that will be used only periodically.

The radon zone does influence the type of initial screening that must be conducted. Long-term screening (at least two months in duration) using alpha-track testing must be performed for zone 1 properties. For properties located in zones 2 or 3, short-term screening using short-term charcoal canister

detectors with a residence time of 48 to 96 hours may be used as well as long-term alpha-track detectors with a minimum residence time of 48 hours. If the initial short-term screening indicates radon concentrations greater than 4 pCi/L, long-term screening must be conducted in the same area where the short-term screening was performed.

The chapter also contains detailed requirements for screening that will have a duration of one week or less. The screening must be performed under closed-building conditions with (to the extent reasonable) all windows, outside vents, and external doors closed (except for normal entrance and exit use) for 12 hours prior to the radon test and during the radon test. Normal entrance and exit use includes opening and closing a door. An external door should not be left open for more than a few minutes. Internal-external air exchange systems (other than a furnace), such as high-volume attic and window fans should not be operating during radon screening and testing and for at least 12 hours before measurements are initiated. Air conditioning systems that recycle interior air may be operating. Normal operation of permanently installed air-to-air heat exchangers may also continue during closed building conditions.

If the results of any of the long-term alpha-track screening indicates concentrations of radon gas exceeding 4 pCi/L in any habitable area of the property, new section 13.14(c) requires the environmental consultant to discuss

in the environmental report the mitigation method that will be used to reduce these concentrations to 4 pCi/L or lower. The consultant is also required to review the scope of work for any proposed radon mitigation measures and discuss the appropriateness of the scope, cost and schedule for the required work.

If the Property is located in a Zone 1 county and alpha-track testing cannot be completed prior to the Origination Date, the consultant must provide a written estimate of the cost of mitigation that would be necessary to reduce radon gas concentrations below the federal action level. Freddie Mac may require the lender to establish a radon mitigation escrow in the amount of 150% of the estimated cost of mitigation. If the post-closing long-term radon sampling reveals that the radon levels are at or below 4 pCi/L, the environmental consultant must issue a statement that the Property meets the Freddie Mac environmental eligibility radon standards.

If radon mitigation measures cannot be completed prior to the Origination Date, the borrower must have a signed, binding, fixed-price radon mitigation contract with a qualified service provider that will provide for completion of radon mitigation measures within 90 days of the Origination Date. In addition, the Seller/Service must establish a radon mitigation escrow equal to 150% of the estimated cost of mitigation. The radon mitigation must be performed by a qualified radon mitigation firm. It is unclear if the mitigation firm must be licensed in the state where the property is

located or if an out-of-state licensed mitigation firm may be used. Section 13.14(d) states that acceptable radon mitigation measures may include ventilation of living spaces, sealing off radon infiltration sources, and/or sub-slab depressurization/soil vapor extraction from beneath the slab of the building.

When the mitigation is complete, the qualified radon mitigation contractor must state in writing that the work has been satisfactorily completed, that a minimum of 48 hours of post-mitigation confirmatory testing has been conducted, and that the radon levels at the property are now at or below 4 pCi/L.

Commentary: *Due to rising interest rates are rising, many borrowers are taking advantage of Early Rate-Lock programs where the borrower can lock the interest rate, establish the mortgage amount, and set other key provisions of a proposed mortgage after preliminary underwriting review but before the lender submits the final underwriting package (including third-party reports). Many lenders want to have environmental reviews completed before rate lock so they can evaluate the environmental risks at that stage. If environmental issues are identified, the period between rate lock and closing is used to resolve the environmental issues or establish mechanisms for addressing the environmental concerns such as submitting documentation to a state agency, entering into a voluntary cleanup program, ordering operation and maintenance plans or completing Phase II investigations so a post-closing escrow can be established. Unlike Fannie Mae*

loans, Freddie Mac loans are generally non-recourse for the originating lender unless there are specific carve-outs. Thus, conservative lenders may have a greater tolerance for environmental issues at a property if the loan otherwise meets Freddie Mac underwriting requirements.

Lender Liable for Not Disclosing Contamination

It seems that each year we report on a case where a lender has been found liable for not adequately disclosing environmental conditions of foreclosed property that it has sold. The most recent example is *Dennis Hess v. Chase Manhattan Bank USA*, 2006 Mo. App. LEXIS 350 (Mo. Ct. App. March 28, 2006).

In this case, the bank foreclosed on a three-bedroom home in January 1999, after its mortgagor was convicted the prior month of illegal dumping of paint and solvent wastes on the property. EPA had investigated the illegal dumping on the property and had numerous discussions with the bank and its representatives about its investigation. However, the bank never disclosed the existence of the EPA investigation or its contact with EPA when it sold the property to the plaintiff in April 1999 for \$52,000.

Prior to taking title, the plaintiff had inspected the property and noted that the home needed repairs and that there was some debris on the property but did not notice any paint cans or other signs of dumping of hazardous waste. In fact, there were numerous cans of waste paint in the foundation of an old barn that was located approximately 300 feet

from the house and overgrown with weeds.

After taking title, the plaintiff hired a construction company to remove some trees and burn or bury all trash and debris located on the property. The plaintiff received the necessary permits from the local government agencies to perform this work. The contractor then dug three large holes to bury the debris, including the paint cans. When EPA learned of the burial of the paint cans, it issued a CERCLA section 106 Unilateral Administrative Order (UAO) in January 2000 requiring the plaintiff to remove the paint cans. The plaintiff complied with the UAO and EPA issued a letter to plaintiff confirming that he had fully complied with the UAO.

The plaintiff then filed a lawsuit against the bank and its broker, charging the defendants with fraudulent non-disclosure for failing to disclose EPA's involvement with the property. In addition to its common law claim for fraud, the plaintiff alleged violations of the Missouri Merchandising Practices Act (MPA) by concealing, suppressing and omitting material facts about the property, namely EPA's prior involvement with the site. The plaintiff sought punitive damages and attorney fees under the MPA.

The bank argued that it had no obligation to disclose EPA's involvement because of the "as is" clause in the sales agreement and that the plaintiff could not bring a private action under the MPA because the version of the law in effect at the time of the sale was limited to persons who purchase or

lease goods or services.

The court dismissed the plaintiff's MPA claim, but allowed the claim for fraudulent non-disclosure to proceed to trial. The jury awarded the plaintiff \$52,000 in actual damages. The defendant filed a motion for judgment notwithstanding the verdict (JNOV) on the basis that it had no legal duty to disclose EPA's prior involvement with the property or that the plaintiff had a right to rely on the bank to make such a disclosure but the court denied the motion. The plaintiff also filed a post-trial motion to reinstate its MPA claim, but the trial court denied the motion. Both parties then appealed.

On appeal, the court rejected the bank's argument that it had no duty to disclose as a matter of law and that the plaintiff could not rely on the bank's silence because the contract provided that the bank did not make any express or implied representations, guaranties or warranties regarding the condition of the property. The court began its analysis by noting that there can be a common law duty to disclose material facts where a party has superior information or specialized knowledge that was not known or reasonably available to the plaintiff. In the jury instruction, the trial court instructed the jury to consider whether the bank had superior knowledge or information about the EPA involvement with the property that was not within the fair or reasonable reach of the plaintiff. The jury was also instructed to consider if the plaintiff had reasonably relied on the bank's silence regarding the EPA involvement and environmental conditions of the property. Then, in a

highly technical ruling, the court said that the bank was not attacking the basis upon which the plaintiff asserted that there was a duty to disclose or if the plaintiff's reliance was reasonable, but simply that the plaintiff had waived its rights to full disclosure by agreeing to the "as is" clause. The court said that waiver was an affirmative defense and because the bank had not specifically pleaded this affirmative defense, it could not rely on the defense as a basis for overturning the jury's verdict. Thus, the court affirmed the judgment on the common law fraud claim.

On the MPA claim, the appeals court noted that the law had been amended in 2000 to allow parties to bring their own private actions for MPA violations involving real estate transactions. Prior to those amendments only the state attorney general was authorized to bring actions for violations involving real estate transactions. Since the attorney general could prosecute such claims, the court concluded that the bank already had an existing duty to make full disclosure in 1999 to the plaintiff and that the 2000 amendments were simply a procedural change that allowed the plaintiff to bring an action in its own name instead of waiting for the attorney general to bring an enforcement action. Since the 2000 amendments were procedural and did not create any new obligations or duties on the defendant, the court held that the 2000 amendments could be applied retroactively. Therefore, the court not only ruled that the trial court had improperly dismissed the plaintiff's MPA claim,

but because the MPA claim was based on the same operative facts of the common law claim for fraud, the appeals court held that the trial court must instruct the jury to find the bank liable under the MPA. The appeals court held that on remand, the only issue for the jury to consider would be to determine the actual and punitive damages that the plaintiff was entitled for the bank's violation of the MPA.

Commentary: *Purchasers and lenders often ask counsel and consultants if they have any obligations to report or disclose contamination. As this case illustrates, even if a state does not have a statutory disclosure law, there may be an obligation under common law to disclose the existence of contamination or the results of prior investigations. It is not only prudent to err on the side of full disclosure in transactions, but in emerging areas such as vapor intrusion, to look back at prior disclosures to see if they could form the basis of a claim for non-disclosure. For example, in the 1980s and 1990s, it was not uncommon to use OSHA PELs in determining if contaminants levels detected in residential projects built on landfills or contaminated sites posed a health risk. It is clear from recent EPA and state guidance that OSHA PELs are not the appropriate standard for determining risk at residential developments and that the OSHA PELs are more lenient by a magnitude of up to seven times, depending on the chemicals of concern. Thus, owners of residential properties that made statements to tenants in the past that contaminants*

did not pose a risk health that were based on old science should consider amending the disclosures.

In past issues, we have cautioned purchasers, lenders and consultants to not simply rely on NFA letters, but to evaluate the adequacy of cleanups done in the past. The same applies to conclusions about risks posed by contaminants contained in prior reports. During due diligence, these statements should be assessed against the current state of the knowledge about the chemicals of concern and the exposure pathways. What might have been considered a "safe" level of exposure 20 years ago may now be a basis for a toxic tort or property damage claim.

***Court Refuses to Dismiss
Consultant For Failing to Identify
USTs During Phase I***

In *Neumann v. Carlson Environmental, Inc.*, 2006 U.S. Dist. LEXIS 26114 (N.D.Ill. April 20, 2006), the plaintiffs retained Carson Environmental, Inc (Carson) in 2000 to perform a Phase I in connection with a contract to purchase a parcel in Elk Grove Village, IL. The Carlson report indicated that there were no USTs on the property even though the records maintained by the local fire marshal indicated that four USTs were located at the property. Carlson concluded that the property did not have any RECs and plaintiff waived its right to object to the environmental conditions of the property.

Two years later, the plaintiffs tried to sell the property and a prospective purchaser retained Carlson to perform a Phase I update.

This time Carlson noted that the fire department records showed that there were four USTs at the property and identified the tanks as a historic REC (HREC) because of the absence of any data that the tanks had been properly abandoned or had not leaked. The sale fell through and plaintiff commissioned Carlson to perform a Phase II investigation. Carlson did not detect any VOCs above state cleanup levels.

In 2003, plaintiff once again put the property on the market. A prospective purchaser performed a Phase II and found a variety of VOCs including PCE, TCE, DCE and benzene above state soil cleanup objectives. The plaintiff was only able to sell the property after it agreed to remove the USTs, remediate the soil contamination and obtain a no further remediation (NFR) letter from the Illinois EPA. The plaintiff also had to establish a \$300K environmental escrow to cover the cost of the remediation.

Plaintiffs subsequently filed a lawsuit against the prior owners for failing to disclose the presence of the USTs and Carlson for breach of contract, negligence, negligent misrepresentation and consumer fraud.

Carlson filed a motion to dismiss, arguing, *inter alia*, that the plaintiff's negligence claim was barred by the economic loss doctrine because its duty to inspect and provide a report arose pursuant to a contract. Interpreting Illinois law, the federal district court said that the economic loss doctrine does not bar claims for professional malpractice since the performance of professional services creates a duty

that arises outside of a contract. Here, the court held, Carlson had a professional duty to provide an accurate environmental report outside of a contract by virtue of its particularized knowledge and expertise. Accordingly, the court denied Carlson's motion.

Commentary: *The opinion did not contain many facts since the court was ruling on a motion to dismiss where the court determines if the plaintiff has adequately pled the elements of a cause of action. However, it appears that the property had been previously occupied by a tool company. Given the historical use as a manufacturing facility and the important role that the state fire marshal plays in the regulation of USTs, it is hard to fathom how a consultant could comfortably state that there were no USTs and no RECs without having first reviewed the fire department records. This case illustrates yet again the importance of performing comprehensive historical investigations during environmental due diligence and in reviewing local regulatory records, especially in states where local governments have been delegated a significant role in administering environmental programs.*

Consultant Settles Malpractice Claim After Failing to Identify Former Degreasing Pit As REC

The failure of a Phase I report to identify a former degreasing pit as a REC was at the center of the controversy in an unreported New Jersey case, *48 Horsehill, LLC vs. Kenro Corporation, et al*, No. MRS-L-

43-02 (Law Div. February 22, 2006). In this case, the defendant Kenro Corporation (Kenro) had owned a manufacturing facility to assemble photographic and graphic arts equipment in Cedar Knolls, NJ from 1958 to 1985. The manufacturing process included a degreasing process that used TCE and was located in a concrete-lined pit.

In 1985, a computer software company (ICC) agreed to purchase the property from Kenro. The sale triggered what was then called the New Jersey Environmental Cleanup Responsibility Act (ECRA). After agreeing to remove 55-gallon drums of TCE and to close the degreasing pit, Kenro obtained a negative declaration from the New Jersey Department of Environmental Protection (NJDEP). However, Kenro never decommissioned the degreasing pit. Instead, the software company, which never used TCE, placed a 200 square foot concrete patch over the pit.

In 2001, the plaintiff purchased the property. The purchase agreement provided that the plaintiff would perform its own environmental due diligence and that the seller was not making any environmental representations and warranties. The plaintiff retained Atlantic Geosciences (Atlantic) to perform a Phase I and they did not identify the concrete patch or the former degreaser as a REC.

After taking title, plaintiff was notified by downgradient neighbors that TCE had been detected in their drinking water wells. Plaintiff then retained Triassic Technology (Triassic) to perform a Phase II. Triassic drilled holes through the

concrete patch and found a void with strong chemical odors. Sampling from beneath the pit detected elevated concentrations of TCE in the soil and groundwater. Triassic concluded that the TCE had been migrating for 33 years and that the degreasing pit was in hydrologic contact with the groundwater. Triassic also concluded that the failure to properly decommission the degreaser pit had contributed to the contamination. During removal of the degreaser pit, workers had to use full face respirators because of the strong chemical odors and vapors.

The plaintiff filed a complaint seeking damages from Kenro, ICC as well as Atlantic. The claim against Atlantic was for breach of contract and professional malpractice. Shortly before the scheduled trial date, the plaintiff reached a settlement with Atlantic.

The trial court dismissed the plaintiff's common law claims of fraud, negligent misrepresentation and negligent remediation as well as statutory claims under the Consumer Fraud Act and the state Spill Compensation and Control Act (Spill Act). On appeal, though, the court reversed most of the key rulings of the trial court.

One of the significant rulings by the appeals court was that defendant's due diligence did not prohibit it from maintaining its common law fraud claim. The ICC defendants argued that because the plaintiff had conducted its own inspection, it could not have relied on defendant's silence or non-disclosure about the existence of the degreaser. However, the court found that plaintiff's inspection did not

uncover the TCE contamination because the ICC defendants had allegedly deliberately concealed the existence of the contamination with the concrete patch. While the court said the plaintiff was entitled to rely on its own report for visible damage, it was justified in relying that defendants would not willfully conceal environmental contamination. Moreover, because the contamination was obscured by the concrete patch and not readily observable, the court said the contamination was a latent defect that the ICC defendants had a duty to disclose.

On the plaintiff's Spill Act claim, the ICC defendants argued they could not be liable as a discharger because they had not used TCE. However, the court found that there was sufficient evidence that the degreasing pit was an source of ongoing discharges into the environment through ICC's ownership of the property. Therefore, the court reversed the dismissal of the plaintiff's Spill Claim and remanded the issue back to the trial court for further proceedings.

Court Upholds Limitation of Liability in Home Inspection Contract

In *Dicker v. The Housemaster*, 2006 N.Y. Misc. LEXIS 228 (Sup. Ct.-Nassau February 9, 2006), the plaintiffs retained the defendant to conduct an inspection of a home they were contemplating purchasing. The agreement contained a Limited Inspection Guarantee that provided that the defendant would reimburse the plaintiffs for repair expenses resulting from alleged inspector

negligence up to maximum of \$1500. The agreement also stated that without the limitation, the inspection would have to be “more technically exhaustive, would likely require the services of specialists and would cost substantially more...” than the \$520 inspection fee. The agreement also provided that more extensive inspection services were available upon request to perform a re-inspection of any inaccessible or concealed areas. A separate page was attached to the agreement titled “Additional Terms and Conditions” that stated, *inter alia*, that the inspection could not “detect latent conditions or concealed, hidden, obstructed or inaccessible areas” and also excluded mold or other potential contamination or health risks from the scope of the inspection. Another document titled “Important Mold Information” that was signed by the plaintiff acknowledged that the inspection was “neither a mold detection/identification evaluation nor a mold insurance policy.”

The written report assigned a “fair” rating to the shower and tile work in a bathroom attached to the master bedroom. A comment indicated that the tile work had been repaired and sealed. The report also rated the ceiling and walls of the garage below as “satisfactory” with the comment “rear area of ceiling has prior water damage (dry).” After the closing, the plaintiffs learned that the master bathroom had an active water leak with extensive rot and mold below the shower.

After the plaintiffs’ sought to recover their renovation costs, the defendant filed a motion to dismiss.

The court first observed that a home inspector who fails to exercise reasonable care in performing an inspection may be liable for simple or professional negligence. In addition, the court said that public policy does not allow a party to insulate itself from liability for gross negligence. However, the court said a contractual provision absolving a party of ordinary negligence will be enforced where the limitation makes the service more affordable. Thus, the court held that the contract precluded any claim based on the condition of the shower and tile work because these areas had been rated as “fair” and there was no allegation of gross negligence. Because the garage ceiling had been rated as “satisfactory”, the court allowed this claim to proceed, but it would be subject to the \$1500 recovery limitation.

***State Court Refuses to Dismiss
Trustee For Contaminated
Property***

In *Martin v. Ward*, 2006 Wash. App. LEXIS 605 (Ct. App. April 10, 2006), the beneficiaries of an estate alleged that a trustee bank had breached its fiduciary duties by mismanaging the trust assets. The trust was established in 1955 and was terminated in 1998 when the last income beneficiary died. At that time, the principal trust assets consisted of two commercial properties in Seattle. The remaining beneficiaries agreed that the trustee, Union Bank of California, would wind up the trust by selling the two properties. One property was sold and the proceeds distributed. However, while marketing the

second property, the bank learned that a dry cleaner who had operated on the ground floor had impacted the subsoils.

In 1999, a purchaser offered to buy the property for \$1.6 million provided the sale proceeds be used to remediate the property prior to distribution to the beneficiaries. Due to the of the uncertainty of the cleanup costs, some of the beneficiaries refused to approve the sale. When the beneficiaries could not reach agreement, a referee was appointed to sell the property. The referee concluded the proposed offer was not in the best interests of the trust and relisted the property. The referee eventually agreed to sell the property "as is" for \$1.55 million. However, when the Phase II uncovered more extensive contamination, the purchase price was reduced by another \$450,000.

Meanwhile, some of the beneficiaries filed a lawsuit against the bank, alleging *inter alia*, that it mismanaged the property by proposing a sale that exposed the beneficiaries to unlimited environmental liability and for failing to locate copies of general liability insurance policies that had been paid for by the trust and that would have covered the remediation costs. The bank moved for a judgment on the pleadings, arguing that the trust exculpatory clause immunized the bank from liability. The clause provided in part that the trustee would not be liable for losses for "matters beyond its control, nor for errors in judgment, nor in the exercise of its discretion...unless the same shall happen through its own willful default or gross negligence."

The trial court agreed that the exculpatory clause absolved the bank of any liability and granted the bank's motion.

On appeal, the court said the exculpatory clause relieved the bank of liability for discretionary decisions unless the bank actions constituted bad faith, gross negligence, or willful default. The appeals court upheld the trial court's ruling that the bank had not breached its discretionary duty when it proposed the first sale of the property, even though it was inferior to the later sale. However, the appeals court ruled that there was a question of fact whether the bank had been grossly negligent when it failed to maintain adequate insurance records. The court said that while it was impossible to ascertain if the policies would have actually provided coverage for the contamination, there was a reasonable possibility that coverage might be available since the policies were issued prior to the time of the pollution exclusion. Thus, the court reversed that portion of the judgment and remanded back to the trial court the claims that survived the exculpatory clause.

Study Asserts Petroleum-Contaminated Sites Pose Low VI Risk

A study by an EPA work group of a dozen petroleum-contaminated sites in the United States and Canada suggests that the presence of clean fill material can minimize the risk of vapor intrusion. According to an article published in the current issue of L.U.S.T.L.I.N.E summarizing the results of the study, significant bio-attenuation appears to

occur at sites that have at least 5 feet of clean coarse soil or about 2 feet of clean fine-grained overlying soil. The article by Robin Davis of the Utah Department of Environmental Quality suggested that the presence of clean soil will have sufficient oxygen to allow anaerobic microbial population to thrive and degrade the hydrocarbons.

There has been considerable debate about the extent that petroleum sites pose a risk of vapor intrusion. The petroleum industry has argued that petroleum products quickly biodegrade and therefore do not pose a significant risk of vapor intrusion. While EPA's VI draft guidance primarily addresses VOCs, some states include petroleum in their VI guidance because of the presence of benzene, a known human carcinogen. The American Petroleum Institute (API) is currently funding a vapor intrusion study in Colorado. Last year, API issued its own guidance for assessing vapor intrusion at petroleum-contaminated sites.

While the EPA work group study does suggest that sites with clean soil may not pose a significant risk of vapor intrusion because of bio-attenuation, the problem is that these conditions do not exist for thousands of former gas station and other sites with USTs that were closed during the 1980s and even the 1990s. Many of these sites are now donut shops and restaurants benzene levels exceed state thresholds. Often the tanks were removed under the authority of the local fire marshal who allowed piping and even parts of old tanks to be left in the ground as well as

contaminated soil to be backfilled into the excavation. The author of the vapor intrusion study acknowledged in correspondence with the SEJ that such sites with shallow sources and no clean overlying soil will not have significant attenuation.

Indeed, we are aware of a number of former gasoline station sites closed as recently as ten years ago that were rejected for CMBS financing because soil gas vapor exceeded the state indoor inhalation risk. Of course, just because the concentration of vapors exceeds a state screening level does not mean there is a completed VI pathway. For example, if the contaminant is present in the groundwater and the screening level is based derived from the J&E model, the screening level will be about 0.005 to 0.020 mg/L and will fail the VI pathway. In contrast, the data from the VI study indicated that about 1 mg/L benzene in groundwater will not result in a completed VI pathway if there is clean overlying soil.

Commentary: *The limitation of the EPA work group study has important implications for sites that have UST funds. In our last issue, we reported the results of on an informal SEJ survey that found that only two states, which have UST funds that pay for cleanup of petroleum contamination (and thus relieve property owners of liability, take the potential of vapor intrusion into account when prioritizing sites. Instead, they seem to focus only on groundwater contamination. As a result, sites that might pose a risk of vapor intrusion may be given a low ranking and not be addressed for*

years even though they are presenting a risk to occupants.

PA VI Lawsuit Illustrates Difficulty of Assessing VI Pathway

A Pennsylvania state court in Norristown resumed hearing testimony this month in a landmark vapor intrusion case. In *Susan B. Fralick Ball, et al. v. Bayard Pump & Tank, et al.*, the plaintiff homeowners are seeking damages for personal injury and medical monitoring for vapor intrusion from contamination resulting from leaking USTs at a nearby gas station.

To establish that they had been exposed to petroleum vapors, the plaintiffs' retained an environmental consultant who determined that the Johnson-Ettinger (J-E) model vapor intrusion was not suitable because the model was not designed for petroleum contamination and because the homes were constructed on bedrock. Instead, the plaintiff's expert developed a "hybrid" model that used elements of the J-E model and the state vapor intrusion guidance. Since there was no actual indoor air sampling in the homes of most of the plaintiffs, the modeling has become a critical issue

The defendants have asked that the court prevent the plaintiffs from introducing expert testimony on vapor intrusion under the *Frye* test on the basis that the expert's hybrid model has not been generally accepted by the scientific community. The defendants have also retained Dr. Paul Johnson, one of authors of the J-E model, to discredit the expert's hybrid model. The defendants also assert that the hybrid model also failed to comply

with some of the requirements of the state vapor intrusion guidance.

Commentary: EPA and many states have adopted guidance documents that authorize the use of the J-E model to assess the potential for vapor intrusion. As a result, the J-E model is fast becoming a widely-accepted if not the industry standard for assessing vapor intrusion. Of course, guidance documents do not have the force of law and the authors of the J-E model acknowledge that the model has certain limitations. For example, it is generally understood that the J-E model may over-predict impacts from petroleum contamination because the model does not take biodegradation into account. In addition, the model may not be suitable for scenarios involving fractured bedrock.

Until the ASTM vapor intrusion task force develops its vapor intrusion standard, we should expect to see more defendants challenging the vapor intrusion studies developed by experts hired by plaintiffs.

SUPERFUND/BROWNFIELDS

EPA Inspector General Launches EJ Investigation of Ringwood Mine Cleanup

In our last issue, we reported that EPA had decided to re-list the Ringwood Mine Superfund site on the National Priorities List (NPL) more than a decade after the agency had determined that the cleanup had been completed and had formally removed the site from the NPL. Since our report, the site has been added back to NPL and EPA's Office of Inspector General (OIG) has announced that it will conduct a comprehensive review of the cleanup and delisting of the site.

The OIG announcement followed a request letter from New Jersey Senators Frank Lautenberg and Robert Menedez, and Rep. Frank Pallone to launch a criminal investigation into whether Ford Motor Company had submitted fraudulent test and lab reports and falsified custody records to EPA during the initial cleanup. The officials also asked OIG to investigate whether "environmental racism" was a factor in the "failure of the government to properly clean up the site." OIG declined to conduct the criminal investigation but did promise to disclose any evidence of fraud or criminal activity that it uncovers to local law enforcement authorities. OIG also declined a request to appoint a special master to supervise current remedial efforts at the site because it does not have such authority. However, OIG did agree to perform two reviews with

the first investigation focusing on the initial cleanup decisions and whether EPA conducted adequate oversight of the cleanup. The second probe will examine for the first-time whether EPA properly considered environmental justice issues in the remedy selection process. OIG plans to issue its two reports by early 2007. Meanwhile, state officials have also asked the United States Department of Justice (DOJ) to investigate whether Ford submitted false information about the cleanup to regulators.

The Ringwood Mine site is located near land inhabited by the Ramapough Mountain Indians, a state-recognized Native American tribe that also claims African-American ancestry. Tribal members and other community residents filed a class-action suit in New Jersey state court earlier this year alleging property damages and personal injuries from exposure to the hazardous wastes.

Update on White Swan Superfund Site

In our July 2003 issue, we reported that EPA planned to add a NJ bank branch office owned by Fleet Bank to the National Priorities List (NPL). Since our article, the White Swan Laundry and Cleaning, Inc. site (a/k/a Magnolia Avenue Ground Water Contamination) has been added to the NPL (69 FR 56949, Sept. 23, 2004). In addition to impacting the drinking water, this site has been identified as a source of vapor intrusion requiring the

installation of sub-slab depressurization systems at many residences.

This site in Wall Township was acquired by Summit Bank in the 1990s and Fleet Bank (now Bank of America) then took title to the property when it acquired Summit Bank. Shortly after Summit Bank acquired the property and converted the site to a branch location, the Monmouth County Health Department (MCHD) discovered that groundwater samples collected from three private irrigation wells had exhibited concentrations of up to 1,546 parts per billion (ppb) of tetrachloroethylene (PCE) and lower levels of trichloroethylene (TCE). New Jersey Department of Environmental Protection (NJDEP) conducted its own investigation and found a PCE plume 2.5 miles long and one mile wide that had impacted one of the municipal wells used by Wall Township.

NJDEP identified the former dry cleaning establishment as a probable source of the PCE contamination. The bank entered into a Memorandum of Agreement with NJDEP to conduct a site investigation. The investigation revealed a septic system that had an interconnected septic tank and seepage pit. Sampling from the septic tank detected PCE at a 7,200 ug/L, soil samples collected from the seepage pit excavation had at PCE concentrations up to 9,100 ppm and groundwater samples found PCE concentrations up to 84,000 ug/L or ppb. The bank removed the septic system and excavated 820 cubic yards of contaminated soil from its property.

Based on these findings, NJDEP sampled indoor air at residences and a commercial business located near the bank for PCE vapors. The sampling revealed that indoor air in several adjacent buildings had significantly elevated levels of PCE vapors. NJDEP installed fans to ventilate the impacted properties and requested EPA to take over the investigation. EPA collected approximately 300 samples from 220 buildings. Elevated levels of PCE vapors were also detected in the basements 24 residences and 3 commercial establishments. EPA requested the Agency for Toxic Substances and Disease Registry (ATSDR) to assess the risk posed by the documented PCE exposures. ATSDR concluded PCE concentrations of 60 µg/m³ or more above presented a "Public Health Hazard, the second highest classification that ASTDR uses when assessing risks posed by sites with releases of hazardous substances. ATSDR also concluded that homes with concentrations between 6 and 60 µg/m³ represented a slightly increased risk of cancer.

EPA has installed subsurface vapor mitigation systems at nine properties while NJDEP has installed subsurface vapor mitigation systems at 18 residences. Monitoring and maintenance of those systems is underway. After further delineation of the shallow groundwater plume, additional indoor air testing may be performed. While EPA is currently funding additional investigations, the only viable PRP for the White Swan site remains the bank. Thus, it is anticipated that EPA will likely seek reimbursement of its response costs from the bank.

Commentary: *This site is a poster child for illustrating the importance of doing comprehensive historical due diligence even when purchasing properties that appear to have relatively benign current uses. Apparently, neither bank performed the kind of environmental due diligence that they customarily expect from their borrowers. Had the banks examined the historical use of the property, they would have learned that the site had utilized a septic system until 1986 when it was connected to the local sewer system. The historical investigation would also have disclosed that the White Swan Laundry and Cleaner had operated at the site from the 1960s to the early 1990s. The combination of this highly risky past use combined with the existence of septic tanks which can serve as a pathway for soil and groundwater contamination should have put the purchasers on notice to conduct Phase II investigations.*

EPA Identifies More Sites in Several States With Vapor Intrusion

In **New York**, EPA has decided to collect soil gas samples from below the foundations of up to 150 homes in Little Valley, following preliminary sampling of 28 homes that revealed elevated levels of trichloroethylene (TCE) vapors under their foundations. The action is an example of the EPA initiative to review the vapor intrusion (VI) pathway during the five-year review of remedies.

The initial investigation at the Little Valley Superfund site focused on the risk posed by a regional

groundwater plume that extended approximately eight miles. There are approximately 200 residences and small businesses in the immediate vicinity of the site that use private wells as the sole source of drinking water. Between 1989 and 1995, approximately 104 wells in the vicinity of the site were sampled with 42 found to have TCE concentrations that exceeded the maximum contaminant level (MCL) of 5.0 micrograms per liter (ug/l). Based on its preliminary investigation, EPA determined that the contaminant levels at the site did not pose an immediate health risk and proceeded to a focused feasibility study (FFS) to alternative water supply systems. While the FFS was performed, some residents installed treatment units on their wells and others purchased bottled water. Based upon the findings of the FFS, EPA issued a Record of Decision (ROD) in September 1996 that called for the installation of point-of-use air stripper treatment units on all affected and potentially affected private wells. Installation of the air stripper treatment units at 90 residences was completed in August 1997 and granular activated carbon units were subsequently installed. In April 2002, the five-year review concluded that the TCE concentrations in the groundwater were decreasing in all but a few drinking water wells and that there was no unacceptable risk associated with exposure to the contaminated groundwater because of the treatment systems. EPA also issued an Explanation of Significant Differences (ESD) requiring only the use of granular activated carbon

units, because the air strippers were reaching the end of their useful life, maintenance requirements associated with these units would likely increase, and the contaminant levels in the groundwater had decreased.

However, in September 2005 concerns over vapors intrusion prompted EPA to sample indoor air from the foundations of some homes. Air samples were collected from within several of these homes in January 2006. EPA intends to test under the foundation of up to 150 additional homes in July 2006. The sampling will involve drilling a hole through the basement floor to obtain a sample of the soil gas immediately below the home. Depending on the sampling results, EPA may return to take samples of the air inside of the homes. If needed, the Agency could install mitigation systems to vent the gases.

In **Montana**, EPA announced it will investigate if a PCE release from a former dry cleaner poses a risk potential for vapor intrusion in a neighborhood near downtown Billings. The community is concerned that vapors may be impacting as many as 180 homes and 15 to 20 businesses.

The study involves the Central Avenue Cleaners and Big Sky Linen site that was added to the state superfund list in 1992. The regional groundwater plume is believed to encompass 500 acres. The Montana DEQ collected groundwater samples in the 1990s that detected PCE in some irrigation and domestic wells. However, because all residents in the area are connected to the city's drinking water supply, the agency

concluded that further investigation was not necessary. The state agency also conceded in a local newspaper article that it had to focus its limited resources on other high-priority cleanup sites.

After residents raised concerns about the potential for vapor intrusion, the Montana DEQ asked EPA to conduct the VI investigation. EPA plans to install groundwater wells to delineate the extent of the impacted area. The agency will then collect indoor air samples and soil gas samples from buildings located above the PCE plume, the DEQ noted.

Meanwhile, in **North Dakota**, EPA announced that it had completed a \$3 million cleanup at the Camelot Cleaners site in West Fargo, ND. EPA removed more than 5,000 pounds of PCE and its byproducts from the soil and shallow groundwater. The treatment equipment still at the site will be removed and the building will be dismantled.

Commentary: *In our last issue, we reported on an informal survey of state dry cleaner trust fund programs that revealed that only two state program take the VI pathway into account when prioritizing sites for state-funded cleanups. Instead, they typically focus on groundwater contaminant levels and whether the groundwater is used for drinking water purposes. As a result, we cautioned that current owners, purchasers, and lenders should not rely on the determination of these state programs when evaluating the risks posed by these sites but should independently assess the potential*

for vapor intrusion. If a site poses a risk of vapor intrusion to current occupants or adjacent properties, the current or future owner of the contaminated property could find itself subject to lawsuits for property damage or personal injury even where groundwater is not used for drinking water. Some recent VI studies have suggested that vapors below sites with extensive pavement such as shopping centers might not degrade due to the absence of oxygen and could travel considerable distances due to preferential pathways such as utility conduits or convective transport from the buildup of soil vapor pressure under the impermeable area.

ATSDR Study Confirms Increased Cancer Rate at Endicott VI Site

An updated study by the Agency for Toxic Substances and Disease Registry (ATSDR) and the New York State Department of Health (DOH) has found high rates of testicular and kidney cancers, birth defects of the heart and low birth weights in the area of Endicott, NY. The report concluded that the cancer rate was more than would be normally expected and could not rule out TCE exposure as the cause for the cancer cluster.

Since residents in the 300-acre affected area are connected to city water, ATSDR determined the Endicott water supply does not pose a significant health risk. Instead, the increased cancer risk may be due to exposure to TCE vapors in indoor and outdoor air over the last few decades. A preliminary report by the ATSDR in July 2005 determined airborne TCE emissions from the IBM factory 1987 to 1993 posed a

"low risk" of cancer to residents. ATSDR is also considering the feasibility of using computer modeling to determine a building-by-building map of past levels of vapor intrusion in the affected area of Endicott.

EPA Issues PCB Brownfield Guidance

To facilitate redevelopment of property contaminated with PCBs from electrical and hydraulic equipment, EPA issued its "Polychlorinated Biphenyl (PCB) Site Revitalization Guidance Under the Toxic Substances Control Act" (64 FR 16703). The primary focus of the guidance is the PCB remediation-waste provision contained in TSCA regulations at 40 CFR 761.61, which governs the management of waste generated as the result of PCB spills and associated cleanups. The guidance was originally intended to streamline the TSCA process for brownfield redevelopment. Unfortunately, the final version was primarily a regurgitation of the existing TSCA options for cleanup and disposal of PCBs. It does allow property owners to obtain EPA approval of risk-based cleanup or disposal of PCBs in a manner other than those prescribed in the TSCA regulations; however, owners of such property always had the option of seeking such approval from EPA. Nonetheless, it does serve as a useful summary of the relevant PCB regulations that could impact PCB-contaminated property.

Commentary: *PCBs could be present in the hydraulic elevators or lifts of buildings constructed prior to*

the PCB ban. If staining or leaking hydraulic fluid is observed in pits or concrete surfaces below this equipment, it would be advisable to confirm that the hydraulic fluid does not contain PCBs. Often times, maintenance staff will simply soak up the oil and dispose of it in the dumpster. If the oil contains PCBs, this would not only constitute a violation of the PCB disposal rules but could result in CERCLA generator liability. In addition, the integrity of any concrete floor should be evaluated to assess the potential for migration of PCBs into the subsurface. EPA's PCB Spill Cleanup Policy does provide for different levels of cleanup depending on whether the spill has occurred in low or high occupancy areas.

EPA Announces Prospective Purchaser Agreements

EPA agreed to enter a rare prospective purchase agreement (PPA) with Kanani L.L.C. (Kanani) for the Chem-Wood Facility located at the Campbell Industrial Park in Ewa Beach, HI. Kanani plans to purchase the Chem-Wood Facility for storage of supplies and materials, parking of vehicles on paved areas, and other similar uses. In exchange for a covenant not to sue, Kanani agreed to implement a groundwater and soil cleanup, maintain security of the perimeter of the property, and maintain the integrity of the existing asphalt cap.

Although not stylized as a PPA, EPA entered into what is being touted as a model Bona Fide Prospective Purchaser Agreement (BFPP) with a covenant not to sue involving Clinton Gregg Investments LP (CGI) to facilitate the purchase

and redevelopment of 36-acre superfund site in downtown Houston, TX. According to an EPA press release, this agreement marks the first time that the agency has entered into a covenant not to sue for an NPL site with a non-liable third party who does not yet hold title to the contaminated property. The agreement involves the former Texas Electric Steel Casting Co. (TESCC) facility that was used for steel re-melting, molding, and specialty steel manufacturing from 1926 until 1992. After TESCC filed for bankruptcy in 1986, Many Diversified Interests, Inc. (MDI) acquired the property in 1990 and reopened operations as the San Jacinto Foundry. Operations ceased when MDI filed for bankruptcy in 1992 and the site was placed on NPL in 1999.

To facilitate sale of the property in a Section 363 free and clear bankruptcy auction, the MDI bankruptcy trustee negotiated the agreement with EPA. Clinton Gregg submitted the winning bid and agreed to enter into the covenant not to sue with EPA. Under the agreement, the Clinton Gregg Investments LP of Houston will purchase the property for \$7.8 million and implement the EPA-approved remedy. CGI plans to build a mixed use residential and commercial development. The company estimates it will spend approximately \$6.6 million on the cleanup and expects to complete the cleanup in 3-5 years. The agreement also allows EPA to take over work and seek stipulated penalties if the agency determines that the cleanup is not being properly implemented. In

addition to the covenant not to sue, EPA also agreed to release any windfall lien and remove the non-priority CERCLA liens that had been recorded against the property.

Roundup of Significant CERCLA Settlements, By State

In a complex agreement, EPA entered cost recovery settlement for the Mohawk Tannery Superfund Site in Nashua, **New Hampshire**. The settlement resolves the liability of Chester Realty Trust (Chester), the owner of the Site, and Warren W. Kean for EPA's past costs of \$3,452,311.00. The settlement requires Chester Realty Trust to use its "Best Efforts" to sell its real property holdings at "Fair Market Value" and shall attempt to make good faith efforts annually to sell an interest in a real estate limited partnership. The "net sales proceeds" consisting of sums after payment of mortgages, taxes and appraisals are to be placed into an escrow along with any "Net Insurance Proceeds" consisting of proceeds remaining after taxes and legal fees from prosecuting claims against insurance carriers. In addition, Warren W. Kean is obligated to make an annual minimum cash payments of \$25K. However, these annual payments will be increased by any excess distributions he receives from Chester that exceed either \$10K per month or \$120K in any 12-month period during the ten year period following execution of the agreement.

In a cost recovery settlement involving the Intermountain Waste Oil Refinery NPL Site), Intermountain

Oil Company agreed to pay to EPA the "Net Sales Proceeds" from the sale of its only asset, a two-acre parcel of land in Bountiful, **Utah**. In exchange, the Settling Party will resolve its liability for all response costs at the Site in connection with the work performed at the site.

In *United States v. Monarch Greenback, L.L.C.*, et al., No. 02-436-S-EJL (D. Idaho), a federal district court approved a consent decree providing for the payment of \$66,000 as well as potential future payments that could total up to \$200,000. Additionally, one of the Defendants, Monarch Greenback, LLC, agreed to establish and fund an escrow account to pay for operation and maintenance at the **Idaho** site. In exchange, the United States agreed to provide a covenant not to sue and contribution protection under CERCLA to all of the Defendants. The federal government also agreed to provide a covenant not to sue under the Clean Water Act to the Article 5 Trusts, A.H. Burroughs, III, Karen Weaver Eccles and O.H. Davison. This latter release was of particular interest in light of recent case law that has held owners of defunct mines liable for acid mine discharges from those properties.

In *United States v. Sahli Enterprises, Inc. and Michael Sahli*, No. 06-C-1627 (N.D. Ill) the current owner agreed to a consent decree resolving his liability as a current owner because he is the alter-ego of Sahli Enterprises, Inc. This settlement requires a one-time payment of \$222,500 based upon the settling defendant's ability to pay and unique equitable considerations.

Additionally, although the United States does not at this time anticipate any further response activities at the **Illinois** site. Sahli Enterprises also agrees to continue to provide EPA with access to the site. In addition to a covenant not to sue, United States agreed to release its non-priority CERCLA lien.

In another interesting settlement, Unidynamics/Phoenix, Inc. and its parent company, Crane Co. agreed to pay \$6.7 million in past costs and all future oversight costs, and pay \$500,000 in penalties, and continue to implement remedial actions at the Phoenix-Goodyear Airport North Superfund Site (PGA-North) in **Arizona**. As a supplemental environmental project (SEP), the settlement also requires the companies to spend \$1 million to inventory and assess up to 25 possible Brownfields sites in the city of Goodyear, complete four more extensive site assessments, and conduct cleanups at three of those sites. Goodyear is the community most impacted by the site contamination.

Unidynamics/Phoenix, Inc. manufactured defense and aerospace component systems, including pyrotechnics and explosives from 1963 through 1994. PGA-North is part of the larger Phoenix-Goodyear Airport Area Superfund site that was placed on the NPL in 1983 after the Arizona Department of Health Services discovered TCE and other VOCs in local water supply wells. The penalties are a result of the companies' failure to comply with two EPA orders, issued in 1990 and 2003, requiring site cleanup. In the

late 1990s, perchlorate was found in area wells, and was added as a contaminant of concern for the PGA-North Site. The companies continued some cleanup activities required in the orders, but failed to conduct certain portions of the cleanup, forcing the EPA to expend funds and conduct the work in their place. EPA is now working to confirm the full extent of contamination and adapt the cleanup to address it.

EPA entered into an interesting Agreement for Recovery of Past Response Costs with **California** involving the Stringfellow Acid Pits Superfund Site. At this site, EPA had provided federal funds to the State of California from 1983 to 1996 pursuant to a cooperative agreement entered into pursuant to section 104(c)(3) of CERCLA. The cooperative agreement provided that the State would be responsible for 10% of the remedial action costs, or 50-100% of the total response costs if the State was an operator of the site. Because the State was involved in selecting the original location and management techniques for the site as a hazardous waste disposal facility, a federal district court had ruled in 1995 that was an a CERCLA operator. In November 2004, EPA's OIG concluded an audit of the assistance accounts accessed by the State through the State Superfund Contract and recommended that the State was not entitled to reimbursement for substantial claims for interest accrued on its incurred costs. However, OIG did not consider the State's potential liability as an operator of the Site. Under the cost recovery settlement, EPA agreed to

reimburse the State in an amount consistent with the recommendations of the OIG and will not seek additional costs from the State for its potential operator liability. In exchange, the State covenants to accept the settlement as a final determination of the amount of its reimbursement, precluding further claims for recovery of the interest accrued on the State's response costs. A portion of the payments from the EPA to the State will go specifically toward further investigation and response to the recently discovered perchlorate contamination at the Site.

Commentary: *For those of you closely following the post-Aviall litigation, the cooperation agreement that was the focus of this settlement was the kind of agreement that some recent decisions held a state had to enter into with EPA for the state's own agreements with PRPs to constitute administrative settlements under section 113(f)(3) of CERCLA. In the early days of the CERCLA program, some states with large numbers of contaminated sites entered into cooperative agreements with EPA so they could either obtain funding or implement measures that would serve as a credit to their 10% cost-share obligations. However, this model has not been used since the mid-1980s, which is why those post-Aviall opinions were wrongly decided.*

Brownfield Backlash In New Jersey

In prior issues, we have discussed a number of high profile sites in New Jersey where the

adequacy of the cleanups and NJDEP oversight have been called into question. In the wake of what is perceived as failed cleanups at the Ringwood Mine site; dozens of chromium-laced hotspots in Secaucus and Jersey City, waterfront developments in Edgewater; and around the EnCap golf project in Meadowlands, legislators are beginning to re-evaluate the wisdom of the brownfield reforms that were enacted in the 1990s.

In recent hearings for proposed legislation held by the State Assembly's environment and judiciary committees, legislators said that brownfields legislation may have gone too far in stripping NJDEP of its power to require permanent cleanups at sites. According to the testimony, NJDEP only has the authority to accept or reject "pave and wave" cleanup proposals and cannot force property owners to engage in full-fledged remedial alternatives as is done under the CERCLA remedial process.

In response, NJDEP officials testified that they would like the power to order full cleanups at sites where schools, day-care centers or housing will be built, or when such buildings are nearby. NJDEP representatives also indicated that they plan to issue new rules this summer requiring property owners to notify neighbors of cleanup plans, especially when young children might be exposed to contamination. However, they cautioned against taking a one-size-fits-all approach since that would slow down cleanups throughout the state

The Assembly is considering three bills that would alter the state brownfield program. Two of the bills, A1128 and A1894, would impose criminal penalties on property owners and consultants who knowingly or recklessly provide inaccurate information about cleanup efforts at sites listed by the state. The third bill, A1893, would require more public notice of the contamination dangers of Brownfields sites for local officials and neighbors of the former manufacturing facilities.

The legislature is also considering a bill that would remove a 10-year statute of limitations for certain environmental crimes. The legislation was prompted in part by the discovery of contaminated soil in 2000-01 at the company's former Hamilton Zonolite facility that contained as much as 40% asbestos. EPA determined the asbestos-contaminated soil posed an imminent and substantial endangerment to residents and removed more than 9,000 tons of contaminated soil from the plant. The facility manufactured insulation from vermiculite ore that originated from the company's Libby, Montana mine. Earlier this decade, EPA learned that the ore was contaminated with tremolite, one of the most dangerous forms of asbestos. Allegations have been made that the company made deliberate misstatements about the presence of asbestos and the legislation is designed to prevent statutes of limitations on these alleged crimes from expiring.

Connecticut Brownfield Law Goes Into Effect

While New Jersey is re-considering its brownfield program, Connecticut's new brownfield legislation went into effect. The legislation was enacted to jump start a brownfield program that by all accounts had not been particularly effective in stimulating the reuse of contaminated sites. Ironically, one of the sponsors of the legislation used the New Jersey brownfield program as a model for some of the changes to the Connecticut program.

One of the features of the new law is to provide for better coordination among the state Department of Environmental Protection, the Department of Economic and Community Development and the Connecticut Development Authority. The new law creates a lead agency, the Office of Brownfield Remediation and Development within the Department of Economic and Community Development, which will coordinate the efforts of DECD, the Department of Environmental Protection and the Connecticut Development Authority. The new agency is supposed to help identify funding that's available for cleanup and streamline the remediation process, help local governments comply with cleanup requirements, and help resolve remaining liability issues.

Commentary: *The state brownfield program has had some successes such as the Waterbury Brass Mill Center, Hartford Learning Corridor and Adriane's Landing to Windham Mills in Willimantic. Since 1993, the state has invested \$320 million in*

brownfield remediation, which has leveraged \$700 million in private investment and brought 740 acres back into use. However, for less public, run-of-the-mill brownfield projects, the state brownfield program was perceived as not being very useful. As an interesting side note, one of the more successful brownfield sites in Connecticut was Pfizer Global Research and Development center in New London, CT. This project was also the impetus for the eminent domain action that resulted in the United States Supreme Court's controversial Kelo decision.

NY Legislature Amends Brownfield Cleanup Program

In its final day of business for the year, the New York State Legislature plugged a crucial hole in the state brownfield cleanup program (BCP). It approved a bill that will allow developers of multi-family and single-family housing to be eligible for the generous brownfield redevelopment tax credit.

Under the BCP, developers may claim refundable tax credits of up to 22% of the total costs of the buildings and improvements constructed on a brownfield site. However, because the property had to be "qualified tangible property" under the tax law (*i.e.*, depreciable in the hands of the developer), the only type of residential property that was eligible for the brownfield tax credit was rental property. Developers of condominiums and single-family homes could not claim the tax credit since the property would not be placed into service by the developer but by the purchaser. This quirk in the law

meant that the BCP tax credit would not be available to builders of affordable housing.

The measure will become effective as soon as it is signed into law by Governor Pataki. However, it is unclear if the change in the law will apply to residential projects admitted into the BCP after the effective date or if developers of existing BCP residential projects that were ineligible for the tax credit may claim the tax credit once the cleanup is completed.

While the legislature was amending the BCP, the NYSDEC completed a rewrite of its proposed remedial regulations. The agency had proposed a comprehensive overhaul of its Part 375 regulations earlier this year, but because of significant amount of comments, the NYSDEC decided to re-propose the rulemaking. The most significant change in the re-drafted proposed rules is a new subpart 5 "Remediation Stipulation Program" that creates a voluntary cleanup program for sites that are not eligible for the BCP.

Shortly after the BCP went into effect, NYSDEC (in what became to be known as its "Manhattan Rule") narrowed the universe of sites that qualified as a brownfield site. The common perception was that this was an attempt to limit the amount of tax credits that would be generated by expensive Manhattan projects that would have been built even without the BCP tax credits. However, the guidance turned the meaning of brownfield on its head since it had the effect of excluding sites that were not seriously contaminated or where

there was simply a perception of contamination. Under the guidance, sites contaminated with historic fill were excluded from the program even if the developer was forced to manage the fill as a hazardous waste.

Exacerbating the problem was the fact that the agency terminated its voluntary cleanup program (VCP) when it launched the BCP. Thus, owners or developers of sites contaminated with hazardous substances that were excluded from

the BCP because of the NYSDEC's narrow definition of brownfield had no other mechanism of voluntarily remediating a site short of having it identified as a state superfund site. This created a perverse incentive for developers and owners to implement "at-risk" or "self-directed" cleanups without the benefit of NYSDEC oversight. The proposed subpart 5 essentially resurrects a modified version of the old VCP.

CLEAN WATER ACT

Supreme Court Unable To Reach Consensus on Definition of Wetlands

The United States Supreme Court remanded two wetlands decisions back to the United States Court of Appeals for the Sixth Circuit, but was unable to reach agreement on the standard the Appeals Court was to use when it reconsiders the cases. The issue at stake in these cases that were consolidated as *Rapanos v. United States*, 2006 WL 1667087 (June 19, 2006) was whether wetlands draining into ditches or man-made drains that eventually empty into traditional navigable waters were subject to the jurisdiction of the section 404 Clean Water Act wetlands program.

The first consolidated case, *United States v. Rapanos*, 376 F.3d 629 (6th Cir. 2004), involved three parcels of land that the petitioner sought to develop. The state of Michigan advised Rapanos that his land probably contained jurisdictional wetlands because they flowed through ditches or drains into tributaries of navigable waters that were located 11 to 20 miles from the parcels. After a wetland consultant retained by Rapanos concluded that the land contained wetlands, Rapanos reportedly demanded that the consultant destroy his report and began filling in the wetlands without obtaining a wetlands permits. The Army Corps of Engineers (Corps) determined that Rapanos' land contained jurisdictional wetlands because they were adjacent to

tributaries of navigable waters and issued cease and desist orders. Rapanos ignored the stop work orders and eventually destroyed a total 54 acres of wetlands. Following a two-week trial, a district court upheld the finding that one of the parcels contained jurisdictional wetlands, but rejected the Corps' assertion of jurisdiction over the two other parcels. The Sixth Circuit affirmed the ruling finding that there was a sufficient hydrologic connection between the wetlands and the navigable waters.

The second consolidated case, *Carabell v. United States Army Corps of Engineers*, 391 F.3d 704 (6th Cir. 2004), was less dramatic. The petitioner sought a wetlands permit to fill approximately 12 acres of forested wetlands to build a condominium development. A four-foot wide berm separated the wetlands from a ditch that was connected to a drain that continuously conveyed water to a creek that emptied into the St. Clair Lake, located one mile from the Carabell parcel. The Corps denied the permit application because the development would destroy the water storage function of the property and degrade the water quality of the creek and lake. After the Carabells' challenged the assertion of federal jurisdiction over the wetlands, a federal district court granted summary judgment to the Corps on the basis that the wetlands were adjacent to a tributary of a navigable water and the Sixth Circuit affirmed.

In a series of contentious opinions, the justices adopted

different tests for determining when wetlands were subject to the CWA. Relying on the plain text of the statute, a plurality of four justices led by Justice Scalia ruled that use of the term “navigable waters” in the CWA meant that wetlands had to be relatively permanent, standing water and that there had to be continuous surface connection or exchange with navigable waters for wetlands to fall within the scope of the CWA. Justice Anthony Kennedy rejected this narrow reading of the statute and criticized the plurality as being inconsistent with the structure and purpose of the law, especially for disregarding the valuable ecological role played by wetlands such as aiding water quality by filtering contaminants, serving as nesting or spawning grounds, and providing buffering from storm surges (a startling omission, in this editor’s view, in this post-Katrina era). Instead, Kennedy said the key test should be if the wetlands had a significant effect on the chemical, physical, and biological integrity of waters of the United States. He also said that there could be such a “significant nexus” even if there was not a continuous direct connection or exchange of water between the wetlands and a navigable water, such as when a destruction of wetlands would impair water quality of navigable waters by releasing pollutants or contaminated runoff normally held by the wetlands. However, because the lower courts had focused on the adjacency of the wetlands or mere existence of a hydrologic connection without evaluating the importance of the adjacency or hydrologic connection,

he agreed with the decision to remand the cases back to the Sixth Circuit to determine if there was a significant nexus between the wetlands and the tributaries. In doing so, though, Kennedy suggested that there might be sufficient evidence in the record to find the existence of such a significant nexus. The dissenting opinion authored by Justice Stevens and joined by three other justices accused the plurality of engaging in a revisionist reading of the Court’s prior wetlands jurisprudence would have deferred to the interpretation of the Corps and affirmed the judgments of the Sixth Circuit who had jurisdiction over the wetlands in the two cases.

One week after its *Rapanos* ruling, the Court vacated another case involving discharges to non-navigable tributaries that had been decided by the Seventh Circuit, *Gerke Excavating Inc. v. United States*, U.S., No. 05-623, 6/26/06). Since two circuits will have to choose among differing tests advanced by strongly-worded, conflicting opinions, there is a good chance that the Supreme Court will soon have its fourth opportunity this decade to more precisely define what constitutes a jurisdictional wetland under the CWA. It would not be hard to envision a scenario where the *Rapanos* dissenters join with Kennedy to forestall any further weakening of the federal wetlands program.

Commentary: One of the more interesting sideshows of the battling opinions was the economic analysis

of the impacts of the federal wetlands program. The plurality asserted that \$1.7 billion was spend each year applying for wetlands permits with the average applicant supposedly spending 788 days and \$271,596 seeking an individual wetlands permit while spending 313 days and \$28,915 obtaining a nationwide permit. The dissenting opinion, meanwhile, said the mean cost for 80% of wetlands applicants was \$29,000 with a median cost of \$12,000 and that for the remaining 20% of the applicants, the mean cost

was \$272K with the median cost at \$155K. The dissent also pointed out that the permit application costs amounted to less than 1% of the \$760 billion spent each year on private and public construction and development projects.

None of the opinions, though, discussed the fines for non-compliance or costs to restore wetlands that were illegally filled. From the recent settlements discussed in the next article, these costs can be significant.

INDOOR ENVIRONMENTAL ISSUES

Roundup of Recent Mold Insurance Cases

In response to the explosion of mold-related lawsuits earlier this decade, insurers began adding mold exclusions to their homeowner policies. As disputes involving these policies have begun to work their way through the judicial system it appears from a sampling of recent decisions that the courts are for the most part interpreting the exclusions as the insurers had hoped and finding no coverage for mold-related damage.

For example, in *Ortiz v. Allstate Insurance Co.*, 2006 Mich. App. LEXIS 1070 (Mich. Ct. App., April 6, 2006), the plaintiffs' home suffered water damage in April 2000 when the local fire department responded to a fire in the attic. After the fire, plaintiffs filed a claim under their homeowner policy for the fire damage and the insurer approved methods for drying out the house. The plaintiffs' general contractor warned them that the approach authorized by the insurer would not adequately dry the house and that it would be necessary to use additional dehumidifiers and fans to properly dry the house. As it turned out, insulation and building materials were in fact not adequately dried and mold began to grow on these materials after the reconstruction was completed.

In April 2002, plaintiffs filed a complaint alleging that the defendant was responsible for the mold

damage and for personal injuries resulting from exposure to the mold. The defendants filed a motion for summary judgment, arguing that the policy excluded coverage for mold. Plaintiffs responded that the exclusion did not apply because the mold was a result of a covered loss, namely water damage. The trial court dismissed the plaintiffs' claim for violations of the state Uniform Trade Practices Act, but denied the defendant's motion for the breach of contract claim because there was a genuine issue of material fact if the mold was caused by the fire suppression effort.

On appeal, the defendants argued that the trial court erred when it found that the homeowners policy was ambiguous for mold coverage caused by a covered water loss. The appeals court found that exclusion 15(d) clearly and unambiguously excluded mold from being a covered loss. Plaintiffs countered that they were entitled to payment under the "Building Structure Reimbursement" clause. This clause provided that the policy would pay for reasonable and necessary expenses for "treatment or removal and disposal of contaminants, toxins or pollutants" required to complete repair or replacement of the part of the building structure damaged by a covered loss. However, the appeals court held that this clause only applied to a covered loss and the mold exclusion precluded recovery regardless of the clause.

In *Nelson v. Hartford Underwriters Insurance Company*, 2006 N.C. App. LEXIS 1185 (Ct. App. June 6, 2006), the plaintiffs had purchased a new home in September 1996 and almost immediately began noticing unusual odors. In 1999, the defendant issued a homeowners policy that had a mold exclusion as well as an exclusion for faulty workmanship. Plaintiffs filed a mold claim in 2001 and the defendant's inspector issued a report indicating that the mold on carpeting, curtains and floors was a result of an oversized HVAC that caused the house to cool down very quickly before the system could extract sufficient moisture from the air. The defendant then denied the claim under the mold and faulty workmanship exclusions.

After plaintiffs replaced the HVAC system, the mold did not diminish and they filed a second claim in March 2002. The plaintiffs alerted the inspector to additional water leaks that they had failed to mention during the first inspection. Since several types of mold had been identified in the house, the insurer suggested that the plaintiffs move out of the house. The insurer conducted a more thorough investigation and concluded that the mold was attributable to two additional causes. First, a nail penetrating the shower boot in the master bedroom that allowed water to seep into the sub-flooring, the wall between the rooms and under the carpet. The other cause was associated with a repair of a leak the Jacuzzi in 1997 in which the plumber contractor failed to remove or treat water damaged materials between

the Jacuzzi and the two bedrooms.

Plaintiffs filed their action against the insurer and contractors before the insurer had an opportunity to complete its review of the second claim. The trial court granted Hartford's motion for summary judgment. After settling with the other defendants, plaintiffs appealed. The appeals court noted that the state supreme court had expressly rejected a manifestation of harm trigger point for insurance coverage. Therefore, the appeals court said it had to determine when the injury occurred and not when the mold growth occurred. Since the defects causing the on-going mold infestation occurred prior to the Hartford policy, the trial court had properly granted the defendant's motion for summary judgment on the breach of contract claim.

The court also rejected the plaintiff's claim that Hartford had violated the state's unfair claims settlement practices act, finding that Hartford's actions did not cause any new injury, were not a proximate cause of the pre-existing injury and did not prevent plaintiffs from taking steps to eliminate the mold.

Finally, *Nova Casualty Company v. Waserstein*, 424 F. Supp.2d. 1325 (S.D. Fla. 2006) involved a renovation of an office building where employees of a bank charged that they had been injured when the building owners had negligently exposed them to microbial organisms and indoor allergens during the renovation. Prior to purchasing the building in 2000, the building owners had approached Combined Underwriters of Miami, and asked about the availability of

an insurance policy that would provide "full coverage." The insurance firm assured the defendant that it would provide a policy that would cover everything they would need and procured a GCL policy from Nova. Just prior to the renovation, the defendant contacted the insurance brokerage again, advising them of the planned renovation and sought assurance that that they had full and complete coverage.

As it turned out, the policy contained a pollution exclusion. After the owners filed a claim under the policy, Nova sought a declaratory judgment that it had no duty to defend or indemnify under its policy. The federal district court ruled that

the microbial organisms and indoor allergens alleged to have caused the injuries in the complaint were contaminants that fell within the pollution exclusion. Therefore, Nova did not have a duty to defend or indemnify the defendant. However, the court found that the defendant had introduced sufficient evidence to show that it had relied on the representations of the insurance agent that it had sufficient coverage and allowed the renovation to begin to its detriment. Thus, the court held that Nova was not entitled to summary judgment on the defendant's equitable estoppel defense. Under state law, this defense can be asserted to prevent the forfeiture of insurance coverage.

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