

# SCHNAPF ENVIRONMENTAL JOURNAL

A Newsletter Covering Recent Environmental Developments and Caselaw

December 2007

Vol. 10, Issue 6 of 6

## Contents

<b>BROWNFIELD DEVELOPMENTS .....</b>	<b>2</b>
<i><b>NYDEC ORDERED TO ACCEPT CONTAMINATED SITE INTO BCP.....</b></i>	<b>2</b>
<b>ENVIRONMENTAL DUE DILIGENCE/MALPRACTICE CLAIMS .....</b>	<b>3</b>
<i><b>NY APPEALS COURT UPHOLDS MALPRACTICE CLAIM AGAINST LAWYER FOR NEGLIGENT ADVICE DURING DUE DILIGENCE.....</b></i>	<b>3</b>
<i><b>CLAIM AGAINST CONSULTANT NOT DISCHARGED BY BANKRUPTCY ORDER .....</b></i>	<b>6</b>
<i><b>DEVELOPER'S MALPRACTICE ACTION AGAINST CONSULTANT PROCEEDS TO TRIAL</b></i>	<b>7</b>
<b>HAZARDOUS SUBSTANCES .....</b>	<b>9</b>
<i><b>USEPA EXTENDS PROPOSED LEAD BASED PAINT RENOVATION RULE TO CHILD- OCCUPIED FACILITIES .....</b></i>	<b>9</b>
<i><b>CONSUMER PRODUCT SAFETY COMMISSION FINDS LEAD-SWAB KITS INACCURATE</b></i>	<b>11</b>
<i><b>TENNESSEE PROPOSES MAJOR CHANGE TO REPORTING OBLIGATIONS.....</b></i>	<b>12</b>
<i><b>TOY RECALLS RAISE REPUTATIONAL AND LEGAL RISKS .....</b></i>	<b>13</b>
<b>BUSINESS AND REAL ESTATE TRANSACTIONS.....</b>	<b>18</b>
<i><b>ASSET-BASED FINANCING AND MEZZANINE LENDING PLAYING LARGER ROLE IN REAL ESTATE TRANSACTIONS.....</b></i>	<b>18</b>
<b>INVOICE FOR 2008 SUBSCRIPTION.....</b>	<b>20</b>

**Publisher.....**RTM Communications, Inc., Dean Jeffery Telego, President  
510 King Street, Suite 410, Alexandria, VA 22314 USA 703-549-0977 or 800-966-7445  
**Editor.....**Tacy Cook Telego, APR, VP RTMC.  
**Author.....**Lawrence Schnapf, Esq.

For subscription information or to subscribe, visit our Web site at RTMCOMM.com or telephone 703-549-0977.  
Published bimonthly. All rights reserved. Unauthorized reproduction of this journal in any form, including e-mail, photocopy, fax and image scan, is prohibited. Copyright © 2007 RTM Communications, Inc.

*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.*

## BROWNFIELD DEVELOPMENTS

### ***NYDEC Ordered to Accept Contaminated Site into BCP***

In the first reported decision of its kind, a New York State Supreme Court ordered the New York State Department of Environmental Conservation (NYSDEC) to accept a contaminated site into the state Brownfield Cleanup Program (BCP). Lighthouse Pointe Property Associates LLC had submitted a BCP application to develop a \$200 million project on a former municipal landfill consisting of upscale condos, townhouses, restaurants and a promenade along the Genesee River. The applicants had estimated the costs to address contaminants in the landfill would range between \$4 million and \$8 million. In June, the NYSDEC rejected the application because the contaminants were associated with solid waste that was brought to the site rather than from former on-site activities and also because the agency determined the contamination at the site was minimal and would not complicate redevelopment. In overturning NYSDEC's determination, the court said it "could find no rational basis to conclude that the levels of contamination at this site were 'minimal.' "

Because of the enormous tax benefits available to parties admitted to BCP, the program has the most strenuous eligibility criteria in the country. The ruling is unusual not only because courts usually defer to technical determinations of a regulatory agency but also because the court granted the most extreme relief sought by the petitioner-admission into the BCP. Usually, a court will remand the matter back to a state agency for a determination based on the principals or guidance laid out by the court.

*A more detailed analysis of the decision will appear in a later SEJ issue.*

## ENVIRONMENTAL DUE DILIGENCE/MALPRACTICE CLAIMS

### ***NY Appeals Court Upholds Malpractice Claim Against Lawyer for Negligent Advice During Due Diligence***

In *Barnett v. Schwartz*, 2007 NY Slip Op 09712 (App. Div.-2d Dept. 12/11/07), an intermediate appeals court upheld a \$44K jury verdict finding a lawyer committed malpractice for providing negligent advice during due diligence.

The plaintiffs in this case owned a highly successful take-out barbecue restaurant in Brooklyn, NY and were interested in forming a new business to manufacture their celebrated barbecue sauce. In 1992, the plaintiffs found a commercial property near their home in Nassau County. The seller informed them that the property had been previously used by an auto towing company. The plaintiffs' then retained the defendant in November 1992 to negotiate the purchase agreement. During the negotiations, the defendant learned from seller's attorney that the property had been formerly occupied by a rag cleaning business that had collected used rags from the printing industry that had been soaked with inks, solvents and oil. The defendant then sent a letter to the county health department and EPA seeking information about the site. The letter identified the former use and indicated that the building department had advised the purchasers that there might be a problem with an on-site well.

The agencies never responded to the defendant's letter and he did not perform any further investigation. In addition, he apparently never recommended that Plaintiffs obtain an environmental assessment.

In December 2002, the plaintiffs entered into a two-year lease with an option to purchase for \$240K less credits for rent paid. The lease also provided that they had "inspected the premises in their present state. . . . were "familiar with the condition of same, and will accept the same "AS IS."

After taking possession of the property, the plaintiffs made significant investments to the property and purchased equipment for the business. However, in February 2004, the plaintiffs learned from representatives from the state Department of Environmental Conservation (NYSDEC) that the property had been placed on the state superfund registry back in 1990 and had to be remediated. Apparently, solvents were released into a septic system that serviced the property and dry wells.

The plaintiffs contacted the defendant to explore their options. According to the plaintiffs, the defendant told them that they had no recourse against the property owner because of the "as is" clause, litigation would be too costly and that the seller had no funds to pay for any damages. However, because he believed the cleanup would be completed in six months, he advised them to continue to pay rent and to exercise the purchase option.

The defendant negotiated a six-month lease extension but when it became apparent that the remediation would not be completed by the end of the lease, the suspended rent payments. In January 1996, the plaintiff agreed to extend the option in exchange for seller to remediate the property pursuant to a consent decree with NYSDEC. The parties also agreed that the plaintiffs would not pay further rent until the remediation was completed and that all rent payments would be applied towards the purchase price. In September 2000, NYSDEC determined the remediation was completed and the property was removed from the state superfund registry in November 2000. The seller then advised the plaintiffs that it was prepared to proceed with the closing. However, the plaintiffs learned that the NYSDEC would require periodic inspections and indoor air sampling.

Meanwhile, in December 2000, the NYSDEC faxed a letter dated October 31, 1990 issued by NYSDEC to the seller that had not been previously disclosed to the plaintiffs. The NYSDEC letter advised the seller that the property was contaminated and requesting that the seller retain an environmental engineer to submit a remediation plan to the DEC. The plaintiffs asked defendant if the previously undisclosed letter provided grounds for a fraud action against the seller. However, the defendant reminded plaintiffs that a fraud action was not available because of the "as is" clause. Instead, the defendant recommended that plaintiffs negotiate a final purchase price and schedule a closing or else they would risk the credits for the rental payments. Instead, plaintiffs declined to exercise their option. One year later, the property sold for \$280K.

The plaintiffs filed a legal malpractice action seeking \$1 million in damages for lost rental payments and legal fees. During a trial, the defendant testified that he had discussed the letters with the plaintiffs and the possibility of retaining an environmental consultant. He also testified that he had discussed the impact of the "as is" clause and also that he had tried to negotiate an indemnity but the owner of the property refused. The plaintiffs denied having a discussion about the environmental issues with the defendant. The plaintiffs' legal expert testified that the defendant's failure to follow-up on his own inquiries was not in accord with good and accepted legal practice. The plaintiffs' daughter also testified that she attended a meeting between the defendant and her parents in 1996 where the defendant admitted that he had not undertaken adequate environmental inquiries and that he had made "a mistake."

In response, the defendants produced testimony from an expert in environmental geology who said that before 1993 there were no specific standards in place to conduct environmental investigations of property, and the ability to do so was hindered by the lack of computer databases to search for records. A legal expert for the defendant testified that the defendant did not breach a duty of care to the plaintiffs by allowing them to enter into the "as is" agreement for the property without performing a Phase I environmental site assessment (ESA) because the agreement was primarily a lease and environmental assessments were not performed for lease transactions in 1992.

Following two weeks of testimony, a jury concluded that the defendant committed malpractice by

failing to advise the plaintiffs about the environmental conditions and the effect of the "as is" clause. The jury returned a verdict in favor of the plaintiffs, and assessed actual damages in the amount of \$44,000.

On appeal, the defendant asserted that he was not negligent in failing to recommend that the plaintiffs perform a Phase I ESA because there were no definitive standards for environmental assessments in 1992. Moreover, he also argued that there was no connection between any damages suffered by the plaintiffs and the alleged negligence because the plaintiffs had failed to proceed with the purchase for independent business reasons after the cleanup had been completed.

The court found that a fair interpretation of the evidence supported the jury's conclusion that the defendant failed to exercise the care, skill, and diligence commonly possessed and exercised by a member of the legal profession in advising the plaintiffs concerning the agreement. The court said that the plaintiffs did not receive the benefit which they sought from the agreement, namely a lease/purchase of property suitable for immediate use as a plant to manufacture barbecue sauce. Instead, the court explained, the plaintiffs obtained an option to purchase a remediated hazardous waste disposal site some eight years after the agreement was signed, and five years after the date provided for a sale in the agreement, during which time the property remained completely unsuitable for its intended use. The court also found that the defendant did not simply fail to engage in due diligence concerning the environmental condition of the property. Rather, the court said the defendant was clearly aware of actual environmental

issues with the property, failed to follow up on its own inquiries or inform the plaintiffs of the issues and the consequence of signing an "as is" agreement for a contaminated property. The court found that the conflicting testimony on whether there were definitive standards for environmental assessments in 1992 merely raised issues of credibility for the jurors, whose determinations are entitled to great deference.

Throughout the trial and in the appeal, the defendant focused on the fact that plaintiffs would have entered into the agreement regardless of the environmental condition of the property. As a result, the defendant argued that any alleged negligence was not the reason the plaintiffs suffered damage. However, the court held that plaintiffs continued interest in the property did not negate the defendant's negligence. The court noted that the plaintiffs were trying to salvage what they could from an agreement in which they had already invested much time and money in the property. Moreover, the court observed, they continued to pursue the property after they were advised by the defendant that they lacked any legal recourse against the landlord/owner and that cleanup would probably take only six months. The court also ruled that the plaintiffs were entitled to prejudgment interest from the earliest ascertainable date, which in this case was December 21, 1992, the date the agreement was executed.

*Commentary: It strains credulity for a lawyer to argue that environmental due diligence was not commonly performed in the early 1990s since the transaction occurred six years after the innocent*

*purchaser defense was added to CERCLA and many banks were routinely requiring Phase I ESA reports for loans on commercial and industrial properties. In fact, the environmental insurance Industry were performing the equivalent to Phase I ESA when they had risk assessment surveys performed for underwriting RCRA financial assurance requirements back in the early and mid 1980's. Yet to this day, there are many real estate lawyers and smaller law firms without in-house environmental expertise who are not routinely performing environmental due diligence in their transactions. When they do recognize that a Phase I should be performed, they are usually under the impression that all Phase I ESA reports are the same and do not appreciate that the limited nature of an ASTM Phase I ESA. Since the scope of a Phase I ESA will depend on the risk tolerance of the client, it is important for the consultant to understand the transaction and determine the risk threshold of the client.*

### **Claim Against Consultant Not Discharged by Bankruptcy Order**

A federal district court allowed a developer to proceed with a claim for negligent misrepresentation and negligence against a consultant for failing to discover the presence of thorium contamination in an area of Chicago known to have thorium-contaminated fill materials.

In *Grand Pier Center LLC v. ATC Group Services, Inc.*, 2007 U.S. Dist. LEXIS 75672 (N.D. Ill 10/9/07), the plaintiff retained ATC Group Services in September 1997 to

perform a Phase II investigation at a parcel it was considering developing. Based on the July 8, 1999 report, the plaintiff proceeded with the purchase of the property. Two weeks later, ATC Group Services along with other related entities filed a chapter 11 bankruptcy petition. In February 2000, the plaintiff discovered the property was contaminated with thorium. ATC's bankruptcy plan was then confirmed and became effective on April 27, 2000. The approved plan discharged all claims against the ATC entities and contained an injunction prohibiting any claims from being asserted against the reorganized debtors arising from acts or omissions that occurred prior to the confirmation date. Because the plaintiff never received notice of the bankruptcy proceeding, it did not file a claim during the pendency of the bankruptcy proceeding. ATC moved for summary judgment, arguing that the plaintiff's claim was barred by the bankruptcy injunction.

Under the Bankruptcy Code, a debtor is required to provide notice to creditors that are ascertainable through reasonable diligence. The type of notice depends on whether the creditor is known or unknown. Notice by publication in a newspaper is sufficient for unknown creditors while for known creditors a debtor must use a notice that is reasonably calculated to provide actual notice. The court found that the record was unclear if ATC knew about the contamination at the site or of the plaintiff's claim. However, the court noted that the plaintiff had introduced evidence that the discovery of thorium was well-publicized in Chicago. As a result, the court said a fact finder could conclude that ATC should have anticipated the possibility that the

plaintiff might have a claim since it had been hired to investigate a site where the well-publicized thorium contamination was located. Even if the plaintiff was an unknown creditor, the court ruled that the publication was defective because it was captioned in the name of ATC Associates, Inc. and did not identify ATC Group Services.

*Commentary: While the case hinged on the bankruptcy notice, the case does illustrate the importance of consultants familiarizing themselves with local environmental issues and regulatory initiatives.*

### **Developer's Malpractice Action Against Consultant Proceeds to Trial**

After nine years of motion practice and discovery, the parties in *The Ryland Group v. The Payne Firm, 1:04cv381* have advised the district court for the southern district of Ohio to schedule a date for trial.

In this case, the plaintiff entered into an agreement with a local real estate investor in 1999 to prepare a former skeet shooting range for subdivision. In December 1999, the plaintiff retained Alt & Witzig to perform a Phase I ESA. The report recommended a Phase II ESA because there was a possibility that soils might be contaminated from lead shot. The plaintiff instructed the developer to perform the Phase II ESA and advised him that the plaintiff needed to be assured that the appropriate steps were implemented before it would purchase the site. In December 2000, the developer retained Alt & Witzig to perform the Phase II ESA, which identified widespread lead

contamination as high as 4600 ppm. Two samples detected lead contamination at as high as 36,000 and 51,000 ppm at a depth of 15 inches. The Phase II ESA recommended that a comprehensive remediation was necessary and that the lead-contaminated soil should be excavated and disposed off-site at a cost in excess of \$1 million. Instead, the developer retained the defendant who estimated the cleanup could be completed for \$50,000 by mixing the contaminated soil and placing it under a cap. The defendant also advised the developer that the deep samples were invalid and concluded the soil contamination was limited to the upper six inches of soil.

The developer then retained a contractor to use roto-tilling to mix the impacted soils with uncontaminated soils in order to implement the remedy recommended by the defendant. The areas requiring remediation were flagged by the defendant and also directed the contractor to chemically treat the mixed soils to minimize leaching of lead. In some areas, contaminated soils were spread over areas of the site that were not impacted and in other areas contaminated soil was buried and covered with two feet of fill material. In September 2000, the defendant sent a letter to the developer that all soils at the site were below EPA's 400 ppm cleanup standard and that indicated that the site was suitable for residential development. The letter indicated that the plaintiff could rely on the letter pursuant to the terms and conditions of the agreement between the defendant and the local developer.

The plaintiff then purchased the property and constructed 46 single-family homes. In November 2002, one of the purchasers retained a consultant to

collect soil samples after learning that the site has been used as a shooting range. After the homeowner discovered that lead was present at 10,000 ppm at a depth of six inches, the plaintiff agreed to release the homeowner from its contract.

The plaintiff then retained the consultant that had been hired by the purchaser to investigate the site. In 2003, the Ohio EPA requested USEPA to perform an emergency removal and placed the site on the national priorities list (NPL). The USEPA notified both the plaintiff and the defendant that they were liable under CERCLA and the plaintiff agreed to enter into an administrative order on consent (AOC) to complete the remediation. In the meantime, homeowners and purchasers filed lawsuits against the plaintiff who ultimately agreed to buy back all of the homes.

The plaintiff incurred over \$7 million in damages and brought an action against The Payne Firm and the developer seeking contribution under CERCLA as well as damages for a variety of common law claims including fraud, negligent misrepresentation, negligence and indemnity.



## HAZARDOUS SUBSTANCES

### ***USEPA Extends Proposed Lead Based Paint Renovation Rule to Child-Occupied Facilities***

In January 2006, EPA proposed its Lead-Based Paint (LBP) Renovation, Repair, and Painting regulations (71 FR 1588 1/10/06) establishing workpractices for minimizing exposure to lead when disturbing painted surfaces and creating certification programs for various categories of workers. Earlier this year, EPA published a supplemental proposal to extend the requirements to renovations of child-occupied facilities beyond residential housing to include public or commercial buildings constructed prior to 1978 (72 FR 31022, 6/5/07).

The proposal defines a “child-occupied facility” as a building or a portion of a building constructed prior to 1978 that is visited regularly by a child under 6 years of age on at least two different days within any week (Sunday through Saturday period). The visits must last at least 3 hours, result in combined weekly visits of at least 6 hours, and the combined annual visits must total at least 60 hours. Examples of child-occupied facilities that will be subject to the rule include day-care centers, preschools, and kindergarten classrooms, libraries and recreational facilities.

Under the two proposed rules, renovations would be performed by certified firms that would have to use certified renovators to perform or direct uncertified workers who perform regulated renovation activities. Prior to

commencing work, renovation firms working in child-occupied facilities in public or commercial buildings will be required to distribute lead hazard information to owners and occupants and obtain acknowledgments, like those required under the Pre-Renovation Education Rule for target housing. Unlike the Pre-Renovation Rule, EPA is not proposing to exempt projects in public or commercial buildings where the renovation firm has obtained a signed statement by the owner of the building indicating that no child-occupied facility is present in the building. Instead, the firm would be required to determine if a particular renovation in a public or commercial building involves a child-occupied facility.

The certified renovator would also be responsible for training uncertified workers on lead-safe work practices, be present at the work site during key stages of a renovation as well as other times either on-site or by telephone, and be able to use an acceptable test kit to determine whether LBP is present on components to be affected by a renovation.

Certified firms will have to post signs clearly defining the work area and warning occupants and other persons not involved in renovation activities to remain outside of the work area. Before beginning the renovation, a certified firm would have to isolate the work area so that no visible dust or debris leaves the work area while the renovation is being performed. Waste from the renovation activities would have to be contained to prevent releases of dust and debris.

While the certified firm would have to clean the work area after the renovation is completed, the proposed rule will not require dust clearance sampling. However, EPA is proposing to require a cleaning verification process involving disposable cleaning cloths. Dust clearance sampling could be performed in lieu of this cleaning verification process but would have to be done by a certified inspector, risk assessor, or dust sampling technician. The certified dust sampling technician would be responsible for collecting dust samples at renovation sites, sending the collected samples to an accredited laboratory and evaluating the sample results for compliance with established clearance levels.

EPA is proposed to implement the rule in two phases. The first phase would cover target housing where a child under age 6 with an increased blood lead level resides, rental target housing built before 1960, owner-occupied target housing built before 1960 where a child under age 6 resides, child-occupied facilities used by a child under age 6 with an increased blood lead level, and child-occupied facilities built before 1960. The second phase would extend to rental target housing built between 1960 and 1978, owner-occupied target housing built between 1960 and 1978 where a child under age 6 resides, and child-occupied facilities built between 1960 and 1978.

The rule will also apply to common areas in multi-family rental target housing. The proposed rule defines common areas as the portion of a building that is generally accessible to all occupants such as hallways, stairways, laundry and recreational rooms, playgrounds, community centers, garages, and boundary fences. To

exempt a renovation in a common area in owner-occupied multi-family target housing, EPA is proposing to require the renovation firm to obtain the signature of every owner with access to the common area, stating that, in addition to the units being owner-occupied with no children under age 6 in residence, no child care for children under age 6 is provided in the units.

EPA is not proposing to cover all common areas in public or commercial buildings that contain child-occupied facilities. The agency is concerned about common areas that are actually used by children under age 6 such as classrooms, bathrooms, and cafeterias as opposed to common areas that the children merely pass through. EPA suggested that such pass through common areas might be hallways, stairways, and garages.

In addition, for public or commercial buildings that contain child-occupied facilities, EPA said that the child-occupied facility encompasses only the exterior sides of the building that are immediately adjacent to the child-occupied facility or the common areas routinely used by children under age 6. As a result, EPA is not proposing to cover all exterior renovation projects on public or commercial buildings that contain child-occupied facilities but only those exterior renovation projects that are performed on the same side or sides of the building as the child-occupied facility or common area.

Renovations performed by renovation contractors and their employees in child-occupied facilities would be covered, as would be renovations by building owners in child-occupied facilities, if the building owner receives rent for the child-occupied facility's space. Renovations in child-occupied facilities that are performed by

employees of the building owner or of the child-occupied facility would be covered if the employees receive wages or other compensation for the work performed. Also included within the definition of renovation will be work performed at a public or commercial building for the purpose of converting the building or a portion of the building into target housing or a child-occupied facility.

The proposed rule will continue to not apply to minor repair and maintenance activities that disrupt two square feet or less of painted surface per component; and renovations where specified methods have been used to determine that the areas affected by the renovation are free of lead-based paint.

*Commentary: One of the most vexing issues that the legal subcommittee of the ASTM Vapor Intrusion had to grapple with was when state or federal risk-based standards or OSHA Permissible Exposure Limits (PEL) should be used for determining if and/or when mitigation was required. It will be interesting to see if EPA's proposal to extend its LBP regulatory authority from purely residential buildings to commercial and public buildings is adopted. If so, this could begin the path towards applying the state and federal risk-based vapor intrusion standards to public and commercial buildings at least when children are present. It is not inconceivable that the concept of "child-occupied facilities" may be extended to such uses that are frequently visited by children such as department stores and malls, museums, airports, offices, restaurants and hospitals.*

## **Consumer Product Safety Commission Finds Lead-Swab Kits Inaccurate**

When LBP is addressed in Phase I environmental site assessments (ESA), the consultant is usually asked to assess the presence of LBP by applying specially-treated swabs to painted surfaces. However, a recent study by the U.S. Consumer Product Safety Commission (CPSC) has called into question the reliability and usefulness of these tests.

In October, the CPSC recommended that site assessors should not use the kits to evaluate the presence of potential lead hazards because the swab kits did not reliably detect the presence of lead. The announcement followed a study by the CPSC staff where more than half of the tests results in false negatives and several false positives. Moreover, none of the kits consistently detected lead in products if the lead was covered with a non-lead-based coating. In comparison, the CPSC found that X-ray fluorescence (XRF) correctly identified the presence of lead in 12 of 13 samples.

The CPSC study involved two common types of home lead test kits that use chemical reactions involving rhodizonate ion or sulfide ion. CPSC staff found that test results from both types of kits may be affected by substances such as iron, tin or dirt, or by paint colors that can cause the color in the test kit to change or hide the color change, thereby interfering with interpretation of the test results.

*Commentary: Lenders have accepted the use of swab tests test is relatively inexpensive and there is a common*

*perception that the greatest risk of exposure to LBP is from exposed painted surfaces. It will be interesting to see if the CPSC will cause lenders to tighten their requirements for LBP testing.*

*In any event, the swab tests may not be used to certify that a building is "lead-free" under EPA LBP disclosure rules. Thus, even if swab samples do not detect lead in painted surfaces, building owners will still have to comply with the LBP disclosure rule if the building falls within the definition of "target housing" and a lender should still require the borrower to implement a LBP O&M plan to ensure that painted surfaces are properly maintained and to ensure compliance with the EPA Pre-Renovation Education rule.*

### **Tennessee Proposes Major Change to Reporting Obligations**

As part of an overhaul of its groundwater classification rules, the Tennessee Department of Environment and Conservation (TDEC) is proposing a major departure from the conventional approach to reporting releases of hazardous substances. Under the proposed rulemaking, TDEC Division of Water Pollution Control (the Division) would require owners and prospective purchasers of industrial or commercial property to report sampling of groundwater or perched water to the TDEC if a reasonable person would conclude that the contamination poses a substantial risk to health or safety. The mandatory reporting would encompass situations where contaminant concentrations exceed general use criteria for potable water, could result in vapors being released at levels that could cause an explosion hazard or exceed a

current inhalation hazard with a hazard quotient of greater than 1 or a cancer risk of greater than  $1 \times 10^{-6}$ .

**Commentary:** *The proposal rule raises a host of interesting questions. The most obvious issue is that the contamination must be reported if a **reasonable person** would conclude that it poses a substantial risk to health or safety; but who knows what a **reasonable person** would conclude? Since the examples refer to hazard quotients and cancer risk levels, it is unclear if a purchaser would have to perform a risk assessment for all groundwater sampling results collected from commercial or industrial purposes? It is also unclear if the mandatory reporting obligations apply to ecological risks or just substantial risks to human health.*

*The rule is limited to property used for commercial or industrial purposes. It is unclear if this determination would be based on zoning or actual use. For example, would a purchaser of land planning to re-zone agricultural land to support a commercial project be subject to the mandatory reporting? Likewise, how will the mandatory reporting apply to a mixed use development? Would the developer only have to report contamination on the commercial part of the property? Will concerns over cleanup liability and decreased property values cause parties to avoid performing Phase II ESA reports to avoid triggering the mandatory reporting obligations?*

*Under the proposed groundwater classification rules, the TDEC commissioner would be authorized to establish an Area of Control that would allow groundwater criteria to be achieved over a period of time or establish an alternative cleanup*

standard than is less stringent than drinking water standards. Other significant revisions include increasing the total dissolved solids concentration for Unusable Ground Water from 3,000 ppm to 10,000 ppm, and removing the current Limited Use Groundwater classification.

EPA and most states have adopted reporting standards known as Reportable Quantity (RQ) that are based on quantity of hazardous substance over a 24 hour period. These reporting obligations were established in the early days of state and federal hazardous waste and remediation programs when management practices for hazardous chemicals were just being implemented and spills of hazardous substances were commonplace.

However, 32 years after the Resource Conservation and Recovery Act was enacted and nearly three decades after the passage of CERCLA, the principal problem facing the country is historical contamination from past practices. Because reporting obligations are often expressed using active gerunds (e.g., spilling, discharging, etc) and it is often not possible to determine if historical contamination occurred in a 24-hour period or was the result of minor repeated spillage over a long period of time. Most environmental lawyers and consultants take the view that the discovery of purely historical contamination is not a reportable event. A consequence of this interpretation is that historical contamination is not reported to regulatory authorities, thus allowing developers and property owners to ignore contamination or implement self-directed cleanups. Transacting parties can devote a significant amount of time negotiating how the discovery of contamination is to

be handled. Indeed, many contracts have "no hunt" provisions that prevent purchasers from further characterizing suspected contamination at risk of forfeiting their contractual indemnifications or liability allocations.

The absence of mandatory reporting obligations for purely historical contamination is probably why there are still thousands of contaminated sites nearly three decades after CERCLA was enacted and is probably a significant factor in the creation of brownfields. If the owners of those impacted parcels were required to disclose the contamination to regulatory authorities prior to abandoning the sites, the contamination would likely have been addressed either by the responsible party or the regulator.

In the author's view, EPA and states should consider the approach Tennessee is considering and alter their reporting obligations to the discovery of contamination above applicable cleanup standards. This would not only accelerate the remediation of contaminated sites but also help encourage greater transparency and promote sustainable reuse of those properties.

### **Toy Recalls Raise Reputational and Legal Risks**

In the wake of massive recalls of toys and other foreign manufactured products containing lead, many companies are scrambling to develop product safety mechanisms and third party verification procedures to ward off lawsuits and increased regulatory oversight. Many consumer groups are using the incidents to call for reforms in the free trade models used for global commerce.

For example, Wal-Mart Stores, Inc., is now requiring recent test documentation for all toys on shelves now. The company has ordered tests from independent labs, and is discussing new standards for testing and safety with other retailers and industry. Wal-Mart will also assist its suppliers and foreign government officials to develop new safety steps. The company also plans to purchase more products from Europe and North America. Mattel is also establishing enhanced quality control procedures. However, implementing effective quality control procedures in China can be a daunting task because China's economy is dominated by thousands of tiny factories. Some companies are turning to ASTM F963-07e1 Standard Consumer Safety Specification for Toy Safety for guidance

In 2007, an estimated \$385 million in toy recalls were announced, with 94% of the recalls involving toys manufactured in China. A coalition of environmental groups tested 1268 toys and found that 35% contained lead. Only 23 items tested involved toys recalled this year. 17% of the children's products tested had lead levels above the 600 parts per million (ppm) federal standard that would trigger a recall of lead paint.

CPSC has issued 18 recall notices affecting more than 6.7 million pieces of jewelry for children and teenagers that it says contain dangerous levels of lead. High levels of lead have also been found in the paint used on fake pearls. A recent study suggests that the source of lead in Chinese-made jewelry is ironically from computers and other recycled electronic products that are sold to Asian metal traders who strip the lead and sell the recovered lead to alloy makers who frequently mix it with other

materials and sell it to jewelry makers. Chemists at Ashland University in Ohio studied the composition of jewelry and key chains containing lead and determined that some also contained levels of copper and tin, suggesting the source was lead solder used in electronic circuit boards. Other jewelry samples were also found to contain antimony, a toxic metalloid element used to harden lead used in batteries. Lead has even turned up in snaps on Chinese-made overalls and shirts for babies and toddlers and on gardening gloves for kids.

Vinyl products are also receiving increased scrutiny since the CPSC issued a warning in May that baby bibs with cracked or peeling vinyl surfaces could pose a hazard to infants if pieces were swallowed. Lead has also been detected in baby bibs and soft, vinyl lunchboxes. Likewise, vinyl mini-blinds can yield lead dust when they deteriorate that can be hazardous if ingested. The lead in vinyl (also known as polyvinyl chloride or PVC) is sometimes added as an inexpensive stabilizer, may be contained in the pigments used to add color or it can come from recycled vinyl, which may have contained lead from its earlier use. Lead also may be present in plastic or PVC jewelry components. The CPSC is working with an international standard-making organization that could create a voluntary standard to limit total lead in vinyl children's products.

Ceramics cookware can also pose a risk of lead exposure because the glazes often contain lead, which enhances color and shine. If the glazes are not properly fired or sealed at a high-enough temperatures, lead can leach from a plate or vessel into the food or liquid. According to the Food and Drug Administration (FDA) which regulates

food contact surfaces and has imposed tight limits on the amount of lead that can leach into food, defective ceramics are usually imported from Mexico. However, FDA has also warned that some brass pots made in India that are lined with lead instead of tin may also leach unacceptable levels of lead.

The first class action lawsuit was filed by an Alabama mother against Mattel and Target Corp., which sells Mattel toys, alleging negligence and asking for funds to medically monitor children who "suffered an increased risk for serious health problems." In a 1993 decision, California's highest court ruled that medical-monitoring costs could be recovered if the need for monitoring is "a reasonably certain consequence" of exposure to a toxic substance. A similar suit was filed against Mattel earlier this month in federal court in New York.

After filing a lawsuit under California's Safe Drinking Water and Toxic Enforcement Act of 1986 (also known as Proposition 65), the Center for Environmental Health (CEH) reached a settlement in 2006 with 100 retailers, manufacturers and suppliers to stop selling lead-laden jewelry. The settlement requires that metal components in and coatings on children's jewelry must contain less than 600 ppm of lead, while plastic (PVC) components can contain no more than 200 ppm. In 2007, CEH announced additional litigation over lead-tainted bibs.

California Attorney General Jerry Brown filed a lawsuit against 20 companies under Proposition 65 accusing them of selling toys containing unlawful amounts of lead and failing to warn the public of the health dangers. Proposition 65 is a California state law that regulates chemical carcinogens and

reproductive toxins in order to protect public and environmental health. The statute requires that manufacturers, distributors, and retailers of products containing chemicals known to the state of California to cause cancer or reproductive harm provide a "clear and reasonable" warning when the concentrations of those chemicals exceed the safe harbor levels established by the California Office of Environmental Health Hazard Assessment (OEHHA). OEHHA has established the carcinogenic "No Significant Risk Level" (NSRL) for lead at 15 micrograms per day and the reproductive toxicity "Maximum Allowable Dose Level" (MADL) at 0.5 micrograms per day. The companies may be liable for up to \$2,500 per day for each violation.

*Commentary: Several federal regulatory agencies have jurisdiction over products, but the CPSC is the primary federal agency authorized to establish standards for "consumer products. Section 15(b) of the Consumer Product Safety Act (CPSA) requires manufacturers, distributors, importers and retailers of consumer products to "immediately inform" the Commission of information which "reasonably supports the conclusion" that a product either fails to comply with an applicable consumer product safety rule or with a voluntary standard upon which the CPSC has relied, contains a defect which could create a substantial product hazard or creates an unreasonable risk of serious injury or death. The CPSC considers the reporting threshold to be relatively low and potentially met even where the potential hazard is not sufficiently well-documented or serious to warrant suspension of product sales*

or recall of products distributed to consumers. CPSC has aggressively enforced the Section 15(b) notification requirements and has imposed penalties even in the absence of injuries. In addition to civil penalties, the CPSC may seek to impose criminal penalties up to \$50,000 and/or a prison sentence not to exceed one year.

Under the Federal Hazardous Substances Act (FHSA), 15 U.S.C. 1261 et seq., CPSC may ban products identified as "hazardous substances" if they contain toxic quantities of lead sufficient to cause substantial illness as a result of reasonably foreseeable handling or use, including ingestion. Pursuant to its authority under the CPSA and the FHSA, the CPSC has banned specific products, toys and other articles intended for use by children, and furniture for consumer use that contain lead-containing paint which the Commission defines as paint containing lead in a concentration of greater than 600 parts per million (0.06% by weight). Following action by California and Illinois limiting the amount of total lead that is permissible in children's products, the CPSC recently announced it will consider identifying jewelry with more than 600 ppm of lead as a banned hazardous substance (72 FR 920, 1/9/07).

CPSC's "Guidance for Lead in Consumer Products" recommends that manufacturers who use lead in a consumer product should perform the "requisite analysis" before distribution to determine whether the exposure to lead causes the product to be a "hazardous substance." If it is a hazardous household substance but is not intended for use by children, the Guidance requires precautionary labeling. The Guidance further notes

that any firm that purchases a product for resale is responsible for determining whether that product contains lead and, if so, whether it is a "hazardous substance." The CPSC advises companies to report if there is doubt if a defect could present a substantial product hazard.

In addition to the CPSA, companies may have obligations under the Toxic Substances Control Act (TSCA) obligations. Under its TSCA §8(e) Reporting Guidance, EPA has taken the position that TSCA Section 8(e) requires manufacturers, importers and distributors to report immediately any new information which "reasonably supports the conclusion" that a substance they manufacture, import, process or distribute presents a substantial risk of injury to health or the environment. EPA defines a "substantial risk" as a risk of considerable concern because of (a) the seriousness of the effect, and (b) the fact or probability of its occurrence. Unlike "unreasonable risk" under TSCA, economic or social benefits of use or costs of restricting use are not considered when determining whether there is reasonable support for a conclusion of "substantial risk" for purposes of §8(e).

Under the TSCA §8(e) Reporting Guidance, a company that becomes aware of information demonstrating that a product contains a chemical that is recognized or suspected of causing serious adverse health effects (e.g., cancer, birth defects, neurotoxicity) that was previously unknown to EPA, the newly discovered exposure data must be reported to EPA under section 8(e). This reporting obligation extends to previously unknown exposure to a hazardous or toxic constituent in a product such as the absorption from



*manufactured products or articles where data shows that widespread or significant exposure to the toxic component has occurred or is substantially likely to occur, and such exposure presents a substantial risk of injury to health or the environment. The TSCA 8(e) Reporting Guidance suggests that companies consider the toxicity of the constituent, the constituent's concentration in the product, and whether significant exposure to the toxic component has occurred or is likely to occur at any stage in the product's lifecycle from production through disposal. In cases of extremely toxic chemical substances in products in commerce, exposure may generally be presumed.*

*In April, EPA sent a letter to a number of toy, jewelry and other consumer products companies about the 8(e) obligation as part of a settlement of a lawsuit filed by Sierra Club over lead in products. Under the settlement, EPA has committed to promulgate a regulation adding lead and lead compounds to the TSCA Section 8(d) Health and Safety Data Reporting Rule. When EPA takes this action, producers, importers and processors would be required to conduct a comprehensive file search and to submit all unpublished "health and safety studies" contained in their files. EPA also agreed to notify a number of companies of their obligation under TSCA to inform EPA if they obtain information that products they manufacture or import present a risk of lead-poisoning to children. The letter states that "In addition to possible obligations under the Consumer Product Safety Act and the Federal Hazardous Substances Act, persons who process or distribute lead in products may also have obligations under the Toxic*

*Substances Control Act."*

*It should be noted that the American Academy of Pediatrics recommends 40 ppm level of lead as the maximum that should be allowed in children's products. According to a study released by Michigan State University blood levels of lead previously believed to be safe could be contributing to attention deficit hyperactivity disorder. The study examined children with and without attention deficit hyperactivity disorder, ADHD, and found that all 150 children had at least some lead in their blood. While the Centers for Disease Control and Prevention has established 10 micrograms per deciliter (mcg/dl) level as the maximum acceptable blood lead levels, the average blood lead level of children with ADHD in the Michigan State study was less than 1.3 mcg/dl.*

## BUSINESS AND REAL ESTATE TRANSACTIONS

### ***Asset-Based Financing and Mezzanine Lending Playing Larger Role in Real Estate Transactions***

Until the financial markets seized up in August, securitized loans were the dominant form of financing for office towers, apartment buildings and shopping centers. Conduit lenders who originated the securitized loans did not hold loans on their books like traditional lenders but sold them to investors. As a result, the conduit lenders reportedly did not require rigorous due diligence and allowed their underwriting standards to erode as they chased the lucrative fees associated with securitized loans. Indeed, the emergence of so-called commodity due diligence shops was a result in large part from the incredible growth in securitized loans.

Since the era of the “Henny Youngman economy” (take my money please) ended, some studies estimate that the volume of securitized loans has fallen off by as much as 90%. While lenders have tightened the lending reins, borrowers with highly-leveraged bridge loans that were based on projected rent increases or property appreciation are having to sell properties to refinance their loans, contribute additional equity or seek mezzanine debt to fill the financing gap.

In real estate deals, mezzanine debt occupies the middle ground between the secured creditors who have first priority liens and a property owner’s equity. Mezzanine investors are

willing to invest in properties because they are able to demand yields in the teens and are positioned to take over the property if the owner defaults on its mezzanine debt. Indeed, much mezzanine debt is called “hard mortgages” because the investors follow a “loan to own” investment model where the investors actually anticipate there is a good likelihood that they will take control of the property and eventually sell it for a profit. Many of the remediation funds that provide up-capital for the cleanup of property that is to be developed follow the loan-to-own strategy.

The mezzanine investor typically takes an interest in the entity that owns the building or property as opposed to the actual real estate. As a result, mezzanine lenders will usually not commission their own Phase I ESA reports but usually “piggy-back” or review the reports generated by the senior lender.

Another form of lending that is returning to prominence is asset-based lending or commercial finance. These loans are typically extended to businesses and are collateralized by liens on equipment, inventory, accounts receivables and mortgages. These lenders will hold the loans and foreclose on their collateral if the borrower defaults. Indeed, most of the early lender liability caselaw such as Fleet Factors involved a variety of asset-based lenders. These lenders will usually perform Phase I ESA reports prior to closing on a loan and should also perform additional environmental

diligence prior to foreclosing on the facility or personal property of a defaulted borrower. The HSBC settlement that was discussed in SEJ earlier this year was an example of a defaulted asset-based loan where the lender did not follow prudent foreclosure procedures.

*Commentary: SEJ has been periodically discussing trends in real estate and*

*corporate financing so subscribers can better understand client's needs and also help subscribers position themselves to take advantage of market opportunities. When designing environmental due diligence for a client, a consultant should take time to understand the nature of the transaction to better understand the potential risks facing the client as well as determine the particular risk threshold of the client.*

Copyright (c) 2007 by RTM Communications, Inc. The Schnapf Environmental Journal is a bi-monthly newsletter 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.



**RTM Communications, Inc. offers  
The Schnapf Environmental Journal**

**INVOICE FOR 2008  
SUBSCRIPTION**

*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 environmental issues.*

NAME \_\_\_\_\_

TITLE \_\_\_\_\_

COMPANY \_\_\_\_\_

ADDRESS \_\_\_\_\_

CITY \_\_\_\_\_ STATE \_\_\_\_\_ ZIP +4 \_\_\_\_\_

PHONE \_\_\_\_\_ FAX \_\_\_\_\_

E-MAIL \_\_\_\_\_

SIGNATURE \_\_\_\_\_

\_\_\_\_\_ **One-Year Subscription (e-mail only, Six Issues) for \$500.00 per office**

\_\_\_\_\_ **One-Year Subscription (e-mail only, Six Issues) for \$195.00 per individual**

*Please make checks payable to RTM Communications, Inc. and Mail to  
RTM Communications, Inc., 510 King Street, Suite 410, Alexandria, VA 22314 USA*

OR call 703-549-0977 to pay by credit card or verify your anniversary date

OR go to [www.rtmcomm.com/journals](http://www.rtmcomm.com/journals) to subscribe and pay on line