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**A Newsletter Covering Recent Environmental Developments and Caselaw**

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# DUE DILIGENCE AND DISCLOSURE

## *ASTM Issues Vapor Intrusion Standard*

On March 3rd, ASTM published its “Standard Practice for the Assessment of Vapor Intrusion into Structures on Property Involved in Real Estate Transactions" (E-2600-08).

The standard is designed to define commercially reasonable protocol for performing a vapor intrusion assessment (VIA) on a particular site to determine if a vapor intrusion condition (VIC) exists at a property. The intent behind the standard is to be able to quickly and inexpensively screen-out or eliminate sites that are not likely to have a potential for vapor intrusion.

The new standard does not replace the ASTM E1527-05 standard and is not intended to expand or modify what constitutes an “all appropriate inquiry” (AAI) as defined by EPA’s AAI rule or the ASTM E1527-05 standard practice for performing Phase 1 Environmental Site Assessment (ESA) investigations. Instead, E2600 is meant to evaluate if a site has been impacted by chemicals of concern (COC) that may migrate as vapors into existing or planned structures on a property due to contaminated soil and groundwater on the property or within close proximity to the property. E2600 may also be used independently in the absence of a Phase 1 ESA if the user simply wants to determine if a site is or has the potential to be impacted by a VIC.

The standard does not establish new criteria for determining if the vapor intrusion exposure pathway poses or may pose an unacceptable risk to human health. Instead, E2600 establishes a conservative four-tier approach for performing a vapor intrusion assessment (VIA) and mitigating vapor intrusion.

E2600 may be used for property with existing structures, structures that will be substantially renovated, property without existing structures as well as for vacant property where development is contemplated.

The VIA must be performed by a consultant who qualifies as an environmental professional under the E 1527-05 standard for Phase 1 reports.

Like other ASTM standards, E2600 includes new terminology. The focus of the standard is to identify or eliminate vapor intrusion conditions (VICs). E2600 defines a VIC as “ the presence or likely presence of any COC in the indoor air environment of existing or planned structures on a property caused by the release of vapor from contaminated soil or groundwater either on the property or within close proximity to the property, at a concentration that presents or may present an unacceptable health risk to occupants.” The definition of VIC does not apply to “de minimis conditions.” The possible presence of a VIC is referred to as a potential

vapor intrusion condition or pVIC.

The first two tiers discussed in the standard are to be used to identify pVICS. If a pVIC is identified in this initial screening, the process gradually progresses toward a more complex assessment involving increasingly greater use of site-specific data. For those sites that cannot be screened out, the process provides alternative methods to determine whether a VIC exists. If a VIC is found to exist, the process describes general mitigation alternatives.

Under the Tier 1 Non Numeric Screening assessment, a database search is performed to determine if there are sources of contaminants or chemicals of concern on the property or within specific search distances of the subject property. The databases that are searched are the same as those for the ASTM E1527-05 standard for Phase I ESA reports with search distances modified depending on the chemical of concern. If no sites with COCs are identified within the relevant search radius, the site can be screened-out. However, if the screening assessment cannot eliminate the vapor intrusion pathway because of the presence of COCs within the search radius, the site will be determined to have a pVIC.

If the vapor intrusion pathway cannot be eliminated using the Tier 1 non-numeric screening, the investigation can then proceed with the Tier 2 Numeric Screening, which involves reviewing sampling data against look-up tables that use generic risk-based concentrations.

If the property cannot be screened-out using the Tier 2 assessment (e.g., the potential that the site could be impacted by vapor intrusion pathway cannot be eliminated), then a user may proceed to a Tier 3 Site Specific Screening or proceed directly to the Tier 4 Mitigation. The purpose of the Tier 3 investigation is to confirm if a VIC is present. The nature of the vapor intrusion investigation could be dependant on regulatory agency guidance or policy. For example, some states allow modeling based on soil gas, soil or groundwater sampling. Other states require indoor air samples to be collected during certain times of the year.

For Tier 4 Mitigation, E 2600-08 provides a menu of options including building design, institutional controls or engineering controls, such as, installing vapor barriers or sub-slab depressurization systems.

E2600 contains nine appendices that include a list of typical chemicals of concern, web links to state and EPA vapor intrusion guidance and requirements, a questionnaire for gathering necessary information and a detailed legal appendix discussing the sources of liability for vapor intrusion.

## *Federal Government to Tighten Lender Due Diligence Standards In Response to Credit Crisis*

One year after the first sub-prime mortgages began to default, the credit crisis has begun to impact commercial loans and corporate transactions. In response, federal banking agencies are preparing to implement recommendations issued by the President's Working Group on Financial Markets that will include

more stringent due diligence standards for mortgage-back securities. In addition, the report calls on bank supervisors to give much more scrutiny to the due diligence, risk management, and risk awareness policies at banks.

While a detailed analysis of the credit crisis is beyond the scope of this newsletter, we have periodically reported developments in the credit markets to help readers understand how they can better serve their clients in this difficult period as well as identify business opportunities afforded by the changing economic conditions.

Back in August, federal authorities were assuring nervous credit markets that the mortgage woes were confined to sub-prime loans. However, it is now clear that an unforecasted once-in-a-century perfect storm has hit the economy. After years of dispersing risk to investors through securitizations and syndications, banks now find themselves unable to sell loans originated in 2007. With investors fleeing all forms of mortgage-backed securities, banks are having to record these loans on their balance sheets at what some executives consider liquidation values partially because of new accounting rules that require assets to be priced at fair market value. Jittery lenders are now focusing on preserving capital reserves and are becoming risk adverse as a result of the enormous write-downs the banks are being forced to recognize.

With the value of collateral plummeting, a massive de-leveraging is taking place as private equity investment funds and other highly-leveraged financial institutions that borrowed heavily to fund their investments are now being forced to sell assets at fire-sale prices or provided additional collateral to satisfy margin calls. This then sets off a vicious downward cycle known as a margin spiral where forced sale of assets drive their prices lower, triggering more margin calls. If the funds cannot raise enough cash to satisfy the margin calls, the lenders will seize their assets.

The commercial real estate sector is also beginning to exhibit signs of deterioration. For the first time since 1990, not a single commercial mortgage-backed security transaction was sold in a month (January) and only one in February, and the cost of protection against default on such securities issued in 2005-2006 has more than tripled. Many borrowers who purchased commercial properties at the top of the market in 2007 used highly-leveraged bridge loans or interest-only loans that they planned to pay off within 6 to 12 months when they flipped these properties for a large profit. Some experts estimate that more than $50 billion interest-only loans written at aggressive loan-to-value ratios could default this year if the loans cannot be refinanced.

Instead, these borrowers now find themselves unable to re-finance these loans because the properties values are less than the loans. As a result, the borrowers either have to post additional collateral or default on their loans. Even owners of income-producing commercial properties such as malls, hotels and office buildings who acquired the

properties at the peak of the market using highly-leveraged bridge loans or interest-only loans are falling into default. As the economy contracts, vacancies at these properties are increasing which cause declines in cash flows.

The February report of the Architecture Billings Index (ABI), a leading economic indicator of construction activity, had its lowest level since October 2001. One reason for the slowdown is plummeting home sales and competition from foreclosure sales. Many homes builders are stuck with unsold inventory and land, and beginning to default on their construction loans. Statistics from the U.S. Census Bureau indicate that the construction sector has suffered the fastest decline in spending since the federal government began keeping records in 1964.

Thus far, small and regional banks that were unable to compete with the conduit lenders and money center banks for the CMBS market have avoided massive write-downs. However, these smaller banks concentrated on construction loans and are beginning to feel stress from rising construction loan delinquencies. While construction-related loan losses are on the rise, state and federal banking regulators are performing thorough reviews of the loan portfolios of these banks. Moreover, unlike their larger brethren, many smaller banks have not yet adopted the "mark to market" accounting models and investors are growing increasingly concerned that the smaller banks will have to recognize significant losses. Some analysts fear that nearly 200 small banks may fail over the next three years because of these mounting housing-related losses.

Many businesses that formerly sold commercial paper or relied on asset based lenders to provide working capital now find their sources of affordable funding drying up. Indeed, a recent Duke University study found that 35% of companies surveyed reported decreased availability of credit and higher interest rates while 60% of the companies have put off expansion plans. CIT, a major lender to small and medium-sized businesses had to tap all of its $7.3 billion emergency line of credit because of an inability to refinance its commercial paper. The asset-based lender will have to constrict its lending and sell assets to conserve cash.

For the first quarter of 2008, the volume of asset-based securizations was down 81% from the same period last year. The few commercial mortgage-backed securities (CMBS) pools that have been issued have been priced at four percentage points above the ten-year Treasury note benchmark. Last year, the yields on the triple-A-rated portion of CMBS loans were less than one percentage point above this benchmark.

While the securitization market is virtually shut down, banks are being forced to hold onto to highly leveraged collateralized loans obligations (CLOs) that were used to fund corporate acquisitions. At the height of the credit boom, CLOs accounted for as much as 60% of securitized debt. The presence of these loans on their books reduces capital reserves, thereby reducing

capacity to make new loans. The volume of corporate transactions is far below last year. In the first quarter of 2007, 790 deals closed with a value of $241.15 billion compared to 488 transactions this year valued at $65.43 billion. For the debt that can be sold, lenders are being forced to take a "haircut" frequently disposing of CLOs at 90 cents on the dollar. Indeed, Goldman Sachs was reported to have sold the debt used in the acquisition of Chrysler for just 63 cents on the dollar. Some collateralized debt obligations or CDOs, which are pools of debt instruments, are being sold at 5 cents to the dollar!

*There have been several noteworthy cases during the past few months where lenders have been using material adverse change clauses to terminate transactions. The clogged pipeline of leveraged loans is impacting restructuring plans as companies are unable to sell off non-core assets. Some companies seeking to emerge from chapter 11 bankruptcies are finding it increasingly hard to find exit financing.*

## B-Piece Buyers Increase Diligence on New Loans

The due diligence performed by purchasers of the riskiest portions of CMBS loans has dramatically increased. These so-called B-piece buyers are carefully reviewing properties proposed to be included in new CMBS pools. In many cases, the B-piece buyers have forced issuers to drop troublesome properties from the pools.

In the past, B-buyers often piggybacked on the environmental diligence performed by the issuer of the CMBS pools. Now, though, it is not unusual for the B-piece buyers to perform desktop reviews or their own Phase I ESA reports. Moreover, environmental consultants and environmental attorneys retained by B-piece buyers are questioning conclusions in Phase I ESA reports and carefully vetting assumptions used to develop environmental loan reserves. In some cases, the B buyers are asking for more stringent environmental covenants and are requiring cleanups to be performed under state oversight so that a no further action letter may be issued. One of the key concerns appears to be the absence of closure documentation for USTs and former dry cleaners. As a result, borrowers are increasingly being asked to perform Phase II ESA investigations to eliminate concerns that potential uses have not impacted the collateral.

***Commentary:*** *Not all investors are as concerned about potential defaults. Some private equity funds use "loan-to-own" business models where the they actually hope a borrower will default because they will be able to acquire an equity interest in the business or project. Like mezzaine lenders, these "loan-to-own" funds do not take a senior lien on the real estate but take back a pledge on the stock, membership or partnership interest in the entity that owns the project.*

## *Are Accounting Rules Contributing to Market Woes?*

In past issues, we have discussed the potential impact of certain accounting rules issued by the Financial Accounting Standards Board (FASB) specifying how companies have to recognize, measure and disclose environmental liabilities. The FASB rules that environmental professionals are probably most familiar with are FASB Statement No. 143 "Accounting for Asset Retirement Obligations" (SFAS 143) and FASB Interpretation No 47 "Accounting for Conditional Asset Retirement Obligations' (FIN 47) since these rules specifically discuss environmental liabilities.

SFAS 143 and FIN 47 are part of a paradigm shift by FASB towards fair value accounting. As financial institutions are being forced to record massive write-downs on securitized loans, though, some financial executives are suggesting that a shift to fair value accounting rules is exaggerating losses and exacerbating market disruptions. If correct, these criticisms may have important implications for environmental liabilities.

Underlying the shift towards fair value accounting is the assumption that there is a viable market for the assets. However, some analysts and executives are arguing that this approach does not work when the markets become illiquid, such as, with securitized mortgages. Because the market for these bonds has essentially shut down, financial institutions are being forced to rely on the CMBX index, which tracks the cost of protection against defaults categories of commercial real estate bonds. Securities are trading at levels that imply default rates as high as 80%. This, in turn, forces holders of these instruments to mark down their assets. Each markdown pushes the market lower, causing more write-offs. Some executives complain that companies are being forced to record financial losses on holdings that they have no intention of actually selling at current prices. In essence, many analysts argue that forcing companies to value securities based on the prices they sell today essentially forces a company with on-going operations to adopt a liquidation accounting analysis.

FAS 157 "Fair Value Measurements" establishes the framework for measuring fair value using generally accepted accounting principles (GAAP) and expands disclosure for fair market valuations (FMV) which is defined as the price that a seller would receive to transfer an asset or liability in an orderly transaction between market participants. FAS 157 created a fair value hierarchy that provides companies with three techniques for measuring FMV ranging from an active, existing market (Level 1) to the so-called Level 3 category where FMV estimates are based on the value that a hypothetical third party would place on an untraded asset.

In March, the SEC issued letters to 30 companies providing guidance on how they should justify the use of Level 3 estimates. According to the SEC, companies may utilize the level 3 valuation technique only after determining that actual market prices or related

observable data is unavailable. If those unobservable estimates are deemed material, then companies should explain in the Management's Discussion & Analysis section of the financial statement how they were determined. Companies are also required to explain how the resulting FMV of their assets and liabilities and possible changes to those values, impacted or could impact their operations, liquidity, and capital resources. This additional information should include the amount of Level 3 assets and liabilities, and the reason why any of those items can no longer be measured against observable inputs. In addition, companies must explain why any material FMV changed and share the nature and type of assets underlying any asset-backed securities. The commission also requested that the companies describe their valuation techniques and models and how they are validated. Finally, the SEC indicated that future MD&As could include a range of values around the derived estimates to show how the numbers could change. These ranges would show investors how "sensitive" fair value estimates are to a company's use of unobservable inputs.

***Commentary:*** *The impact that this trend will have on the sale of contaminated properties with asset retirement obligations (AROs) remains to be seen. Purchasers and lenders have long been wary of the potential of liability associated with contaminated properties. Indeed, it has been the reluctance to redevelop these properties that has led to the state brownfield initiatives. These state brownfield reforms have helped incentivize the redevelop- ment of contaminated properties and created a marketplace for these sites.*

*Unfortunately, the credit dislocations are impacting the willingness of lenders or investors to finance brownfield projects. Concerned about their reserves and nervous about how well other financial institutions have vetted liabilities associated with loans they are trying to sell, lenders are once again becoming more cautious about the risks associated with environmental issues. Thus, a site with significant conditional AROs may be more difficult to transfer and face downward valuation pressure if the lender requires significant reserves or stringent environmental covenants requiring remediation. Of course, if the sale of a property with AROs is part of a strategic acquisition and the purchaser is using its own cash or stock as to compensate the seller, the purchaser may be willing to fully price the property.*

*FASB continued its march toward fair-value accounting when it issued a revised FAS 141(R) for business combinations. FAS 141(R) replaces the long-standing "probable and reasonably estimable" criteria for calculating contingent liabilities under FAS 5 with fair-value measurement. FAS 141(R) requires companies that acquire assets or assume liabilities in a deal to record the items at their acquisition-date fair value rather than at historical costs. One result of the new rule will be that buyers in corporate transactions will likely have to recognize more environmental liabilities at significantly higher cost estimates than reported by sellers.*

### *Can Environmental Transfer and Insurance Products Help Establish Fair Market Values?*

The FVM accounting rules represent a subtle but significant shift in the treatment of environmental liabilities. Under the old accounting regime, companies were required to report what the probable and reasonably estimated amounts that they would have to pay (i.e., damages). This approach was why an environmental attorney might advise a client that it might have potential environmental liability of $100 million but an accountant might tell the client that its probable and reasonably estimated damages are only $10 million.

In contrast, the FMV rules focus not on actual amounts to be paid but liability. For example, a company might estimate that the low end of a cleanup might be $250K and not recognize potential off-site toxic tort or property damage claims where no claims have yet to be filed. Under the FMV approach, the company may have to recognize a higher remediation cost as well as the potential off-site liability.

One way to address this potentially higher liability is to possibly obtain environmental insurance quotes or an offer from an environmental liability transfer entity since such offers would be an indication of a Level 1 active market. For example, assume a company originally estimated that it had a $250K cleanup but has information that the actual liability for both the cleanup and toxic tort liability may be $10 MM. If the company can obtain an environmental insurance policy for $2 MM, the company could argue that it has a Level 1 (active market) FMV liability of $2 MM. Alternatively, if an environmental liability transfer company offers to buy the company's liability for $5MM, the company could assert that its FVM for that liability is $5 MM.

What if the company cannot obtain an environmental insurance policy for the particular liability because the limits it seeks are not available? Well, if a company with a similar kind of liability was able to obtain a policy with lower limits, it might be possible that the company could use the other policy to extrapolate FMV under the Level 2 analysis.

There may also be scenarios where the liability may be estimated using a mixture of FVM accounting. For example, the liability for soil may be able to be calculated using Level 1, groundwater using Level 2 and toxic tort using Level 3.

**Commentary:** *It is likely that auditors will want to obtain estimates from environmental consultants or environmental attorneys to assist with the FVM accounting. The new rules carry particular implications for environmental consultants have become comfortable with developing the lowest probable cost estimates. Consultants will likely need to use a more conservative approach to satisfy the Level 3 analysis.*

### *Koch Industries Files Action for Non-disclosure*

A subsidiary of Koch Industries Inc. recently filed an $800 million lawsuit against DuPont in connection with its purchases of the former Dupont Textiles and Interiors (DTI) fibers business. Two subsidiaries of Koch paid $4.2 billion in cash for the DTI assets in 2004. The lawsuit filed in the federal district court for the Southern District of New York claims that 14 plants located in the United States, Canada, the United Kingdom, the Netherlands and Brazil are out of compliance with environmental laws and require remediation. Koch is also seeking punitive damages.

The complaint in Invista v. E.I. Dupont De Nemours and Company, No. 08-CV-3063 (S.D.N.Y.) states that prior to the execution of the purchase agreement in November 2003, Invista was only allowed to perform limited due diligence on the facilities prior to the sale and relied on the broad environmental indemnity as well as Dupont's stated corporate environmental policy. According to Invista, the company was unable to verify compliance with the Prevention of Significant Deterioration (PSD) and Non-Attainment New Source Review (NNSR). The complaint also alleges that because Dupont personnel did not appear to have a fundamental understanding of these programs and could not explain the rationale for their conclusions that these permit programs did not apply, the parties agreed that non-compliance with the PSD/NNSR programs would be identified as "known violations." Dupont also made representations that the facilities were in compliance during the past three years and agreed to indemnify the purchaser for environmental liabilities exceeding $400K.

Less than a month after the closing, Invista claims that it discovered violations involving an unpermitted benzene treatment unit located at the plant in Victoria, TX had been placed into service in 2000 and that the Plant in Orange, TX had been venting benzene directly into the atmosphere since 1992. After discovering the violations, Invista entered into a corporate audit agreement with EPA under the agency's Koch Industries and EPA's revised voluntary audit policy that allows purchasers of corporate assets to negotiate reduced penalties for reporting violations voluntarily discovered after the closing. EPA waived the 21-day reporting and 60-day completion of corrective action deadlines to allow the company to continue to operate its facilities. Invista implemented an 18-month audit of 50 acquired plants and identified 687 instances of alleged noncompliance that the complaint asserts existed at the time of the closing. In addition to the earlier violations at the Texas plants, Invista determined that other US facilities had made major modifications without complying with the PSD/NNSR programs, had failed to comply with Title V permits for several air pollution sources, were in non-compliance with RCRA and CWA violations and had significant OSHA violations.

Following discovery of the violations, Invista negotiated a

consent decree to correct the violations involving historical benzene emissions reporting and failure to undergo new source review for modifications to air sources. Invista agreed to pay a fine of $1.7 million. Invista states that it has spent $140 million to investigate conditions at the US plants and anticipates expending between $300 million and $450 million to upgrade the plants pursuant to a consent decree with EPA under the Clean Air Act. The company also said it will incur more than $200 million in increased operating costs at the plants. Invista has not yet determined the costs to bring the non-US plants into compliance. At the time of this writing, DuPont had not yet filed its answer to the complaint. In a press release, DuPont denied the allegations and claimed Invista was trying to force DuPont to pay for capacity expansions and other capital projects.

***Commentary:*** *This lawsuit has generated quite a buzz among environmental professionals because of the alleged damages represent approximately 20% of the purchase price. The lawsuit also illustrates the danger of relying on contractual promises of a seller in lieu of performing comprehensive environmental due diligence. Dealmakers often analogize corporate transactions to courtships where the parties are on their best behavior during the pre-closing courtship and have their greatest leverage. As one wag once said, if the pre-closing relationship (honeymoon) is difficult, the post-closing relationship between the parties (marriage) is going to be bad. As with this transaction, once the deal closes, the buyer may find that its only recourse to obtain the benefits it thought it had negotiated is to file a lawsuit.*

*In fairness, though, this transaction also appears to be consistent with the practice followed during the more frothy days of the M&A market when sellers had significant leverage. Until the credit markets seized up, it was not uncommon for sellers of corporate assets under an auction model to forcefully resist requests by prospective purchasers to perform significant environmental due diligence. Instead, the bidders had to basically price their bids on the information provided in data rooms. If prospective bidders conditioned their offers on additional information or sought to make material changes to the proposed agreements, they would essentially disqualify themselves. Bidders increasingly became comfortable with this approach because of the perception that the assets would continue to appreciate. Human nature being what it is, purchasers and their lenders also got caught up in the bidding war and would provide concessions to win the deal.*

# LITIGATION

## *Federal Courts Address Contours of CERCLA Statute of Limitations*

In the wake of the Supreme Court decisions *Cooper Industries, Inc. v. Aviall Services, Inc*., 543 U.S. 157 (2004) and *United States v. Atlantic Research Corp*., 127 S. Ct. 2331 (2007), federal courts are grappling with some of the collateral issues left unanswered by those decisions. Two recent opinions shed some light on the applicability of the various CERCLA statute of limitations.

In *Douglas Autotech Corp. v. Scott Fetzer Co*., 2008 WL 205217 (W.D. Mich. Jan. 23, 2008) the United States District Court for the Western District of Michigan held that the discovery of "new" contamination did not commence a new time period for bringing a contribution action under Section 113(g) of CERCLA. In this case, the plaintiff purchased a manufacturing facility from the defendant in 1991 and remediated soil and groundwater impacted with TCE from a "chip shed" that had a concrete waste vault. The remedial action was completed in 1992. In 2003-2005, as part of its post-remedial monitoring, the plaintiff noticed that the TCE levels in the groundwater were not declining as anticipated and suspected an off-site source. Following an investigation, the plaintiff discovered that the defendant had operated degreaser pits that had caused extensive TCE contamination of the soils and groundwater. The plaintiff then filed a complaint in October 2007 seeking recovery of its response costs from all remedial actions and a declaration of future liability under Sections 107 and 113 of CERCLA. The defendant responded with a motion to dismiss, arguing that the action was barred by the Section 113(g).

The court ruled that the plaintiff's cleanup was a remedial action governed by the six-year statute of limitations of 113(g)(2)(b) which commences upon completion of the on-site physical remediation. Since the groundwater treatment system started in December 1992, the court concluded that the six-year limitation period expired in 1998.

The plaintiff argued that the newly discovered TCE was a separate CERCLA "facility" that was subject to a new six-year limitation period. However, the court ruled that since the contamination from the chip shed and degreasing was TCE and these areas were part of a single manufacturing operation there was just a single “facility” for purposes of the CERCLA statute of limitations. In so holding, the court adopted the rationale of a decision in *Cytec Indus., Inc. v. B.F. Goodrich Co*., *232 F. Supp. 2d 821, 830-32 (S.D. Ohio 2002)* where a 54-acre manufacturing site with multiple ponds and landfills was identified as a single CERCLA “facility”. The court noted that contaminated sites are sometimes administered through the

designation of operable units and suggested that in such cases there might be grounds for independent limitations periods.

***Commentary:*** *This decision illustrates the importance of performing comprehensive due diligence to ensure that all sources of contamination are identified before commencing remedial activities. Frequently, purchasers will direct their consultants to focus on obvious areas of concerns without considering possible historical operations.*

## *Massachusetts Supreme Court Declines to Hold Parent Liable for MGP Subsidiary*

In Scott v. NG U.S. 1, Inc., 2008 Mass. LEXIS 136 (March 7, 2008), the Massachusetts Supreme Judicial Court (SJC) held that a parent corporation was not liable under the Massachusetts Superfund law (Chapter 21E) for contamination at a former manufactured gas plant that had been owned and operated by a subsidiary the parent did not own or control at the time the subsidiary released hazardous materials and sold a contaminated site. In so holding, the SJC applied the reasoning of the United States Supreme Court decision in *United States v. Bestfoods*, 524 U.S. 51 (1998).

In this case, the plaintiff purchased property in Salem to develop and sell townhouses. During construction, he discovered MGP-related wastes that had migrated from an abutting parcel where a former MGP had been owned and operated by Salem Gas from 1850 to 1890. Salem subsequently sold the land and the MGP was dismantled in 1906. Though a series of stock transactions beginning in 1926, Salem Gas became a subsidiary of the New England Electric System (NEES), the corporate predecessor to defendant NG U.S. 1 in 1947. In 1953, NEES consolidated the operations of Salem Gas with two other gas companies in a "gas division" which was later incorporated. In 1973, NEES later sold the stock and assets of the consolidated corporation to Boston Gas which assumed all existing liabilities. The defendant, National Grid USA (UG US 1) subsequently became the corporate successor to NEES.

The issue before the court was whether the defendant could be held indirectly liable under Chapter 21E under a veil piercing theory. The plaintiff alleged that between 1931 and 1951, Salem Gas operated as a "nominal subsidiary" of NEES and that after 1951 the Salem Gas business was operated by NEES without regard to corporate formality. In particular, the plaintiff alleged that NEES and its various gas subsidiaries shared employees, management, marketing, supply, operations and merchandising, that the president of Salem Gas and other NEES gas subsidiaries was also the head of the unincorporated gas division of NEES, and that final authority on important matters rested with NEES management.

The court began its analysis stating that that neither CERCLA nor Massachusetts environmental laws had displaced bedrock principles of

corporate common law and that the state law for disregarding the corporate form was not materially different than the standard espoused in Bestfoods. The court said that under Massachusetts law, the corporate veil may be pierced only if the parent exercises "pervasive control" and there is some "fraudulent or injurious consequence" or there is "confused intermingling with 'substantial disregard of the separate nature of the corporate entities." The court ruled the question was not whether the corporate veil could be pierced at some point after 1931 but whether it should be pierced during the time of the release or threatened release of oil or hazardous material. The court found that the defendant and its predecessors did not exercise any direct involvement in activities causing the contamination since the releases had occurred more than thirty years before North Boston purchased its first share of stock in Salem Gas, and before NEES's predecessor purchased its first share of stock in North Boston. Moreover, the court noted, there was no evidence that NEES had any ability to direct or control environmental measures on a site, which had been sold decades before Salem Gas was acquired. In addition, the court observed that the plaintiff did not suggest that North Boston acquisition was related to the then-discontinued operations at a site no longer owned by Salem Gas. Finally, the court said that Chapter 21E enacted ten years after NEES sold its interest in Salem Gas, and the plaintiff had not identified any other source of statutory or common-law obligation during the period NEES owned Salem Gas that imposed obligations on NEES to investigate, identify, or respond to possible environmental contamination from coal tar caused decades before on property that was not owned by NEES or its related entities.

***Commentary:*** *It may turn out that the Scott decision will become more noteworthy for the ruling on the recoverability of attorney's fees. Under Section 4A of Chapter 21E, a court is required to award fees and costs to a defendant if a plaintiff does not participate in pre-suit negotiations in good faith, or if a plaintiff has no reasonable basis for claiming that the defendant is liable. The court held that a standard for determining if attorney costs should be awarded was if it was "reasonably clear" that there was no basis under existing law that defendants could be held liable at the time of the filing of the complaint. Because the trial judge had applied the commonly used for ruling on motions to dismiss-namely it is beyond a doubt that the plaintiff can prove that there is no set of facts in support of his claim. Accordingly, the SJC sent the case back to the trial judge for further consideration on liability for the defendant's attorney fees.*

## *Endicott Residents Sue IBM Over Vapor Intrusion*

Two sets of residents have filed a lawsuits against IBM Corp. alleging personal injuries and property damages from vapor intrusion associated with a former IBM plant located in Endicott, N.Y. Thus far, 240 plaintiffs have sued IBM and it is anticipated that 1,000 plaintiffs may eventually file claims against the company seeking an estimated $100 million.

The complaints were filed in New York Supreme Court in Broome County. In the first action, *Blaine v. International Business Machines Corp*., N.Y. Sup. Ct., No. 2008/000012, 1/3/08), the plaintiffs seek damages for personal injuries, property damages, medical monitoring, lost business income under a variety of state common law theories. The plaintiffs allege that a plume containing benzene, tetrachloroethylene, trichloroethane, trichloroethylene, and trichlorotrifluoroethane has migrated from the former IBM plant through soils and groundwater, and is volatilizing into homes and businesses. Plaintiffs also assert that because there is no reliable technology that can completely remediate the contamination, they will continue to be exposed to toxic vapors for decades.

Under the direction of the New York State Department of Environmental Conservation (NYSDEC), the company has installed ventilation systems in more than 440 properties and also paid local homeowners another $2.2 million under a property benefit program negotiated by the state attorney general's office. They rejected a $3 million settlement offer in 2007.

## *TCE Settlement of $1.6 MM Does Not Include Claims for Vapor Intrusion*

The settlement approved by the federal district court for the Middle District of Pennsylvania in *Martin v. Foster Wheeler Energy Corporation,* 2007 U.S. Dist. LEXIS 92021 (M.D.PA. December 14, 2007) did not involve a release for potential exposure to vapor intrusion.

In this case, Foster Wheeler (FWC) operated a manufacturing plant in Mountaintop, Pennsylvania that used a vapor degreaser. When the plant shut down in 1988, FWC entered into a consent order with EPA and what is now the Pennsylvania Department of Environmental Protection (PADEP)to investigate certain environmental conditions at the facility. Following the discovery of TCE in some private wells in October 2004, FWC entered into an Administrative Settlement Agreement with EPA and PADEP to provide alternative public water supply at the affected residences as well as to abandon the private wells. This program was completed except for a number of property owners who declined to participate. In the meantime, FWC has continued to conduct remedial activities at the FWC site in the area known as the Affected Area.

A number of residents living in the vicinity of the site filed a class action seeking property damages and funding for medical monitoring. All but 20 of the 147 impacted parcel

owners subsequently reached a settlement that consisted of a payment of $1.64 million with the payments allocated based on three settlement classes. The first category was plaintiffs that lived within the geographic settlement area that had used a private well would receive 4% of their appraised value plus $20,200 for medical monitoring and water damage to their property. The category 2 class members consisting of those residents living within the settlement area that did not have wells also received 4% of the appraised value and a payment of $4800. Finally, the category 3 class members, who received 2% of their property value and a payment of $3,000, were those plaintiffs living in the buffer area. In exchange for the payment, the plaintiffs agreed to file deed restrictions preventing their properties from using the groundwater and agreed to release FWC from all claims except those relating to personal injuries and wrongful death.

In approving the settlement, the court said the fundamental issue was whether the settlement or compromise in a class action suit is "fair, reasonable and adequate". In determining if a class action settlement is fair, reasonable and adequate, the court said it had to weigh the following nine factors: 1) the complexity, expense and likely duration of litigation; 2) the reaction of the class to the settlement; 3) the stage of the proceedings and the amount of discovery completed; 4) the risk of establishing liability; 5) the risk of establishing damages; 6) the risk of maintaining the class action through the trial; 7) the ability of the defendants to withstand the greater judgment; 8) the range of reasonableness of the settlement fund in light of the best possible recovery; and, 9) the range of reasonableness of a settlement fund in light of all the attendant risks of litigation.

The court indicated that it believed the plaintiffs would have difficulty proving by a preponderance of the evidence that FWC was the source of the TCE or that they had been exposed to levels of TCE above naturally occurring background levels. The court also said there was no evidence presented indicating if the prescribed medical monitoring regime would be effective or ineffective in early detection of any TCE-related illnesses.

Some of the members of the settlement class objected to the settlement because FWC was not required to address the potential of vapor intrusion. However, the court noted that indoor air had been sampled at the residence with the highest concentration of TCE in the groundwater and that TCE was not detected at levels posing a health hazard.

Because of the difficult proof problems that the plaintiffs faced and because the release did not include claims for personal injuries, the court felt that the settlement was fair and adequate.

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