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

BROWNFIELDS AND DUE DILIGENCE

Brownfield Deals Collapsing Under Weight of Market Disruptions

Many brownfield projects are stalling or being abandoned because of changing market conditions or financing difficulties. Some states facing severe economic pressures are cannibalizing brownfield incentives and trust funds to reduce budget deficits caused by lower than expected revenues from real estate transactions. The faltering of the brownfield market is not surprising since these developments are first and foremost real estate projects. What is interesting though is how the various state brownfield programs are being impacted differently because of how their incentives are structured.

For example, according to a report in The Detroit News, Michigan has awarded over $300 million in brownfield tax credits since 2000 to developers to redevelop blighted areas. The tax credits are awarded to specific parcels from a bond program and developers have up to ten years to use the tax credits. Many of the projects that were awarded brownfield tax credits are defunct or not viable under current market conditions. Unfortunately, because the tax credits are not assignable and the state cannot withdraw the credits, the financial incentives cannot be used for new projects or to replenish the bond fund use to finance the finite pool of available tax credits. As a result, some Michigan cities are concerned that awarded tax credits may expire unused while other worthwhile projects could use the incentives.

In New York, the legislature just enacted a 90-day moratorium preventing the Department of Environmental Conservation from accepting new applications to its Brownfield Cleanup Program (BCP) because of a looming budget deficit and the unexpected costs of the BCP. When the legislature established the BCP in 2003, it calculated that the program would cost the state $135 million in lost revenue from the highly lucrative tax credits. However, recent estimates show that the first 25 projects to emerge from the BCP resulted in over $1 billion in tax credits and that the cleanup anticipated to be completed this year will result in another $500 million in tax credits.

The brownfield cutbacks come at a time when affordable housing developers are increasingly looking to the brownfield programs to fund financing gaps caused by the loss of tax credit investors. Brownfield projects usually are considered high risk projects that require high risk returns. However, affordable housing developers contemplating developing contam- inated sites were able to use a combination of tax credit investors and state brownfield incentives to attract the necessary funding to complete their projects. In normal times, for-profit and nonprofit developers could finance up to 65% of the project costs from tax credit investors who were willing to pay 95

cents per tax credit dollar. However, financial institutions with massive losses from the credit disruption do not have profits to shelter. As a result, tax credits are being priced at 75 to 79 cents on the dollar. Thus, a developer who is awarded a $1 million tax credit can only sell $790K whereas last year it might have been able to receive $950K. Affordable housing developers that had hoped to plug this financing gap with brownfield funds may now have to delay closings or the start of construction until market conditions improve, or worse terminate these much needed housing projects.

Credit Crisis Contributing to "Re-Brownfielding" of Cities

As national vacancy rates approach levels not seen since the Great Depression, entire swaths of neighborhoods in many urban areas are being abandoned creating new blighted areas. In some states, the vacant homes were once brownfield sites that had been rejuvenated as part of brownfield initiatives.

Most of the hardest hit cities are in the Midwest that were already suffering from losses in manufacturing jobs. Indeed, the treasurer of Cuyahoga County recently estimated that 10% of Cleveland's housing stock is now vacant. Other impacted cities are located in those states that had the most overheated real estate markets: Arizona, California, Florida, Georgia and Nevada.

The rising number of vacancies and foreclosures are straining local government budgets already suffering from weak economies, declining sales taxes and falling revenues from real estate transactions. Homes that are abandoned or undergo foreclosure cause property values to drop, accelerating the pace of defaults and uncollected property taxes. As residents flee their neighborhoods, commercial establishments are forced to close, frequently leaving behind hazardous materials used in their businesses. Vacant homes frequently attract vandals, drug dealers and meth labs. To prevent further deterioration of neighborhoods, cities with constrained resources are being forced to spend money cutting lawns, draining pools and securing homes. Cleveland recently sued 17 banks asserting that they created a public nuisance by extending sub-prime loans that have created a foreclosure crisis. A class action lawsuit filed in federal court alleges that the volume of sub-prime loans constituted a pattern of corrupt activity that exposes the banks to liability under RICO.

To minimize their costs and try to halt the spread of these blighted areas, cities are beginning to explore a variety of strategies. Some local governments in California where speculators and investors consider the drop in the real estate market as buying opportunities are trying to acquire the homes so they can be sold to low wage owners who were priced out of the market during the real estate bubble. A City-County Reinvestment Task Force in San Diego is exploring a variety of alternatives to finance these acquisitions by either floating bonds or creating a fund that would be financed by banks looking to

comply with the Community Reinvestment Act (CRA) obligations. Providence, Rhode Island is considering conveying properties that have been acquired through tax foreclosure to community development corporations. Another approach is to create land banks such as the Michigan Land Bank Fast Track Authority that usually obtains foreclosed homes for the cost of clearing title from banks or purchases tax liens from local governments, and then donates the properties to charities or housing programs for use by low-income residents. Nonprofts such as Enterprise Community Partners is raising funds to foundations and financial institutions to buy foreclosed properties and then renovate them for sale or rent.

Because vacant structures are often vandalized or quickly fall in disrepair, some local governments feel they are better off demolishing the structures. Because demolition can be very expensive and can involve removing asbestos, lead-based paint, transformers or other electrical equipment with PCBs, the conventional wisdom is that that developers would be more willing to acquire the vacant land. The Genesee County land bank has demolished 800 homes since 2002 and built 200 homes. The sales of the homes replenish the land bank. Cleveland is also considering establishing a land bank. Congress is considering establishing a grant program to buy foreclosed and abandoned homes. Foundations are also establishing funds to reduce the number of homes that go into foreclosure, acquire foreclosed homes and refurbish them for sale or as rental units, or perhaps demolish the structures and establish parks or open space. For example, a consortium in Cleveland is considering acquiring 450 foreclosed properties at a cost of approximately $21 million.

Commentary: *Not all local governments are comfortable with taking title to the abandoned properties, particularly commercial properties. This is because of uncertainty over the scope of the CERCLA exclusion for involuntary acquisitions by local governments. Acquiring title through formal eminent domain or tax foreclosure proceedings can be lengthy and costly. To short-circuit the process (and quickly obtain control over vacant properties before they deteriorate), municipalities or local redevelopment agencies will frequently take title through negotiated agreements that do not go through the full legal process of obtaining a court order. However, conservative municipal counsel often advise local governments that such transactions could be considered voluntary acquisitions that would not qualify the local government for the CERCLA liability exemption. Even if the government initially satisfies for the exemption, it could still forfeit that immunity from liability if it fails to exercise due care for hazardous materials that may be present at the property and failing to secure the property against vandalism, such as where copper piping might be ripped from transformers containing PCBs.*

Disconnect Growing Between Asset Purchasers and Lenders

In more frothy times, investors

had become comfortable aggressively bidding for corporate and real estate assets on the assumption that the assets would continue to appreciate in value. As part of this seller's market, it was not unusual for buyers to agree to contractual terms that were very generous to sellers such as no material adverse change (MAC) or material adverse affect (MAE) clauses that give a buyer or lender the right to pull out of the deal or renegotiate the terms in the event of an unforeseen material adverse business or economic change affecting the target company or its assets between the execution of the definitive acquisition agreement and the closing of the transaction. Buyers also generally accepted limited or no representations and warranties as well as minimal due diligence, frequently just relying on the documents contained in a virtual data room.

Buyers were able to agree to these seller-friendly terms because their lenders who were also aggressively competing with other banks for these fee-rich transactions acquiesced to these contractual conditions. During the heady days of 2007, loan agreements frequently contained diluted MAC clauses, lenders frequently agreed to waive financial covenants and often agreed to non-recourse loans where there was no deep pocket to guarantee the loan.

The credit dislocations have shifted the balance of power back to buyers and lenders who are attempting to gain more flexibility in terminating a transaction. Unfortunately, many buyers have not appreciated the extent that the ground has shifted in the past six months. As a result, some buyers are finding themselves having to agree to terms and conditions in their loan agreements that exceed the terms that they received from their sellers.

Lenders are also paying closer attention to real estate appraisals. Because real estate values are depreciating at an accelerated rate, there have been instances where lenders have required updated appraisals and required additional collateral or changed the loan terms to accommodate the reduction in the value of the real estate.

Some lenders are more carefully reviewing environmental reserves and asking their consultants to apply more conservative scenarios for developing environmental escrows. Lenders are also lowering materiality thresholds for environmental conditions and imposing more stringent post-closing covenants. Facing the prospect of having to hold loans on their books for a longer period of time, banks are requiring borrowers to commence or complete environmental actions much quicker and to obtain no further action or closure letters form environmental agencies.

Do Conduit Lenders Qualify for the Secured Creditor Exemption?

We have long admonished lenders about the need to exercise extreme care during loan workouts and foreclosures to avoid inadvertently incurring liability for environmental conditions at facilities owned or operated by borrowers. The most recent example was the HSBC settlement with the State of New York that we reported in our May 2007 issue.

As the wave of litigation resulting from these busted deals sweeps across the country, attorneys representing borrowers, local governments and other parties are looking for creative legal theories to hold lenders responsible for ensuing financial damage. Conduit lenders have long assumed that they were entitled to the secured creditor exemption of CERCLA that excludes from the definition of a CERCLA owner persons who hold “indicia of ownership” through a security interests if that the security interest is held primarily to protect a security interest and the lender did not participate in the day-to-day management of the borrower’s facility.

The secured credit exemption was enacted when most banks engaged in portfolio lending and securizations only played a role in consumer debt. Just like the emergence of fractional ownership interests that we discussed in our August 2007 issue, the application of the CERCLA secured creditor exemption to conduit lenders has not been tested. Creative lawyers could argue that a conduit lender is not entitled to CERCLA immunity because its primary motive for holding indicia of ownership was not to protect a security interest but to generate fees by quickly selling loans. An analogy could be made to private equity investors that will frequently hold a security interest in the assets of a business along with their various levels of equity. Since the primary motive of the private equity investor is to profit from the turnaround of the business and protect its investment interest, it would probably not qualify for secured creditor exemption. The preamble to the former EPA lender liability rule indicated that lenders can have a secondary profit motive such as loan interest without jeopardizing their safe harbor status but will forfeit their immunity when the primary purpose for holding indicia of ownership was an investment or profit motive.

Commentary: *Lenders who foreclose on contaminated property are also immunized from CERCLA liability if they take commercially reasonable steps to sell the property. The 1996 lender liability amendments to CERCLA clearly state that lenders will not lose their immunity from liability so long as they take steps that are consistent with prudent lending practices and protection of its security interest. When a borrower defaults on a loan, the lender will want to take actions to preserve the value of property while it finds a buyer.Collecting rent, paying taxes and even repairing the roof would appear to be the kind of actions that a lender would do to protect its collateral value. Yet as we discussed in our March 2006 and*

May 2007 issues, the State of New York brought a cost recovery action against a holder of a mortgage note for taking such actions in State of New York v. Fumex Sanitation et al, No. CV04-1295 (E.D.N.Y).

Many of the real estate projects that have collapsed during the credit disruptions were located on brownfields or sites with complicated environmental histories. Environmental reviews are usually required for sale of properties in bankruptcy, undergoing foreclosures on defaulted construction projects. However, many defaulted construction loans were part of CDO. Frequently, the trust agreements for the CDOs require that before a trustee can foreclose on the property, it must ensure that the property is in compliance with all applicable environmental laws. Thus, it is important for a consultant retained by the trustee to verify if it should perform an ASTM E1527 Phase I ESA or if the assignment should also include a limited compliance audit. It is also important for lenders to familiarize themselves with state lender liability statutes that can vary from the CERCLA exemption. Some state statutes may require lenders to take actions that go beyond what the CERCLA exemption requires to assert the liability protection. In addition, some state statutes will not immunize lenders from common law liability or negligence.

EPA Issues LBP Renovation Rule

EPA recently issued its lead-based paint (LPB) "Renovation, Repair and Painting" rule (73FR 21691 (April 22, 2008) that will take effect in April 2010**.** The rule covers all rental housing and non-rental homes where children under six and pregnant mothers reside. Parties subject to the rule include builders, painters, plumbers and electricians.

The LBP renovation rule will apply to renovation, repair or painting activities where more than six square feet of LBP in a room is disturbed or where 20 square feet of lead-based paint is disturbed on the exterior. Only certified contractors may perform on projects disturbing the minimum thresholds of LBP. They must follow certain work practices and perform clearance sampling.

Environmental organizations have criticized the rule because the clearance procedures only require wiping a wet cloth along surfaces in the building and seeing if the cloth is as white as a reference card. EPA estimates the rule will cost an average of $35 per renovation or repair job.

American Institute of Architects Revises Standard Form for LEED Construction

In our March 2007 issue, we reviewed some of the contract issues that building owners and consultants need to consider for buildings that are to constructed to satisfy green building design standards. The American Institute of Architects (AIA) revised its form of Professional Services Agreement to help architects deal with the contractual

issues associated with green buildings.

The form, B214–2007, establishes duties and responsibilities when the owner seeks certification from the U.S. Green Building Council's Leadership in Energy and Environmental Design (LEED®). The B214–2007 is a scope of services document and is not designed to be used as a stand-alone owner-architect agreement. Among other things, the architect's services include conducting a pre-design workshop where the LEED rating system will be reviewed and LEED points will be targeted, preparing a LEED Certification Plan, monitoring the LEED Certification process, providing LEED specifications for inclusion in the Contract Documents and preparing a LEED Certification Report detailing the LEED rating the project achieved.

According to the AIA, architects may use B214–2007 in two ways: First, the form may be incorporated into the owner-architect agreement as the architect's sole scope of services or in conjunction with other scope of services documents. Alternatively, the form may be attached to G802™–2007 (Amendment to the Professional Services Agreement) to create a modification to an existing owner-architect agreement.

Record Number of Shareholder GHG Disclosures Filed

The 2008 proxy season is upon us and once again, investors are seeking greater disclosures from companies on climate-related risks and their effects on business.

Thus far, 54 resolutions on climate change have been filed, nearly twice the number in 2006. Targeted companies include oil and coal companies, airlines, power producers, banks and other companies. The resolutions filed with ConocoPhillips and Chevron Corp. request their boards to commission independent reports on the environmental effects of their activities in Alberta's oil sands. Three resolutions filed with Exxon Mobil ask for the adoption of a new policy on renewable energy research and development and establishment of comprehensive greenhouse-gas reduction targets. A resolution filed with Exxon last year seeking greenhouse-gas reduction targets received 31 percent support.

According to CERES, 14 of the 54 resolutions were withdrawn after companies "agreed to disclose potential impacts from emerging climate regulations and strategies for reducing greenhouse-gas emissions."

Meanwhile, three major investment banks (Citigroup Inc., J.P. Morgan Chase & Co. and Morgan Stanley) announced the formation of "Carbon Principles" guidelines that weigh the risks of future greenhouse-gas regulations and incorporate GHG risk when evaluating financing proposed power projects. Bank of America recently also adopted the Carbon Principals. The initiative currently applies to

privately-owned coal-fired power plants; however, the banks believe that the Carbon Principals represent best practices for public power entities. The banks have also considering extending the guidelines to municipal utilities which produce approximately one-third of the nation's electrical power. The power industry is the most capital intensive sector of the economy and accounted for $427 billion in financing in 2007.

LITIGATION

CERCLA Liability Imposed on Developer For Spreading Arsenic-Contaminated Soil

A former property owner who inadvertently spread arsenic-contaminated dirt during grading activities for a residential development nearly thirty years ago could not assert the CERCLA third-party defense and was held liable as a former owner in *United States v. Honeywell,* 2008 LEXIS 13432 (E.D. Cal. Feb. 22, 2008).

In this case, Charles Bruner purchased an undeveloped parcel known as Ray Vista in 1978. The Ray Vista Site was located adjacent to the Mesa de Oro mound of mine tailings that had been generated by the Central Eureka Mine. At the time that Bruner purchased the site, the adjacent tailing mounds were covered with vegetation. However, aerial photos showed that the tailings had been subject to extensive erosion prior to 1977 that had allowed arsenic-contaminated soils to migrate onto the development site.

Following his purchase of the property, Bruner retained contractors to excavate and grade the site to facilitate construction of streets and the installation of the underground utilities. He also contracted with the City of Sutter Creek for the construction of the streets, street lighting, sanitary sewers, water distribution pipes, and other utility distribution facilities. Thereafter, he built four homes on two streets in the subdivision.

In 1995, EPA discovered that arsenic contamination from the historical mining operations at the Site had migrated to the Vista Ray residential subdivision ("Vista Ray"). EPA implemented a response action which involved excavation of the arsenic-contaminated soils from all of the residential lots, placement of clean soils as well as landscaping. The federal government then commenced a cost recovery suit against Honeywell International and other responsible parties. Honeywell and the defendants ultimately agreed to pay EPA $600K along with an additional $120K in funds collected from contribution actions that had been filed against other responsible parties. The only third-party defendant that refused to settle was Bruner, and the settling parties sought $160K in response costs.

Bruner argued that he was entitled to assert the innocent purchaser defense because he did not know or have reason to know of the presence of the contamination but the court did not reach that issue because he could not assert the first element of the third party defense.

The innocent purchaser defense is technically part of the CERCLA third-party defense, which provides that a person will not be liable if the defendant can show that the release was (1) solely caused by an act or omission of a third party (2) whom the defendant did not have any direct or indirect contractual relationship (3) that the defendant exercise due care with respect to the hazardous substances and (4) took precautions against the foreseeable

acts or omissions of third parties. The innocent purchaser's defense is used to satisfy the second prong of the third party defense. If the defendant can show that it did not know or had no reason to know of contamination, it would be deemed to not be in a "contractual relationship" with a person who caused the contamination.

Bruner argued that the contamination was solely due to mine operations. However, the court said the arsenic-contaminated soil was spread either by Bruner's actions or those of his contractors. Distinguishing other cases where parties had been able to assert a defense based on the passive migration of the contaminants, the court said that Bruner took affirmative steps in developing his land. The court noted that he actively graded and excavated the property, that it was reasonable to expect that any contaminants in the soil would have been agitated and that it is eminently foreseeable that development of such land would result in a release of whatever hazardous substances were in the soil.

Because Bruner could not show that a third party was the "sole" cause of the release of arsenic from the Vista Ray subdivision, the court ruled there was no need to discuss whether he exercised due care or took the proper precautions to prevent such a release. Likewise, because the court found that Bruner had actively contributed to the "release" of the hazardous substance at the time he undertook development, the issue of whether he had "reason to know" of the presence of a hazardous substance was irrelevant. While the court held that Bruner was liable, it determined that there were genuine issues of material fact on the amount of Bruner's equitable share of the response costs and that further discovery was required before the Bruner share of the costs could be established.

Commentary: *This is one of those harsh cases that have given CERCLA a bad name and perhaps the type of situation that Congress had hoped to ameliorate when it enacted the Innocent Landowners (ILO) Defense in 1986. Had the defendant been able to get past the "solely caused by" prong, it might have been able to demonstrate that in 1978 it would not have had any reason to know of the arsenic contamination, especially since the mine tailings had been covered with vegetation. Since the decision was at the summary judgment stage, it is unlikely that sufficient discovery had been conducted to determine if Bruner had exercised due care.*

This case also shows the differences between the ILO/TP defenses and the BFPP/CPO defenses. Under the latter, the court would have been able to directly analyze if the defendant had taken "reasonable steps/appropriate care," which is to be informed by the third party due care caselaw.

Federal Government Liable For Response Courts

The United States Court of Federal Claims recently held that the United States must reimburse Shell Oil Company and three other oil companies for the costs of remediation aviation fuel byproducts that had been disposed during World War II.

In *Shell Oil Co. v. United States*, U.S. Claims LEXIS 29 (Fed. Cl. Feb. 8, 2008), the federal government required large volumes of 100-octane aviation fuel ("Avgas") to support the war effort. Instead of seizing and directly operating the refineries, the Defense Supplies Corporation (DSC), a component of the Reconstruction Finance Corporation (RFC), entered into Avgas contractual agreements with the Plaintiffs. The contracts contained a provision where the federal government agreed to bear the risk of increased costs in the production of avgas unless the government was willing to accept reduced production. The agreements also contained a reimbursement clause providing that the federal government would pay any new or additional taxes, fees, or charges, other than income, excess profits, or corporate franchise taxes, that the oil companies might be required to pay by any municipal, state, or federal law due to the production, manufacture, sale or delivery of the avgas.

The Avgas refining process generated acid sludge and spent alkylation acid. Prior to the war, the Avgas waste by-products were placed into tank cars and transported for reprocessing. However, the tank cars had to be used to transport the Avgas. Plaintiffs requested additional resources for the construction of new reprocessing plants to eliminate the waste but the government denied these requests. As a result, some of the Avgas waste was disposed at the McColl refinery site. After the war ended and the contracts expired, the waste was left in waste sumps.

EPA and the State of California commenced response actions at the McColl site and filed an action under CERCLA seeking past response costs in 1991. The oil companies asserted the "Act of War" defense and also claimed that the government was liable as a CERCLA arranger. The district court granted partial summary judgment in favor of the government, dismissing the "Act of War" defense and the parties entered into a partial consent decree where the oil companies provisionally agreed to reimburse the governments $18 million for costs incurred through 1990. However, the oil companies reserved the right to recover those funds should the United States ultimately be held responsible for the cleanup.

The district court subsequently ruled that both the federal government and the oil companies were jointly liable. Following an allocation trial, the court ruled that the government was 100% liable for the cleanup costs. On appeal, the Ninth Circuit reversed, holding that the federal government was not liable as an "arranger" for the avgas waste and remanded the case back to the district court. The district court resolved all remaining claims but transferred the oil companies counterclaim for breach

of contract to the Court of Claims pursuant to 28 U.S.C. § 1631.

The plaintiffs asserted that they were entitled to recovery under the reimbursement clause of the contracts. The government argues that the reimbursement clause was a supplemental pricing term and not an indemnification clause. Even if it could be construed as an indemnification, the government asserted that the clause was expressly limited to "taxes, fees, and charges" incurred by reason of the production, manufacture, sale, or delivery of avgas", and that CERCLA liabilities did not fit into those categories.

Agreeing with the plaintiffs, the court ruled that ordinary meaning of the term "charge" included costs and expenses. While CERCLA liability was not contemplated by the parties at the time the contract was executed, the court said that cleanup costs clearly were a "new charge as contemplated by parties under the language of the contracts qualified as a “new charge.” Moreover, the court said it was an undisputed fact that but for the contracts' production of avgas there would not have been any CERCLA "charge".

The government also claimed that the reimbursement clause only covered costs imposed during the performance of the contract performance. However, the court rules that the plain language of the reimbursement clause did not limit reimbursement to costs imposed during contract performance.

The government also argued that even if the CERCLA liabilities were construed as a charge, the plaintiffs liabilities were not a result of the production of Avgas but the plaintiffs decision to dump the acid waste at the McColl site. The court likened this argument to a murder defense where the shooter claims it was the bullet that killed the victim. It was beyond dispute, the court went on, that production of the avgas entailed disposal of the hazardous waste and that the only way the plaintiffs could have avoided disposing of the waste was by reducing or stopping the production of avgas, which would have been in violation of their contractual obligations. Furthermore, the court found that there were no reasonable alternative methods of disposal because the huge volume of avgas required by the Armed Forces resulted in a correspondingly huge volume of acid waste that overwhelmed existing treatment facilities. Indeed, the court noted, when the oil companies sought permission to transport the waste or alternatively to build additional treatment facilities, the government refused to authorize the diversion of resources necessary to implement alternatives.

Accordingly, the court ruled that the money paid by the plaintiffs to the government as a result of their CERCLA liability was a reimbursable charge under the Avgas contracts.

Cleanup Costs Paid By Insurance Policy Not Recoverable In Contribution Actions

In another case involving a World War II facility, the U.S. District Court for the District of Nevada ruled that

the plaintiff could not recover the costs of an insurance policy in a contribution action.

In *Basic Management Inc.(BMI) v. United States*, 2008 U.S. Dist. LEXIS 16138 (D. NV 2/25/08), a facility known as the BMI Complex had been used as a chloride and magnesium plant during World War II. After the war, the site was divided and changed hands and uses several times.

In 1991, certain former owners and then-current owners and operators of the BMI Complex entered into the first of a series of consent agreements with the State of Nevada Division of Environmental Protection (NDEP). Plaintiffs were not parties to the 1991 agreement but they did enter into a second consent agreement with the NDEP along with other parties in 1996. Later, the plaintiffs and other non-party PRPs executed separate settlements with the NDEP referred to as the "Soils Settlement Agreement" and "Groundwater Settlement Agreement." The Soils Settlement Agreement set up an escrow account used to purchase an insurance policy for soils contamination covering remediation costs, third party claims for clean-up costs, bodily injury and property damage, and legal expenses. Similarly, the Groundwater Settlement Agreement established an escrow account used to purchase an insurance policy covering remediation costs, third party claims for clean-up costs, bodily injury and property damage, and legal expenses for groundwater contamination and related pollution conditions not covered by the soils policy.

At the same time, the plaintiffs obtained two insurance policies from American International Specialty Lines Insurance Company ("AISLIC") covering soil and groundwater contamination. Under the policies, investigation and remediation costs at the BMI Complex were pre-funded and capped. Invoices for cleanup costs were submitted directly to AISLIC, and AISLIC paid the vendors directly. The premiums for the policies were paid by other PRPs who were not parties to the instant lawsuit. As of February 2008, all claims submitted to AISLIC under those policies had been paid, totaling approximately $22 million.

In 2002, the plaintiffs filed a cost recovery and contribution action alleging that they had incurred over $22 million in cleanup cost. In addition to the costs covered by the insurance policies, the plaintiffs claimed that they had incurred pre-insurance response costs of $ 890,868.

In its claim against the federal government, the plaintiffs asserted that the United States was liable as a past owner and arranger for contamination relating to magnesium plant operations during World War II as well as its involvement with an ammonium perchlorate facility from 1945 to 1962. In response to plaintiff's motion for summary judgment, the federal government acknowledged that it had previously admitted liability for the World War II operations but argued that the plaintiffs had not established that they had "incurred response costs" that were "necessary" and

"consistent" with the national contingency plan.

The court summarily dismissed the government's contention that the costs were not response costs, relying on the plain meaning of the statutory language. The court said the plaintiffs had adequately documented that the costs were to investigate, characterize and remediate the site.

The also rejected the notion that the costs were not "necessary." The government had argued that the costs were not "necessary" because the plaintiffs had selected the most expensive of three alternatives for cleanup of the site. Specifically, the United States claimed that instead of selecting the $ 10 million remedy for capping soils, the plaintiffs had chosen a $ 74 million option of excavating and disposing of soils at an on-site landfill to meet residential land use standards. The government argued that selected remedy was not cost-effective and not "necessary" because it was motivated solely by plaintiffs' intent to profit from sale of the property to residential developers. In response, the plaintiffs argued that CERCLA did not REQUIRE the least expensive response action, that their motive is irrelevant, and the option selected was the one approved by the NDEP.

The court found that there was no authority that the term "necessary" required that the least expensive clean-up option and that "cost-effective" inherently meant "least expensive." Rather, the court said, the term "cost-effective" referred to the most cost effective method for alleviating the threat to human health and the environment in the specific location, surroundings and likely uses for the land. For example, the court explained, if property is in the middle of high density residential or commercial uses, full remediation of potential health and environmental hazards would be greater. Similarly, if the pollution effects can be expected to travel underground to other residential or environmentally sensitive sites, simple overhead encapsulation may be insufficient under this law. Given the site's location in Henderson, Nevada, and its proximity to residential developments, the court held it was reasonable to conclude that the more expensive excavation option to meet a higher cleanup standard was necessary to address the threat to human health and the environment.

The court agreed with the government, though, that the plaintiff had not incurred the bulk of the response costs. The court said that to bring a contribution action, a plaintiff must show that it has or will actually incur the specific cost for which it seeks contribution. Otherwise, the court said, the plaintiff could obtain a windfall for a cost which it may never incur or have to pay. Moreover, the court said that Section 114 of CERCLA barred any person from recovering compensation under state or federal law for the same response costs that were recovered under CERCLA.

The plaintiffs countered that they should not be precluded from receiving the costs that they are entitled to under CERCLA simply because they had the foresight to purchase insurance. Plaintiffs also charged that the "collateral source rule" from tort law precluded the

defendants from offsetting their CERCLA liability with any insurance monies received by plaintiffs. However, the court said that this principle was used in personal injury cases. In contrast, it is the environment and not the plaintiffs who have been injured. The court said that in a CERCLA contribution action, the parties responsible for causing that injury who fronted the money to fund the repair of that environmental damage are entitled to reimbursement from the other responsible parties to the extent they expended beyond their share of actual responsibility for the environmental damage.

The court acknowledged that the plaintiffs could have paid for the costs themselves and submitted those claims to AISLIC for reimbursement under the insurance polices. However, the court said that the structure that the plaintiffs had agreed to was that AISLIC would pay the vendors directly and was obligated to do so into the future. Thus, while the Court agreed that the plaintiffs had incurred "liability" for the cleanup, they had not incurred the specific costs directly paid by or reimbursable by the insurer. Therefore, the court declined to apply the collateral source rule to the recovery of response costs in this CERCLA contribution action. Indeed, the court went on to hold that this doctrine had been preempted by the federal statutory mandate of CERCLA barring double; the recovery bar prevents plaintiffs from recovering costs paid by AISLIC.

The court said it was unnecessary to address the NCP consistency issue in the motions before it because the vast majority of the response costs herein were held to be unrecoverable. The court ruled that the allocation of the pre-insurance response costs incurred by plaintiffs, totaling $ 890,868, must be decided at trial.

Commentary: *In another part of the decision, the court used the Bestfoods reasoning to conclude that the holder of the majority interest in the joint venture that had operated the magnesium plant was not liable as an indirect operator of the site or under a common law corporate veil piercing theory.*

A similar case involving a contribution action where the plaintiff was found to have received more than its fair share of settlement funds was Friedland v. TIC, 2008 U.S. Dist. LEXIS 4076 (D.Col. 1/18/08). There, a former director and officer of the Summitville Consolidated Mining Company was was sued by the federal government to recover response costs and entered into a settlement where he agreed to pay $ 20.7 million. While the federal lawsuit was still pending, the plaintiff and others filed suit in Montana state court against Industrial Constructors Corp. ("ICC") and its insurer, United States Guaranty and Fidelity Corp. ("USF&G"), seeking indemnification pursuant to a contract for work performed by ICC at the site. Not long after the cost recovery action was resolved, the Montana lawsuit was settled where ICC assigned its claims against its insurers to plaintiff who subsequently settled the assigned claims. He also reached a settlement with Travelers Indemnity Company under his employer's liability insurance policy. It was

undisputed as a result of these settlements, plaintiff has recovered more than he agreed to pay in recovery costs.

NY Court Refuses to Dismiss Bank from LBP Case

In a case as interesting for its international financing implications as environmental liability, a New York state appeals court rejected a motion for summary judgment filed by a bank that it was not an owner of a building where a child was alleged to have suffered personal injuries due to exposure to lead-based paint (LPB).

In *Roni v. Rahim*, 2008 N.Y. App. Div. LEXIS 2813 (App. Div-3/25/08) the plaintiffs alleged that their infant had suffered lead poisoning when it ingested LBP present at a multi-family building that had been constructed in 1933. The building had allegedly been purchased by the defendant Baitul Center prior to the time that the plaintiffs occupied their apartment. The deed to the property was issued in the name of the defendant United Bank of Kuwait, PLC, which funded the purchase of the building. This arrangement allegedly was made pursuant to an Islamic financing program whereby the Baitul Center borrowed money from the Bank without interest. The defendants claimed that the deed was intended to operate as security for the loan and that the building was then leased by the Bank to the Baitul Center with the understanding that the latter would acquire the title at the end of the lease term.

At the time the infant plaintiff's family moved into the apartment in question, the building was subject to the NYC LPB Law known as Local Law No. 1 of 1982 requiring an owner of a multiple dwelling built prior to 1960 to remove or cover any peeling paint in any dwelling unit in which a child or children six years of age or younger resided. The law created a rebuttable presumption that paint used in buildings constructed prior to 1960 contained hazardous levels of lead.

The Bank filed a motion for summary judgment on the grounds that it was not the owner of the building but only a mortgagee. The Bank argued that even if it were deemed to be the owner, it had not been given notice that a child six years of age or younger resided in the plaintiffs' apartment. The trial court denied that the motion and appeals court affirmed, holding that the bank failed to demonstrate as a matter of law that it was not the "owner" of the property and that it did not have notice that the infant plaintiff resided therein during that time period.

In a related proceeding, the Bank moved for summary judgment on its cross claim for contractual indemnification against the Baitul Center based upon the contractual indemnification clause of the lease (2008 N.Y. App. Div. LEXIS 2748, App. Div.. 3/25/08). The court held that the bank failed to demonstrate as a matter of law that the indemnification provisions shifted all responsibility for third-party claims to the Baitul Center regardless of the Bank's own negligence. As a result, the court ruled that the indemnification provision would be

unenforceable under the state General Obligations Law § 5-321.

Pollution Exclusion Held Not to Apply to Property Held By Bank as Trustee

In *Bank of America, v. Travelers Indemnity Company*. 2008 U.S. Dist. LEXIS 4249 (W.D.WA. 1/22/08), Safeway, Inc., sued Bank of America in 2004 in its role as trustee of the Donald C. and Mary Clare Jurgensen Trust (the "Trust"). Bank of America held title to the property pursuant to a quit claim deed to Bank of America's predecessor, Rainier National Bank on May 14, 1980. Safeway asserted that the petroleum contamination originated from the adjoining property that was the primary asset of the Trust. The source of the contamination was alleged to be a former laundry, dry cleaner and dye facility that had operated on the site between 1918 and the 1950s.

In April 2004, the Department of Ecology sent a letter to Bank of America notifying the bank of the agency's interest in the site and suggesting that the carefully document any response actions that it implemented in support of their argument that paragraph 2 of the pollution exclusion precludes coverage. The plaintiff tendered notice of the Safeway complaint to Travelers Casualty and Surety Company who denied a defense on the grounds that the pollution exclusion excluded coverage for the underlying litigation and that Bank of America may have breached the policy by impairing Traveler's contribution and/or subrogation rights against other insurers. This argument fails for two reasons. First, the letter does not contain "any governmental direction or request imposed upon the insured." The letter simply provides the costs plaintiff seeks to recover were incurred in defending a suit initiated by Safeway, Inc., not the government.

The pollution exclusion excluded from coverage environmental contamination at or from property "owned by" the insured. Thus, the court said the key issue was whether the property held in trust is "owned by" the trustee. The defendants argued that under Washington law and the terms of the trust, the trustee has the authority to manage and convey the trust property in the same manner and to the same extent as the trustors. They also asserted that the parties must have intended "owned by" to include trust properties because the policy was issued to "a trust department that will only own property in trust." Any contrary interpretation, the defendants argued, would gut the pollution exclusion because it would not apply to any of the properties held by Rainier National Bank.

The court disagreed. It said that under Washington law, title and ownership are not necessarily the congruent and that the nature of the transaction, the intent of the parties, and any other relevant indicia of ownership must be examined. Here, the court explained, Rainier National Bank took legal title to the property as part of a trust agreement where the property and any income derived therefrom were to be utilized for the benefit of the trustors, not Rainier National Bank. The court pointed out

that in trust agreements there is a separation of legal and beneficial ownership. When the trustors die, the trust properties are to be distributed to their designated heirs so that the plaintiff did not have long-term interest in the trust estate.

The court also noted that the policy was written for Rainier National Bank, not just its trust department. Absent some evidence to the contrary, the court continued, one must assume that the bank held title to one or more properties, such as, its branch offices or foreclosed premises for its own benefit. In the court's view, neither the text of the policy nor the context in which it was written compel an interpretation of "owned by" that would include trust properties. Instead, the court said that the pollution exclusion would only apply for environmental contamination at the properties truly owned by the bank

At best, the court said, the meaning of "owned by" as used in the pollution exclusion was ambiguous where the insured property is held in trust. Construing the phrase in favor of the insured as required under Washington law, the court ruled that the trust property was not "owned by" Bank of America and therefore the pollution exclusion did not apply. Accordingly, the court held that Travelers had a duty to defend Bank of America in the underlying environmental contamination suit and granted the bank's motion for partial summary judgment.

Bankruptcy Court Dismisses Claims Against Parent Corporation

. In two related bankruptcy proceedings, *In re Alper Holdings USA, 2008 Bankr. LEXIS 86, (Bankr. S.D.N.Y. Jan. 15, 2008) and 2008 Bankr. LEXIS 522(Bankr. S.D.N.Y. 2/25/08),* the bankruptcy court disallowed claims filed against the parent of the debtor. In this case, Saltire manufactured automotive tire valves and associated products at a plant in Dickson County, Tennessee from 1964 until 1985. From 1985 through August 2004, Saltire implemented remedial actions to address TCE contamination that had impacted the groundwater. Seven years after the Dickson Plant closed and decades after the alleged disposal of TCE, Alper became the controlling shareholder of an entity known as First City Industries Inc. ("First City") which was an incidental and indirect parent of Saltire.

Beginning in 2003, numerous lawsuits were filed against Alper alleging personal injury and property damage arising from Alper's failure to adequately monitor, control, supervise and/or maintain the disposal of the TCE the Dickson facility.

The court ruled that Alper had no direct liability to the claimants in both cases. To establish a direct cause of action against Alper, the court said that the plaintiffs had to prove that Alper owed a duty to them, that the duty was breached, and that the breach was the cause in fact and proximate cause of their injury or loss. Because Alper had not operated the Dickson Plant, the court

found no breach of duty regarding the initial disposal of the wastes. Similar, the court found no evidence that Alper actually participated in or oversaw Saltire's remediation in Dickson County that would support a finding that Alper may have assumed a duty of care to the plaintiffs.

Alternatively, the plaintiffs argued that Alper was indirectly liable for the negligent acts or omissions of Saltire in its remediation efforts on an alter ego or corporate veil piercing theory. In support of this allegation, the plaintiffs pointed to the existence of a management agreement between Alper and Saltire providing that Alper would oversee certain environmental remediation for Saltire, and that an Alper employee who was also an officer of Saltire was involved in the clean-up activities. Applying a Bestfoods analysis, the court ruled that there was no evidence of an eccentric relationship between Alper and Saltire justified the extraordinary remedy of piercing the corporate veil.

Plaintiffs Barred From Removing VI Case to State Court Because of Energy Policy Act

Section 1503 of the Energy Policy Act of 2005 (42 U.S.C. § 7545) provides that legal actions filed after the enactment date (August 8, 2005) related to allegations involving actual or threatened contamination of methyl tertiary butyl ether (MTBE) may be removed to the appropriate United States District Court, 2005 Amendments, 'Claims Filed After Enactment'). The potential interplay of this law and vapor intrusion was illustrated in Bonds v. Nicoletti Oil Co., Inc, 2008 U.S. Dist. LEXIS 6810 (E.D. CA. 1/28/08).

In that case, homeowners filed claims for property damage due to the presence of a gasoline plume from a petroleum storage facility. The complaint alleged that the plaintiffs had suffered damages in excess of $ 25,000 in diminution of their property value as a result of the presence of the contaminants of benzene, ethyl benzene, toluene, tetryl ethyl lead and MTBE on their property. Among the allegations, the plaintiffs claimed the presence of contaminants made their property less suitable for habitation because of the build up of dangerous pollutants in the soil, air and water, and the build up of potentially explosive gases in the confined spaces of the structures on the property.

The defendant had the case moved to federal court and the plaintiffs filed a motion to remand. The plaintiffs argued that they did not depend on any claim of MTBE contamination to maintain any of their causes of action. Moreover, they asserted that removal to federal court was not required because of the word "may" in Section 1503. However, the court said this was irrelevant since the defendant had elected to exercise its rights under the statute.

The defendant filed a motion to dismiss the negligence, nuisance and trespass claims on the grounds that the complaint was barred by the statute of limitations. Because the contamination of plaintiffs' properties remained on their property, the court ruled that denied the defendant's motion to strike those counts.

On a related motion to

dismiss, the defendant argued that the plaintiffs had not pled sufficient facts to justify a delayed discovery of the contamination. Under the state delayed discovery rule, a plaintiff whose complaint shows on its face that a claim would be barred without the benefit of the discovery rule must specifically plead facts to show the time and manner of discovery and the inability to have made earlier discovery despite reasonable diligence. The defendant argued the plaintiffs were not entitled to the delayed discovery rule because they could have discovered the contamination through the exercise of reasonable diligence by reviewing the files of the regional control board beginning in the late 1980s. The defendants also argued that the plaintiffs were out on constructive notice of the contamination by the installation of groundwater monitoring wells within 175 feet of their homes that required street lane closings.

The plaintiffs responded that the first time they could have reasonably been put on notice was April 8, 2004 when regional water control board sent them a letter advising them that a release of gasoline and diesel fuel had impacted the groundwater and *may* have migrated beneath their property and that the primary potential health hazard (if any) was the possibility of gasoline vapors in indoor air.

The court found that there were numerous factual issues involved in this aspect of the motion to dismiss. For example, the court said it was unclear if the testing and drilling on the defendant's facility and the work done on the street near the plaintiffs homes was publicized? It was also unclear when the defendant or the water board became aware that the that the contaminated ground had possibly migrated under plaintiffs' properties. Other than the April 8, 2004 letter, the court said that all of the public records in the file of the water board referred to defendant's facility. Therefore, the court said. when each Plaintiff discovered their respective injury raised questions of fact. Plaintiffs allege they did not know the purpose of the monitoring wells; what test results were achieved; or that they had any duty to inquire about the wells unless and until defendant publicly disclosed the purpose of the wells and testing results. Accordingly, the court granted the defendant's motion to dismiss but allowed the plaintiffs to amend their complaint.

Federal Court Allows Property Owners to Proceed With Common Law Claim for Injunctive Relief

In *Gail v. New England Gas Company*, 2008 U.S. Dist. LEXIS 6923 (D.R.I. 1/30/08), coal gasification wastes by employees of Tiverton, Rhode Island while excavating for the installation of a sewer interceptor. The Rhode Island Department of Environmental Management ("RIDEM") later determined that the wastes were associated with a former MGP owner or operated by New England Gas Company ("NEG"). RIDEM sent a "letter of responsibility" to NEG. After NEG denied responsibility, RIDEM initiated administrative enforcement proceedings against NEG that are

pending. In the meantime, no remedial work has been undertaken.

In 2005, approximately 120 residents filed a lawsuit against NEG asserting claims for negligence, strict liability, and public nuisance. The plaintiffs sought damages for diminution in value and some also alleged personal injuries resulting from continued exposure to the hazardous substances. The complaint also sought an order from the court compelling NEG to remediate their properties.

NEG filed a motion for partial judgment on the injunctive relief claim, contending that landowners did not have common law right to remediation of property and that such authority was vested exclusively in RIDEM. NEG also argued that even if there was such a common law right to remediation exists, this Court should defer to RIDEM. NEG pointed to *Hydro-Manufacturing Inc. v. Kayser-Roth Corp., 640 A.2d 950 (R.I. 1994)* for authority that Rhode Island did not recognize a common law duty to remediate. However, the court said that decision involved a very narrow question of whether a seller owed a duty to future owners to refrain from engaging in activities that contaminate the property. The court explained that the rationale underlying the decision in *Hydro-Manufacturing* was that a purchaser of property has an opportunity to inquire if the previous owner had engaged in activities that may have contaminated the property and, if so, the purchaser could bargain with the owner to remediate the property or reduce the sale price. In contrast, the plaintiffs in the case before the court had not purchased their properties NEG and therefore, had no opportunity to protect themselves through a negotiated arms-length transaction. Accordingly, the court ruled that the *Hydro-Manufacturing* does not negate a landowner's common law right to seek abatement as a remedy for the contamination of his property. Moreover, the court held that the plaintiffs also have a statutory right to injunctive relief under *Rhode Island General Laws § 10-1-1*, which expressly confers on a private citizen the right to bring an action "to abate [a] nuisance and to perpetually enjoin the persons or persons maintaining the nuisance."

Turning to the argument that the state Industrial Property Remediation and Reuse Act ("IPRRA") and the Hazardous Waste Management Act ("HWMA") pre-empted any common law rights to seek abatement or other injunctive relief against the party allegedly responsible for contaminating the landowner's property, the court said there was no evidence that the legislature intended to the preempt or extinguish the common law rights of property owners when it enacted legislation regulating hazardous wastes and giving RIDEM authority to enforce the legislation. does not demonstrate an intent to extinguish the common law right of a landowner to in an action.

The court was also unpersuaded that it should refrain from ordering injunctive relief because six years had elapsed without any remediation despite the diligent efforts of RIDEM. The court also said it was unlikely that allowing plaintiffs to pursue their claims for

injunctive relief would interfere with or disrupt RIDEM's efforts to remediate the site. The court noted that the plaintiffs were not asking for specific remedial action and that the only express reference to remediation contained in any of the complaints was that NEG be ordered to pay money into a fund that would be used to remediate the plaintiffs' properties. The court also did not envision a grant of injunctive relief interfering with any action to be taken by RIDEM since RIDEM would not be precluded from requiring NEG to take whatever additional action RIDEM may deem necessary to remediate the site.

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