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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.

LITIGATION

NJ State Court Upholds Denial of Brownfield Funding Application

When states began launching their brownfield programs ten years ago, they touted the financial incentives such as tax credits, loans and grants that were available to assist developers of contaminated sites. Not surprisingly, the brownfield incentives have become popular with developers and are increasingly being viewed as one of the entitlements to obtain when developing projects.

To ensure that the costs of the brownfield programs do not spiral out of control, some states are beginning to review applications with greater scrutiny and are starting to reject applications for financial assistance involving projects that are only moderately contaminated or where the contamination does not pose a significant obstacle to redevelopment.

Naturally, developers are challenging these administrative decisions and creating a field of brownfield case law.

A recent example of this trend was *JDN Real Estate-Hamilton, L.P. v. State of New Jersey*, No. A-3138-05T5 (App. Div. 10/16/06). In this unpublished decision, the plaintiff filed an application to enter into a reimbursement agreement with the Commerce, Economic Growth and Tourism Commission State of New Jersey (Commerce Commission) under the state brownfield law formally known as the Brownfield

and Contaminated Site Remediation Act (Brownfield Act). Under this law, developers are eligible to receive up to 75% of the cleanup costs based on the amount of taxes generated by a redevelopment project. The law also provides that applications must be approved by both the Commerce Commission and the State Treasurer.

In this case, the project involved a retail center known as Hamilton Marketplace that was to be constructed on a site consisting of woodland and agricultural land. The applicant requested financial assistance because of the presence of pesticides. The Commerce Commission approved the application but the State Treasurer rejected the application on the grounds that there was no evidence of contamination at the site that posed a health risk to residents and the financial assistance was not required to commence or complete the project. In addition, the Treasurer ruled that the proposed project was not the type of development project contemplated by the Brownfields Act. The state treasurer said the financial assistance under the Brownfield Act was funded through dedicated tax revenues must be reserved for projects that clearly require State financial assistance. The Treasurer ruled it was not in the public interest to allow the project to receive brownfield financial assistance because the site was not formerly zoned or used for commercial or industrial purposes, the contamination was limited to relatively a small portion of the

overall site, and was not included on a priority list established by the Brownfields Redevelopment Task Force. Moreover, by the time the Treasurer made its final decision, the retail center had already been completed.

The developer then sought review of the application denial. The court agency decision was afforded a presumption of validity and reasonableness and that it could not substitute its judgment for that of an administrative agency when the findings of the agency are supported by credible evidence. Because the court found that the conclusions of the State Treasurer were supported by the record, that it had applied the appropriate factors and properly interpreted the Brownfield Act, it affirmed the decision of the State Treasurer.

This past summer, a New York state court summarily dismissed a petition filed by a developer whose application to enroll in the state brownfield cleanup program (BCP) was denied by the New York State Department of Environmental Conservation (NYSDEC). In *Jopal Enterprises LLC, and Belmont Villas LLC v. Sheehan*, NO.: 00803-06 (July 31, 2006), a developer planned to construct an affordable housing project for seniors on a vacant parcel that was believed to be contaminated because of the evidence of illegal dumping in the form of abandoned automobiles, household waste and construction debris as well as its proximity to a state superfund site. The developer performed a Phase II Environmental Site Assessment (ESA) and the

analysis of the groundwater samples revealed concentrations of heavy metals, semi-volatile organic compounds (SVOCs), Volatile Organic Compounds (VOCs) in eight of the 28 groundwater samples exceeded state groundwater standards. The NYSDEC initially prohibited the developer from renewing a dewatering permit until a groundwater investigation was completed.

Meanwhile, the developer filed an application to enroll in the BCP which defines a brownfield site as real property where the presence or potential presence of contamination complicates the reuse of the land. However, because the contamination was only marginally above the groundwater criteria and there was no evidence in the record that the contamination was a result of prior industrial or commercial use of the property, the NYSDEC denied the application. Had the application been accepted into the BCP, the developer would have been eligible for tax credits of up to 22% of the \$32 million cost of the project.

The developer then filed a lawsuit known as an Article 78 Proceeding seeking an order voiding the denial of its BCP application and ordering the agency to admit the project into the BCP. The petitioner also sought damages for construction delays associated with the delayed renewal of the dewatering permit that allegedly caused the project to incur additional interest costs of \$68,250 for each month's delay; lose \$300,000 in capital contributions from tax credit investors, and \$192,700 in lost rent

each month until the units are placed in service.

In a two-page decision, the court summarily rejected the petition. The court said it could not substitute its judgment for that of the agency responsible for making the determination and must give great weight and judicial deference to factual evaluations in the area of the agency's expertise that are supported by the record. The court then found that there was substantial evidence in the record to support the NYSDEC determination that the contamination on the petitioners' property was minimal and did not complicate its redevelopment or reuse.

The petitioner had also argued that the NYSDEC had acted arbitrarily and capriciously by relying on the non-statutory eligibility criteria contained in a NYSDEC guidance document. The petitioner argued that the agency could not use the criteria to determine if the site was eligible for the BCP because the criteria were not contained in the statute and had not been adopted pursuant to formal rulemaking procedures. However, the court ruled that NYSDEC did not have to formally adopt the criteria as rules or regulations to be valid, noting that the state administrative procedures act specifically excluded from formal rulemaking requirements any forms and instructions, interpretive statements and statements of general policy which in themselves have no legal effect but are merely explanatory. Accordingly, the court ruled that NYSDEC properly denied the petitioners' application.

Commentary: *The arbitrary and capricious standard is a very high standard to meet and these decisions illustrate the heavy burden facing parties when seeking to overturn administrative decisions. For this reason, it is important that applications include all information that is necessary to document how the projects qualifies for any statutory and administrative eligibility criteria that will be used by the reviewing agency even if the applications does not specifically request such information. Not only will this force the agency to respond to the information in any negative determination but it will allow the information to be made part of any administrative record that would be reviewed in a subsequent judicial proceeding.*

Aviall Roundup

The United States District Court for the Central District of California ruled in *AMCAL Multi-Housing Inc. v. Pacific Clay Oro Fund*, No. 06-280 (C.D. Cal. 10/6/06) that a developer of contaminated property did not have a right to bring a contribution action under CERCLA Section 107. In this case, the defendant had owned and operated a clay product and ceramic manufacturing facility on a parcel of property between 1923 and 1953. In 2002, the plaintiff purchased the property to build a mixed use development consisting of 300 affordable housing units and retail uses. A Phase II ESA performed prior to acquisition of the site revealed the presence of petroleum hydrocarbon contamination in

portions of the site in the areas where previously identified storage tanks had been located. The report also indicated that there was widespread contamination in the shallow soils consisting primarily of lead and other heavy metals. Despite this information, the plaintiff proceeded with the transaction. During demolition, the plaintiff unexpectedly discovered buried kilns, tunnels, drainage channels, and other wastes contaminated with lead and other hazardous materials. The plaintiff incurred over \$6 million in costs implementing a voluntary cleanup approved by the Los Angeles County Fire Department, the Los Angeles Regional Water Quality Control Board, and the California Department of Toxic Substances Control. The plaintiff then sought recovery of its costs from the defendant under Section 107 and the defendant filed a motion to dismiss.

The court first ruled that the plaintiff was a responsible party because it was the current owner of contaminated property and was not eligible to bring a cost recovery action under Section 107. At oral argument, counsel argued that the plaintiff qualified for the innocent landowner (IL) defense because the bulk of the contamination that it remediated was from lead putty in the previously unknown tunnels and not the surficial lead in the soil detected during the Phase II ESA. However, because the complaint did not allege any of these facts, the court ruled that the plaintiff did not qualify for the IL. Also during oral argument, plaintiff's counsel also asserted that it qualified for the bona

fide prospective purchaser (BFPP) defense. Again, since the complaint did not allege any facts to support this claim, the court ruled that the plaintiff did not qualify for the BFPP.

Relying on other federal district court decisions in California, the Second Circuit's decision in *Consolidated Edison Co. v. UGI Utilities Inc.*, 423 F.3d 90 (2d Cir. 2005) and the Eighth Circuit's opinion in *Atlantic Research Corp. v. UGI Utilities Inc.*, 459 F.3d 827, (8th Cir. 2006), the plaintiff claimed that it was entitled to bring a contribution claim under Section 107. However, the court said it was bound by the 1997 ruling of Court of Appeals for the Ninth Circuit in *Pinal Creek Group v. Newmont Mining Corp.*, 118 F.3d 1298 (9th Cir. 1997) that bars PRPs from bringing claims under Section 107. In so ruling, the court dismissed the public policy rationale used by other federal courts for finding an implied right of contribution under Section 107. Those decisions expressed concern that prohibiting contribution actions under Section 107 would discourage parties from voluntarily cleaning up sites and possibly allow the responsible parties to avoid liability, thereby violating CERCLA's "polluter must pay" principle. The court said such concerns for the plight of a party who was a PRP by virtue of its ownership of contaminated property created a false dilemma because it failed to take into account the 2002 amendments to CERCLA that created the BFPP. As a result, the court granted the defendant's motion to dismiss but granted the plaintiff leave to amend its complaint to

plead facts supporting its ILO and BFPP defenses.

Commentary: The CERCLA landowner defenses are affirmative defenses which means that the party seeking to assert the defense has the burden of establishing the defense. It is unclear why the plaintiff's complaint did not contain the factual statements necessary to establish the IL and BFPP but the plaintiff was very fortunate that the court granted it leave to amend its complaint. Perhaps the court was influenced by the fact that the plaintiff was building affordable housing.

The other lesson to take from this case is how difficult it can be to successfully assert the ILO. The plaintiff was willing to proceed with the transaction based on its estimates of the cost to address the surficial lead contamination probably because the lead-related remediation costs would only represent an incremental cost above the expenses already contemplated for the significant earth-moving activities that were planned as part of the construction. However, the plaintiffs had not anticipated encountering tunnels that contained lead putty. Plaintiff's counsel argued that the plaintiff had no reason to know about this type of contamination and therefore should be able to qualify for the ILO for purposes of the costs related to the remediation of the tunnel-related contamination. Should the plaintiff have had reason to know that other contamination might be present at the site because of its historical use? Plaintiff's counsel told the court that

they had "made Swiss-cheese out of the site" and could not have anticipated the tunnels since they were installed before the City of Los Angeles required as-built drawings.

The court did not discuss EPA's all appropriate inquiry rule in its holding, probably because the purchaser acquired the property before AAI went into effect. However, this case is a good example of the difference between AAI and the IL cases that pre-date AAI, which the author calls little AAI or "aai". The preamble states that sampling and analysis is not required as part of AAI but then goes on to say that sampling and analysis

"may be valuable in determining the possible presence and extent of potential contamination at a property. In addition, the fact that the all appropriate inquiry standards do not require sampling and analysis does not prevent a court from concluding that, under the circumstances of a particular case, sampling and analysis should have been conducted to meet "the degree of obviousness of the presence or likely presence of contamination at the property, and the ability to detect the contamination by appropriate investigation" criterion and obtain protection from CERCLA liability" (70 F.R. 66101, November 1, 2005).

Under existing case law, owners may not be able to claim the IL if a preponderance of evidence available to a prospective landowner prior to acquiring the property

indicates that the defendant should have concluded that there is a high likelihood of contamination at the site. Indeed, in the overwhelming number of cases, courts have held that if the purchaser did not learn about the contamination, it did not do an appropriate inquiry and therefore could not qualify for the ILO. It will be interesting to see if the court uses AAI to help its analysis after the Plaintiff files its amended complaint.

Tenth Circuit Rejects New Mexico NRD Claim

In State of New Mexico v. General Electric et al, the United States Court of Appeals for the Tenth Circuit affirmed a district court ruling denying a \$5 billion claim for natural resources damages filed by the State of New Mexico.

This case involved a zone of contaminated groundwater of approximately one square mile that that served as the primary source of drinking water for the City of Albuquerque. After elevated levels of VOCs were detected in one of the 25 wells serving the City, the South Valley Superfund site was placed on the National Priorities List (NPL), EPA ordered the impacted well and other private wells to be plugged and sealed, and ordered installation of a new groundwater well as an interim remedy. Following completion of a RI/FS, EPA issued a Record of Decision (ROD) requiring installation of a groundwater treatment system. The State of New Mexico also entered into agreements with a number of petroleum companies to address petroleum hydrocarbon

contamination in the shallow portion of the aquifer.

The New Mexico Attorney General then retained outside counsel to bring lawsuits against General Electric, ACF Industries (ACF), the United States Air Force (USAF), the Department of Energy (DOE) as well as a number of petroleum companies for natural resource damages (NRD) under CERCLA section 107(f) and state common law. The district court issued a series of opinions that narrowed the issues in dispute. Perhaps the most important preliminary decision was the 2003 decision where the court rejected the State's claim for damages based on "market value replacement cost" and "loss of use." The court said the closure of the well did not affect the State's ability to make water available because the same amount of water could be withdrawn from other well locations within the same basin. Moreover, the court noted that the State had not lost extra capacity because no further water appropriations were allowed since this could adversely impact the water flow in the nearby Rio Grande River. The district court also ruled that the only appropriate measure of damages would be the cost of restoration.

By June 2004, the State's claim had been narrowed to those damages that were not recoverable under CERCLA and would not be addressed by the groundwater remedy. The State sought recovery of groundwater contamination alleged to exist deep below the existing remediation system. However, the court found that the

State had not demonstrated that there was any contamination in the deep aquifer and that any such contamination that might exist would be addressed by CERCLA remedy. Accordingly, the court granted the defendants motion for summary judgment.

On appeal, the Tenth Circuit began by defining the interplay between CERCLA and state common law. The court found that Congress did not intend CERCLA to completely preempt state laws related to hazardous waste contamination but that a state claim could be barred under the doctrine of conflict preemption where the state law claim would be an obstacle to accomplishing CERCLA's objectives. The court then went on to rule that "CERCLA's comprehensive NRD scheme preempts any state remedy designed to achieve something other than the restoration, replacement, or acquisition of the equivalent of a contaminated natural resource." In so ruling, the court emphasized that the State's nuisance and negligence claims that had survived the earlier district court rulings were preempted to the extent that it sought an unrestricted award of money damages that would allow funds to be used for something other than to restore or replace the injured resource (such as attorney fees) since this would interfere with CERCLA's NRD restrictions.

Turning to the State's claim that the ongoing remediation would not address deep contamination and therefore its common law claims should not be barred, the Court ruled that this argument was essentially a challenge to an ongoing remedy that

was precluded by the bar on pre-enforcement judicial review contained in Section 113(h) of CERCLA. The court also affirmed the district court's rejection of the loss of use damage claim.

Commentary: *This case is only the latest in a string of appeals courts and numerous district courts have held that common law claims may be pre-empted by CERCLA. The overwhelming majority of these cases involve private plaintiffs who have sought to recover their cleanup costs under common law theories of contribution, indemnity, restitution or unjust enrichment. In most cases, the courts have held that CERCLA pre-empts these common law claims under the doctrine of conflict pre-emption because they would interfere with the comprehensive settlement procedures that Congress established in CERCLA. Some states have argued that this line of pre-emption cases were limited to private claims for contribution or indemnity. Earlier this year, a federal district court dismissed the State of Alabama's common law claims for nuisance in State of Alabama v. Alabama Wood Treating Corporation, 2006 U.S. Dist. LEXIS 37372 (S.D. AL. June 6, 2006) because the state claims would provide the same or double recovery provided under CERCLA. The New Mexico decision is one of the few appellate decisions to expressly extend the conflict pre-emption analysis to common law claims brought by a state.*

*Federal Circuit Courts
Reinforce Trend Towards Using
Traditional Corporate Law for
Imposing CERCLA Liability*

During the 1980s and 1990s, the majority of federal courts adopted a federal common law approach for evaluating the CERCLA liability of corporate entities such as parent and successor corporations. This federal doctrine dramatically expanded the liability of corporations because it creates liability in circumstances that were not permitted under traditional state corporate law. Courts reasoned that the federal common law approach was warranted to ensure a uniform application of CERCLA.

In 1998, the United States Supreme Court ruled in *United States v. Bestfoods*, 524 U.S. 51 (1998), that a parent corporation could not be held liable as an operator of a subsidiary's facility unless the plaintiff demonstrated that the parent directly managed or controlled operations specifically related to pollution or that the parent would otherwise be liable under traditional corporate veil piercing principles. While this decision was limited to the liability of a parent corporation, it has been increasingly relied on by courts to reverse the earlier expansion of corporate liability in other circumstances. Many courts have said that the teaching of *Bestfoods* is that Congress did not intend to abrogate common law when it enacted CERCLA, and that they must apply common law and not create CERCLA-specific rules when determining corporate liability under CERCLA. Indeed, the Second

and Ninth Circuits used the holding and reasoning of *Bestfoods* to repudiate prior decisions that had imposed successor liability under the substantial continuity test and hold that corporate liability must be evaluated under traditional state corporate law concepts. Two recent appellate decisions illustrate how far the trend has been reversed.

In *State of New York v. National Service Industries, Inc.*, 2006 U.S. App. LEXIS 19790 (2nd Cir. 8/3/06), the State of New York filed an action to recover its response costs incurred at a landfill in Islip, NY. The State argued that the defendant was a successor of the uniform rental business that had disposed dry cleaning wastes at the landfill. In October 1988, Initial Service Investments (ISI) purchased the assets of Serv-All including the customer list, current contracts, trucks, and goodwill for \$2.2 million. ISI initially operated under the same name, used the same trucks and employed some of Serv-All's management and support personal as well as all but one of its truck drivers. However, ISI did not continue Serv-All's practice of dry-cleaning uniforms but instead laundered them in water at one of its facilities. The two owners of Serve-All were paid cash and entered into a seven-year non-compete agreement. Serve-All was subsequently dissolved and the defendant purchased the ISI stock in 1992. Three years later, ISI was merged into NSI.

After spending \$12 million to remediate the landfill, the State filed a cost recovery action against NSI, arguing that it was the successor to

Serv-All under the substantial continuity test. The district court granting summary judgment to the State (NSI I) and the defendant appealed, arguing that the substantial continuity test was no longer good law in the wake of *Bestfoods*. The Second Circuit agreed, vacating the judgment and remanding the matter for further proceedings (NSI II). On remand, NSI moved for summary judgment on the grounds that it was not a legal successor to Serv-All under state corporate law. The State responded that the company was liable under the “de facto merger” theory of successor liability.

To establish a de facto merger under common law, a plaintiff generally has to show that there was (1) continuity of ownership (i.e. same shareholders), (2) cessation of ordinary business with prompt dissolution of the acquired company, (3) assumption of liabilities ordinarily necessary for the uninterrupted continuation of the business, and (4) continuity of management, personal, physical location and general business operation. The parties agreed that the transaction satisfied the last three prongs of the de facto merger test and the State did not dispute that there was no continuity of ownership between the companies. However, the State argued that New York law was broader than common law and did not require a finding of continuity of ownership.

The district court observed that the New York Court of Appeals had not explicitly held if continuity of ownership was necessary for a “de facto merger” to occur. However,

after reviewing the body of state law, the district court predicted that the Court of Appeals would require a showing of continuity of ownership to establish a de facto merger and entered judgment for the defendant (NSI III).

The State appealed, arguing that New York law was unsettled on the requirement for continuity of ownership. The Second Circuit affirmed, finding that several New York courts had held that continuity of ownership was the essence of a merger and had required this element in tort and contract cases. Moreover, the court pointed out that the Court of Appeals had rejected application of the “product line” theory of successor liability in an earlier 2006 case, suggesting that that court would not eviscerate traditional common law norms of successor liability in tort cases.

The liability of parent corporation was the issue in *Atlanta Gas Light Company v. UGI Utilities, Inc.*, 2006 U.S. App. LEXIS 22647 (11th Cir. 09/06/06). In this case, a predecessor of UGI acquired a minority investment interest in 1887 in the Saint Augustine Gas & Electric Company (St. Augustine Gas) that owned and operated the manufactured gas plant. While Augustine maintained its own board of directors, UGI nominated most of the local superintendents and provided certain administrative services to St. Augustine. Senior UGI executives occupied several board and officer position of the company. The companies also had overlapping directors; UGI formed oversight committees, a UGI employee served as plant

superintendent at one point and refurbished the plant, UGI served as purchasing manager and consulting engineer and was paid a fee for supervision of the MGP. In 1928, American Gas and Power, a predecessor of Centerpoint Energy Resources Corporation (collectively "Centerpoint") acquired the stock of St. Augustine Gas. From 1928 to 1935, St. Augustine entered into management and engineering contracts with Centerpoint and there was significant overlap in directors and officers. In 1944, AGP sold all of the St. Augustine assets to an individual who merged the assets into a new corporation, Savannah-St. Augustine Gas Company which changed its name to South Atlantic Gas Company in 1945. In 1966, the company merged with the plaintiff. As part of this transaction, the plaintiff acquired the assets to the MGP.

The City of St. Augustine acquired the former MGP site in 1989 to facilitate the redevelopment of a waterfront complex that would include 24,000 square feet of boutique shops, an 83-room upscale boutique hotel, a world-class spa, 96 condominium units, 15 lofts, and a 65 slip inland Marina. Following discovery of contamination at the 13-acre site, Atlanta Gas Light Company (AGLC) and the City agreed to implement an Environmental Evaluation/Cost Analysis (EE/CA) with AGLC paying approximately 90% of the \$7 million dollar cleanup. AGLC then sought contribution from Centerpoint and UGI alleging they were liable as successors to the operators of the St. Augustine MGP.

In May 2005, the district court ruled that the plaintiff had not demonstrated that the defendants' relationship with the former MGP plant fell outside the norms of corporate behavior outlined in *Bestfoods*. Therefore, the court said the defendants could not be liable as CERCLA operators.

On appeal, a three judge panel of the 11th Circuit began its analysis by reviewing the *Bestfoods* test for imposing CERCLA liability on corporations. The court said that under *Bestfoods*, a parent corporation could be liable as an owner through a corporate veil piercing analysis or if it operated the facility. The court went on to say that *Bestfoods* established three routes for holding a parent liable as an operator. The first route was when the parent directly operated a facility instead of its subsidiary or alongside it as part of a joint venture. The second was where an officer holding positions in both companies departed from the norms of parental influence and the third was when an officer acting solely as an agent of the parent corporation and not acting on behalf of the subsidiary managed or directed activities at the facility.

After quickly finding that there was no evidence to support the last two routes of *Bestfoods* liability, the panel proceeded to examine if the defendants could be liable for directly operating the facility.

For its claims against UGI, AGLC asserted that UGI supervised the plant through its centralized committees, UGI management contracts with St. Augustine Gas, and the fact that UGI personnel occupied the majority of the director

and officer positions at St. Augustine Gas. It also noted that that UGI nominated substantially all of the local superintendents and regularly approved their salaries. Finally, AGLC observed that UGI received a fee for providing the services described in the contract and pursuant to the practices preceding the contract.

However, the court said there was nothing in the record that would support a finding that UGI operated the St. Augustine plant or operated the pollution-causing sources. Instead, the court said the management contract allowed St. Augustine to receive advice from UGI's various skilled personnel, to have access to UGI's network of professionals, and in general to benefit from access to UGI's vast experience. The court said the record suggested that these activities were in the nature of rendering advice, that the consultation was primarily from a distance with only occasional on-site visits, and that UGI provided such advice to numerous similar facilities in which UGI had a similar equity interest. While the contract provided that UGI would act as its purchasing agent for St. Augustine for significant purchases, there was no evidence that UGI's consultation involved disposal of hazardous waste or that UGI managed, directed or conducted operations related to pollution. To the extent that an UGI employee managed the plant for a short while, the court said he was appointed to serve as acting superintendent during that period, and thus was presumed to have been working on behalf of St. Augustine Gas, not UGI.

In support of its claim against Centerpoint, AGLC noted that Centerpoint replaced the St. Augustine Gas officers and directors with Centerpoint senior executives after it acquired AGP in 1928 and also entered into a similar management contract with St. Augustine Gas.

The appeals court said that is was required by *Bestfoods* to look at the facts through the prism of corporate norms and that from this view AGLC had not adduced enough evidence that defendants managed the plant so as to hold them liable under CERCLA. The court said that existence of overlapping officers and directors, the use of oversight committees, and the review and approval of capital budgets was consistent with traditional parent/subsidiary relationships that did not cause UGI or AGP to be liable as an operator under the *Bestfoods* analysis. The court also found that the management contracts were simply consulting arrangements where the defendants only made recommendations or provided advice that St. Augustine was free to ignore.

The court found that the descriptions of the engineering work to be performed by Centerpoint under its technical services agreement contemplated general engineering advice and assistance on proposed additions, extensions and alterations, and design, supervision and construction on substantial additions, extensions and alterations. Because the engineering activities did not actually involved operating activities related to leakage or disposal of hazardous

waste, the court said the contracts could not serve as basis for establishing that the defendants managed or directed "operations specifically related to... leakage or disposal of hazardous waste." The court found the testimony of a former engineer made in 1942 before the Securities and Exchange Commission particularly illuminating on the nature of the services provided to the MGP. The employee testified that he was the general manager of Centerpoint's Jacksonville plant, which paid at least part of his salary. However, in addition to his Jacksonville job, he indicated that he simultaneously served Centerpoint, acting as a "sponsor" and engineer for 40 other subsidiaries of Centerpoint, including the St. Augustine MGP. He said his duties for the St. Augustine plant involved consulting by telephone with the local management in St. Augustine an average of 3-4 times per week and that visited the St. Augustine plant approximately 6-7 times a year

The Eleventh Circuit concluded that a reasonable jury could not find from the record that either defendant managed, directed or conducted operations of the St. Augustine MGP specifically related to pollution, leakage or disposal of hazardous waste and affirmed the judgment of the district court.

Property Owner Allowed To Introduce Evidence Requiring Cleanup More Stringent than Agency Cleanup Standards

A federal district court in New York allowed a restaurant owner to

introduce evidence that the most suitable cleanup for property impacted by an adjoining gasoline site was to excavate soil beneath the building on the property even though the remedy was beyond that which would be required by the New York State Department of Environmental Conservation (NYSDEC).

In *Lambrinos v. Exxon Mobil Corp.*, 2006 U.S. Dist. LEXIS 54565 (N.D.N.Y. 8/4/06) the issue before the court was the amount of damages to award the plaintiff following summary judgment ruling that the defendant was liable under the New York Navigation Law for a gasoline spill that had migrated beneath the plaintiff's restaurant. The plaintiff's expert proposed a corrective action plan that called for excavation of soil to address benzene contamination beneath the building. The expert indicated that this was the most effective remedy to restore the site to its pre-spill conditions.

The defendant filed a motion seeking to prevent the plaintiff from introducing its expert's report into evidence under the United State's Supreme Court decision in *Daubert v. Merrell Dow Pharmaceuticals Inc.*, 509 U.S. 579 (1993). The defendant argued the report was not scientifically valid because the conclusion that excavating below the building was necessary was not feasible and failed to conform to industry standards.

The court found the regulations implementing the Navigation Law list the remediation objective as restoring the environment to its pre-spill condition where feasible. The defendant relied

on a telephone conference with the NYSDEC project manager where he indicated that the agency would not require excavation beneath the building as part of the approved remedy. Because the NYSDEC had declined to participate in the trial by making a recommendation on the appropriate remedy, the court said the defendant could not use the telephone conference with the NYSDEC project manager to demonstrate that the expert's proposal was unreliable.

The defendant argued that excavation was not feasible because it was an extreme and extraordinary remedy that was only done in cases involving residential buildings with drinking water wells. However, the court ruled that the rarity of this type of remedy was not necessarily evidence of its feasibility. The court went on to hold that the issue for the trial was the scope of the remediation and that the jury must decide if it was feasible to return the site to pre-spill conditions.

Commentary: Now that most states permit risk-based cleanups that take land use into account, parties to transactions involving contaminated property will frequently establish the cleanup goals for the remediation. Sellers will want to limit their cleanup obligations to the existing use of the property and allow the use of institutional or engineering controls with the buyer assuming the incremental costs or delta for any additional remediation required as a result of a change in use.

A more recent trend that we have witnessed involves divestitures of corporate properties where the purchaser is planning to redevelop the site into a higher use such as residential or mixed use. In some cases, the selling corporations have negotiated a right to participate in the increased value arising from the change in use. For example, in a recent deal that seller sold the property to a residential developer where the seller agreed to remediate the site to a residential cleanup standard. In exchange for this more stringent cleanup, the seller secured the right to receive a certain percentage of sales prices of residential units that sold above a certain threshold price.

DUE DILIGENCE

Implementation of AAI Rule Off To Rocky Start

When EPA promulgated its All Appropriate Inquiry (AAI) rule on November 1, 2005, the agency decided that the rule would not take effective for one year to provide the regulated community with an opportunity to familiarize its member with the law. Despite this grace period, the two weeks following the November 1, 2006 implementation date has been marked by confusion and misinterpretation of the scope and requirements of AAI.

Perhaps the area of greatest confusion has been what additional tasks are the responsibility of the environmental professional (EP) or the user as well as what happens if the user does not provide the EP with sufficient information. AAI clearly states that the EP is required to report the results of its investigation of the following criterion: Interviews with past and present owners (40 CFR 312.23), reviews of historical sources (40 CFR 312.24), reviews of government records (40 CFR 312.26), visual inspections (40 CFR 312.27), commonly known or ascertainable information (40 CFR 312.30) and degree of obviousness of contamination (40 CFR 312.31). In contrast, persons seeking to assert the three CERCLA landowner defenses are required to conduct "additional inquiries" per 40 CFR 312.22. These inquiries are for cleanup liens (40 CFR 312.25); specialized knowledge or experience of the person (40 CFR 312.28);

relationship of purchase price to fair market value if uncontaminated (40 CFR 312.29) and commonly known or ascertainable information (40 CFR 312.30).

The person seeking the defenses is not required to provide this additional information to the EP but has to demonstrate that it complied with these requirements. The EP is only required to report on the results of its required inquiries. If the person seeking the defenses provides the "additional inquiries" to the consultant, the EP should take this information into account. The preamble to the AAI rule states at 70 FR 66082 that if any information not furnished to the EP that may affect the EP's ability to render an opinion about the potential for conditions at the property that are indicative of a release, then the EP could identify this as a "data gap." The EP would then have to comment on the significance of this data gap.

Another common area of confusion has been whether the EP needs to review the chain of title. This can be problematic because the chain of title frequently is not ordered until the transaction is about to close and well after the Phase I Environmental Site Assessment (ESA) had been ordered and completed. In addition, chain of title often can cost \$300 or more per parcel and can take several weeks to obtain depending on the county where the records are retained. In addition, multiple chains of titles might have to be ordered if the property had been subdivided in the past or was part of a larger tract of

land. However, AAI does not require the EP to obtain a chain of title. Instead, the rule provides that the EP should exercise its professional judgment in determining what types of historical records may provide useful information. EPA mentioned in the preamble that while the chain of title may provide important information, it may not be the only source of this information. One of the reasons for reviewing chain of titles is to obtain information about land use controls. However, EPA indicated in the preamble that there may be other sources of information that the EP may review that could yield this information as well.

The new criterion for searching environmental liens has also caused some confusion. AAI clearly states that this information is the responsibility of the user (the person interested in asserting one of the CERCLA landowner defenses).

Many consultants have also raised concerns about the AAI requirement to identify if there is a relationship between the value of the property and contamination. Again, this is an obligation of the user. If the EP is not provided with this information and the EP believes the absence of this information affects its ability to determine if there are conditions at the property indicative of a release, the EP can provide an opinion on the significance of this data gap.

Questions have also been raised on the extent that the EP is required to conduct interviews of current operators and owners of the property. Some consultants and property owners thought that every tenant at a property would have to

be interviewed and that this would be burdensome and problematic for a shopping center. The AAI rule provides that only the five largest tenants would have to be interviewed. To the extent this is not possible and the EP believes the missing information is significant, it can provide an opinion about the significance of this data gap.

One approach that has been adopted by several conduit lenders who are requiring ASTM E1527-05 for their Phase I ESA reports is to allow the report to contain limitations or exceptions for information that is the responsibility of the user. ASTM 1527-05 is more stringent than AAI by requesting the user complete a Questionnaire in accordance with Appendix X3 of ASTM 1527-05. Of course, if the borrower wants to be able to say it complied with AAI or ASTM 1527-05, the borrower would have the burden of providing this information to the consultant or keeping the documentation of these tasks in its own records.

FDIC Revises Guidelines For Environmental Risk Programs To Incorporate AAI

The Federal Deposit Insurance Corporation (FDIC) issued a Financial Institution Letter 98-2006 (FIL-98-2006) on November 13th that revised the FDIC's "Guidelines For An Environmental Risk Program." The updated guidelines recommend that financial institutions incorporate EPA's AAI rule in the environmental risk management programs. The updated guidelines replace FIL-14-93.

FIL-98-2006 retains the same structure as the FIL-14-93 with separate sections on addressing environmental risks during the loan application, loan documentation, monitoring loans, involvement in borrower operations and foreclosure.

The revised guideline suggests that financial institutions adequately consider the requirements of the AAI rule in their environmental risk programs noting that an environmental evaluation that meets AAI will help borrowers achieve the CERCLA landowner defenses. FDIC indicated that a lender's environmental risk program should be designed to ensure that the institution makes an informed judgment about potential environmental risks and consider such risks in its overall consideration of risks associated with an extension of credit. The guidelines said that since an institution's environmental risk program may be tailored to its lending practices of the institution, the lender should make its own decision concerning when and under what circumstances to require a borrower to perform an environmental property assessment that meets AAI. FDIC recommends that individuals who administer a bank's environmental risk program become familiar with the statutory elements of the various CERCLA defenses.

According to the updated guidelines, lenders should determine if a borrower should perform an AAI-quality environmental evaluation as part of its pre-loan risk analysis. FDIC states that the decision to require AAI may be made on a case-by-case basis after considering the

risk characteristics of the transaction, the type of property and the environmental information collected during the initial risk analysis. If environmental concerns are identified during the loan application process, FDIC said that a bank may decide to require the borrower to implement an environmental evaluation that satisfies AAI. FIL-98-2006 also suggests that it may be necessary for the loan officer or another representative of the bank to visit a site to determine if there are obvious environmental concerns. Interestingly, the guidelines do not address how lenders should require borrowers to comply with the user responsibilities under AAI.

In the monitoring section, FIL-98-2006 states that a lender's environmental risk assessment does not end with the extension of credit but that a bank should continue to monitor the borrower and the real property collateral for potential environmental concerns during the life of the loan. In particular, the guidelines indicate that a lender should be aware of changes in the business activities of the borrower that result in a significant increased risk of environmental liability associated with the real property collateral. If there is a potential for environmental contamination to adversely affect the value of the collateral, FIL-98-2006 suggests that the institution might exercise its rights under the loan to require the borrower to resolve the environmental condition and take those actions that are reasonably necessary to protect the value of the real property.

Finally, the guidelines recommend that lenders conduct an investigation that complies with AAI prior to taking title to the property by foreclosure or other means.

***Commentary:** Though the rating agencies have not formally announced, they have indicated that they will be requiring Phase I Environmental Site Assessments to comply with AAI/ASTM 1527-05. However, because the environmental due diligence protocols of the rating agencies generally just refer to ASTM E1527, it is likely that the rating agencies will take the position that their protocols will require compliance with the most recent version of E1527.*

NY Agencies Issue Revised Vapor Intrusion Guidance

The New York State Department of Environmental Conservation (NYSDEC) and New York State Department of Health (NYSDOH) issued revised guidelines for evaluating vapor intrusion in October. The revised guidelines incorporate and respond to comments that the agencies received during public comment periods.

Perhaps the key change between the draft and final version of the NYSDEC "Strategy for Evaluating Soil Vapor Intrusion at Remedial Sites in New York" (DER-13 October 18, 2006) is the elimination of the 100 foot vertical and horizontal threshold for screening out sites. Instead, the agency will use site-specific factors. For sites where remedial activities

are currently on-going, the soil vapor intrusion pathway will be evaluated as part of the remedial process. Evaluation of legacy sites (defined as sites where remedial decisions were completed prior to January 1, 2003) will occur along three tracks. For current or former NPL sites in New York, EPA will take the lead or provide oversight. For non-NPL sites, NYSDEC will provide responsible parties with the opportunity to conduct soil vapor evaluations. For sites where the responsible parties decline, are unable or no viable responsible parties can be identified, the NYSDEC will conduct the evaluation and seek to recover its costs. NYSDEC will apply weighting factors for the four ranking criteria to prioritize legacy sites that are to be evaluated by the agency. Additional scoring points will be added for sensitive receptors such as day care centers, elder care facilities and hospitals. Points will also be added to a site's score if there are preferential pathways such as pipes and pipe bedding, joints and fractures, sumps and other penetrations into the buildings.

The NYSDEC indicated that its goal is to have each of the nine regional offices evaluate at least five legacy sites per year. However, we understand that the agency is ahead of this goal and has completed initial evaluations on just over 200 sites. It is unclear at this time how many of these legacy sites will actually be required to implement additional remedial actions to address the vapor intrusion pathway.

The most significant change in the NYSDOH "Guidance for

Evaluating Soil Vapor Intrusion in the State of New York” is that the agency tightened the criteria for TCE based on the July 2006 report of the National Academies of Sciences. As a result, the decision matrix for TCE requires mitigation at lower levels.

Court Rules Property Owner Waited Too Long to Sue Bank

The Michigan Court of Appeals reversed a ruling allowing a property owner to rescind a sale of contaminated property by a bank because the statute of limitations for contract claim had expired.

In *Ragan v. First National Bank Acceptance Company*, 2006 Mich. App. LEXIS 2506 (Ct. App. 08/15/06), the defendant took title to a site that had been previously used as a gas station. The site was eligible for reimbursement from the now defunct Michigan Underground Storage Tank Financial Assurance Fund (MUSTFA). The bank retained an environmental consultant to remove the tanks and prepare an Initial Assessment Report for submission to the Michigan Department of Environmental Quality (MDEQ). In July 1993, the defendant agreed to sell the property for \$25,000 pursuant to an installment land contract that provided the plaintiff would make an initial \$5,000 payment at the closing, monthly payments of \$500 per month for three years and a final balloon payment at the end of the three-year period. The agreement contained a representation that the Property qualified for MUSTFA and that the bank had already incurred the \$10,000 deductible. The bank also

covenanted that if the property required additional remediation, the seller agreed to assume liability for those costs.

In May 1994, the purchaser quitclaimed its interest in the Property to the plaintiff. Two years later, the plaintiff tried to obtain a construction loan to redevelop the site. However, since the defendant had not completed the cleanup, the plaintiff could not obtain the financing or subsequently sell the property.

In 2003, the plaintiff commenced a lawsuit, asking the court to either rescind the contract or order the defendant to complete the cleanup to the satisfaction of the MDEQ. The trial court concluded that the defendant's failure to complete the remediation warranted rescission of the contract and ordered the bank to return \$7, 829 in principal payments made under the installment contract.

The appeals court found that the bank's decision not to complete the cleanup constituted a breach of the contract and that the equities in the case favored the plaintiff. However, because the six-year statute of limitations for breach of contract claims had expired in 2002, the court ruled that the bank was entitled to judgment and vacated the decision of the trial court.

Commentary: *This short decision is full of lessons for purchasers of contaminated property. First, while state UST trust funds can be useful tools to help facilitate transactions, it is important for a purchaser to evaluate the solvency of the trust fund and verify the property's*

eligibility for reimbursement during due diligence.

The other teaching from this case is that it is important for purchasers to monitor progress of cleanups since the statute of limitations for bringing breach of contract claims or other common law claims may be ticking. Here, the bank was basically able to run out the clock and the plaintiff ended up having to foot the bill for the cleanup.

Michigan Court Allows Claim to Proceed Against Bank

In another Michigan case, the plaintiff was a bit more fortunate since it was allowed to proceed with a claim under the Michigan Natural Resources and Environmental Protection Act (NREPA).

In *Hicks Family Limited Partnership v. First National Bank of Howell*, 2006 Mich. App. LEXIS 2933 (Ct. App. 10/3/06), the defendant foreclosed on property owned by G&G Paint Developers in 1983. The property was contaminated from buried drums containing paint and paint thinners. The defendant then sold the property to J.D. Hicks and his wife under a purchase agreement where the bank agreed to “have all equipment inside and out, all stock debris and residue removed from the premises at time of closing in compliance with E.P.A. Rule and Regulations.” After Mr. Hicks died in 1996, his wife conveyed her interest in the property to a revocable living trust, which subsequently conveyed the property to the plaintiff in 1996.

Between 1983 and 1997, the defendant retained a number of environmental consultants to

remediate the property but the MDEQ rejected a petition for delisting in 1997. In 2004, the plaintiff began to redevelop the site and discovered several buried drums as well as soil and groundwater contamination. The plaintiff then sought cost recovery and contribution under NREPA as well as common law claims for negligent performance of contract, breach of contract, fraud and nuisance.

The trial court granted the defendant’s motion for summary judgment. On appeal, the court agreed that the common law claims were barred by the statute of limitations. The plaintiff argued that the statute of limitations should not have begun to run until it discovered the buried drums because it could not have known about the additional drums until it began excavating the site. However, the court refused to apply the discovery rule. The court said the evidence adduced at trial showed that the plaintiff did not exercise reasonable diligence to discover its claims. The court said that the plaintiff was aware of the environmental history when it acquired the property and that there was no evidence that the plaintiff monitored the progress of the cleanup. Even if the plaintiff did not know about the particular buried drums, the court concluded that the plaintiff knew or should have known that the defendant was not adequately remediating the site as early as 1997 when the MDEQ rejected the delisting petition in 1997.

The plaintiff also argued its claims were still ripe since the presence of the buried drums

constituted a continuing tort each day the drums remained at the property. However, the court ruled that the wrongful act was the burial of the drums and that continued presence of the drums was only a continuing effect of the defendant's past failure to remove the drums. Thus, the court affirmed the dismissal of the common law claims.

On the NREPA claim, the plaintiff argued that the defendant was liable as a past owner at the time of disposal or as a person who arranged for disposal of hazardous substances because its contractor had ruptured a drum during excavation. The court acknowledged that complaint was poorly pleaded but noted that the defendant had not introduced facts sufficient to refute the merits of these claims and argued that the evidence the plaintiff sought to introduce was inadmissible. The court said that under the circumstances, the plaintiff should be provided the opportunity to amend its complaint to more fully identify the factual claims that the defendant should be liable, and reversed the dismissal of the plaintiff's NREPA claim.

Commentary: *In what we are calling "Son of Aviall," the defendant argued that NREPA's right of contribution should be construed in a manner consistent with the United State Supreme Court's decision in Cooper Industries v. Aviall Services, 543 U.S. 157 (2004). The court noted that Michigan courts interpreting NREPA often look to CERCLA for guidance and found that there was no material difference between the savings clause of CERCLA §*

113(f)(1) and NREPA § 20129(3). Since NREPA does not allow a party who is not already a defendant in an action under NREPA to bring a contribution action, the court ruled that the appeals court had properly granted summary judgment to the defendant. A federal district court reached this same conclusion this past summer in Wacker Chemical Corporation v. Bayer Cropscience, Inc., 2006 U.S. Dist. LEXIS 61483 (E.D. MI. 08/18/06).

Developers Agree to \$350K Settlement for Improperly Managing Naturally-Occurring Asbestos

An El Dorado Hills developer and a construction contractor agreed to pay \$350,000 to settle claims that they had failed to control emissions of naturally-occurring asbestos while excavating a hillside to construct building pads and roads for a 1,400 home development. West Valley LLC, which is owned by Lennar Communities, Inc., of Roseville, AKT Investments, Inc., of Sacramento, and DeSilva Gates Construction of Dublin had been charged with 47 violations of state air and water pollution laws at the 982-acre site.

Because the area has pockets of naturally-occurring asbestos, El Dorado County, requires special dust-suppression measures such as heavy watering for construction in areas known or likely to contain asbestos. The El Dorado County Air Quality Management District had approved an asbestos hazard dust mitigation plan for the Valley View project but inspectors observed thick clouds of dust drifting from the

development site towards an apartment complex and two day-care centers. West Valley representatives claimed that they did not detect asbestos in any soil samples taken at sites where blast dust allegedly exceeded regulatory limits. However, the developers' geologist found asbestos in the same construction unit where the blasting took place. In addition the asbestos violations, West Valley also violated county restrictions on construction dust and failed to prevent sediment-laded stormwater runoff from discharging into a tributary of Carson Creek.

Commentary: *In our August 2005 issue, we discussed recent studies that had indicated that naturally-occurring asbestos (NOA) was more prevalent than originally believed with NOA present in at least 50 of the 58 counties in California and 27 states. There are no federal regulations addressing NOA so states and local governments that are known to have high occurrences of NOA are beginning to develop NOA standards. These requirements usually consist of engineering controls designed to prevent generation of asbestos-laden dust during construction activities as well as to minimize long-term risks from exposure to asbestos fibers in soils. For example, the El Dorado County's Air Quality Management District (AQMD) promulgated a local ordinance NOA fugitive dust to minimize construction and mining generated and requiring disclosure of the presence of NOA in real estate transactions.*

Since the presence of NOA minerals may not necessarily be

obvious, it is important to evaluate the geology of a proposed or existing project to determine if NOA mineral may be present. Unfortunately, the methodology for assessing environmental risk posed by NOA is not well-developed since the existing assessment methods were developed either for health risk assessment of asbestos in industrial settings or for the economic assessment of naturally occurring deposits for minerals exploitation. Moreover, the mere presence of NOA on a site does not pose a risk unless the material can become respirable. As a result, NOA assessment may have to be performed on a site-specific basis using actual disturbance scenario to determine the exposure risk. This can be a daunting task, though, because the absence of widely accepted threshold air concentrations for asbestos fibers can make it difficult to develop a relationship between concentrations of NOA and the amount of soil or rock disturbance necessary to generate harmful doses of NOA-bearing dust.

Jury Finds Property Owner Who Fails to Implement Recommendation of Building Inspection Liable for Oil Spill From Deteriorated Tank

A Massachusetts appeals court ruled that a roofing contractor whose workers moved a rusted aboveground heating oil storage tank (AST) during a construction project was not responsible for the subsequent collapse of the tank because the property owner had

negligently ignored the recommendations of a building inspector about the condition of the tank.

In *Palochinko v. Reis*, 2006 Mass. App. LEXIS 862 (App. Ct. 08/11/06), the plaintiff acquired a ten-room commercial guesthouse in Provincetown in 1995. Prior to taking title, a building inspector warned the plaintiff that the legs of a 275-gallon AST were rusted and the pads supporting the legs had deteriorated. The building inspector recommended placement of a firm base under the tank as well as construction of secondary containment but the plaintiff failed to implement these recommendations.

Shortly thereafter, the plaintiff hired the defendant to re-shingle the guesthouse. During this project, the defendant's workers slid the tank approximately a foot away from the structure to gain access to the shingles at the rear of the building. After replacing the shingles, the defendant's crew returned the tank to its original location. The oil contractor subsequently made several fuel deliveries during the next three months without incident but during a fuel delivery in February 1996, the tank fell over when one of its legs collapsed, allowing 40 gallons of oil to escape.

The plaintiff was informed by the Massachusetts Department of Environmental Protection (MADEP) that it was strictly liable for the spill under chapter 21E. The plaintiff incurred approximately \$28,000 in cleanup costs and \$8,000 in legal fees and then sought damages under Chapter 21E and common law. The plaintiff also alleged the defendant had engaged in unfair and deceptive practices by failing to inform him that the tank would have to be moved and that its workers were not licensed to perform such work. While the jury found the defendant was a responsible party under 21E, it concluded that the plaintiff was 60% responsible for the spill because of his failure to follow the building inspection report and reduced the damage award by that amount. On the plaintiff's unfair practices claim, the court found in favor of the defendant because state law bars plaintiffs from recovering if they are more than 50% negligent. However, because the defendant had refused to participate in dispute resolution, the court awarded the plaintiff litigation costs and attorney's fees.

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