



Environmental Practice BRIEFING

WINTER 2004

Following are recent developments in environmental law and policy that may be of interest to our colleagues, clients and friends:

Developments in Historic Contamination Liability and Cleanup Schemes in the United States

While most modern environmental laws governing air, water and soil pollution in the United States were enacted in the 1960s and early 1970s, it took several high-profile events, including the discovery of toxic chemicals buried under a residential community in Love Canal, New York, to focus legislators on environmental contamination due to historic industrial operations. First in New York in 1979, then at the federal level in 1980, and soon thereafter in states across the United States, legislatures enacted laws allocating liability for the cleanup of contaminated properties, establishing funds to clean them up and providing site remediators the right to seek compensation from liable parties for cleanup costs.

Together, the federal Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA," also known as the "Superfund law") and the "State Superfund" laws, as they have come to be known, made it very clear that environmental liabilities relating to historic contamination had become actionable and potentially costly and, therefore, could no longer be ignored or glossed over in business transactions (including, especially, real estate transactions). The addition of an environmental component to business transactions, however, had an unintended consequence: in some cases a rational business decision was made to limit the potential losses on a particular business or site by not operating, transferring or cleaning up the business or site at all. Thus many sites were either mothballed or abandoned.

As a result of the chilling effect that these laws have had both on the actual cleanup of some sites and on certain business transactions, legislators, developers, environmentalists and others have sought to refine CERCLA and the State Superfund laws so that those laws' remedial goals could be accomplished with fewer negative impacts on business transactions. Following are three recent developments in this overall effort.

Ramifications of the 2002 Amendment of CERCLA

On January 11, 2002, CERCLA was amended by the Small Business Liability Relief and Brownfields Revitalization Act (the "Brownfields Amendment"). The Brownfields Amendment, among other things, provides and clarifies limitations to CERCLA liability for parties that are only responsible for cleaning up a contaminated property due to their status as "owners" of the property. Specifically, the Brownfields Amendment clarifies certain criteria a party must prove to qualify as an "innocent landowner," and provides protection from CERCLA liability to "bona fide prospective purchasers" and "contiguous property owners." Bona fide prospective purchaser status is available to landowners who purchase contaminated property and know at the time of purchase that the property is contaminated. Innocent landowner status is available to landowners who purchase contaminated property and do not know at the time of purchase that the property is contaminated. Contiguous property owner status is available to landowners who purchase contaminated property

Abu Dhabi
Beijing
Brussels
Düsseldorf
Frankfurt
Hong Kong
London
Mannheim
Menlo Park
Munich
New York
Paris
Rome
San Francisco
São Paulo
Singapore
Tokyo
Toronto
Washington, D.C.

IN THIS ISSUE:

Focus on Historic Contamination Liability and Cleanup Schemes in the U.S. and the Proposed U.S. Regulation of NO_x, SO₂ and Mercury in Air

that “is contiguous to or otherwise similarly situated with respect to” another property that is the only source of contamination existing at the landowners’ property and who do not know at the time of purchase that the landowners’ property is contaminated.

To benefit from the new protections, a party claiming to be a bona fide prospective purchaser, an innocent landowner or a contiguous property owner must prove, by a preponderance of the evidence, certain criteria. A threshold criterion for the three classes of protected landowners is whether, before purchase, the landowner performed “all appropriate inquiry” into the previous ownership and uses of the property. Before the Brownfields Amendment, it was unclear what scope of investigation would satisfy the “all appropriate inquiry” criterion and, with different courts promulgating different, and often highly subjective, tests, it was impossible for a purchaser to know what pre-acquisition steps had to be taken to secure innocent landowner protection. Under the Brownfields Amendment, satisfaction of the “all appropriate inquiry” criterion, for innocent landowners as well as for bona fide prospective purchasers and contiguous property owners, depends upon when the property was purchased. For property purchased prior to May 31, 1997, satisfaction of the criterion depends upon factors such as commonly known information about the property, the value of the property if it were not contaminated and the ability of the landowner to detect the contamination prior to the acquisition. For property purchased on or subsequent to May 31, 1997, satisfaction of the criterion is achieved by performing a “Phase I” environmental site assessment that conforms to standards promulgated by the American Society for Testing and Materials (“ASTM”).

To qualify as a bona fide prospective purchaser, an innocent landowner or a contiguous property owner, a party must also prove that it lacks certain affiliations with a party potentially responsible for the contamination. Bona fide prospective purchasers and contiguous property owners must prove they have no such affiliation through any familial, contractual, corporate or financial ties. They must also prove that they are “not ... the result of a reorganization of a business entity that was potentially liable” for the contamination. The criteria applicable to innocent landowners are less broad. To qualify for innocent landowner status, a landowner must prove that the act or omission that caused

the release of hazardous substances was caused by another party with whom the landowner has no employment, agency or contractual relationship.

In addition to the threshold criteria of “all appropriate inquiry” and a lack of certain affiliations with a party potentially responsible for the contamination, to qualify as a bona fide prospective purchaser, an innocent landowner or a contiguous property owner, a party must prove that it is satisfying certain ongoing obligations. These include: (a) complying with land use restrictions related to any response action and not impeding the effectiveness of any institutional control; (b) taking reasonable steps to stop a continuing release of hazardous substances, prevent threatened future releases, and prevent or limit exposure to earlier existing releases; and (c) cooperating with persons authorized to conduct response actions and providing access to the property.

Recently, the federal Environmental Protection Agency (“EPA”) clarified its interpretation of certain criteria applicable to the contiguous property owner liability exclusion. In its January 13, 2004 publication, Interim Enforcement Discretion Guidance Regarding Contiguous Property Owners, EPA indicated the following.

- A landowner might not qualify as a contiguous property owner because there are “multiple, discrete (i.e., not commingled) releases” at the landowner’s property, “some of which originated on the landowner’s property, and others the landowner did not cause or contribute to as they migrated from another property not owned or operated by the landowner.” EPA, however, retains the right to not pursue a landowner for any discrete, non-commingled releases that migrated from another property.
- In EPA’s opinion, the Brownfields Amendment protects landowners whose property was contaminated by pollution migrating from another property “even if the property is not located immediately next door.” In analyzing whether a potential contiguous property owner’s property is “similarly situated with respect to ... [a] property” where releases have occurred or are occurring, EPA will determine whether the subject property “has been impacted by a release from a contaminated property at a distance in the same or a similar way that it would have been impacted by a

release from a contaminated property adjoining the landowner's property." EPA will not bring an enforcement action against a landowner of a property that has been impacted by contaminated groundwater migrating from another property even if such property is "some distance away" from the subject property.

- According to EPA, contiguous property owner status is "clearly" available to "current owners of property." EPA indicates that, "in exercising its enforcement discretion, EPA may treat former landowners" as protected contiguous property owners as long as the former owners, during the period of their ownership, met all of the relevant contiguous property owner criteria.

It is expected that, by specifying that performance of an ASTM Phase I assessment constitutes "all appropriate inquiry" and by providing for liability protection to purchasers of property with known contamination (i.e., bona fide prospective purchasers) and purchasers of property that has been contaminated by neighboring properties (i.e., contiguous property owners), the Brownfields Amendment will facilitate real estate transactions that involve contaminated properties.

EPA's "One Cleanup" Program

In the Spring of 2003, EPA introduced its "One Cleanup Program." The Program endeavors to better coordinate the investigation, cleanup and revitalization of contaminated sites that are subject to various (and sometimes competing) requirements of federal, state, local and tribal cleanup laws and programs. The uncertainty engendered by having multiple laws and programs governing a single site can complicate, and ultimately chill, efforts to redevelop that site.

The goals of the Program are to: (a) recognize and affirm an appropriate range of cleanup approaches; (b) promote mutual acceptance of cleanup decisions; (c) provide clear and useful information about cleanups to interested parties; (d) use efficient, effective and protective management approaches; and (e) promote innovative solutions to site cleanup obstacles. According to one of the Program's guidance documents, EPA, "wherever appropriate, will develop policies for uniform application under superfund, [Resource Conservation and Recovery Act] corrective action, oil, underground storage tank, federal facilities, and brownfields programs."

As a preliminary effort, EPA is identifying at least one "pilot" site in each EPA region to serve as a model for "One Cleanup Program" implementation. For example, EPA recently reported that a pilot "One Cleanup Program" project has been identified in eastern Idaho. The effort to coordinate the separate CERCLA and Resource Conservation and Recovery Act cleanups currently underway there will be stimulated with a \$38,000 grant to develop an informational website for the effort.

New York's Amendments to its State Superfund Law and the Creation of its New Brownfield Cleanup Program

On October 9, 2003, New York Governor George E. Pataki signed into law Assembly Bill A.9120, the New York State Brownfield Clean Up Act (the "Act"). The Act refinances and refines New York's State Superfund program and creates a new brownfield cleanup program (the "BCP").

—Amendments to New York's State Superfund Program

Like many State Superfund laws, New York's Inactive Hazardous Waste Disposal Site Law (the "IHWDSL") is substantially similar to CERCLA. It has a liability structure like the federal law (although the definition of "hazardous wastes" under the IHWDSL prior to amendment was significantly narrower than "hazardous substances" which are the subject of CERCLA liability) and provides a mechanism by which parties that clean up a contaminated site can seek compensation from a liable party. Also like the federal scheme, New York has enacted regulations and other rules governing the process of selecting an appropriate remedy and actually cleaning up a contaminated site. New York's State Superfund law has been subject to criticisms similar to those leveled against CERCLA.

Recognizing that most sites covered by the IHWDSL will eventually be cleaned up pursuant to the newly created BCP, New York legislators did not spend much of their recent effort on reforming the State Superfund law. For example, the Act does not simplify the actual cleanup process, including the onerous and ambiguous remedy and cleanup standard setting procedures that have been the subject of much of the criticism of the state program. The Act does bring the IHWDSL more in line with the federal scheme. It expands the definition of "hazardous wastes" in the IHWDSL to include CERCLA "hazardous substances," thus making the

liability coverage of the two laws parallel and bringing approximately 300 new New York sites into the program. Modeled on CERCLA's 1998 amendments, the Act amends the IHWDSL to provide liability protections to lenders, fiduciaries and municipalities. The Act incorporates CERCLA's expanded "innocent landowner" protection into state law (but does not incorporate the new bona fide prospective purchaser protection). In addition, the Act also provides for reinvigoration of the "Superfund" established by the state to finance public cleanups under the IHWDSL; the state cleanup fund had ceased to be able to finance new projects when funding was discontinued in March 2001. The Act designates a \$120 million infusion into the state cleanup superfund; going forward, these funds are to be generated by bond sales, state General Fund revenue, and fees on business and industry.

—New York's New Brownfield Cleanup Program

Prior to enactment of the Act, if an owner or developer sought a release from the State from environmental liability for a New York site contaminated with hazardous wastes but did not want to endure the burdens of cleaning up the site in accordance with the IHWDSL, its only alternative was to remediate the site in accordance with New York's voluntary cleanup program (the "VCP").

The VCP was established in 1994 by the New York State Department of Environmental Conservation ("NYSDEC"). The VCP is not a statutory program and is governed by just a few guidance documents. It is implemented by the NYSDEC on a case-by-case basis. These weaknesses, together with the difficulty that owners and developers had in actually obtaining a satisfactory liability release under the program, resulted in the VCP being subject to almost as much criticism as the IHWDSL.

Specifically, owners and developers argued that New York's stringent cleanup and liability regimes, incompetent and inflexible state bureaucracy, inconsistency of application, and paucity of funding rendered the cleanup of New York sites that were contaminated, but not so badly as to require direct government oversight of the cleanup, to be uneconomical. A 1996 survey indicated that there were at least 6,000 of such brownfield sites in New York.

After more than a decade of criticism and seven years of negotiations, New York has established in the BCP an

entirely new voluntary cleanup program based on statutory cleanup standards correlated with future site use. In what seems to be a real effort to stimulate brownfield redevelopment in the state, the BCP has been structured to support consistent and reasonably objective implementation. The Act also establishes tax incentives estimated to be worth \$135 million for qualified properties for which a Certification of Completion under the BCP has been issued. Unlike many state voluntary cleanup programs, however, the BCP cannot be characterized as a simplification of the relevant State Superfund program; the BCP has so many requirements, procedures and standards that it may end up being as complex and difficult to comply with as the IHWDSL. The full structure (and potential impacts) of the BCP will not be knowable until regulations are promulgated by the NYSDEC.

The BCP covers any site contaminated with hazardous wastes (as defined in the IHWDSL, as amended) and petroleum products, other than sites on the National Priorities List established under CERCLA, Class 1 or 2 sites listed on New York's state priority list and sites subject to state or federal corrective actions. Both owners or operators of a site during the time that the contamination was released there (known as "Participants") and non-Participant parties (known as "Volunteers") are eligible to be in the BCP. To enter the BCP, the applicant (whether Participant or Volunteer) must enter a cleanup agreement with New York State in which the applicant agrees to cover the NYSDEC's oversight and administrative costs, to resolve disputes through arbitration, to hold the NYSDEC harmless with respect to the site and to provide information developed during any investigation undertaken by the applicant to the NYSDEC. By entering into the agreement, the applicant undertakes to investigate the site and to clean it up in accordance with the BCP.

The BCP provides for four different "tracks" for selecting a site-specific remedy. These tracks, which are associated with specified cleanup levels and requirements for institutional and/or engineering controls, are categorized by the intended use of the remediated site. The four tracks are: (1) unrestricted use; (2) restricted use (without engineering controls); (3) restricted use (with engineering controls); and (4) site-specific use. Overlaid on these tracks is a hierarchy of remedies (with "contamination removal and/or treatment" being most preferred by the

state and “treatment of the source at the point of exposure” being the least preferred by the State). The applicant is required to utilize the most preferred remedy available and, if the remedy selected is not “contamination removal and/or treatment,” to demonstrate to the NYSDEC why a lesser remedy must be used. For sites deemed to be of “Significant Threat” the NYSDEC selects the remedy itself. The BCP has public participation requirements which include specified notice and comment periods and, for “Significant Threat” sites, the right to require applicants to provide grants of up to \$50,000 to municipalities and community groups to support this public participation.

If the remedy actually undertaken utilizes engineering or institutional controls (e.g., use restrictions, operation and/or maintenance requirements, continuing physical barriers), the requirements of the specific controls must be set forth in an environmental easement benefiting the State to be recorded on title to the site in the applicable land records. A local government receiving an application for a building permit or other land use approval for the site must forward the application to the NYSDEC for determination if the change is consistent with the requirements set forth in the environmental easement.

Pursuant to the BCP, once the NYSDEC has issued a Certificate of Completion for a remediation project pursuant to the BCP, the applicant is released from liability to the state with respect to any costs arising from the contaminants that were subject to BCP cleanup. This release is subject to various circumstances that limit the release including, significantly, a future change in applicable cleanup standards and the failure of the applicant to make substantial progress towards development of the site within three years after the remediation is complete.

United States Regulation of NO_x, SO₂ and Mercury in the Air

On December 17, 2003, EPA proposed rules to regulate nitrogen oxide (“NO_x”) and sulfur dioxide (“SO₂”) emissions from the utility sector in the United States. In a separate but closely related action two days earlier, EPA proposed its first ever rule to regulate mercury emissions from United States coal-fired power plants.

The proposed Interstate Air Quality Rule (the “Proposed Air Rule”) and the proposed Utility Mercury Reductions Rule (the “Proposed Mercury Rule”) are designed to work as an integrated, multi-pollutant regulatory package. Together, the rules encourage the installation of pollution control technology designed to reduce mercury, NO_x and SO₂ emissions. EPA anticipates that facilities installing pollution control technology to address NO_x and SO₂ emissions will also achieve reductions in mercury emissions. EPA refers to this as “co-benefits”. Both the Proposed Air Rule and the Proposed Mercury Rule embrace market-based mechanisms to achieve emissions reductions from the utility sector.

According to EPA, the Proposed Air Rule would require the deepest cuts in SO₂ and NO_x emissions from power plants in more than a decade, resulting in significant reductions in the levels of fine particles and ground-level ozone in the air. Significant reductions in mercury emissions, resulting in emissions equal to 30-70 percent of current levels, are also expected from implementation of the Proposed Mercury Rule. If both rules become final and binding, they will require that the regulated community undertake the largest single investment in pollution prevention in the Clean Air Act’s history.

Proposed Interstate Air Quality Rule

The Proposed Air Rule recognizes that pollutants from 29 states and the District of Columbia “contribute significantly” to the inability of “downwind states” to comply with the National Ambient Air Quality Standards (“NAAQS”) for fine particles and ozone. Areas that do not comply with these standards, dubbed “nonattainment areas”, are the intended beneficiaries of the Proposed Air Rule and are located primarily in the eastern half of the United States.

Similar to the 1998 NO_x SIP Call rule, which targeted air pollution in downwind states, the Proposed Air Rule would require “upwind” states to submit revised State Implementation Plans (“SIPs”) that include proposed measures to reduce emissions of SO₂ and NO_x. SO₂ and NO_x contribute to both ozone and particulate pollution. EPA expects that the Proposed Air Rule would dramatically reduce and permanently cap SO₂ and NO_x emissions in the eastern half of the United States.

EPA has assigned emission reduction requirements to each state that corresponds to the overall caps. Though each state is free to adopt its own measures to satisfy the reduction requirements of the Proposed Air Rule, the establishment of statewide caps on SO₂ and NO_x emissions from electric generating units is strongly recommended.

The Proposed Air Rule would reduce power plant emissions in two phases. By the second phase of the program, total SO₂ emissions would be reduced to approximately 30 percent of current levels, while NO_x emissions would be reduced to approximately 35 percent of current levels. EPA intends to finalize this rule in 2005.

Proposed Utility Mercury Reduction Rule

In the Proposed Mercury Rule, EPA seeks comments on two approaches to reduce mercury emissions from coal-fired power plants. The first approach applies technology-based standards pursuant to Section 112 of the Clean Air Act. The second approach sets a mandatory, declining nationwide cap on total mercury emissions from coal-fired power plants.

The first approach in EPA's proposal sets "maximum achievable control technology" ("MACT") standards for mercury emissions from coal-fired electric utilities. MACT standards require the installation of currently available control technologies irrespective of cost. The proposed MACT-based levels would reduce nationwide emissions by 29 percent by 2007.

EPA also proposed the creation of a cap-and-trade program.* The cap-and-trade program would be modeled on EPA's Acid Rain Program and would require power plants to meet strict emission caps in two phases. Under the program, states would be allocated specific amounts of mercury emissions, which would in turn be provided to utilities, which would trade them. In the first phase, emissions would be reduced by taking advantage of "co-benefits" achieved via the reduction of SO₂ and NO_x emissions pursuant to the Proposed Air Rule. The cap-and-trade program would ultimately reduce mercury emissions by approximately 69 percent.

* The adoption of the cap-and-trade approach would require EPA to revise its December 2000 finding that it is "appropriate and necessary" to regulate emissions using MACT standards. The Proposed Mercury Rule proposes this revision.

Environmental Practice BRIEFING

SHEARMAN & STERLING LLP



Members of Shearman & Sterling LLP's Environmental Practice Group provide legal advice regarding a wide variety of international, foreign national, federal and state environmental matters relating to business transactions and other matters of interest to Shearman & Sterling LLP clients. This publication is intended only as a general discussion of the issues presented. Nothing in this document should be regarded as legal advice. Shearman & Sterling LLP would be pleased to provide additional details about any matter discussed in this Briefing or advice about specific circumstances that might implicate environmental concerns. For more information on the topics covered in this publication, please contact Françoise S. Labrousse ((33-1) 53 89 70 00), Jason Y. Pratt ((212) 848-5449), Nandini N. Ramnath ((212) 848-4867), Jeffrey L. Salinger ((212) 848-7574), Bernard A. Weintraub ((212) 848-7442), or any other member of the Environmental Practice Group.