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Winter of 2003-2004, Hot One For Superfund Developments

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While the Winter of 2003-2004 will be remembered by many for its record low temperatures and seemingly endless snowfall, Superfund practitioners will remember it more for a flurry of pronouncements from the courts and the U.S. EPA on important CERCLA liability issues. As discussed more fully below, these pronouncements create confusion on an important contribution issue, eliminate a form of successor liability and clarify the contiguous property owner defense.

Contribution Confusion

In late December 2003, the United States District Court for the District of New Jersey ruled that a potentially responsible party ("PRP") may not initiate a CERCLA §113 contribution action unless the United States first commences a §107 action or issues a §106 unilateral administrative order to the claimant. *E.I. DuPont De Nemours & Co., et al. v. US et al.*, 2003 WL 23104700 (D.N.J. December 30, 2003). Relying primarily on the common law definition of "contribution," the Court reasoned that a right of contribution exists only in favor of a tort-feasor who is sued by an aggrieved party and who "has discharged the entire claim for the harm by paying more than his equitable share of the common liability." Therefore, absent an initial federal enforcement action, the claimant has no statutory right of contribution under CERCLA. In so holding, the Court acknowledged that its narrow interpretation "might very well hamper some PRP efforts at removal and remediation of hazard waste sites." The Court also acknowledged that CERCLA §113(f) expressly permits a contribution action by a party without an initial law suit or unilateral administrative order if the party has resolved its CERCLA liability with the United States through settlement.

The *Dupont* case is at odds with the decision of the United States Court of Appeals for the Fifth Circuit in *Aviall Services, Inc. v. Cooper Industries, Inc*., 312 F.3d 677 (5th Cir. 2002) (*en banc*). In *Aviall*, the Fifth Circuit held that §113 permits a contribution claim "at whatever time in the cleanup process the party, seeking contribution, decides to pursue it," irrespective of whether an initial action pursuant to CERCLA §§106 or 107(a) has been initiated by the government. The court reasoned that any other reading "create[s] substantial obstacles to achieving the purposes of CERCLA," by reducing the potential for the reallocation of cleanup costs among PRPs, and by discouraging voluntary cleanups.

This split in authority should be short lived. The U.S. Supreme Court granted certiorari in the *Aviall*

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case on January 9, 2004 and will likely issue a decision later this year.

Substantial Continuity Test Curtailed

Generally, under the common law, when a corporation sells or transfers all of its assets to another, the successor corporation is not liable for the predecessor's liabilities. One exception to this general rule is the "mere continuation" exception, where the purchasing corporation is merely a continuation of the transferor corporation, with the purchasing corporation having the same stock, stockholders and directors as the selling corporation. Prior to the United States Supreme Court's decision in *United States v. Bestfoods*, 524 U.S. 51 (1998), some federal courts recognized a more relaxed standard than the "mere continuation" exception, known as the "substantial continuity test" (also known as the "continuity of enterprise" approach). Under this exception, a court would consider eight-factors in determining if an asset purchaser acquired the liabilities of its predecessor:

(1) retention of the same employees;
(2) retention of the same supervisory personnel;
(3) retention of the same production facilities and location;
(4) production of the same products;
(5) retention of the same name;
(6) continuity of assets;
(7) continuity of general business operations; and
(8) whether the successor holds itself out as a continuation of predecessor.

This relaxed test exposed the purchaser in an asset transaction to the seller's liabilities, even where the seller expressly retained those liabilities.

In *New York v. National Serv. Indus.*, 352 F.3d 682 (2nd Cir. 2003), the United States Court of Appeals for the Second Circuit interpreted *Bestfoods* to mean that "when determining whether liability under CERCLA passes from one corporation to another, [the court] must apply common law rules and not create CERCLA-specific rules." Since the substantial continuity test was not part of the federal common law, the court held that it could not be used to determine whether a corporation takes on CERCLA liability in an asset purchase. The United States Court of Appeals for the First Circuit reached the same result, but for different reasons, in *United States v. Davis*, 261 F.3d 1, 53-54 (1st Cir. 2001) (*Bestfoods* requires application of state, rather than federal common law, in determining successor liability and the substantial continuity test is not part of Massachusetts common law).

Notwithstanding that the two federal appellate courts to consider the issue have held that the substantial continuity test cannot be used in determining CERCLA liability, some federal district courts still apply it, even after *Bestfoods*, including district courts within the Third Circuit. *See, e.g., Pennsylvania Dep't of Envtl. Protection v. Concept Sciences, Inc.*, 232 F.Supp.2d 454, 459 (E.D. PA 2002). Moreover, the test remains viable in determining successor liability under state Superfund-type statutes such as the New Jersey Spill Compensation and Control Act. *Analytical Measurements, Inc. v. Keuffel & Esser Co.*, 843 F.Supp. 920, 926 (D.N.J. 1993); *New Jersey Dep't of Transp. v. PSC Resources, Inc.*, 175 N.J. Super. 447, 467 (N.J. Super. Ct. Law. Div. 1980).

In sum, while the "substantial continuity" exception appears to have been eliminated as a basis for CERCLA liability in the First and Second Circuits, the issue is not yet settled beyond those circuits, and the exception may well remain viable under state Superfund-type statutes.

Contiguous Property Defense Clarified

On January 13, 2004, the U.S. EPA issued a guidance document, "Interim Enforcement Discretion Guidance Regarding Contiguous Property Owners," interpreting a provision added to CERCLA in 2002, which exempts certain contiguous property owners from CERCLA liability. The guidance document does not have the binding effect of a regulation, but it does explain how the U.S. EPA is likely to apply the law.

The Small Business Liability Relief and Brownfields Revitalization Act, or "Brownfields Amendments" to CERCLA, adopted in January 2002, added the contiguous property owner and bona fide potential purchaser defenses to CERCLA, and clarified the innocent purchaser defense. The contiguous property owner provision, CERCLA §107(q), provides that "a person that owns real property that is contiguous to or otherwise similarly situated with respect to, and that is or may be contaminated by a release or threatened release of a hazardous substance from, real property that is not owned by that person," and that does not "cause, contribute, or consent to the release or threatened release," is not an "owner or operator" subject to CERCLA liability for cleanup costs, provided that additional conditions are met. The amendment is intended to protect landowners whose property is polluted as a result of their neighbors' actions.

The additional conditions include first, that the landowner seeking protection is not potentially liable for response costs at the facility, nor "affiliated" with potentially responsible individuals or entities, through a familial, contractual, or financial relationship, or through business reorganization. Second, contiguous property owners must obtain their property without knowledge or reason to know it is contaminated, after conducting all appropriate inquiry. Third, property owners who want to insure protection must assume several ongoing obligations, including:

(1) taking "reasonable steps" to stop and prevent releases of hazardous substances and to prevent human and environmental exposure to hazardous substances;

(2) cooperating with, assisting, and providing access to those who conduct response actions;

(3) complying with land use restrictions and institutional controls used in the response action;

(4) complying with information requests and administrative subpoenas; and

(5) providing legally required notices.

The no affiliation, all appropriate inquiry, and continuing obligations criteria are relevant to the contiguous property owner, innocent purchaser, and bona fide potential purchaser defenses to CERCLA liability and are described in the U.S. EPA's "Interim Guidance Regarding Criteria Landowners Must Meet in Order to Qualify for Bona Fide Prospective Purchaser, Contiguous Property Owner, or Innocent Landowner Limitations on CERCLA Liability" or "Common Elements Guidance," issued in March 2003.

The new contiguous property owner guidance describes elements that are unique to the contiguous property owner defense, clarifies how the defense applies to current and former property owners, explains how the defense interacts with the EPA's enforcement policies regarding residential homeowners and contaminated aquifers, and sets forth mechanisms the U.S. EPA can use to protect qualifying contiguous property owners.

The unique elements of the contiguous property owner defense are (1) the landowner did not cause, contribute, or consent to the release or threatened release; and (2) the landowner's property is contiguous to, or otherwise similarly situated with respect to, the property from which there is a release or threatened release. With respect to the first requirement, for example, a landowner who dumps leaking drums next door, causing groundwater contamination beneath his own property, is not protected from liability for cleanup costs. When contamination originates both on-site and off-site, the U.S. EPA has the discretion to not pursue an enforcement action against the landowner for the portion that originates off-site.

With respect to the second requirement, the "otherwise similarly situated" language in the statute means that the property of the landowner who seeks protection does not have to actually touch the property that is the source of the contamination, so long as the properties affect each other in a way that is similar to how immediately neighboring properties affect each other. Therefore, when a plume of groundwater contamination extends far from its source, affected property owners may qualify for contiguous property owner protection, even if their property is far away from the source property.

The policy goes on to state that the defense applies to both current property owners and past owners who owned the property at issue at the time of disposal. Additionally, the contiguous property owner defense is largely consistent with the agency's preexisting policies of not pursuing enforcement actions against the owners of residential property or property contaminated by subsurface migration of hazardous substances from other property through a contaminated aquifer, where those owners do not contribute to the contamination. To the extent that the pre-existing policies are broader than the contiguous property owner defense, or vice-versa, the broader protection will apply.

Finally, the contiguous property owner policy explains that, upon written request or where the U.S. EPA conducts a response action, it can issue assurances that no government enforcement action will be taken against the landowner who qualifies for contiguous property owner protection. The agency can also provide a settlement protecting the landowner from contribution and cost recovery actions by private parties. Regardless of whether an assurance or settlement is requested or obtained, the contiguous property owner provisions provide a defense against government or private action under CERCLA.

For more information regarding Superfund developments or other environmental issues, please contact Richard F. Ricci, Esq., Chair of the Environmental Law Practice Group, at 973.597.2462 or rricci@lowenstein.com.