Message from the Chair

Dear Committee Members:

Welcome to the second volume of our Committee's newsletter. It is jam packed, in every version, with a wealth of information. Enclosed is a wide variety of information including an update on CERCLA liability as it relates to land owners; a review of the impact and ramifications of the recent US Supreme Court Decision in Aviall; an overview of environmental law in China, a review of Brownfields legislation in Ontario, Canada, an article about waiving attorney client and work product privilege and then finally an update on SEC reporting and environmental risk for corporate directors.

As always, we are interested in contributions for our next newsletter. If you would like to contribute or discuss a contribution please contact me as noted below. As well, we are forming a speakers roster and if you are interested in speaking opportunities please call and make sure to get in touch with me.

Cheers,
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Preserving CERCLA Defenses: Reasonable Steps
Ronald R. Janke

As enacted in 1980, CERCLA contained few defenses, with the result that potential acquirors and their lenders avoided potentially contaminated properties, or "brownfields" In the intervening years, Congress has strengthened defenses against clean-up liability. This article provides a useful overview of each of the principal defenses available to secured creditors, innocent landowners, prospective purchasers and others, with links to legislation and EPA policies.

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Clean-ups, Contribution, and Cooper Industries v. Aviall Services
Robert M. Steele

On December 13, 2004, the U.S. Supreme Court held in Aviall that a potentially responsible party (PRP) under Superfund who had voluntarily cleaned up a site could not bring a CERCLA section 113(f)(1) contribution action to recover clean-up costs from another liable party. The Court based its ruling on the fact that the PRP had not been sued first by the EPA or a state under Superfund, nor had it already resolved its own liability in an administrative or judicially approved settlement. This article analyzes the history of Superfund contribution over the last 25 years, and considers what may be expected from Congress, the
states and the courts in the wake of Aviall, a decision that explicitly contradicted the understandings of nine Circuits and will potentially change practice and advice that has been standard since the Superfund Amendments and Reauthorization Act of 1986.

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**Environmental Law Outlook in China**  
*John C. Cole*

As China's economy has developed, its environmental regulatory regime has become stronger, with a greater focus on enforcement. The author notes, for example, that China's State Environmental Protection Administration recently ordered thirty major projects involving billions of dollars to shut down for failure to comply with environmental impact assessment legislation. The article also considers recent revisions to the Solid Waste Law and China's growing emissions trading regime. In addition, forthcoming legislation will reportedly provide tax and other incentives designed to raise the market share of renewable energy sources to 5% by 2010 and 10% by 2020. Finally, the author outlines the multiplicity of national, provincial and local authorities involved in environmental regulation in China, concluding that the implementation of Chinese laws and regulations requires a uniform understanding of underlying policy goals by the disparate regulators, as well as uniform enforcement by the agencies of various levels of government.

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**Minefields of Opportunity: Liability in Ontario's Brownfields Remediation Regime**  
*Jim Harbell*

Recent Ontario regulations implementing key provisions of the Brownfields Statute Law Amendment Act are a good first step, but only a first step, toward removing some of the legal disincentives to dealing with and developing brownfields in that province. The new regime includes mandatory filing of a Record of Site Condition (RSC) on completion of remediation. An RSC will ostensibly protect past, present and future owners and occupiers from the threat of further clean-up orders. However, as the author notes, the existence of an RSC does not preclude civil liability. In addition, the new regulations do not provide explicit protection from orders regarding off-site contamination. The absence of adequate civil liability and off-site contamination provisions may in themselves be sufficient to derail the prospects of significant brownfields development.

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**"Waiving" Goodbye to the Internal Investigation**  
*Judson W. Starr and Michael S. Munson*

Whether a corporation will face charges under environmental law statutes depends to some extent on the degree to which it cooperates with regulators and investigators. Recently, in the wake of Enron and other corporate scandals, the DOJ and EPA have shown more inclination to consider a corporation's agreement to waive its attorney-client privilege as an important indicator of its "co-operativeness". As the authors point out, this creates a
dilemma for companies, making it problematic for them to conduct internal investigations of environmental "incidents", even for the purpose of deciding whether to waive or not. The article discusses how internal investigations might be conducted so as to minimize the risk should waiver be necessary and suggests that the effects of the policy of encouraging "voluntary" waiver may be contrary to the underlying aims of environmental legislation.

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Calling All Directors...You May Still Be At Risk...Sarbanes-Oxley, SEC Reporting and Environmental Risk

Cynthia C. Rettallick, J.D.

In the fallout of recent corporate scandals, corporate directors have been paying more attention than ever to their D&O insurance requirements. Nevertheless, because environmental risks are unique, many directors and officers are more exposed than they realize on the environmental front. In particular, as the author notes, directors and officers can be unpleasantly surprised by two typical exclusions that arise in environmental securities claims: the "pollution exclusion" (denying coverage for claims whose underlying cause is the actual or alleged discharge of pollutants) and the "failure to maintain adequate insurance exclusion" (which prevents D&O insurance from being used as a substitute for adequate coverage at the corporate level). After discussing these exclusions, the author concludes by arguing that site-specific risk management strategies may have to be developed in order to ensure appropriate liability protection.

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Preserving CERCLA Defenses: Reasonable Steps

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Introduction: Landowner Liability Under CERCLA

When the Comprehensive Environmental Response, Compensation and Liability Act of 1980, commonly known as CERCLA or Superfund, was enacted 25 years ago, it contained few defenses. The recognition of the need for the enactment of additional defenses grew as CERCLA’s basic liability scheme began to be articulated by EPA and the courts as imposing strict, retroactive, joint and severable liability for releases and threats of releases of hazardous substances. This recognition occurred most quickly and widely in the situation where an entity was going to acquire property. Upon acquiring the property, the new owner could be ordered by the government to investigate contamination and to take a wide variety of other response actions with respect to releases of hazardous substances on the property. Alternatively, the new owner might be required to reimburse governmental or (in some cases) private parties for their future expenditures in responding to releases on the property.

The angst over CERCLA liability experienced by commercial developers and other future property owners was shared by their lenders. The ability of a borrower to repay its mortgage could be threatened by CERCLA liability costs. In addition, the lender faced CERCLA liability itself if it foreclosed or if actions to protect its security interest its actions were viewed as operating the facility before or after foreclosure.¹ This liability could be larger than the value of the loan or the property.

¹ See 56 Federal Register 28798 (June 24, 1991) (issues reviewed in preamble to EPA proposed lender liability rule).
Problems Perceived with Landowner Liability

Imposing CERCLA liability on landowners, including banks protecting or foreclosing on loans, seemed wrong-headed and perverse to many. Landowner liability did not square with the rhetoric of “making the polluter, not the taxpayer” pay for cleaning up contamination, which was used to support CERCLA enactment. After all, acquiring title to property does not make one a “polluter.” In addition, viewed against a backdrop of a general system of environmental law in which pollution control and remediation responsibilities are basically premised on causation (hence the articulation of “polluter pays” as a legislative “principle”), it seems strikingly unfair to impose CERCLA clean-up liability on a landowner who did not cause the pollution.

Questions of fairness aside, landowner liability had social implications. The threat of liability for pre-existing contamination casts a large shadow over properties which may have been contaminated with hazardous substances by prior uses. Properties which exist under this shadow have become known as “Brownfields,” regardless of whether they actually have been contaminated to any substantial extent by prior uses. One result of this shadow or stigma has been reduced reuse of Brownfields and increased sprawl.

Defenses to Landowner Liability

Over the last two decades, Congress has enacted a series of amendments creating defenses against clean-up liability under CERCLA. These changes to the CERCLA liability scheme have been made cautiously. The defenses are narrow. To a considerable extent, these provisions reflect rules and policies that the EPA had adopted to address these issues. See, e.g., 57 Federal Register 18344 (April 29, 1992) (EPA lender liability
rule). To a large extent, the adequacy of these defenses in achieving their purposes depend on how they are implemented by buyers, lenders and the EPA.

**Secured Creditor Exemption**

In 1996 Congress amended CERCLA to further define at length a provision, which was added in 1986, exempting from the statutory definition of “owner or operator” a “lender that, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect [its] security interest.” 42 U.S.C. Section 9601(20)(E)(i). The Asset Conservation, Lender Liability and Deposit Insurance Protection Act of 1996, 110 Stat. 3009. Virtually all the words and phrases in this exemption are now defined by the new provisions added to the statute. See 42 U.S.C. Section 9601(20)(E)-(G). These provisions clarify what a secured lender may do before and after foreclosure to avoid the liability-triggering act of “participating in management.” By carefully limiting activities to those listed in the statute, a security lender may preserve this exemption. One mandatory act to preserve this exemption occurs upon foreclosure. Thereafter, the lender must “seek to sell, re-lease (in the case of a lease finance transaction), or otherwise divest…, the facility or vessel at the earliest practicable, commercially reasonable time, on commercially reasonable terms, taking into account market conditions and legal and regulatory requirements.” 42 U.S.C. Section 9601(20)(E)(ii).

**Innocent Landowner Defense**

The innocent landowner defense was enacted in 1986 and appears in 42 U.S.C. Section 9601(35)(A)(i). This section, which is read in conjunction with the third-party defense in 42 U.S.C. Section 9607(b)(3), provides a defense for liability from hazardous
substances which an innocent landowner did not know or had no reason to know about before purchasing the property. It was modified by the 2002 amendments.

To establish and preserve the innocent landowner defense, several requirements must be met. The owner must:

- acquire ownership after all disposal of hazardous substances occurred at the facility;
- make all appropriate inquiry regarding the previous ownership and use of the property before acquisition;
- take reasonable steps to stop any continuing release, prevent any threatened future release, and prevent or limit any human, environmental or natural resource exposure to any previous release;
- fully cooperate with and assist persons conducting response actions; and
- comply with any land use restrictions and institution controls established in connection with a response action.

To establish and preserve the innocent landowner defense, it is also necessary to demonstrate compliance with the third-party defense set forth in 42 U.S.C. Section 9607(b)(3). The landowner must establish by a preponderance of the evidence:

- the act or emission which caused the release and the resulting damages were caused by a third-party with whom the landowner has no employment, agency or contractual relationship;
- the landowner exercised due care with respect to the hazardous substances concerned;
- the landowner took precautions against the foreseeable acts or omissions of any such third party and the foreseeable consequences of such acts or omissions.

**Bona Fide Prospective Purchaser Defense**

The 2002 amendments added a new “bona fide prospective purchaser” defense in 42 U.S.C. Section 9607(r). In contrast to the innocent landowner defense, this new defense can apply to hazardous substances which the purchaser knew were on the property when it was purchased after January 11, 2002.
There are several elements to the bona fide prospective purchaser defense. To establish and to preserve this defense, the owner must:

- not be affiliated with any potentially liable party through a familial, financial, corporate or contractual relationship;
- acquire ownership after all disposal of hazardous substances occurred at the facility;
- make all appropriate inquiry regarding the facility before acquisition;
- provide all legally required notices regarding the hazardous substances released at the facility;
- take reasonable steps to stop any continuing releases, prevent or limit any threatened future release, and prevent or limit human, environmental or natural resource exposure to any previous release;
- fully cooperate with and assist persons conducting response actions;
- provide all legally required notices regarding the discovery or release of the hazardous substances;
- comply with any land use restrictions and institutional controls established in connection with a response action; and
- comply with any information request under CERCLA.

**Contiguous Property Owner Defense**

CERCLA’s broad landowner liability concept presents issues where the source of the contamination is on an adjacent property. The 2002 amendments provide a defense to landowner whose property is contaminated by releases migrating from contiguous property which it does not own. 42 U.S.C. Section 9607(g). This defense basically codified an earlier EPA policy. See 60 Federal Register 34790 (July 3, 1995).

There are several elements to the contiguous property owner defense. The first two are that the owner (1) did not cause, contribute or consent to the release and (2) is not affiliated with a potentially liable party through a familial, financial, corporate or contractual relationship. The last five elements involve actions which must be taken after
the contamination is discovered. Hence, they are particularly relevant in terms of what must be done to preserve this CERCLA defense. These elements require the owner to:

- make all appropriate inquiry regarding the facility before acquisition;
- take reasonable steps to stop continuing releases, prevent or limit future releases, and prevent or limit human, environmental or natural resource exposure to any previous releases;
- fully cooperate with and assist persons conducting response actions;
- provide all legally required notices regarding the hazardous substances, released at the facility; and
- comply with any land use restrictions and institutional controls established in connection with a response action.

**Common Elements**

The 2002 amendments establish several elements for establishing each of these defenses, some of which are common to all these defenses. Two of those common elements, including the “All Appropriate Inquiry” element, which relates to acts which must be taken before acquiring the property. The remainder of these common elements impose continuing obligations which must be met after hazardous substances are discovered in order to preserve these defenses. The “Reasonable Steps” requirement is an example of these continuing obligations. The EPA’s March 6, 2003 Interim “Common Elements” Guidance discusses all these elements.

**All Appropriate Inquiry**

The 2002 amendments specify as an element of the landowner defenses a duty to conduct all appropriate inquiry before acquiring the property. The amendments state that purchasers of property before May 31, 1997 shall take into account such things as commonly known information about the property, the value of the property if clean, the ability of the defendant to detect contamination, and other similar criteria. 42 U.S.C. Section 9601(35)(B)(iv)(I). For property purchased on or after May 31, 1997, the
procedures of the American Society for Testing and Materials (ASTM), including the
document known as Standard 1527-97, entitled “Standard Practice for Environmental
Site Assessments: Phase I Environmental Site Assessment Process”, are to be used until

The 2002 amendments require EPA to promulgate regulations establishing
standards and practices for all appropriate inquiry and set out criteria that must be
addressed in EPA’s regulation. 42 U.S.C. Section 9601(35)(B)(iv)(II). The all appropriate
inquiry is the subject of proposed EPA regulations. See 69 Federal Register 52542
(August 26, 2004).

The proposed regulations contain many elements. For example, it defines the
qualifications of the “environmental professional” who is to conduct the inquiry. The
proposed regulation expands the ten statutory criteria for all appropriate inquiry by
requiring that certain additional inquiries be conducted. The proposed regulation defines
certain responsibilities of the purchaser in providing information to the environmental
professional. Complying with the requirements of the current ASTM standard or with the
EPA rule, when it is enacted, is crucial to preserving these defenses.

Reasonable Steps

Another common element of establishing the innocent landowner, the prospective
purchaser and the contiguous property owner defenses is that person take “reasonable
steps” to (1) stop any continuing release, (2) prevent any threatened future release, and
(3) prevent or limit any human, environmental, or natural resource exposure to any
previously released hazardous substance. Unlike the “all appropriate inquiry” element,
CERCLA does not set forth statutory criteria and rulemaking obligations to clarify what
constitutes “reasonable steps.” The vagueness of this term can be a subject of considerable consternation to a property owner who was careful to take “all appropriate action” only to have his liability defense threatened by potential after-the-fact disagreements over whether his actions were “reasonable steps.”

Clarification can be obtained by reviewing EPA’s March 6, 2003 Interim “Common Elements” Guidance as to the agency’s interpretation of “reasonable steps,” which also discusses other elements in these landowner defenses. EPA notes that a bona fide prospective purchase who knew of contamination might be subject to greater reasonable steps obligations than other protected landowners who did not have an opportunity to plan affirmative steps prior to purchase. EPA emphasizes that any owner generally must take some affirmative steps must be taken when confronted with hazardous substances on its property. In particular, EPA points out that giving timely notification to government authorities of the discovery of contamination and taking basic actions to assess the extent of contamination would be reasonable steps. EPA states that generally, but not necessarily always, “reasonable steps” as to remediation are something less than the remedy a liable party under CERCLA would have to take. Recognizing that reasonable steps will depend upon the facts of each specific case, EPA states that upon request it may, in its discretion, provide a comfort letter addressing reasonable steps at a specific site. If so, EPA may confer with state authorities before issuing such a letter.

EPA notes in its “Common Elements” Guidance legislative history which states that conducting groundwater investigations or installing groundwater remediation systems will not be required to preserve this defense for contiguous property owners
absent exceptional circumstances. As a further example, EPA states that if a leaking drum is discovered, the drum should be segregated, contained and its contents identified.

In the preamble to the proposed All Appropriate Inquiry rule, EPA discusses how data gaps identified during a pre-acquisition environmental assessment relate to reasonable care obligations. EPA states: “A person’s inability to obtain information regarding a property’s ownership or use prior to acquiring a property can affect the landowner’s ability to claim a protection from CERCLA liability after acquiring, if a lack of information results in the landowner’s inability to comply with any other post-acquisition statutory obligations that are necessary to assert protection from CERCLA liability.” 69 Federal Register 52542, 52560 (August 26, 2004). As an example, EPA states: “if a person does not identify . . . prior to acquiring a property, a leaking underground storage tank that exists on the property, the landowner may not have sufficient information . . . to take reasonable steps to stop on-going releases after acquiring the property.” (Id.) These statements indicate that, in EPA’s view, “reasonable care” obligations start before property is acquired.

Conclusion

Because of CERCLA’s liability scheme, establishing and preserving CERCLA defenses is important when property is being acquired or when contamination is encountered on owned property.
Clean-ups, Contribution, and Cooper Industries v. Aviall Services

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Introduction

For all the billions of dollars at stake in the thousands of lawsuits spawned by Superfund since its passage twenty-five years ago, the United States Supreme Court has not weighed in on key issues and evolving applications of Superfund as often as one might think.¹ When it has done so, the Court has usually clarified existing interpretations and supported the majority of Circuit Courts of Appeal on selected issues that those lower courts have grappled with for many years. But on December 13, 2004, the Supreme Court rendered a decision on an important part of Superfund that contradicts the reading of nine Circuits and potentially changes practice and advice understood since the Superfund Amendments and Reauthorization Act of 1986 (SARA). That decision, already the subject of much debate and attention in the environmental legal community, is Cooper Industries, Inc. v. Aviall Services, Inc.² (“Aviall”).

The Aviall Court ruled 7-2 that a Superfund potentially responsible party (PRP) who “voluntarily” cleaned up a site could not bring a CERCLA Section 113(f)(1) contribution action against another liable party, in order to recover clean-up costs, because it had not been sued first by the EPA or a state under Superfund, nor had it already resolved its own liability in an administrative or judicially approved settlement.³

³ Id.
To best understand this holding, one must look at the history of this issue both in the statute and in the courts.4

**Superfund Contribution Through the Ages**

From the beginning, CERCLA liability was meant to be harsh and often unfair. **Section 107** creates strict, no-fault clean-up liability for certain categories of parties like past and present site owners, operators, and arrangers of hazardous substance disposal. Superfund liability has also been interpreted to be retroactive and joint and several. Any liable party (with few defenses) can be made to perform or pay for an entire clean-up even if there are other parties that share the liability. Also, litigation was always a built-in ingredient of Superfund. The party paying more than its fair share should seek relief, if EPA would not do it, by pursuing other liable parties in private litigation to recover all or part of its Superfund response costs.

**1980 to 1986.** Superfund originally established liability in **Sections 106** and **107** but did not specify contribution in **Section 113** (governing litigation and enforcement).5 A person *without* liability with necessary response costs could pursue a party *with* liability for recovery of those costs under Section 107. But what of a liable PRP spending money and seeking to sue non-participating PRPs for full cost recovery or for contribution and equitable apportionment of total costs? While not explicit in the statute, many courts in the early 1980’s held that CERCLA Section 107 allowed such PRP cost recovery or contribution either directly by its language or impliedly from its intent, or as a matter of federal common law.6 Because of continued uncertainty, however, Congress when

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4 This article presumes that the reader has at least a basic awareness of what federal Superfund is and how it was enacted to address hazardous substance sites created over many years.

5 42 U.S.C. §§ 9606, 9607, and 9613.

6 See, e.g., *United States v. New Castle County*, 642 F. Supp. 1258 (D. Del. 1986); *Wehner v. Syntex*
enacting the SARA amendments in 1986 added an explicit codified contribution right under which liable parties could pursue other liable parties in court.

**1986.** New Section 113(f) was added by SARA and reads as follows:

(1) Contribution. – Any person may seek contribution from any other person who is liable or potentially liable under section 107(a), during or following any civil action under section 106 or under section 107(a). . . . In resolving contribution claims, the court may allocate response costs among liable parties using such equitable factors as the court determines are appropriate. Nothing in this subsection shall diminish the right of any person to bring an action for contribution in the absence of a civil action under section 106 or section 107.

. . .

(3) . . . (B) A person who has resolved its liability to the United States or a State for some or all of a response action or for some or all of the costs of such action in an administrative or judicially approved settlement may seek contribution from any other person who is not party to a settlement referred to in paragraph (2). 7

**1986 to 2004.** After SARA, these two Superfund contribution vehicles gave a PRP seeking to gain funds from other PRPs its clearest avenue of attack if the paying/performing plaintiff also met the other prerequisites for recovery, such as the applicable statute of limitations under Section 113, and proving that its clean-up and response costs were incurred in conformance with the National Contingency Plan (NCP) regulations. 8 Courts hearing these cases usually focused on determining what equitable factors could or must be used in resolving contribution claims under CERCLA.

However, several other interesting and important developments occurred over these years. (1) Most District Courts and Circuits came to rule that PRPs could no longer seek contribution under Section 107, but instead had to use Section 113, which was

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7 42 U.S.C. § 9613(f).
8 40 CFR Part 300.

created for that purpose. A private Section 107 action is reserved for total cost recovery claims brought only by non-liable or “innocent” parties, not by liable PRPs, subject perhaps to only a few exceptions. PRPs had continued trying to use Section 107 as well as Section 113 because of such comparative advantages under Section 107 as joint and several liability (instead of apportionment), a more favorable statute of limitations, and a different burden of proof for NCP compliance.

(2) Section 113(f)(1) was interpreted almost universally to allow PRP contribution actions against other PRPs even if there was no Section 106 or Section 107 lawsuit against the contribution plaintiff first by EPA or a state, and even if there was no judicial or administrative liability settlement yet by the plaintiff PRP with those authorities. Orders, notices, threats of enforcement, voluntary agreements, and sometimes even just the private knowledge of having Superfund liability could allow a PRP to respond at a site and still pursue contribution. After starting to expend eligible costs in conformance with the other rules and conditions, that PRP could initiate Section 113 claims and litigation against other PRPs. Lawyer advice to clients followed this approach accordingly. Courts justified this view by noting the use of the permissive word “may” in Section 113(f)(1), the contradictory savings sentence at the end of that same subsection (repeating some of the drafting murkiness that plagued the original language of CERCLA), and the intent and public policy behind Superfund. Interpreting Section 113 contribution broadly encouraged clean-ups with less time and cost from agency involvement and litigation, encouraged volunteers to step up to the plate and aided state

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10 See, e.g., Kalamazoo River Study Group v. Rockwell International Corp., 274 F.3d 1043 (6th Cir. 2001); Amoco Oil Co. v. Borden, Inc., 889 F.2d 664 (5th Cir. 1989).
programs, and assisted in brownfields redevelopment as a growing national movement. Even if there still remained uncertainty in finding other PRPs with assets and successfully meeting all requirements to recover from them, and even if that could also be accomplished sometimes outside of Superfund, this interpretation of Section 113 facilitated clean-ups at many sites. Initial parties facing liability did not have to be sued or wait to settle before moving forward. Nine Circuits agreed.\(^\text{11}\)

(3) Owners of contaminated sites, with voluntary programs and brownfield laws active at the state level, often looked to other non-Superfund means of PRP recovery against fellow PRPs. At times all claims would be combined, adding to federal CERCLA any state statutory cost recovery and contribution actions, state common law contribution if available, and other state common law claims for nuisance, trespass, negligence, and the like.\(^\text{12}\) Sometimes only the state claims would be brought if a volunteer clean-up party under state law did not have to raise its clean-up effort to meet such NCP requirements as public notice and participation in remedy selection (or other federal prerequisites). However, in some jurisdictions a disturbing group of cases also began to find that other contribution actions such as these state law claims were now \textit{pre-empted} by CERCLA Section 113’s existence for hazardous substance clean-up situations.\(^\text{13}\) While justified for some by the need to remove state obstacles and conflicting requirements from the full objectives of CERCLA, such holdings also seemed to ignore the savings language at the


\(^{12}\) See, \textit{e.g.}, \textit{Ergon, Inc. v. Amoco Oil Co.}, 966 F. Supp. 577 (W.D. Tenn. 1997) (Tennessee has a common law equitable contribution right in an environmental clean-up setting).

\(^{13}\) See, \textit{e.g.}, \textit{Fireman’s Fund Insurance Co. v. City of Lodi}, 302 F.3d 928 (9\textsuperscript{th} Cir. 2002), \textit{cert. denied}, 538 U.S. 961 (2003).
end of Section 113(f)(1) preserving the right to bring other unspecified contribution actions, presumably outside of Superfund.¹⁴

(4) While the Resource Conservation and Recovery Act (RCRA)¹⁵ provides strong federal authority applicable to defined “hazardous waste” situations, it has been interpreted as not allowing a private party to recover its clean-up costs from other liable parties. Such a plaintiff may be able to sue under RCRA and its citizen suit provisions to compel other liable parties to take response actions, but not to recoup one’s own prior response expenditures.¹⁶

So for a PRP seeking contribution, CERCLA Section 113(f) has become even more important over time. In some cases Section 113(f) may provide the only way to make the claim, often without RCRA or CERCLA Section 107 being available, and sometimes even without state statutes or common law or contractual rights either.

**Cooper Industries v. Aviall Services**

The *Aviall* case arose from typical Superfund site facts faced by many companies over the years from both sides. (Will Cooper someday regret the change it has brought about?) Aviall’s multi-million dollar clean-up of property it had purchased from and operated (and contaminated) after Cooper was at the behest of the Texas Natural Resource Conservation Commission but no formal action was ever filed. The District Court disallowed PRP Aviall’s Superfund Section 113 contribution action against prior site owner and fellow PRP Cooper because Aviall had not been sued first by EPA or

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¹⁵ 42 U.S.C. § 6901 et seq.
Texas under CERCLA Sections 106 or 107. On appeal, the Fifth Circuit initially confirmed the lower court, causing some shock waves in the Superfund community. However, on rehearing *en banc* that appeals court overturned its prior holding and the lower court opinion to follow the other Circuits and allow Aviall’s Section 113 action.

The Supreme Court decision reversing the Fifth Circuit came on December 13, 2004. The *concise opinion* was authored by Justice Thomas and should be read in its entirety for a good description of the issues and prior authorities. Seven justices made up the majority. The two dissenters did not disagree with the Court’s reading of Section 113, but did propose to go back to a right of contribution under Section 107 which the majority declined to address under the facts and case posture before it.

The *Aviall* Court found that the language of Section 113(f)(1) was clear enough so that the policies and purposes of CERCLA did not need to be consulted. Section 113(f)(1) authorized contribution only after an initial civil suit, and to hold otherwise would be to disregard that conditional language and give it no effect, which would not have been intended by Congress. In the Court’s view, this clear statement was not clouded by the savings clause at the end of Section 113(f)(1) preserving other contribution actions. The Court also noted the alternate contribution avenue under Section 113(f)(3)(B) after an approved settlement, and cited other supporting features like the statute of limitations triggered either by date of judgment or by date of settlement.

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17 See 2000 WL 31730 (W.D. Tex. 2000). Previously Aviall had consolidated its Section 107 count with its (continued) Section 113 count in light of prevailing law.
18 See 263 F.3d 134 (5th Cir. 2001).
19 See 312 F.3d 677 (5th Cir. 2002).
While the majority left open the possibility of a return to cost recovery or contribution under Section 107 in no-suit, no-settlement situations, it also noted the Circuit Court decisions against that position. It seemed to cast doubt on there being an implied contribution right there when an explicit one has been provided elsewhere in the statute. At the same time, the Court also seemed to view the savings sentence at the end of Section 113(f)(1) as rebutting any presumption that that section is the exclusive contribution cause of action available to a PRP—perhaps signaling that state law claims should not be considered preempted by the mere existence of Section 113 of Superfund as a mechanism of pursuing contribution for one’s environmental remediation costs.22

2005 and Beyond

It remains to be seen how revolutionary the Supreme Court decision in Aviall will prove to be. Analysts and pundits are already working overtime on this subject, and seminars and discussions are appearing weekly. More to the point, pending Superfund contribution cases brought by voluntary clean-up parties seeking reimbursement from non-cooperating fellow PRPs are starting to be dismissed by lower courts whose hands are tied when the facts show no prior lawsuit or settlement involving the contribution plaintiff.23

What will the real-world level of impact be, and what responses will come from private parties, courts, and governments? There are many different views so far and only time will tell as events unfold this year and beyond.

22 543 U.S. _______, 59 ERC 1545 (2004). There is a very interesting parallel between the debate on interpretation within the Aviall opinions and judicial interpretations of insurance contracts in environmental insurance coverage cases. Does something less than litigation count as a “lawsuit” triggering an insurer’s duty to defend when insurance policy language declares that a suit is first required?

**Congress.** There is always the chance that Congress could act to “fix” the problem created by this decision and change or clarify the language of Section 113(f)(1). How soon that might happen, or if it would at all, are impossible to know. No doubt any targeted Superfund bill might engender political moves from both sides in Congress including an inevitable debate on the Superfund program budget and tax reauthorization, even if a Section 113 bill is styled as “rescuing” brownfields from the Supreme Court. There is also the amazing fact that the United States’ amicus brief in *Aviall* sided with Cooper! Presumably this position was taken to favor the many federal agency PRPs facing liability at Superfund sites. Other amici, however, including industry commenters and states, supported Aviall and the prior consensus on how to read Section 113. One commentator has alluded to an apparent split reaction within the current administration in that the Solicitor General’s support for Cooper may have gone against “EPA’s strong entreaties to support the Aviall position.” Such internal federal government disagreement could certainly affect whether Congress would or could take any corrective action.

**States.** Those states pushing forward on brownfields will now be concerned that fewer volunteers will step forward to participate in their programs if the Superfund contribution right is harder to attain. Parties may choose to “lie in the weeds” until sued by EPA or a state due to *Aviall*. States may see more sites left for clean-up by governments themselves with their own scarce funds before PRPs can be made to take action. *Aviall* has already been decried as anti-brownfields and thus out-of-step with recent public policy progress. In New York, for example, sites subject to existing

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enforcement actions may not be eligible to participate in the state brownfields program, yet such prior actions may now be needed to preserve CERCLA contribution rights.

One response from states could be to amend their own statutes, if necessary, to make sure that performing PRPs have a state law cause of action for contribution available against other PRPs. Such a step might even be advantageous if the state chooses to lower the Superfund hurdle of NCP compliance as a prerequisite to seeking contribution, possibly realizing a net improvement overall for a performing PRP. (Of course, federal courts overruling scattered findings of federal pre-emption of state contribution mechanisms would be helpful too.)

States may want to broaden their brownfields program eligibility requirements. They may also try to make themselves more available (despite the time and cost) for “quickie” deals with volunteer PRPs either in the form of lawsuits filed just to trigger Section 113(f)(1) for the PRP, or of settlements using model agreements with standard terms that can avoid reinvention of the wheel and delay at every site. However, such settlements still might be too difficult to do routinely and also may become the subject of challenges if terms are too unreasonable to non-participating parties or do not follow certain basic principles and procedures.

Much more attention is likely to be given to making sure that state voluntary and brownfield agreements can qualify as approved settlements resolving a party’s liability with the state and granting protection, in light of Superfund Section 113(f)(3)(B). Special efforts to put appropriate qualifying language into state orders and agreements may involve some guesswork until more case determinations are reached on this specific point. One can envision situations, however, in which either the private party addressing
a site or the state, or both, may be reluctant to “resolve” even partial liability in a document that is primarily an interim step taken to move a site response forward.

**Courts.** As mentioned, presuming that lower federal courts must now follow *Aviall* on the cases before it (new contribution cases will presumably reflect altered strategies to meet Section 113), then moving away from pre-emption of state law in jurisdictions that saw those rulings would ease the burden on some performing PRPs who can take advantage of those state causes of action. Much speculation also centers on either lower federal courts or the Supreme Court going back to finding an explicit PRP cost recovery or implied PRP contribution right in CERCLA Section 107 despite the weight of recent opinions against that view. Dissenters in *Aviall* could perhaps bring other justices around in a case where this issue is properly framed, argued, and put before the panel. Otherwise, it seems doubtful that the literal reading in *Aviall* leaves the lower federal courts with much “wiggle room” or, for example, that parallel interpretations from other areas could be transported into the Superfund Section 113 arena now. (Perhaps the reverse will take place in future state-level environmental insurance decisions, even though strict construction of statutory terms and interpretation of policy contract terms have differences as well as similarities.)

It should be noted that subsequent to the Supreme Court’s ruling in *Aviall*, the Fifth Circuit has ruled that Aviall on remand may amend and litigate issues left unresolved by the higher Court, such as the viability of now trying to use Section 107. Cooper petitioned the Supreme Court to overturn this holding on March 4, 2005.

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25 *Aviall Services, Inc. v. Cooper Industries, Inc.*, No. 00-10197 (5th Cir. Feb. 15, 2005).
EPA. The federal agency must also be concerned about *Aviall* dampening PRP initiative and Superfund fairness, and the potential impacts on its own resources at federal sites. However, EPA may also have its power increased in discretionary areas like the granting of settlements or the naming of parties under Section 106 Unilateral Administrative Orders (UAOs). The Court was silent on this point in *Aviall* while amicus United States argued that a UAO is not a qualifying Section 113 “settlement.” If a UAO is neither a civil action nor a liability settlement, and the recipient can neither challenge the UAO (at least as to the remedy, if not defy the liability at severe risk) nor move right away or even later for contribution against other PRPs not so named, then the EPA decision on who gets issued the UAO and who does not becomes even more important. There might be constitutional questions raised as well.

Another concern may be conflict of interest with federal PRPs. Federal PRPs might be able to delay or avoid liability if not named up front or pursued by EPA, because now they also cannot be on the private PRPs Section 113 defendants’ list either if EPA will neither sue nor settle first with the private PRPs. Also, sovereign immunity may shield federal PRPs from state law claims brought against other PRPs.

**Private Parties.** As noted throughout this article, parties facing Superfund liability will have to analyze their specific situations even more closely in the post-*Aviall* world to make sure that, if it is important at that site, contribution rights against others are protected when going forward with a site response. Some companies may want to hang back and not be proactive until or unless forced to act. Others will still enter state voluntary programs but will work harder to gain the state authorizations that will trigger federal Superfund contribution, as well as gain state contribution rights too. Aside from
altering Superfund contribution actions and some of the strategies, philosophies, timing and logistics of clean-up site responses, *Aviall* should also make transactional environmental due diligence even more important than it has been already. Satisfying a third-party defense might convert a PRP purchaser/owner into an “innocent” non-PRP in the future who could then seek to use *Section 107* for cost recovery. Creating contract-based rights and indemnities and having environmental insurance in sale and successor situations, and having them last and be viable, are also more important if statute-based rights of action are now narrower than before and cannot be relied upon as avenues of relief for parties doing private or state voluntary clean-ups. In Superfund site situations not involving a prior transaction or successive owner PRPs, however, such as with multiple arranger PRPs undertaking a landfill remedial action, this additional basis for cost recovery likely will not exist.

**Conclusion**

It is too soon to know how this Supreme Court decision will play out. For now it is certainly true that longstanding strategies, balancing of factors, and advice to clients at many Superfund sites and in other hazardous substance clean-up situations have changed in an unexpected way. Interested parties should keep a close watch on this topic even after the bar programs and law firm alerts discussing *Aviall* begin to dissipate.
Environmental Law Outlook in China

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China’s maturing environmental regulatory regime is likely to result in increased regulation over the next year. Recent crackdowns also show that enforcement of environmental laws is being given greater priority. This signals a move away from the existing regime whereby environmental monitoring is accomplished by requiring any party attempting to build or expand any commercial facility to complete and submit to government an environmental impact assessment (EIA) and to obtain approval for that EIA. If the EIA describes a breach of China’s environmental laws, approval is generally not forthcoming until the breach has been remedied through clean-up, which can delay other capital investments at the site. Another difficulty that remains in China’s enforcement effort is the wide range of governmental authorities with regulatory power over environmental concerns. The proposed legislation does not address the issue of overlapping legislation and jurisdictional claims by the various enforcement bodies.

Let us turn to China’s EIA requirements and recent legislative developments, as well as some of the more significant regulatory authorities in the environmental field.

Environmental Impact Assessments

Key to China’s environmental protection regulatory regime is the Environmental Impact Assessment Law, which sets up a monitoring system that includes analysis, forecast and assessment of existing and potential environmental impacts. In particular, the law requires that EIAs be conducted in respect of construction projects (including the expansion or overhaul of existing facilities). Construction cannot begin without governmental approval or registration of the relevant EIA.
If a construction project begins without a duly approved or registered EIA, it may be stopped and, if construction is complete, operations may be ordered to cease. Penalties of between RMB 50,000 to 200,000 may also be imposed. Moreover, the persons directly responsible for the project may be subject to personal administrative sanctions. In general, the EIA requirement assists the government to identify problems and places the remedial burden on private parties.

China’s State Environmental Protection Administration (SEPA) recently ordered thirty major projects involving billions of dollars to shut down for failure to comply with EIA requirements. This action, together with other recent developments, demonstrates China’s growing attention to environmental protection.

**Legislative and Regulatory Developments**

Recent revisions to the Solid Waste Law, effective April 2005, expand liability in respect of solid waste pollution. Continued trials of emissions trading and a forthcoming renewable energy law are likely to constitute further short term changes to the regime.

The revised Solid Waste Law applies to substances that are no longer functional or that have been discarded, including semi-solid wastes and gaseous wastes held in containers. It introduces stricter requirements for projects that produce solid waste and expands the scope of liability for solid waste polluters. In particular, the revised law obligates manufacturers, sellers, importers and users of products that may result in solid waste to prevent solid waste pollution. Negligently caused solid waste pollution also gives rise to liability under the revised law.

Emissions trading is also likely to expand. China has indicated that it may introduce a formal emissions trading regime if current trial programs succeed. Some of
the first emissions trading trial programs began in 2000 in the cities of Nantong (Jiangsu Province) and Benxi (Liaoning Province). Additional trials have also been undertaken in the city of Taiyuan (Shanxi Province) with respect to a sulphur dioxide cap-and-trade program. Two power plants in Jiangsu Province have reportedly reached an agreement to trade sulphur dioxide allowances, reportedly the ninth such deal in China. A national regulatory regime providing for a cap-and-trade program has yet to be created, however.

A new law on renewable energy, expected during 2005, reportedly requires that, by 2010, five per cent of China’s total power supply be from renewable energy sources, with the proportion rising to ten per cent by 2020. To encourage renewable energy projects, the draft law also provides for favourable loan terms and tax incentives. Wind and solar energy are identified as priorities. Moreover, it appears that property developers may be required to facilitate the use of solar power in the design and construction of their projects.

Authorities

On entering China, foreign investors are faced with a wide range of authorities with overlapping jurisdictions over environmental issues. SEPA is the main national authority, but numerous other national ministries and authorities may also be relevant. These include:

- The State Environmental Protection Commission of the State Council, which is responsible for significant issues of principle, policy and standards relating to environmental protection and the economy;
- The Ministry of Construction, which is responsible for urban infrastructure development, including wastewater treatment and solid waste management;
- The Ministry of Water Resources, which is responsible for water allocation, and soil and water conservation, including the approval of
industrial wastewater outlets, and supervision and inspection of discharge into internal waterways; and

- The National Development and Reform Commission, which is responsible for administrative oversight of economic development planning, industrial management, and energy efficiency standards.

Provincial, municipal and local-level authorities also play a significant role in regulating environmental protection. Many of the national laws and regulations are general in nature. Provincial, municipal and local governments enact and enforce more specific environmental regulations. Discharge permits for air pollution, for example, are largely regulated at the provincial, municipal and local levels. As a result, proper implementation of any laws or regulations requires a uniform understanding of the underlying policy goals by the disparate regulators as well as uniform enforcement by the various provincial, municipal, local and national government bodies.

**Conclusion**

The trend toward strengthened environmental protection is clear, and regulatory efforts are underway. This, in turn, appears to signal a move by the PRC government to environmentally friendly technologies. Whether such technologies will be adopted in China will largely depend on whether the proponents of such technologies are able to navigate successfully an overlapping web of regulatory jurisdictions in a rapidly changing regulatory environment.
Minefields of Opportunity: Liability in Ontario’s Brownfields Remediation Regime

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Brownfields redevelopment ought in principle to be a win-win proposition for municipalities and developers. The aesthetic and economic restoration of abandoned industrial sites is socially desirable and potentially profitable. Because brownfields are often located in fully serviced districts in or near urban core areas, their redevelopment discourages urban sprawl and enhances tax revenues.

In spite of these benefits, brownfields acquisition and redevelopment in Ontario have been slowed by the fear of Ministry of the Environment (MOE) remediation or clean-up orders (under the Environmental Protection Act or the Ontario Water Resources Act). To allay some of these concerns, the Ontario legislature passed the Brownfields Statute Law Amendment Act (BSLAA) in 2001. On October 1, 2004, Regulation 153/04, implementing key provisions of the BSLAA, came into effect. While this is a welcome development, we believe that caution should be exercised before reliance is placed on the protections of the Regulation.

Record of Site Condition (RSC)

Regulation 153/04 establishes a regime for regulatory sign-off on completion of remediation. This is to be achieved through the filing of a Record of Site Condition (RSC) ostensibly protecting past, present and future owners and occupiers from the threat of clean-up orders. Compliance with this regime purports to offer landowners, developers and investors the opportunity to reap the benefits of brownfields redevelopment free from some of the contingent risks. Specifically, the Regulation sets out:
• the contents of the RSC and other requirements for filing an RSC,
• the property use changes that require the filing of an RSC,
• interim qualifications requirements for the person who certifies the RSC,
• the requirements for conducting site assessments,
• the soil and groundwater criteria that must be met (tied to the proposed property use and reflecting different approaches to site clean-up), and
• the conditions under which a past owner may receive immunity from orders.

The Regulation will be implemented in two phases. The framework for completing and filing an RSC came into force on October 1, 2004 and filing will become mandatory in 2005.

Implications and Limitations

The MOE has championed the Regulation as bringing peace of mind to investors and developers who purchase or redevelop brownfields for which an RSC has been filed. Although the Regulation is a good first step, it has a number of shortcomings. The main problems are the following:

Off-site Contamination

In our view, the absence of an off-site contamination provision in the Regulation is a significant shortcoming. It is true that innocent purchasers are already protected from off-site remediation orders insofar as a purchaser cannot be ordered to execute a clean-up unless it “caused” or “permitted” the contamination. However, establishing causation when it comes to migration can be a complicated task, which is one of the reasons no-fault liability with regard to contaminated sites was originally instituted. If brownfields redevelopment is to be effectively fostered, explicit protection from orders for off-site contamination should be incorporated into the Regulation.
Civil Liability

A greater issue is the threat of civil liability. Unlike most U.S. brownfields legislation, the BSLAA and the Regulation offer no protection from civil liability to those who have filed RSCs or who rely on the accuracy of RSCs in purchasing, occupying or developing land. That the government should have felt it necessary to provide the MOE itself with protection for actions taken in reliance on the accuracy of RSCs is highly revealing, as is the MOE’s recommendation that independent due diligence be undertaken by those wishing to rely on RSCs. This essentially concedes that the Regulation is unlikely to eliminate one of the costliest obstacles to brownfields investment. While the RSC offers some protection from the threat of unexpected orders, significant civil liability concerns remain.

Conclusion

With the Regulation, compliance will become more complicated, not less. Consultants, owners, occupiers, and others need to be aware of these changes and to be prepared to incorporate the costs and procedural consequences into their planning.

While providing an exemption from liability to orders is a good incentive for investment and redevelopment of brownfields, the absence of further protection from off-site contamination and civil liability could be enough to derail the prospects of significant brownfields redevelopment. Only time will tell whether the new and complicated process and its attendant risks will result in increased redevelopment of brownfields sites.
“Waiving” Goodbye to the Internal Investigation

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When the government comes knocking at your company’s door, it can pay to be co-operative. But as prosecutors increasingly require waiver of attorney-client and work product privileges, the cost of co-operation can be high. Corporations and their defense counsel can therefore find themselves in a dilemma. On the one hand, they cannot intelligently decide whether to co-operate without first conducting an internal investigation—not to mention that such an investigation may be critical to preventing further environmental damage and additional charges against the company. On the other hand, the existence of such an investigation would make any subsequent decision to waive privilege (and to co-operate) far more difficult, since the information uncovered in the investigation could give the government a roadmap to successful prosecution. Nor, as defense counsel are finding, does a waiver guarantee leniency. It is indeed a strange new world for environmental corporate defense counsel, and the stakes have never been higher.

What Upjohn Giveth, Enron Taketh Away

Nearly 25 years ago, the Supreme Court recognized the existence of an attorney-client privilege for corporations in Upjohn Co. v. United States, citing the same policies that have grounded the corresponding privilege for non-corporate entities going back to our early common law heritage. The attorney-client privilege and the work product privilege are bedrock principles of our criminal justice system and are deeply embedded in the American psyche. But as the recent wave of corporate fraud scandals begins to
alter our legal landscape, the future of privilege is increasingly up for grabs, as if the reasons justifying its existence no longer apply.

But however corporate privilege fares as a principle of law, aggressive enforcement of environmental law threatens to make it increasingly obsolete for practical purposes. Prosecutors have a considerable amount of leverage, as the following examples show:

- The Environmental Crimes Section and United States Attorneys enjoy broad discretion in determining whether any given environmental violation is to be dealt with through administrative, civil or criminal mechanisms. In corporate investigations, federal enforcement agencies are increasingly insisting upon co-operation and voluntary disclosure at the risk of inviting greater penalties for failing to capitulate to their demand.

- It is now the DOJ’s stated policy to seek waiver as a showing of co-operation. In 2003, the DOJ issued a Memorandum entitled “Principles of Federal Prosecution of Business Organizations,” in which it states that a company’s “timely and voluntary disclosure of wrongdoing and its willingness to co-operate with the government’s investigation” are factors for consideration in determining whether to file charges. According to the so-called Thompson Memorandum, prosecutors may gauge the extent of “co-operation” by considering a corporation’s willingness to disclose the results of its internal investigation and waive attorney-client and work product protections.

Not surprisingly, the benefits of waiver may look better on paper than they are in reality. Waiver does not guarantee that DOJ will not seek charges, and may expose the
company to additional or broadened indictments. The indictment of Arthur Andersen in 2002, substantially resulting from the company’s decision to waive, is a prime example. Waiver effectively transforms a corporation’s attorneys into federal investigators, and may place them in the difficult position of being called upon to testify for the government. How can an attorney effectively represent her corporate client if she is simultaneously helping to build the prosecution’s case, and may even be called as a witness against her client? Additionally, waiver arguably allows federal investigators to sidestep the Fifth Amendment: employees cannot generally “plead the Fifth” in an internal investigation, and may fear losing their jobs if they do so.

The EPA’s Audit Policy, “Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations” also places a premium on “co-operation.” In order for a corporation to gain the benefits of the Policy, including a recommendation that criminal charges not be sought, the company must voluntarily disclose its violations, co-operate with the government investigation, and meet a number of additional criteria. Waiver, again, is listed as a factor for gauging co-operativeness. EPA’s Voluntary Disclosure Board decides whether a party has adequately satisfied each requirement. Even if the Board finds each element to be satisfied, the corporation merely receives a “recommendation” against prosecution. Experience of the defense bar suggests that despite EPA’s recommendation, federal prosecutors generally make independent charging decisions.

Corporate counsel should also be aware that a decision to waive with respect to the government will most likely amount to a waiver of privilege with respect to third parties as well. In other words, because very few courts have recognized the doctrine of
“selective waiver,” waiver with respect to one party for a specific purpose will usually be judged a waiver with respect to all parties for all purposes. If the alleged conduct could potentially give rise to civil lawsuits, waiver can therefore be extremely risky.

**To Investigate or not to Investigate: That is the Question**

Had Hamlet been a corporate defense attorney in these uncertain times, his internal struggle may well have taken such a form. Or, to use a more modern literary reference, such an attorney will frequently find himself or herself in a “catch-22” situation, as already suggested.

Still, internal investigations can certainly be conducted in a way that will minimize risks while providing the corporation with information it needs to make intelligent decisions. As a rule of thumb, internal investigations should be conducted as soon as a corporation becomes aware of a problem. In preparing to conduct an investigation, a company must determine what factual and legal issues are involved before it can decide which employees to interview. As internal assessments can be disruptive, the scope of the investigation should be no greater than what is required to fully uncover underlying facts. Naturally, limiting the scope of the investigation may limit exposure to civil liability or additional prosecution if the company later waives protections. Regardless of the company’s position on waiver, counsel must be very careful to preserve privileges as to all written materials, and to communicate orally with employees where the privilege may not attach. To prevent inadvertent waiver, counsel must be careful when responding to governmental document requests: voluntary disclosure of certain privileged materials could be judged a complete waiver as to that class of documents.
When allegations surface, corporations feel immense pressure from the government, and from within, to disclose and show that they have nothing to hide. Ideally, a company will have sufficient time after discovering the existence of criminal acts to thoroughly investigate the incidents, identify and deal with culpable parties, and to make an informed decision regarding waiver and voluntary disclosure. In reality, this is rarely the case. The best a company can do is to hold off waiving until it has employed experienced counsel to conduct a careful investigation, taking written notes only where necessary. If at all possible, the company should strive to co-operate fully without waiving.

**Final Thoughts: Forced Waiver as Misguided Policy?**

When faced with allegations of wrongdoing, the internal investigation allows a company to fully evaluate the scope of the problem and its potential liability in order to make informed decisions about waiver, voluntary disclosure, and plea agreements. Corporations know their own business, personnel and policies better than anyone else, and will know whether certain results are anomalous and problematic, or routine. Moreover, encouraging companies to police themselves and to conduct effective internal investigations is just plain good policy. Confidential communications with counsel typically unearth details of wrongdoing that would not otherwise be disclosed, particularly to government investigators.

If the goal of enforcement is to change the way companies do business, and not merely to levy fines and jail responsible officers, then effective internal investigations must be encouraged. Such investigations, however, are only as effective as employees’ beliefs that their honest and full disclosure of wrongdoing will not result in the
prosecution of their well-meaning coworkers, or they themselves. Demanding waiver will prevent employees from truthfully disclosing wrongdoing, undermining the effectiveness of internal investigations. Many corporations facing criminal allegations are now forgoing an investigation entirely, hoping to “co-operate” without assisting in their own demise. This is an unfortunate scenario and will surely obscure more wrongdoing than it exposes.
Hundreds of articles and many dozen corporate conferences have been delivered concerning the intended and unintended consequences of the Sarbanes-Oxley Act of 2002. Corporate directors should be fully sated in their need to understand and address the heightened obligations and complementary potential liability that fell out of the corporate scandals of the late 1990s. Protections should be in place, appropriate scrutiny applied and, in theory, ample Directors & Officers (“D/O”) insurance purchased to address any fallout. But as is often the case, environmental risks are unique…and corporate directors may have faulty cover in the face of environmental risk. Special attention to the disclosure and management of environmental risk, with the possible “strategic” application of specialized insurance products, may be critical to ensuring adequate protection.

Much like a perfect storm, just as Sarbanes-Oxley was passed with the stated purpose of strengthening accounting oversight/corporate accountability by enhancing disclosure requirements, heightened scrutiny was directed specifically on corporate environmental liability disclosures, emanating from such diverse sources as the Environmental Protection Agency\(^1\), the General Accounting Office\(^2\), and coalitions of

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2 See e.g., July 2004, U.S. Governmental Accountability Office report concerning disclosures of
“socially responsible” investment fund groups. And the internal corporate protections put in place to cover the potential liability of directors in fulfilling their recently enhanced corporate responsibilities likely contain at least two fundamental gaps in the face of these increased environmental disclosure obligations: (1) inadequate internal corporate controls on environmental disclosure; and (2) incomplete or nonexistent D/O insurance for claims associated with environmental issues. The bottom line is, internal directors and audit committee members could be liable, in their corporate capacity and personally, in a securities claim arising from undisclosed environmental liabilities, and may have no viable insurance for protection.

Certainly, accounting principles and securities laws currently require, and historically have required, companies to disclose environmental liabilities. However, many companies have adopted “conservative” policies that may result in understated environmental disclosures. There are a variety of reasons for this “conservative approach.

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3 See e.g., Goodwin Procter, Environmental Law Advisory, February 2005, “Assessing SEC Disclosure Requirements After Kyoto,” concluding that in the face of the enactment of the Kyoto Protocol in February 2005, there are potentially substantial impacts of greenhouse gas controls of the future operations of public companies and their SEC disclosures. These issues are heightened in the post-Sarbanes Oxley era in which CFOs and CEOs must certify to the contents of their companies’ reports and to the adequacy of the internal systems that produce them. See also the Petition for Rulemaking to the SEC, by the Rose Foundation for Communities and the Environment, requesting clarification the intent of the SEC’s material disclosure requirements with respect to financially significant environmental liabilities. (Revised Petition SEC file #4-463)

4 Items 101 and 303 (the Management’s Discussion and Analysis of Financial Condition and Results of Operation (MD&A)) of Regulation S-K, 17 C.F.R. section 229.101, require companies to disclose material effects of compliance with environmental laws, and a general requirements to disclose “any known trends, demands, commitments, events or uncertainties” that are reasonably likely to have a material effect on a company’s operations. With the advent of Sarbanes-Oxley, the CEO and CFO of SEC-registrant companies are required personally to certify the accuracy of financial statements.

5 Corporations are permitted to, and usually do, indemnify officers and directors to address the liability that may be associated with their corporate responsibilities. In order to manage the risk of financing that indemnification and as an added measure of protection in attracting the most qualified candidates, many corporations purchase Directors’ and Officers’ liability insurance.
First, corporations may not have “knowledge” of the environmental conditions. Virtually all have effective controls in place to ensure compliance with day-to-day operational environmental exposures, and therefore corporations typically are effective in reporting liabilities associated with such exposures. But the same is not true with regard to the discovery, investigation and ultimate disclosure of historical environmental conditions (unless those conditions are the subject of pending legal action). In fact, it is not unusual for corporate management to intentionally choose not to assess such risks, as actual knowledge of historical conditions could trigger significant regulatory clean-up obligations. Second, where a corporation has “knowledge” of environmental conditions, it may conclude that the potential losses are too speculative to estimate with reasonable certainty. Finally, even with “knowledge” of the risk and the ability to estimate the potential losses, management may conclude, with incomplete information, that the potential liability is not “material” and therefore choose not to report it. In any circumstance, the conditions may go unreported or underreported.

Directors’ and officers’ liability can arise upon the discovery of these unreported/underreported environmental exposures—usually at a time of market valuation associated with a sale, purchase, merger or bankruptcy proceeding. If the environmental liabilities are material to the valuation of the company and those liabilities are undisclosed or under-disclosed, litigation against the directors and officers can follow as injured shareholders or creditors seek legal recourse.

Of course, if appropriate insurance is bound to cover directors and officers in the face of an environmental securities claim, then the liabilities associated with such a claim can be managed. But often, much to the surprise of directors and officers, their D/O
insurance fully excludes coverage, including defense costs coverage, for any such claim. The insurance coverage exclusion for environmental securities claims has two independent sources: (1) a “pollution exclusion” denying coverage for any claim that has as its underlying cause the actual or alleged discharge, dispersal or release of pollutants; and (2) an exclusion for failure of a company to purchase or maintain insurance coverage that would have protected it from a significant loss. With regard to the “pollution exclusion,” insurance companies have been excluding coverage for pollution-related claims from general liability policies since the 1980s and similar exclusions have been added to D/O policies. This exclusion can include not only direct actions for clean-up of pollution conditions and third-party personal injury/property damage claims based upon exposure to pollution conditions, but shareholder derivative suits arising out of, or related to, pollution conditions. In general, D/O carriers do not provide coverage for any claim with respect to which clean-up costs are sought, financial harm is incurred or defense expenses are accrued as a result of environmental impairment. A number of carriers have developed a separate line of site-specific environmental insurance to address this coverage gap. These policies are drafted on a site-specific basis to address clean-up liabilities as well as liability that may be associated with third-party toxic tort claims and off-site waste disposal. Clearly, with the imposition of the “pollution exclusion” insurance carriers are steering insureds to insurance specifically underwritten to anticipate pollution-related liabilities. And as if to emphasize the fact that D/O policies are not a substitute for environmental insurance, many D/O policies also contain a coverage exclusion for failure to maintain adequate insurance. This exclusion could be
triggered where a complaint alleges that environmental insurance was available and the company at issue failed to use it.

In total, with the passage of the Sarbanes-Oxley Act of 2002 and the heightened and ever-increasing scrutiny that is focused on environmental liabilities, there will continue to be increased pressure regarding corporations’ reporting of environmental costs and liabilities. This growing pressure can result in increased shareholder lawsuits against corporations for which environmental risks are or may be material. Directors and officers of these public corporations should be mindful of the fact that the D/O coverage purchased on their behalf likely will resist coverage where allegations are in any way related to environmental risk. In such circumstances, alternate, site-specific risk management strategies may have to be developed in order to assure appropriate liability protection.