Waltz Across Texas

10TH Annual
TEXAS ENVIRONMENTAL SUPERCONFERENCE

August 6-7, 1998



Four Seasons Hotel
98 San Jacinto Blvd.
Austin, Texas

Waltz Across Texas

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2. Dale Evans
3. Gene Autry
4. Hopalong Cassidy
5. Lone Ranger
6. Tonto
7. Zorro
8. The Cisco Kid
9. Alexander the Great
10. Pecos Bill
11. Don Quixote
12. Velvet Brown

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Remarks to 10th Annual Texas Environmental Superconference
"Federalism Revisited: Our DIVORCE Becomes Final Today"
August 7, 1998

Many of you were here at this conference last year when I said that the relationship between the TNRCC and Texas and the Environmental Protection Agency was strained and in peril. At the root of this discord was, and is, our disagreement about the level of discretion and decision-making authority Texas should have to administer environmental laws. We remain resolute in our position that we deserve more independence and latitude. We want EPA to "please release us and let us go."

I made the case for this last year, as you recall. Let me remind you of the reasons why we believe Texas deserves greater flexibility.

First, Texas has made statutory and programmatic concessions that are important to EPA;

Second, Texas has more than an adequate pool of human resources ... highly skilled, trained and competent professionals;

Third, we have a legal team whose technical expertise, experience and regard for environmental laws matches that of our federal counterparts;

And, lastly, we have the statutory, regulatory and enforcement mechanisms in place to meet our obligation to the people of Texas to protect their public health and the state's natural resources.

That was a year ago.

What has changed in the twelve months since I went toe-to-toe with Lois Schiffer?

We've seen the issuance by President Clinton of Executive Order 13083, a document that negates the proverb: "Practice what you preach." At first glance, the executive order reads like a true call for a relationship of reciprocity, of mutual exchange by acknowledging principles of federalism, of "checks and balances,"

division of power, experimentation by the states and "maximum administrative discretion for the States and local governments."

So what is wrong with Executive Order 13083?

One troubling thing to state and local governments, as with EPA's interim guidance on Title VI of the 1964 Civil Rights Act, the environmental justice guidance you heard about yesterday, is that they were never consulted about the executive order. And yet the order itself, specifically section 4, which is entitled "Consultation", directs federal agencies to have "an effective process to permit ... State and local governments to provide meaningful and timely input in the development of regulatory policies that have federalism implications." In short, we have what political pundit David Broder called an "Executive Order [that] Urged Consulting, but Didn't."

What else is wrong with the executive order?

It outlines nine reasons - eight not found in a prior executive order on federalism signed by President Reagan - nine reasons why an issue should become "federalized" ... when an issue is one only the vast powers and limitless wisdom of the federal bureaucracy can adequately address.

What are some of those reasons? Here are three, and here's why they demonstrate that this Administration continues to have a "tin ear" to the concerns of state and local governments over federalism.

First, an issue warrants federal action "when decentralization increases the costs of government thus imposing additional burdens on the taxpayer."

This implies a belief that decentralized government, government closest to the people government is to serve, will always cost more, while centralized government will always cost less. Since when has turning anything over to the federal government cost us less money?

Second, an issue is to be federalized "when states would be reluctant to impose unnecessary regulations because of fears that regulated business activity will relocate to other states."

Here we have that old "race to the bottom" warhorse this Administration regularly runs out to frighten people about devolution. Having beaten that horse to death last year, I'll let it rest in peace.

A third reason why only the federal government can address an issue is "when placing regulatory authority at the state or local level would undermine regulatory goals because high costs or demands for specialized expertise will effectively place the regulatory matter beyond the resources of state authorities."

Again, we always know best inside the Beltway. And we'd rather raise the resources at the federal level to deal with problems than allow the states to do so.

Some of the nine reasons for federalization are legitimate. Matters affecting federal properties, international obligations, tribal governments and interstate issues are all true federal concerns. But taken together, these nine reasons are so broad that they would permit making a federal issue of almost anything one wished. Yes, this Administration does want to make a federal case out of everything.

Although they didn't consult them in advance, the Administration received a very strong negative response to the executive order from several groups you may have heard of: the National Governors Association, the Council of State Governments, the National Conference of State Legislatures, the National League of Cities, the U.S. Conference of Mayors, the National Association of Counties, and the International City/County Managers Association.

And just this week the executive order was withdrawn, proving that this Administration has listened to your song, Gregg: "What Part of 'No' Don't You Understand?"

What else has happened in the last twelve months?

Also just this week, we saw the governors of this nation, in a bipartisan resolution of the National Governors Association, ask for more state control over water programs under the Clean Water Act. Governors from Florida to California, from Oregon to Massachusetts, believe EPA should allow them to take charge of the water resources of their states.

What was the response of EPA headquarters?

What you might expect ... opposition to this request, couched with the fear that these changes would "dramatically weaken authority to protect water quality."

But in the end, when I look at the topic "Federalism Revisited" ...

When I continue to see a paternalistic attitude toward the states out of EPA headquarters ...

When states are not to be consulted on questions basic to them ...

When there is a suspicion that states will sell out our people and our environment in a race to lure economic development ...

When those in Washington think only they can protect us from ourselves ...

When I think back over the last year and ask myself "What's changed in the relationship between this Administration and the State of Texas, between EPA headquarters and the TNRCC?"

Nothing has really changed ... and that, my friends, is unfortunate for us all.

But if things have not changed in Washington, there has been a significant change in Dallas.

We have a new regional administrator in Gregg Cooke, my long-time and very good friend. And although as an appointee of this Administration and a representative of EPA I've put him on the spot here this afternoon, we, and I, have great hopes that he can improve our relationship with EPA. He's not yet been on the job for 90 days, but in that time we have made significant progress on issues like NPDES authorization where ... all together now ... "we're as close as we've ever been" ... and would be closer were it not for recent intervention by our friends at the U.S. Fish and Wildlife Service.

I hope, and believe, that progress will continue to be made, because, you see, Gregg and I, and TNRCC and Region 6, in the end cannot get a D-I-V-O-R-C-E ... we have to stay together, for the sake of the children ... for the children, and all of the people and resources, of Texas.

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Divisions **(click to view organizatioal chart)**

Legal - General Law Division

Functions:

- personnel and employment law, ethics and TNRCC operating policy matters
- contracts
- public information/open records
- rules review
- administrative records for APA appeals
- record retention policies
- administrative support to Office of Legal Services

Legal - Environmental Law Division

Functions:

- interpretation of environmental statutes and rules
- assistance to regulation reform effort
- permitting and contested permit cases
- support for legal issues of federal program delegation
- support for litigation in state and federal courts
- rule making

Legal - Litigation Division

Functions:

- enforcement actions coordinated with the Enforcement Division in the Office of Compliance and Enforcement
- litigation liaison for enforcement actions litigated by the Office of the Attorney General
- delinquent fee and penalty actions coordinated with the Financial Administration Division in the Office of Administrative Services
- contested administrative enforcement actions
- assistance in criminal enforcement matters
- supplemental environmental projects and environmental audits coordination

Publications

If the publication you are interested in is not available for viewing on line, see the TNRCC Publications Catalog for ordering information.

- SB 14: Guidance Document for Takings Impact Assessments for Rules (5/96) RG-207
- The Texas Environmental, Health, and Safety Audit Privilege Act (as Amended by HB 3459, 75th Legislature) (9/97) RG-173 (Revised)

References

- Office of Public Assistance for information on requesting hearings and public participation in permitting.
- Office of General Counsel for agenda matters.
- Office of Public Interest Counsel for information on contested matters and how to participate in contested case matters.
- Office of the Attorney General, State of Texas
- State Office of Administrative Hearings (SOAH)

- Texas Ethics Commission
- Environmental Protection Agency (EPA)
- Open Records Operating Policy and Procedure
- TNRCC Supplemental Environmental Project (SEP) Policy Statement, Information Sheet and Proposal Guidelines for Respondents
- Rules
- Enforcement Report to the Commission

TNRCC disclaimer
Comments regarding the Office of Legal Services: legal@tnrcc.state.tx.us
Technical questions regarding the TNRCC Web Server: webmaster@tnrcc.state.tx.us
http://www.tnrcc.state.tx.us/legal/index.html



TNRCC
Office of Legal Services

Legal - General Law Division

Address/Phone/Fax
legal@tnrcc.state.tx.us
Help
August 3, 1998

Kevin McCalla, Director

The Legal - General Law Division, led by Director Kevin McCalla and three senior attorneys, primarily supports the Office of Administrative Services and provides legal counsel on issues related to personnel and employment law, contracts, public information processing and distribution, as well as records retention. The Legal - General Law division also provides a final legal review of agency rules, prepares the administrative records for APA appeals, and provides the Office of Legal Services with administrative support (paralegals and legal secretaries).

TNRCC disclaimer
Comments/Questions regarding Legal Division: legal@tnrcc.state.tx.us
Technical questions regarding the TNRCC Web Server: webmaster@tnrcc.state.tx.us
http://www.tnrcc.state.tx.us/legal/litigdiv.html



TNRCC
Office of Legal Services

Legal - Environmental Law Division

Address/Phone/Fax
legal@tnrcc.state.tx.us
Help
August 3, 1998

Margaret Hoffman, Director

The Legal - Environmental Law Division, led by Director Margaret Hoffman and five senior attorneys, supports the air, water, waste and pollution cleanup programs. The Legal - Environmental Law Division provides legal counsel to the agency in all areas of permitting, rulemaking, and represents the Executive Director in contested permitting matters.

TNRCC disclaimer
Comments/Questions regarding Legal Division: legal@tnrcc.state.tx.us
Technical questions regarding the TNRCC Web Server: webmaster@tnrcc.state.tx.us
http://www.tnrcc.state.tx.us/legal/legaldiv.html



TNRCC
Office of Legal Services

Legal - Litigation Division

Address/Phone/Fax
legal@tnrcc.state.tx.us
Help
August 3, 1998

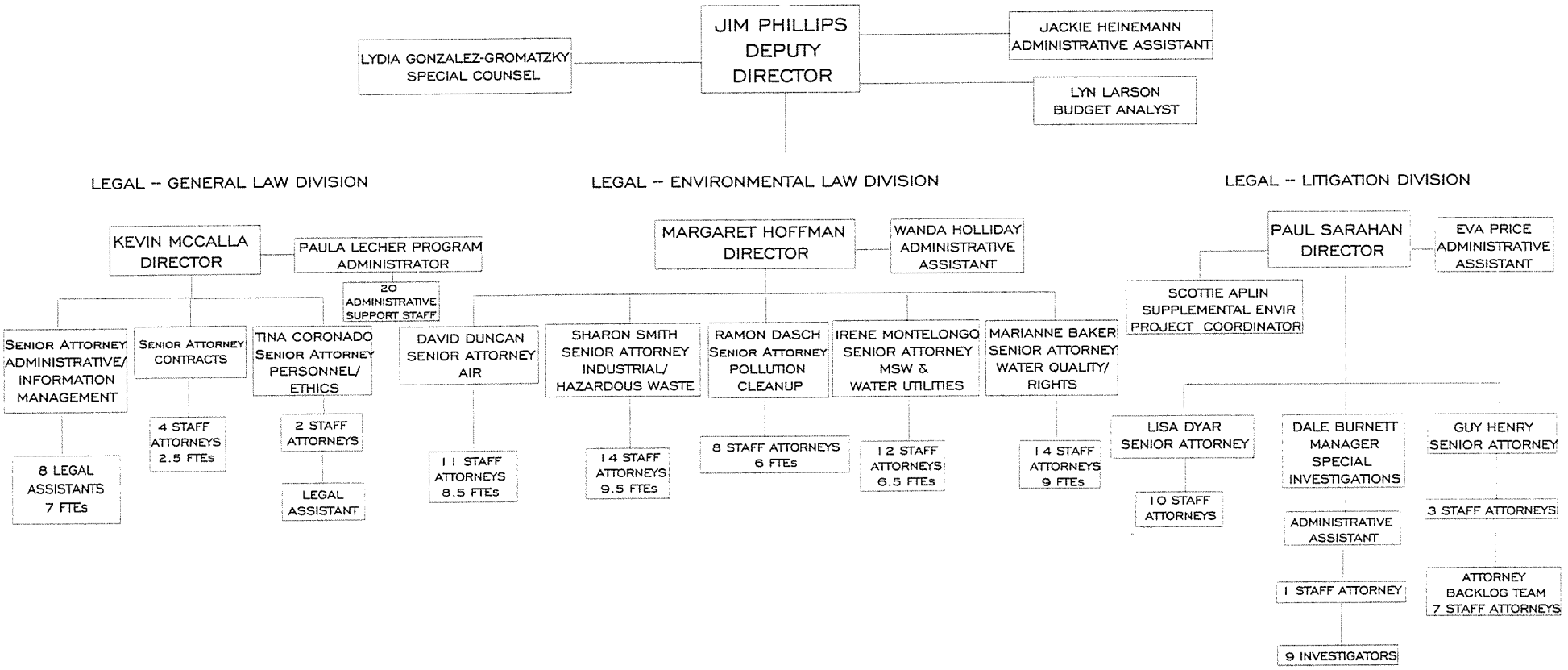
Paul Sarahan, Director

The Legal - Litigation Division, led by Director Paul Sarahan, two senior attorneys, and a manager over special investigations, provides legal representation and support primarily to the Office of Compliance and Enforcement. The division negotiates Agreed Enforcement Orders, litigates enforcement actions, manages delinquent fee and penalty actions, and coordinates the Supplemental Environmental Projects and Environmental Audits programs. The Special Investigations Section of the Legal - Litigation Division serves to investigate and prosecute environmental crimes.

TNRCC disclaimer
Comments/Questions regarding Legal Division: legal@tnrcc.state.tx.us
Technical questions regarding the TNRCC Web Server: webmaster@tnrcc.state.tx.us
http://www.tnrcc.state.tx.us/legal/litigdiv.html

OFFICE OF LEGAL SERVICES

EFFECTIVE AUGUST 1, 1998
(REVISED)



TNRCC ORGANIZATION

June 20, 1998

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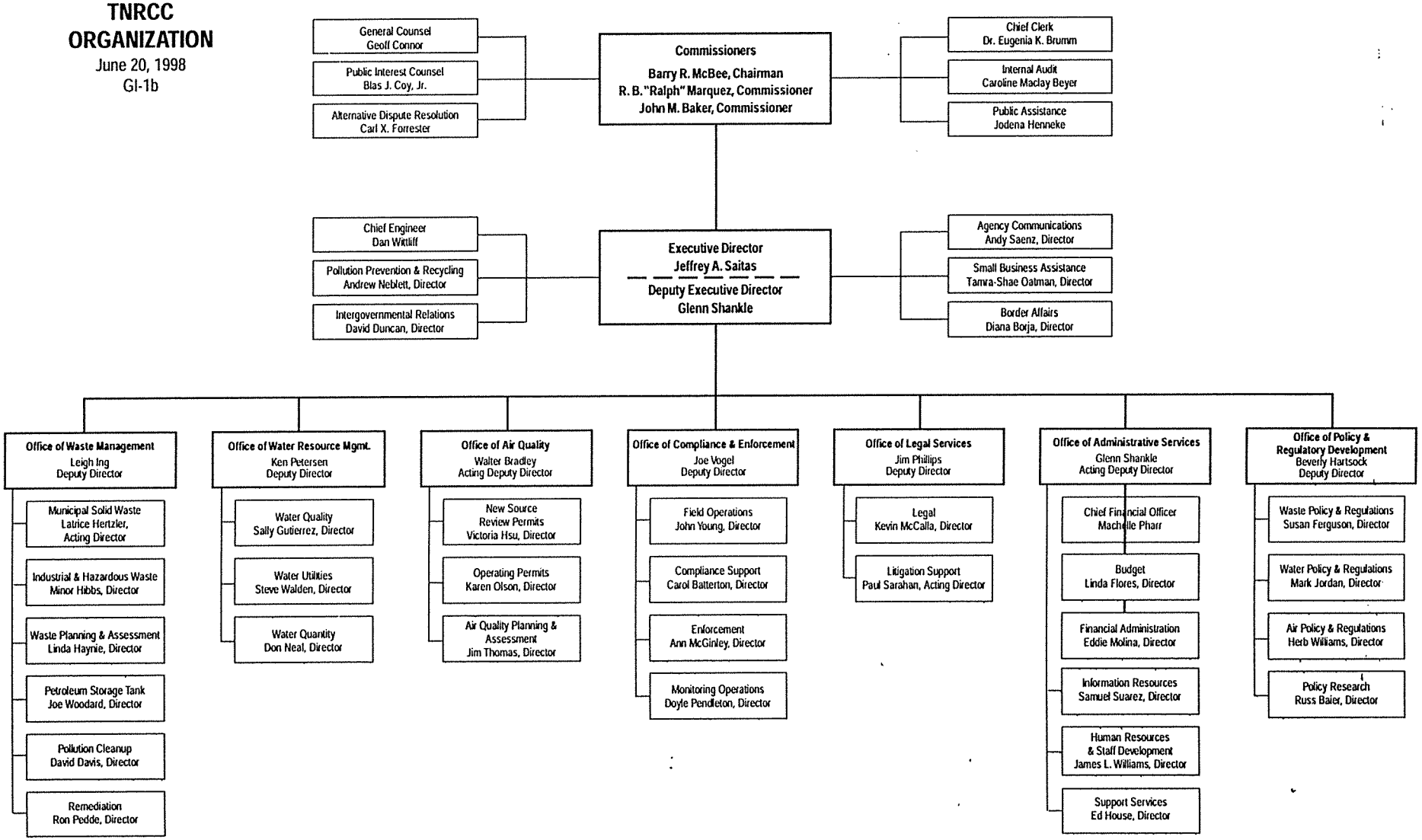

Guest List for Green Pastures Dinner

Table 1

1. Kay Crider
2. Genie Jones, Aviall
3. Leonard Albright (Genie Jones' Guest)
4. Donna Atwood, DFW Airport
5. Steve Comer (Donna Atwood's Guest)
6. Marcia Wise, City of Fort Worth
7. Don Hensch, Safety-Kleen

Table 2

1. Jeff Civins
2. Gregg Cooke, E.P.A.
3. Mike James, OxyChem
4. Kathy Hansen, City of Fort Worth
5. John Lyon, Properties of the Southwest
6. Scott Sherman, TNRCC
7. Ed Strenkowski, Marathon Oil

Table 3

1. Walt Shelton
2. John Howard, Governor's Office
3. Julie Smith, City of Denton
4. Amy Boyd, Intern with City of Denton
5. Stephen Breckenridge, Chromium Corp.
6. James Holloway, General Cable
7. Mrs. Holloway

Table 4

1. Wade Porter
2. Kathy Tullos
3. Harrison Vickers, Gallagher, Lewis & Downey
4. Sam Goodhope, Office of the Attorney General
5. Mary Sherman (Sam Goodhope's Guest)
6. Thomas Edwards, Office of the Attorney General
7. Ingrid Hansen, Texas General Land Office

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Table 5

1. Mary Mendoza
2. Robert Pressley
3. Sue Schwartz, Keeshan & Bost
4. Chad Blanchard, Chromium Corp.
5. Bryan Hale, SACHEM
6. Bane Phillippi

Table 6

1. Larry Gustafson
2. Mike Tatsch, Chromium Corp.
3. Alicia Johnson, City of Fort Worth
4. Nellie Rocha, E.P.A.

Table 7

1. Jim Braddock
2. Darcy Zarubiak, DFW Airport
3. Bahram Payamipour, PVI Industries
4. Mrs. Payamipour
5. David Sisler, Elcor
6. Rick Reeter, DFW Airport
7. Margaret Menicucci

TENTH ANNUAL TEXAS ENVIRONMENTAL SUPERCONFERENCE PROGRAM EVALUATION

5= Excellent 4 = Good 3 = Average 2 = Below Average 1 = Poor

Please complete this questionnaire and leave the completed form on the registration table.

	Presentation	Materials
The Use of Modeling in Environmental Cases		
Jerry Grisak	1 2 3 4 5	1 2 3 4 5
Air Quality Issues		
Pat Finn Braddock	1 2 3 4 5	1 2 3 4 5
Ed Fiesinger	1 2 3 4 5	1 2 3 4 5
Jeff Saitas	1 2 3 4 5	1 2 3 4 5
Land/Use Environmental Equity - Panel Discussion		
Jim Blackburn	1 2 3 4 5	1 2 3 4 5
David Duncan	1 2 3 4 5	1 2 3 4 5
Roliff Purrington	1 2 3 4 5	1 2 3 4 5
John Worrall	1 2 3 4 5	1 2 3 4 5

FRIDAY - August 7, 1998

	Presentation	Materials
Confidentiality and Privilege Issues Arising from Modern Electronic Communications		
David Hricik	1 2 3 4 5	1 2 3 4 5
Expert Testimony/Robinson-Havner Issues		
Mary Wilson	1 2 3 4 5	1 2 3 4 5
Bankruptcy for Environmental Professionals		
Hal Morris	1 2 3 4 5	1 2 3 4 5
Robin Phelan	1 2 3 4 5	1 2 3 4 5
Environmental Hypothetical		
Jack Battle	1 2 3 4 5	1 2 3 4 5
Wade Gates	1 2 3 4 5	1 2 3 4 5
Bernice Heilbrunn	1 2 3 4 5	1 2 3 4 5
Tom Kiehnhoff	1 2 3 4 5	1 2 3 4 5
Environmental Insurance Coverage		
Terrell Hunt	1 2 3 4 5	1 2 3 4 5
Federalism Revisited		
Barry McBee	1 2 3 4 5	1 2 3 4 5
Gregg Cooke	1 2 3 4 5	1 2 3 4 5
VCP/Innocent Landowner Update		
James C. Morriss III	1 2 3 4 5	1 2 3 4 5
Risk Reduction Rules		
Chet Clarke	1 2 3 4 5	1 2 3 4 5
Open Mike		
John Baker, Moderator	1 2 3 4 5	1 2 3 4 5
Bill Ballard	1 2 3 4 5	1 2 3 4 5
Ramon Dasch	1 2 3 4 5	1 2 3 4 5
David Duncan	1 2 3 4 5	1 2 3 4 5
Ken Petersen	1 2 3 4 5	1 2 3 4 5
Scott Sherman	1 2 3 4 5	1 2 3 4 5

TENTH ANNUAL TEXAS ENVIRONMENTAL SUPERCONFERENCE PROGRAM EVALUATION

5= Excellent 4 = Good 3 = Average 2 = Below Average 1 = Poor

Please complete this questionnaire and leave the completed form on the registration table.

In general, the program was	1	2	3	4	5	1	2	3	4	5
The course materials were	1	2	3	4	5	1	2	3	4	5
The program arrangements were	1	2	3	4	5	1	2	3	4	5
The hotel accommodations and services were	1	2	3	4	5	1	2	3	4	5

Are you an attorney? engineer or scientist? student? other ?

Are you in the public sector? private sector?

Suggested topics and/or speakers for the 1999 conference:

Suggested themes for the 1999 conference:

Other comments:

	Presentation					Materials				
THURSDAY, August 6										
Administrative Law Update										
Brian Berwick	1	2	3	4	5	1	2	3	4	5
Senate Bill 1 Implementation										
Tommy Knowles	1	2	3	4	5	1	2	3	4	5
Water Quality Issues										
Ken Petersen	1	2	3	4	5	1	2	3	4	5
Peggy Glass	1	2	3	4	5	1	2	3	4	5
Environmental Issues Confronting Municipalities										
Mayor Kirk Watson	1	2	3	4	5	1	2	3	4	5
Management Strategies to Achieve Compliance - Panel Discussion										
Comm. Ralph Marquez	1	2	3	4	5	1	2	3	4	5
John Caudill	1	2	3	4	5	1	2	3	4	5
Paula McLemore	1	2	3	4	5	1	2	3	4	5
TDH Update										
John Jacobi	1	2	3	4	5	1	2	3	4	5
Carolyn Wright	1	2	3	4	5	1	2	3	4	5
Strategies for Environmental Permitting and Enforcement										
Martha Martin	1	2	3	4	5	1	2	3	4	5

NAME THAT C & W SONG!!!

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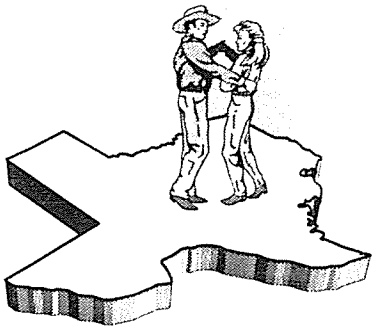
Tenth Annual
Texas Environmental Superconference



M E M O R A N D U M

TO: Attendees

FROM: Planning Committee

DATE: August 6, 1998

On behalf of the Environmental and Natural Resources Law Section ("ENRLS") of the State Bar, the Air and Waste Management Association, Southwest Section, and the Water Environment Association of Texas, welcome to the Tenth Annual Texas Environmental Superconference. As you know, the conference is an annual event established to create a dialogue among the attendees, who are drawn from the public and private sector and from the legal and technical professions. The conference provides excellent continental breakfasts, lunches and snacks, and plenty of breaks to encourage participants to discuss environmental issues informally.

For Friday's open mike session, note cards are provided for you to write your questions. Please place your written questions in the designated box at the registration table. You also may ask questions in person, should you prefer.

As always, there are evaluation forms for the program. We appreciate your taking the time to complete them. The organizers of this program take into account these forms in planning next year's conference. In addition, if you have an interest in having a particular topic presented, or in speaking on a particular topic, the evaluation form is the appropriate place to provide that information. Suggestions for themes for next year also are being solicited. Next year's conference is tentatively scheduled for August 5-6, 1999. Please mark your calendars.

If you have any questions or comments, please do not hesitate to contact any of the Planning Committee at the conference, or, thereafter, Jeff Civins at (512) 867-8477 or civinsj@hayboo.com.

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4 Environmental Issues Confronting Municipalities
Mayor Kirk Watson, City of Austin

5 Management Strategies to Achieve Compliance - Panel Discussion
Commissioner Ralph Marquez, TNRCC
John Caudill, Dupont
Paula McLemore, Albemarle Corp.

6 TDH Update
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Carolyn Wright, Texas Department of Health

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Mary Wilson, Stibbs & Burbach

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Ramon Dasch, TNRCC
David Duncan, TNRCC
Ken Petersen, TNRCC
Scott Sherman, TNRCC

ADMINISTRATIVE LAW UPDATE

BRIAN BERWICK

Waltz Across Texas

10th Annual Texas Environmental Superconference

Administrative Law Update

"Behind Closed Doors"

By Brian E. Berwick[1]

1. **Challenges to agency rulemaking**

a. Rulemaking procedure

i. Statement of reasoned justification

(1) *National Ass'n of Indep. Insurers v. Texas Dep't of Ins.*, 925 S.W.2d 667 (Tex. 1996)

(2) *Unified Loans, Inc. v. Pettijohn*, 955 S.W.2d 649 (Tex. App. — Austin 1997, no pet. h.)

(3) *Accord Agriculture, Inc. v. Texas Natural Resource Conservation Commission*, Cause No. 96-00159, in the 353rd Judicial District Court, Travis County, Texas (judgment rendered in favor of persons who opposed issuance of concentrated animal feeding operation permits-by-rule; notice of appeal filed)

(4) *Lower Laguna Madre Foundation, Inc. v. Texas Natural Resource Conservation Commission*, No. 98-04712, in the 353rd Judicial District (the *Loma Alta* shrimp research facility case)(court sent letter stating intention to rule for the TNRCC, but no final judgment yet)

---

1. Natural Resources Division, Office of the Attorney General of the State of Texas. Any views expressed in this outline or in the author's oral presentation are those of the author alone and do not necessarily reflect the positions of the State of Texas, the Attorney General's Office, the Texas Natural Resource Conservation Commission, or any other state agency.

ii. What happens when a rule is struck down for procedural errors after persons received environmental authorizations under it?

(a) Treatment of persons whose authorizations were timely challenged by reference to the 30 day deadline in Texas Water Code § 5.351, for example, either in the case in which the rule was attacked or otherwise

(b) Treatment of persons whose authorizations were not challenged and arguably are beyond timely challenge

(i) Comparison of the system under federal environmental statutes

iii. Is the Uniform Declaratory Judgments Act available to rule challengers, in addition to Government Code [APA] § 2001.038?

(1) *Texas Health Care Ass'n v. Health & Human Services Comm'n*, 949 S.W.2d 544, 544 (Tex. App. — Austin 1997, no pet. h.)(cautious approach to the issue)

(2) Did the Legislature intend to channelize rule challenges into § 2001.038, which contains no attorney's fee provision?

b. Other rulemaking issues

i. What is the "rulemaking record"?

(1) Treatment of later-generated material

(a) The example of a protectiveness review done by the agency after adoption of an exemption from permitting *(Concerned Citizen of Kaufman and Van Zandt Counties For Cleaner*

Air and Safer Roads v. Texas Natural Resource Conservation Comm'n, Cause No. 97-11553, in the 261st Judicial District Court, Travis County, Texas)(pending)

2. **Eligibility for contested case hearings (standing)**

a. Standing of persons residing near the facility: *Heat Energy Advanced Technology, Inc. v. West Dallas Coalition For Environmental Justice*, 962 S.W.2d 288 (Tex. App. — Austin 1998, petition for review pending)

b. Standing of riparian owners downstream of a wastewater discharge point: *Holton v. Texas Natural Resource Conservation Commission*, Cause No. 97-06408, in the 261st Judicial District Court, Travis County, Texas (court sent letter announcing it will rule for protestant, but no final judgment yet)

c. Other cases coming up

3. **When may the agency reverse the Administrative Law Judge?**

a. *Hunter Indus. Facils., Inc. v. Texas Natural Resource Conservation Comm'n*, 910 S.W.2d 961 (Tex. App. — Austin 1995, writ denied)

b. *Heat Energy Advanced Technology, Inc. v. West Dallas Coalition For Environmental Justice*, 962 S.W.2d 288 (Tex. App. — Austin 1998, petition for review pending)

i. Tension among various reversal standards, for example: Texas Government Code [APA] § 2001.058(e)("only for reasons of policy"); Texas Health & Safety Code [Solid Waste Disposal Act] § 361.0832(c)(if ALJ fact findings are "not supported by the great weight of the evidence"); Texas Government Code [SOAH Act] § 2003.047(i)(2)(in a TNRCC case other than one under Texas Health & Safety Code [Solid Waste Disposal Act] § 361.0832, an amendment of a PFD is to be based solely on the record made before the ALJ and must accompanied by an explanation of the amendment's basis)

c. *Southwestern Public Service Co. v. Public Utility Comm'n*, 962 S.W.2d 207 (Tex.App. — Austin 1998, no pet. h.)

d. *Employees Retirement System v. McKillip,* 956 S.W.2d 795 (Tex. App. — Austin 1997, no pet. h.)

e. F. Scott McCown and Monica Leo, WHEN CAN AN AGENCY CHANGE THE FINDINGS OR CONCLUSIONS OF AN ADMINISTRATIVE LAW JUDGE?, 50 Baylor L.Rev. 65 (1998)

4. **Miscellaneous procedural matters**

a. The need for a party seeking judicial review to get personal service on agency and all other parties: *Employees Retirement System v. McKillip,* 956 S.W.2d 795 (Tex. App. — Austin 1997, no pet. h.)

b. Effect of "premature" filing of suit in court

i. *Simmons v. State Bd. of Dental Examiners*, 925 S.W.2d 652 (Tex. 1996)

ii. *Lindsay v. Sterling*, 690 S.W.2d 560 (Tex. 1985)

iii. *Heat Energy Advanced Technology, Inc. v. West Dallas Coalition For Environmental Justice*, 962 S.W.2d 288 (Tex. App. — Austin 1998, petition for review pending)

(1) Are the courts showing a more "liberal" attitude in honoring premature filings?

c. Effect of failure to move formal admission of administrative record in court

i. *Texas Health Enterprises, Inc. v. Texas Dep't of Health*, 949 S.W.2d 313 (Tex. 1997)

5. **Recaps of some recent reported Texas "environmental" administrative law cases**

a. *Anderson v. Railroad Comm'n*, 963 S.W.2d 217 (Tex. App. — Austin 1998, review denied). The Railroad Commission issued a plugging order against an oil and gas well operator who had failed to respond to a notice of hearing. The operator via a motion for rehearing sought to set aside the default order. The agency denied rehearing and the district court upheld the denial. The Court of Appeals, affirming, wrote that the operator failed to file affidavits or other evidence with his motion for rehearing. Affidavits included in his request for oral argument before the Commission were submitted after the motion for rehearing deadline had passed and therefore could not be considered. The Court could not conclude the agency abused its discretion in declining to set aside the default order. Even if the affidavits proffered in connection with the oral argument request had been eligible for consideration, the agency still would have been entitled to deny the motion for rehearing, because substantial evidence supported its view that the operator had defaulted because of conscious indifference rather than non-receipt of notice.

b. *Heat Energy Advanced Technology, Inc. v. West Dallas Coalition For Environmental Justice*, 962 S.W.2d 288 (Tex. App. — Austin 1998, petition for review pending). Texas Water Code § 5.115(a) says that to get a contested case hearing, a permit opponent must show that he or she has a personal justiciable interest not common to members of the general public, and that the basis of his or her claim of "affected person" status is reasonable and supported by competent evidence.

The West Dallas Coalition for Environmental Justice, a citizen group, asked the Texas Natural Resource Conservation Commission for a hearing to oppose HEAT's application for a renewed permit to store, process, and transship (for use as fuel) hazardous waste in an industrial-residential neighborhood in Dallas. The agency sent the matter to the State Office of Administrative Hearings for a hearing solely on the issue of entitlement to a full, merits hearing. Trying to satisfy the "impact on at least one member" associational standing prong, the group presented the testimony of a member who said he lived a block and a half from the facility and sometimes smelled odors.

The Commission, changing some of the findings and conclusions of the ALJ, held that the Coalition had failed to prove hearing-entitlement. The district court disagreed and reinstated the ALJ's decision.

The Court of Appeals declined to choose between two different reversal standards that might guide Commission consideration of ALJ proposals for decision. It held that even under the more lenient standard, the agency erred by imposing too heavy a burden. To have standing, parties need not show they will ultimately prevail. A showing of potential harm or a justiciable interest is enough.

A threshold issue was whether the Coalition properly invoked court jurisdiction. It had filed suit while its motion for rehearing was pending, and after denial of the motion did not amend its pleadings for several months. The Court of Appeals held that because the Coalition reasonably believed the order might take effect before disposition of the motion for rehearing, and since under Texas Water Code § 5.351, effectiveness triggered the judicial review time clock, court jurisdiction existed. The panel viewed the case as like *Simmons v. State Bd. of Dental Examiners*, 925 S.W.2d 652 (Tex. 1996). In *Simmons*, the appealing party had asked the district court to stay the review proceedings pending disposition of the motion for rehearing. When the motion was overruled, the appealing party timely asked the court to lift the stay, re-invoking jurisdiction. In the Austin Court's view, these steps had not been critical to the case's outcome.

The Commission and permit applicant have petitioned the Texas Supreme Court for review.

c. *Public Utility Comm'n v. Southwestern Bell Telephone Co.*, 960 S.W.2d 116 (Tex. App. — Austin 1997, no pet.). The Public Utility Commission in Docket 11027 granted attorney's fees to a city against Southwestern Bell Telephone Company. The city incurred the fees in a court challenge to a PUC rate order in Docket 8585. In the earlier docket, the parties had agreed to try to settle on fee amounts, or if settlement failed, to let the Company seek an appropriate PUC ruling. When it received the city's claim, however, Southwestern Bell argued the agreement covered only fees incurred in the agency proceedings, not in judicial review proceedings. The PUC rejected this contention.

The district court reversed the PUC decision without reaching the merits, agreeing with Southwestern Bell that the agency lacked jurisdiction in the later docket to interpret or apply an agreement made in an earlier docket.

The Court of Appeals reversed the district court, holding that, as an incident to its power to conduct adjudicative proceedings, the PUC may accept, act upon, and when necessary interpret an agreement among parties to a rate case, including when a dispute arises after the closing of the docket in which the agreement was made. The Court remanded the case to the district court for determination of other aspects of Southwestern Bell's appeal of the fees award.

The Court rejected the argument that it was empowering the PUC to adjudicate private contract rights. The attorney's fee agreement at issue, it wrote, affected the public interest and thus was more than a private agreement.

Brian E. Berwick is a 1970 graduate of Pace University in Pleasantville, New York, and a 1973 graduate of the University of Texas School of Law. He was a Notes and Comments Editor of the Texas Law Review.

In 1966-68 he served in the United States Army as a military policeman in Texas and Viet Nam.

He clerked for Honorable John C. Godbold, United States Court of Appeals For the Fifth Circuit, in 1973-74, practiced law privately for four years, and has been an Assistant Attorney General in what is now the Natural Resources Division of the Office of the Attorney General of the State of Texas from 1979 to the present, except for a short stint in the Elder Law and Public Health Division.

His work has included defense of state statutes, agency rules, and adjudicative actions, civil environmental enforcement, state Superfund cases, suits under the federal National Environmental Policy Act, and petitions for review of United States Environmental Protection Agency rules.

He has taught an environmental law survey course and a seminar entitled "Natural Resource Protection and the Law" at St. Mary's University Law School.

His home address and phone number are 2901 Lafayette Avenue, Austin, Texas 78722-2347, 512 477 8130. His work address and phone number are Natural Resources Division, P.O. Box 12548, Austin, Texas 78711-2548, 512 475 4005. Fax number: 512 320 0052. Internet address: <brian.berwick@oag.state.tx.us>.

SENATE BILL 1 IMPLEMENTATION

TOMMY KNOWLES

Tenth Annual
Texas Environmental Superconference
August 6, 1998

Senate Bill 1 Implementation

By
Tommy Knowles, PhD, P.E.
Deputy Executive Administrator for Planning
Texas Water Development Board

Senate Bill 1 was authored by Senator Buster Brown and sponsored by Representative Ron Lewis. The bill was passed by the 75th Texas Legislature and contained over 200 pages in nine articles.

Today, I will discuss the implementation of the aspects of the bill related to water planning and data collection.

Regional water planning

Some have said the first article is the most important one in the bill since it changed how Texas plans for its long-term water supplies. The bill lays out that water plans " ...shall provide for the orderly development, management, and conservation of water resources and preparation for and response to drought conditions, in order that sufficient water will be available at a reasonable cost to ensure public health, safety, and welfare: further economic development: and protect the agricultural and natural resources of the entire state." Texas Water Code, Section 16.051. Further, the bill creates a new planning process where local groups are to prepare regional plans that are to be incorporated by the TWDB into the state water plan. The regional plans are to be submitted to the TWDB by September 1, 2000 with the state plan due one year later. The TWDB is to approve regional plans and incorporate them into the state plan if they are developed in accordance with Senate Bill 1 provisions and they are not in conflict with another plan. The TWDB has ultimate responsibility to resolve any such conflicts.

The first step in this process was the designation of regional water planning areas. The state was divided into 16 regional water planning areas by the TWDB last February. In doing this, the TWDB considered factors such as river basins, aquifer delineations, water utility development patterns, socioeconomic characteristics, existing regional water planning areas, political subdivisions boundaries, and public comment.

The second step in the process was the development of rules guiding the preparation of the plans. This process began last August with a workshop of interests on how the plans should be developed. A first draft of rules was published in October. A second workshop was held in November. A second draft of rules was published in November, which had 132 changes to the October draft based on public comments. A third draft of rules was published in December that had 159 changes to the November draft. The rules were adopted in February, which had 101 changes to the December draft due to responses to public comment. During the rule adoption process, we held 27 meetings around the state, a public hearing, mailed 13,500 sets of proposed rules, and responded to 140 Public comments.

The third step was to name initial members of the regional water planning groups. The statute requires that members of regional water planning groups represent the following interests: public, counties, municipalities, industries, agricultural interests, environmental interests, small businesses, electric generating utilities, river authorities, water districts, and water utilities. This process began in October when we asked interest groups to offer nominations. By February when the TWDB named initial members, we had received 5,069 nominations for 1,748 individuals. The TWDB named at least one person for each interest for each regional water planning group. The TWDB named 270 individuals as initial members of the regional water planning groups. They have since increased their membership to 317 with many others participating in the meetings in non-voting capacities. Non-voting memberships encourage coordination between regional water planning groups, state and federal agencies, and Republic of Mexico and will help reduce conflicts.

One of their first duties, as a regional water planning group, was to organize themselves and pass by-laws to govern their operations. Among other things, these bylaws identify a quorum necessary to conduct business, how to add members, and methods to resolve disputes. All 16 RWPGs have adopted these bylaws.

A first step in developing their regional water plans is to develop a scope of work - a plan for developing their regional water plan. Thirteen of the regions have received a grant from the TWDB to pay all the costs of scope development, not to exceed $20,000. Members of the RWPG and associated support staff are developing the scopes of work for the other three regions.

The requirements for the regional plans are that they describe the region, consider existing plans, describe the future demands for water (the planning period extends through 2050), describe current water supplies, identify water users with surpluses of water and those with needs (demands exceed current supplies), and plan ways to provide sufficient water to satisfy the needs. They are to develop plans to meet all needs of all users except for some entities who chose to not participate in the planning and for needs with no feasible solution. Terms of participation are set by the RWPG. Also, the RWPG may identify unique ecological stream reaches and unique future reservoir sites and make regulatory, administrative or legislative recommendations.

August 1 was the deadline for submittal of request for funds to the TWDB to complete the regional plans. The 75th Texas Legislature appropriated $7,560,000 for partial reimbursement of regional planning expenses. The funds are to be used for expenses this biennium (ends August 31, 1999), with the expectation that funds to complete the planning may be provided by the 76th Texas Legislature.

The TWDB rules provide that the TWDB may provide up to 75 percent of the eligible costs with 25 percent to be provided by the region. This local contribution may be in cash or in-kind contribution by actually conducting a portion of the study.

For information on regional planning, please check our Web Page at www.twdb.state.tx.us.

Observations to date:

The regional water planning groups are working well. They meet regularly and have good attendance by members. They have had about four months to form, pass by-laws and develop a scope of work. All 16 regions submitted a scope of work by the August 1 deadline. Their work has been remarkable. They have accomplished so much in such a short amount of time.

One region has added another specific interest. The Lower Colorado RWPG added recreation as an interest to account for the heavy recreational use of the Highland Lakes.

The idea of participation has generated significant discussion among RWPG members. Some members have tried to link financial contribution to participation in the planning – a pay to plan arrangement. Other RWPGs have said they will plan for all users in the region. Generally, this question has not been resolved for all regions.

The method of collecting the local match funds has drawn many debates. Some RWPG are seeking voluntary contribution (cash or in-kind) and others are attempting to make assessments to the major governmental users and to counties. This question has not been resolved.

RWPG have expressed the desire for less specific requirements from the TWDB, reimbursement of the administrative cost of operating RWPGs, and full funding of the regional plans by the State.

Groundwater District Management Plans

Senate Bill 1 provides that groundwater conservation districts are to develop a comprehensive management plan that address the following management goals, as applicable: (1) providing for the most efficient use of groundwater, (2) controlling and preventing waste of groundwater, (3) controlling and preventing subsidence, (4) addressing conjunctive surface water management issues, and (5) addressing natural resource issues. These plans are due to the TWDB for certification that they meet statutory requirements on September 1, 1998. By end of July, three plans have been

certified. Three plans are currently under review. The balance of the 40 plans is expected to be submitted by end of August.

Data Collection

The 75th Texas Legislature appropriated funds to enhance the collection of water supply information. Much of the expansion is in making the data more readily accessible. One of the current problems was the lack of real-time information on the amount of water remaining in many of our lakes, flowing in our stream, and in our wells. Using funds provided, the TWDB will be able to add equipment to 60 lakes monitoring stations so that we will have a total of 126 lakes for which real-time information will be available. Also, we will add equipment to 10 stream flow measuring sites so that we will have real-time flow information for 312 sites across the state. Also, 40 wells will be equipped with real-time stations. This information will be available over the Internet.

TEXAS WATER DEVELOPMENT BOARD

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TOMMY R. KNOWLES, P.E.
DEPUTY EXECUTIVE ADMINISTRATOR FOR PLANNING



Tommy R. Knowles was appointed Deputy Executive Administrator for Planning for the Texas Water Development Board on April 1, 1993. Dr. Knowles has held a number of positions in Texas water agencies since he joined the Board in 1973. His professional work has centered on studying the state's underground water resources, in particular the Edwards aquifer in the San Antonio area and the Ogallala aquifer in the Texas High Plains. Prior to his current assignment, Dr. Knowles served as the agency's Director of Planning during the development of the 1990 Texas Water Plan and its amendment in 1992.

Dr. Knowles received a Bachelor of Science degree in Agricultural Engineering in 1970, a Master of Science degree in Civil Engineering in 1972, and a Doctor of Philosophy degree in 1973, all from Texas Tech University. He is a registered professional engineer in Texas and a member of the American Society of Civil Engineers. He serves as Chairman of the Texas Natural Resources Information System Task Force.

Current as of June 1995

Water Quality Issues

Ken Petersen
Peggy Glass

Total Maximum Daily Loads

Establishing Surface Water Quality Priorities for Texas River Basins



Clean Water Act Section 303(d)

- Identify water bodies that are candidates for TMDLs — 303(d) list
  - impaired water bodies
  - threatened water bodies
- Develop TMDLs
  - Underway in 11 water bodies
  - Schedule 135 additional water bodies over the next 10 years
- Implement TMDLs under Section 303(e)

What is a TMDL?

- Technical term: amount of pollution a water body can receive and still meet standards for its use (a load allocation)
- Technical document: submitted to EPA for approval. Includes identification of pollutant, sources, responsible parties, and actions to restore water quality
- Process: for developing and implementing TMDLs



The TMDL Process

- Select candidates for TMDLs from List of Impaired Water Bodies
- Involve the public at the watershed level
- Develop load allocations on certain pollutants
- Submit TMDL to EPA for approval
- Produce and execute an implementation plan to restore water quality
- Monitor water quality to gauge success of plan (attainment of water quality standards)



Implementation Plan Components

- Description of pollution control actions
- Schedule for implementation of pollution control actions
- Legal authorities under which actions will be implemented
- Reasonable assurances
- Monitoring plan to determine effectiveness of control actions
- Measures for determining whether implementation plan is properly executed



Watershed Action Plans

TMDL Load Allocation
(EPA Guidance)
+
Implementation Plan
(TMDL FAC Guidance)

= Watershed Action Plan



Opportunities for Participation

- 305(b) report — Assess quality-assured data to document water quality status and prepare 303(d) list
- 303(d) list — Identify impaired and threatened water bodies
- TMDL development — Develop watershed action plan (load allocation + implementation plan)
- TMDL implementation — Implement pollution control actions



What's Next?

- Assess water bodies in Basin Groups D and E for the 1999 303(d) List
- Address listing process issues
- Begin TMDL development in Basin Groups B and C with steering committee participation
- Develop TMDL guidance document (draft for comment in October)



Internet Resources

- Final State of Texas 1998 303(d) List — *http://www.tnrcc.state.tx.us/water/quality/tmdl/*
- Draft State of Texas 1998 305(b) Inventory — *http://www.tnrcc.state.tx.us/water/quality/data/*
- Environmental Protection Agency TMDL Program [Federal Advisory Committee, litigation status, guidance, publications, nationwide 303(d) list status] — *http://www.epa.gov/owow/tmdl*



Internet Resources

- Environmental Protection Agency Clean Water Initiative [Clean Water Action Plan] — *http://www.epa.gov/cleanwater/*



Attachment to Speaking Notes of
Kenneth L. Petersen, Jr. - TNRCC

UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

AUG 8 1997

OFFICE OF
WATER

MEMORANDUM

SUBJECT: New Policies for Establishing and Implementing Total Maximum Daily Loads (TMDLs)

FROM: Robert Perciasepe
Assistant Administrator (4101) Bob Perciasepe

TO: Regional Administrators
Regional Water Division Directors

Last August I issued a Healthy Watershed Strategy to advance the cause of clean water everywhere. A key component of the Strategy was to "rapidly increase the development and implementation of total maximum daily loads to manage water quality on a watershed scale." Thanks to hard work by State[1] and EPA managers and staffs, EPA now has received and taken action on all State lists required by section 303(d) of the Clean Water Act (CWA). It is now time to move towards the next stage of our strategy to achieve water quality standards -- to make sure that TMDLs are established for all listed waters, and that the load allocations established by TMDLs are implemented by point and nonpoint sources alike.

Almost 25 years after the passage of the CWA, the national water program is at a defining moment. We -- meaning each of you, each of our State, local, and Tribal partners, and all of us in the Office of Water -- are making the transition from a clean water program based primarily on technology-based controls to water quality-based controls implemented on a watershed basis. Technology-based controls, such as secondary treatment of sewage, effluent limitations guidelines for industrial sources, and management practices for some nonpoint sources, have dramatically reduced water pollution and laid the foundation for further progress.

We must continue to preserve and protect the foundation we have worked so hard to put in place. If we are to achieve clean water everywhere, though, we must continue to build capacity to identify remaining problem areas and fix each problem on a watershed-by-watershed basis. The TMDL program is crucial to success because it brings rigor, accountability, and statutory authority to the process. These are the reasons the Administrator and I so strongly support the TMDL program in States, Tribes, and EPA Regions.

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[1]For ease of reference, I am including Territories within the term "States" throughout this memorandum.

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We at EPA will progress most successfully to a water quality-based program -- and more rapidly solve the remaining water quality problems -- by working in full partnership with States and Tribes. Our Federal, county, city, and local partners all need to be enlisted and involved. Moreover, CWA programs such as TMDLs need to be meshed better with numerous other programs and authorities, such as local source water protection programs, the Federal Agriculture Improvement and Reform Act of 1996, and locally-led watershed protection efforts.

I intend the two new TMDL policies presented below in italics to advance the national water quality-based program. I ask each of you to work closely with each State in your Region to help the State water program director and staff fulfill the requirements of section 303(d) and EPA's implementing regulations, and successfully achieve the goals of the TMDL program. To the extent possible, the TMDL program, including the policies below, should be carried out in full partnership with the State, including incorporation of the TMDL program into an Environmental Performance Partnership Agreement.

The TMDL process, in essence, is the following: States identify specific waters where problems exist or are expected; States set priorities; States allocate pollutant loadings among point and nonpoint sources; and EPA approves State actions or acts in lieu of the State if necessary. Point and nonpoint sources then reduce pollutants to achieve the pollutant loadings established by the TMDL through a wide variety of Federal, State, Tribal, and local authorities, programs, and initiatives.

States have primary responsibility for developing lists and TMDLs under section 303(d). Section 303(d)(1)(A) and the implementing regulations (at 40 CFR 130.7(b)) provide States with latitude to determine their own priorities for developing and implementing TMDLs. In particular, the flexibility to States offered by the priority ranking process of section 303(d)(1)(A) is a good opportunity for incorporating rotating basin or other watershed approaches into the TMDL process.

If a State fails to meet its obligations under section 303(d), you will need to step in. However, it is my goal that every State will succeed in fully meeting the requirements of section 303(d) and taking the needed action to implement approved TMDLs. This goal underscores the importance of the EPA partnerships with States, which include providing needed technical assistance, training, and support.

The two new policies presented below in italics establish a nationally consistent approach for establishing and implementing TMDLs. These policies supplement existing regulations and guidance, and will remain in effect unless they are specifically changed by the Office of Water. They have been discussed with the Federal Advisory Committee on the TMDL program, and will be revisited in consultation with EPA and State managers after the Committee submits its report in mid-1998.

Schedules for Establishing Final TMDLs

The regulatory schedule for each State to submit a list of impaired and threatened waters[2] under section 303(d) is April 1 of every even numbered year, i.e., the next list is due on April 1, 1998. Under EPA's regulations, State-submitted section 303(d) lists must identify which waters are targeted for TMDL development in the ensuing two years, and Regional Administrators and States are to determine a schedule for submission of TMDLs for these targeted waters. To achieve clean water everywhere, however, we need to do better than this; we need an overall plan for completing and approving TMDLs for all listed waters. A number of States and Regions have agreed upon comprehensive schedules for establishing TMDLs for all listed waters, but many have not yet done so.

Each EPA Region should secure a specific written agreement with each State in the Region establishing an appropriate schedule for the establishment of TMDLs for all waters on the most recent section 303(d) list, beginning with the 1998 list. Each State schedule should reflect the State's own priority ranking of the listed waters and be integrated with the Environmental Performance Partnership Agreement process. These State schedules should be expeditious and normally extend from eight to thirteen years in length, but could be shorter or slightly longer depending on State-specific factors. These factors may include:

- number of impaired segments;
- length of river miles, lakes, or other waterbodies for which TMDLs are needed;
- proximity of listed waters to each other within a watershed;
- number and relative complexity of the TMDLs;
- number and similarities or differences among the source categories to be allocated;
- availability of monitoring data or models; and
- relative significance of the environmental harm or threat.

I ask each of you to discuss with each State water program director the importance of an overall schedule and plan for establishing TMDLs for all listed waters, and to reach agreement by October 1, 1997 on the best process for developing appropriate schedules. After an opportunity for public discussion, the State should provide to EPA the comprehensive schedule for completing all TMDLs at the same time the State submits its 1998 list to EPA for approval (due on April 1, 1998). The State and EPA may subsequently agree to modify the

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[2] EPA's regulations, at 40 CFR 130.2(j), define "water quality-limited segment" as "any segment where it is known that water quality does not meet applicable water quality standards, *and/or is not expected to meet* applicable water quality standards, even after the application of the technology-based effluent limitations required by sections 301(b) and 306 of the Act" (emphasis added). Therefore, for the 1998 listing cycle States should consider both impaired and threatened waters for inclusion on their 1998 section 303(d) lists. For ease of reference, the phrase "impaired waters" as used in this memorandum refers to both impaired and threatened waters, consistent with EPA's regulations.

comprehensive schedule to reflect changes in the final EPA-approved list of impaired waters, including changes made through the approval process. This April 1, 1998 deadline for submission of the State's 1998 list and comprehensive schedule is important; please make every effort to ensure that each State meets this date.[3]

In developing these comprehensive schedules for completing all TMDLs, Regions and States should keep in mind that waterbodies may be added or subtracted over time as new lists are developed. However, once a waterbody is put on a list and a time schedule is specified for completing the TMDLs for that waterbody, the TMDL for that waterbody should generally be completed within that timeframe; the schedule should not be extended beyond that time frame simply because a new list is developed. For example, if a State lists a waterbody in March 1998 and provides a schedule of 10 years to complete the TMDLs for that waterbody, the State would not provide another schedule of 10 years to complete the same TMDLs when the next list is submitted in the year 2000.

This comprehensive and nationally consistent approach to establishing TMDLs for all listed waters will set the stage for implementing needed water quality-based pollution controls, and help accelerate the restoration and protection of this country's waters.

Implementation of TMDLs for Waters Impaired Solely or Primarily by Nonpoint Sources

A TMDL improves water quality when the pollutant allocations are implemented, not when a TMDL is established. When the State or EPA identifies a water quality impairment on a section 303(d) list and then establishes the TMDL, we begin a water quality-based process, not end one.

Section 303(d) does not establish any new implementation authorities beyond those that exist elsewhere in State, local, Tribal, or Federal law. Thus, point sources implement the wasteload allocations within TMDLs through enforceable water quality-based discharge limits in NPDES permits authorized under section 402 of the CWA. Nonpoint sources implement the load allocations within TMDLs through a wide variety of State, local, Tribal, and Federal programs (which may be regulatory, non-regulatory, or incentive-based, depending on the program), as well as voluntary action by committed citizens. These programs and efforts for control of nonpoint sources should be described in the State nonpoint source management program under section 319 of the CWA. Many States are now working to strengthen their nonpoint source programs in keeping with EPA's Nonpoint Source Program and Grants Guidance (May, 1996), including nine key program elements to achieve and maintain beneficial uses of water.

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[3] The State's comprehensive schedule will not be subject to formal EPA approval pursuant to Section 303(d)(2) and 40 CFR 130.7.

In the case of waters impaired by point sources only or by a blend of point and nonpoint sources in which point sources dominate, EPA regulations (at 40 CFR 122.44(d)(1)(vii)) require that effluent limits in NPDES permits for point sources be consistent with assumptions and requirements of wasteload allocations for the discharge contained in an EPA-approved TMDL. Our Guidance for Water Quality Decisions: The TMDL Process (April 1991) broadly describes the process for deriving wasteload allocations for point sources and incorporating these allocations into NPDES permits, and references several technical documents. This guidance document also describes ways that load allocations are to be set and implemented for nonpoint sources, using current programs and authorities such as Section 319 of the Clean Water Act.

In watersheds impaired by a blend of point and nonpoint sources, this TMDL Process guidance document provides that where any wasteload load allocation to a point source is increased based on an assumption that loads from nonpoint sources will be reduced, the State must provide "reasonable assurances" that the nonpoint source load allocations will in fact be achieved. Our current regulations, guidance, and policies remain unchanged regarding implementation of TMDLs for those waters impaired by point sources or by a blend of point and nonpoint sources in which point sources dominate.

EPA's guidance on implementation of TMDLs is incomplete because it does not yet address implementation of TMDLs for waters impaired only by nonpoint sources or by a blend of point and nonpoint sources in which nonpoint sources dominate. Implementation of load allocations for nonpoint sources in these waters is essential if we are to maintain steady progress toward clean water goals.

For 303(d)-listed waters impaired solely or primarily by nonpoint sources, TMDL implementation may involve individual landowners and public or private enterprises engaged in agriculture, forestry, or urban development. The primary implementation mechanism will generally be the State section 319 nonpoint source management program coupled with State, local, and Federal land management programs and authorities.

For example, voluntary, incentive-based approaches at the State and local level can be used to implement management practices for controlling nonpoint source pollution. In addition, local regulations or ordinances related to zoning, land use, and storm water runoff are often used to abate polluted runoff. Federal land management agencies have responsibilities to resolve nonpoint source problems on Federally owned and managed lands. A Federal agency with such responsibilities may establish a memorandum of understanding with the State water quality agency to accomplish implementation of nonpoint source controls necessary to meet water quality standards, and implement practices through Federal licenses and permits.

For all section 303(d)-listed waters impaired solely or primarily by nonpoint sources, each EPA Region should work in partnership with each State to achieve TMDL load allocations for nonpoint sources. All available Federal, State, and local programs and authorities should be used, including non-regulatory, regulatory, or incentive-based programs authorized by Federal, State, or local law.

For all section 303(d)-listed waters impaired solely or primarily by nonpoint sources, each State should describe its plan for implementing load allocations for nonpoint sources. The State implementation plan may describe how load allocations will be achieved by nonpoint sources for individual waters, for several waters within a watershed, or for all affected waters in the State. Through the Environmental Performance Partnership Agreement or other similar process, each EPA Region and State should agree upon the best strategy for mutual support.

States may submit implementation plans to EPA as revisions to State water quality management plans, coupled with a proposed TMDL, or as part of an equivalent watershed or geographic planning process. At a minimum, each State implementation plan should include:

- *Reasonable assurances that the nonpoint source load allocations established in TMDLs (for waters impaired solely or primarily by nonpoint sources) will in fact be achieved. These assurances may be non-regulatory, regulatory, or incentive-based, consistent with applicable laws and programs. In the case of Federal lands, these specific assurances should reflect applicable Memoranda of Agreement or other mechanisms to achieve implementation of needed management practices; and*

- *A public participation process; and*

- *Appropriate recognition of other relevant watershed management processes, such as local source water protection programs, urban storm water management programs, State section 319 management programs, or State section 303(e) continuing planning processes.*

The continuing planning process established by section 303(e) of the CWA provides a good framework for implementing TMDLs, especially the nonpoint source load allocations. Under the section 303(e) process, States develop and update State-wide plans that include TMDL development and adequate implementation of new and revised water quality standards, among other components. The water quality management regulations at 40 CFR 130.6 require States to maintain water quality management plans that are used to direct implementation of key elements of the continuing planning process, including TMDLs, effluent limitations, and nonpoint source management controls. These State water quality management plans are another way for States to describe how they will achieve TMDL load allocations for nonpoint sources.

Other planning approaches may guide the implementation of TMDLs. Increasing numbers of States are adopting watershed approaches that focus activities and resources geographically. Some States are adopting rotating basin approaches which focus and sequence activities on groups of watersheds located together. In addition, plans designed to deal with problems in specific geographic areas may also facilitate TMDL implementation, e.g., remedial action plans in the Great Lakes, habitat conservation plans, and State coastal nonpoint programs.

To help support cooperative efforts with States to achieve TMDL load allocations for nonpoint sources, I ask each of you to continue your efforts to:

- Provide needed technical assistance, tool development, and training to States, local authorities, and Tribes;
- Clarify TMDL program requirements, as necessary; and
- Focus Federal agency resources and programs to solve nonpoint source pollution problems, especially on Federal lands.

In addition, we at EPA need to provide additional resources to States to move more rapidly towards a water quality-based clean water program. In the President's 1998 Budget, we have requested substantial increases in resources to help States succeed in implementing the TMDL program, including:

- An increase of $5 million in CWA section 106 grants to States;
- An increase of $8 million in internal resources for technical assistance and tool development; and
- An increase of $5 million in internal resources supporting nonpoint source activities.

I intend to commit a substantial part of these resources to resolving nonpoint source problems in 303(d)- listed waterbodies, to the extent that the funds are appropriated.

I am optimistic that this cooperative approach with States will help accelerate the implementation of TMDLs in waters impaired solely or primarily by nonpoint sources. Where a State does not develop a plan for achieving TMDL load allocations for nonpoint sources, I ask you to engage that State by no later than the beginning of FY 1999 in a constructive and focussed discussion of needed actions by State and Federal environmental managers. If necessary, however, you should take additional steps promptly thereafter, including any or all of the following:

- Require the State to update its State water quality management plan under 40 CFR 130.6, or incorporate into the plan additional implementation measures on a State-wide or specific watershed basis.

- Focus substantial grant dollars (including Performance Partnership grants and grants under sections 319, 106, 604(b), and 104(b)(3)) toward those States that are providing reasonable assurances that nonpoint source load allocations established in TMDLs will in fact be achieved.

- Initiate source-by-source reviews of, and where necessary object to, NPDES permits (including minors) in the watershed and in upstream and downstream watersheds, where the NPDES permit regulates the same pollutant covered by the TMDL and further reductions at the point source will speed progress towards achieving water quality standards.

- Deny or revoke a State's enhanced benefits status under the new section 319 nonpoint source guidance and revert to a more intense, project-by-project oversight process on annual section 319 grants.

While I am pleased with the progress of many States, we still have a long way to go before we achieve clean water everywhere. The Healthy Watershed Strategy strives to advance that goal through a watershed approach to pollution control. The two new policies I am establishing today for developing and implementing TMDLs are another step towards the goal of clean water everywhere. It is crucial that EPA managers, together with our Federal, State, local, and Tribal partners, take every step we can to make sure that the TMDL program is carried out effectively and quickly.

I have not fully addressed TMDL requirements for Indian Tribes in this memorandum because circumstances are different from those of most States. I believe, however, that new policies and guidance for developing and implementing TMDLs are needed for waters on Tribal lands. I have asked Kathy Gorospe, Director of the American Indian Environmental Office, and Bob Wayland, Director of the Office of Wetlands, Oceans and Watersheds, to work together to develop these needed policies and guidance.

Thank you for your support. If you have any questions, please call me or contact Bob Wayland at (202) 260-7166 or Geoff Grubbs, Director of the Assessment and Watershed Protection Division, at (202) 260-7040.

cc: State Water Program Directors
Dale Givens, ASIWPCA
Mary Gade, ECOS
All Members, TMDL FACA Committee
OW Office Directors
Susan Lepow, OGC

Kenneth L. Petersen, Jr., Deputy Director
Office of Water Resource Management
Texas Natural Resource Conservation Commission

Kenneth L. Petersen, Jr. graduated magna cum laude from the University of Texas in Austin and received a Doctor of Jurisprudence degree there in 1978.

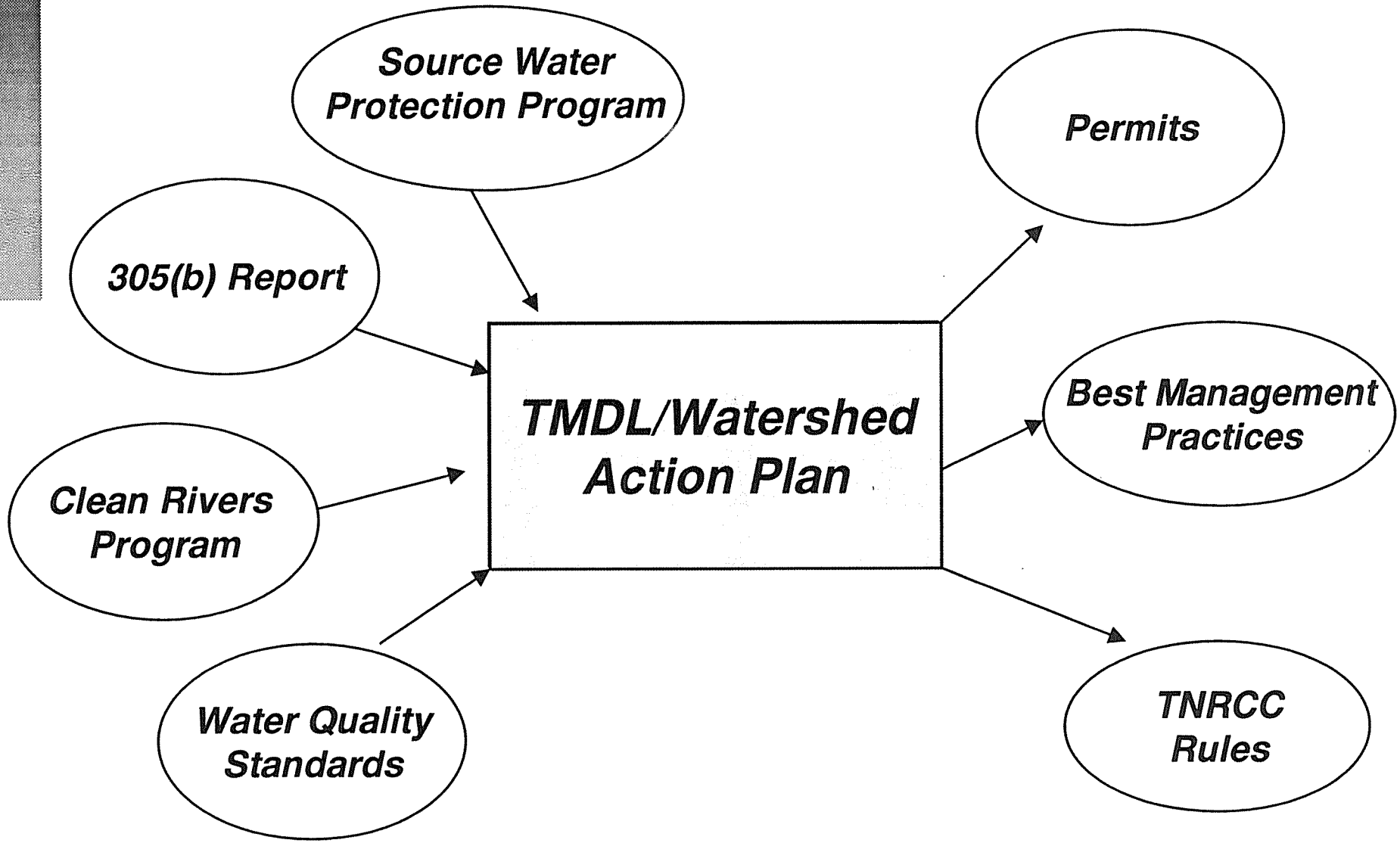
Career experience leading up to the present has involved administrative work before the Texas Natural Resource Conservation Commission and its predecessor agencies, the Texas Water Commission, the Texas Department of Health, and the Texas Air Control Board, as well as related litigation in various courts involving permit applications, rules development, and administrative penalty and compliance proceedings in water quality, municipal solid waste, regulation of constitutional conservation districts, industrial solid and hazardous waste, incineration activities, solution mining, petroleum storage tanks, injection well disposal, water rights, water and wastewater utilities, and Open Meetings and Open Records Act requirements.

Since November 1996, as Deputy Director, Office of Water Resource Management, Texas Natural Resource Conservation Commission, Mr. Petersen has been responsible for the administration of the State's water quality, water resource, and water and wastewater utility programs. He is currently closely involved with House and Senate Interim Committees in the implementation of Senate Bill 1, passed by the 75th Texas Legislature.

Relationship Between TMDLs and Other Water Quality Programs

By
Peggy W. Glass, Ph.D.
Alan Plummer Associates, Inc.

Relationship to Other Programs



Source Water Assessment and Protection Program

Regulatory Basis — SDWA Amended August 1996

Purpose — To identify the susceptibility to contamination of Public Water Supplies so that programs can be enacted to protect these supplies.

Key Components of SWAP

Delineate Source Water Protection Area

Inventory the Location of Potential Contaminants

Perform a Susceptibility Analyses

SWAP Schedule

August 1997 - EPA Guidance Final

February 1999 - Submit Description of Assessment Process to EPA

2 Years After EPA (3.5 years if EPA concurs)

Approval - Complete SWAP

Overview of Program

SWAP

- Source Water Assessment
- Assessment of Risk
- Required

SWP

- Source Water Assessment
- Development and Implementation of Management Programs
- Voluntary

Recent Federal Actions On Water Quality Standards

ANPRM - June 25, 1998

Interim Draft ANPRM - March 1996

Existing Regulations - 1983

Water Quality Standards Issues Related to TMDLs

- Emphasis on watershed approach; considering weight-of-evidence approach
- More guidance on site-specific criteria based on use attainability
- New criteria: nutrient, sediment, and biological
- Antidegradation

State of Texas

SWAP

- Being prepared by USGS
- Waters identified as being at risk will be added to TMDL Segments

BIOGRAPHICAL INFORMATION

PEGGY W. GLASS, PH.D.

Education: B.S. in Chemistry, Southwest Texas State University
Ph.D. in Chemistry, University of Texas at Austin

Dr. Glass has over 25 years of experience in environmental studies related to water quality management, wastewater treatment, and water supply. Most of this experience has been as a consultant with environmental engineering firms, but she also spent six years at the Texas Department of Water Resources, predecessor to Texas Natural Resource Conservation Commission (TNRCC). At the Department of Water Resources, she directed programs related to water quality management planning, water quality standards, and wasteload allocation development.

She is currently a Principal with Alan Plummer Associates, Inc., (APAI). As a consultant, Dr. Glass assists clients in studies to verify appropriate permit limits to maintain water quality standards, update models used in wasteload allocations, and determine uses that are being supported by receiving streams. She serves on two Water Environment Federation (WEF) committees: the Aquatic Criteria Work Group and the Wet Weather Water Quality Subcommittee.

Dr. Glass is a member of the WEF, Water Environment Association of Texas, American Water Works Association, and Texas Water Conservation Association. She is a member of the Board of Directors for TWCA.

Environmental Issues Confronting Municipalities

Mayor Kirk Watson

NOTES

Kirk Watson

On June 15, 1997, Kirk Watson was sworn in as Mayor of Austin. Since taking office, Mayor Watson has been running at top speed. He has shown he possesses the willingness and ability to tackle tough issues and imaginatively solve those issues to the satisfaction of the community. The Mayor has received numerous awards for his work, including The Centex Chapter of the American Society of Public Administrators naming him Public Administrator of the Year in 1998, the Downtown Austin Alliance's 1998 Impact Award for his leadership in revitalizing Downtown Austin, Ballet Austin's 1998 Bravo Award, and S.M.A.R.T., a group dedicated to helping minority youth, named him Community Person of the Year.

Mayor Watson is the managing partner in the Austin, Texas law firm of Watson, Bishop, London, and Galow, P.C. Over the years, Mayor Watson's leadership abilities in the field of law have been recognized through awards such as being named the Outstanding Young Lawyer of Texas of 1994 by the Texas Young Lawyers Association. He graduated first in his class from Baylor Law School and was Editor-In-Chief of the Baylor Law Review. In 1997, he was named one of Baylor's Outstanding Young Alumni and the Young Baylor Lawyer of the Year. He was also specially recognized in 1997 by the Texas Law Fellowships for Excellence in Public Interest Law. Mayor Watson also gives of himself in other ways by lecturing in numerous Continuing Legal Education programs and writing for legal publications. In 1996, he was Vice Chair of Governmental Relations of the Greater Austin Chamber of Commerce.

Governor Ann Richards appointed him as Chair of the Texas Air Control Board in 1991, under his leadership, Texas led the nation in complying with the federal Clean Air Act. He served until the Air Board was consolidated with the Texas Water Commission into the Texas Natural Resource Conservation Commission on September 1, 1993. He was a recipient of the Sierra Club, Lone Star Chapter, Special Service Award in 1994 and the American Lung Association of Texas "Advocacy" Award as an outstanding public health advocate in 1993.

Kirk is married to Liz McDaniel Watson. They have an eight-year-old son, Preston, and a two year-old-son, Cooper.

Management Strategies to Achieve Compliance

Commissioner Ralph Marquez
John Caudill
Paula McLemore

NOTES

Texas Natural Resource Conservation Commission

The TNRCC Commissioners



R.B. "Ralph" Marquez

Ralph Marquez of Texas City was appointed by Governor George W. Bush to the Texas Natural Resource Conservation Commission (TNRCC) on May 1, 1995, and was confirmed by the Texas Senate on May 5, 1995. His term expires August 31, 1999.

Prior to his appointment, Marquez served on several TNRCC advisory committees and task forces. He is a registered professional engineer and has been a vice-chair of the Texas Chemical Council environmental committee, a board member of the Gulf Coast Water Authority, and served on the State of Texas Waste Reduction Advisory Committee. He also served as chairman of the City of Texas City Environmental Advisory Board.

From 1963 to 1993, Marquez worked for the Monsanto Company in various capacities, including internal company consultant for technical, regulatory and legislative environmental issues. He has a bachelor's degree in Chemical Engineering from the University of Texas and a master's degree from the University of Houston-Clear Lake.

JOHN A. CAUDILL

John A. Caudill, Environmental Affairs Leader, DuPont, Laporte, Texas Plant, joined DuPont in 1979.

From 1979 to 1984, Mr. Caudill was assigned to the DuPont's Cape Fear Plant in Wilmington, North Carolina where he worked in Engineering and Manufacturing supervision.

In 1984, Mr. Caudill transferred to Waynesboro, Va. where he served as operations supervisor in the Orlon®, Dacron® and Nylon businesses.

In 1991, Mr. Caudill, was assigned Area Supervisor -Training and Development in LaPorte, Texas to lead Process Safety Management implementation activities. For the last 6 years he has been responsible for Site Environmental Affairs which includes both central regulatory administration and waste treatment operations.

In 1994 and again in 1998 the site was a winner of a Clean Texas 2000, Texas Environmental Excellence Award for pollution prevention achievement.

For the previous four years Mr. Caudill has been chairman of the Clean Industries Team, an industry cross sectional team representing Clean Texas 2000 Clean Industries members that was formed to give advise and counsel to the Texas Natural Resource Conservation Commission concerning the direction of the program. Most recent developments include the development of the Clean Industries Plus Program which is a voluntary Environmental Management Systems program that takes that next step toward environmental excellence beyond the Clean Texas 2000 Program.

Mr. Caudill has served as initiative leader for the Texas Chemical Council committee working with TNRCC to develop the Environmental Compliance Management System Program. This program when adopted later this year will allow facilities that have well documented compliance management systems with excellent compliance histories to exempt from traditional compliance inspections for up to 5 years. In the place of compliance inspections facilities will receive compliance system certifications from TNRCC regional offices.

He received a BS in Mechanical Engineering from North Carolina State University.

Mr. Caudill and his wife, Susan, have three children, ages 15, 17 and 20.

June 1998

BIOGRAPHICAL SKETCH

NAME:	Paula J. McLemore
PRESENT TITLE:	Manager, Regulatory Affairs
PRESENT AFFILIATION:	Albemarle Corporation
CITY & STATE:	Pasadena, Texas
TELEPHONE:	DAY: (713) 740-1157 EVENING: (281) 486-5257
EDUCATION:	B.S. - Southern Illinois University, Carbondale - 1977 President's Degree - Resource Conservation/Ecology
	M.S. - Southern Illinois University, Carbondale - 1978 President's Degree - Geology/Hydrology/Thermal and Environmental Engineering

EXPERIENCE:

1981 to Present

Albemarle Corporation, Pasadena, Texas
Current Position - Manager, Regulatory Affairs

Responsibilities include management of all environmental programs and oversight for all regulatory programs (OSHA, SARA, FIFRA, FDA, RMP) at Albemarle's Pasadena and Deer Park Facilities. Emphasis is on regulatory analysis, policy development, compliance program management, permitting, training, internal auditing and lobbying at the state and federal level. Special projects include evaluation of solid waste disposal sites, management of groundwater monitoring and compliance programs, permitting and closure of solid waste facilities, Superfund site cleanups, OSHA compliance investigations, crisis management planning and community relations. Also serves as media spokesperson, Responsible Care Coordinator and TSCA Steward.

1979 - 1981 City of Granite City, Illinois
Director of Air Pollution Control

Responsibilities included planning, budgeting and directing the activities of the Air Pollution Control Department as well as the management and administration of federal and state grants. Emphasis was on air monitoring, compliance inspections, permit review, regulatory development and emergency response.

RELATED ACTIVITIES:

Guest Lecturer
Environmental Management, University of Houston Clear Lake

Houston Chamber of Commerce Environment Committee

Steering Committee 1983 - 1991
Air Subcommittee Chair 1983 - 1987
Solid Waste Subcommittee Chair 1987 - 1988
Environment Committee Vice-Chair 1988 - 1989
Environmental Division Chair 1989 - 1990
Solid Waste Subcommittee Chair 1990 - 1991
Economic Development Subcommittee Chair 1990 - 1991

Texas Chemical Council (TCC)

Air Conservation Committee
Steering Committee 1984 to 1997
Compliance/Enforcement Chair 1993 - 1994
Water Conservation Committee
Solid Waste Subcommittee

Air and Waste Management Association (A&WMA)

Southwest Section Board of Directors 1984 - 1992
Gulf Coast Chapter Chair 1984 - 1985
Section Chair 1986 - 1987, 1988 - 1989
Technical Council
Basic Science and Technology Division Vice-Chair 1982 - 1986
Waste Division Vice-Chair 1986 - 1990
Board of Directors 1989 - 1992, 1994 - 1997
Finance Committee Chair 1990 - 1991
International Vice-President 1990 - 1991
International First Vice President 1994 - 1995
International President 1995 - 1996

Water Environment Federation (WEF)

American Institute for Pollution Prevention (AIPP)
Implementation Council Chair 1989 - 1992

East Harris County Manufacturer's Association (ECHMA)
Community Relations Committee
Environment Committee
Public Relations Mutual Aid

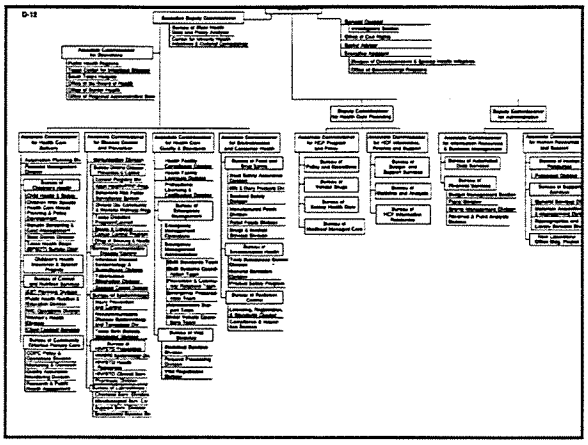
North American Commission on Environmental Cooperation
National Advisory Committee 1995 to 1997

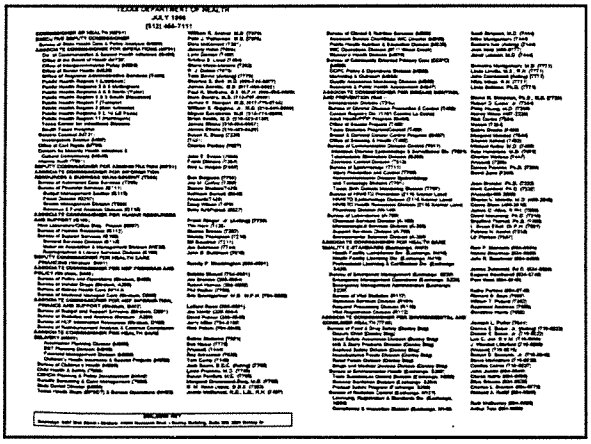
TDH Update

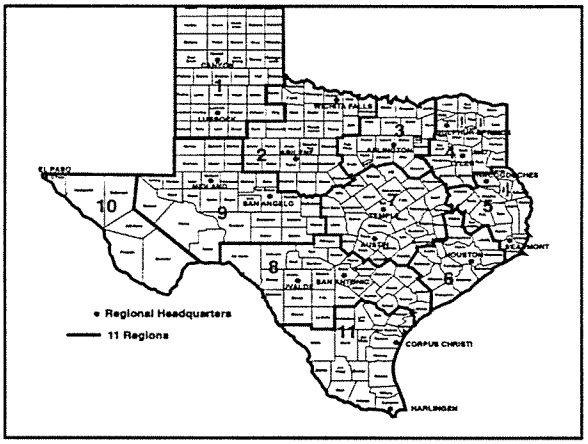
John Jacobi
Carolyn Wright

T D H

TEXAS DEPARTMENT OF HEALTH



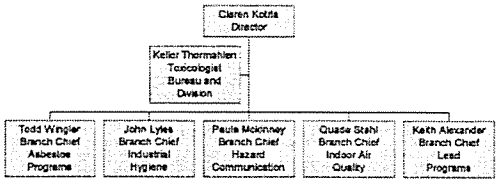




TOXIC SUBSTANCES CONTROL DIVISION

T D H

TOXIC SUBSTANCES CONTROL DIVISION



TDH
ASBESTOS
BRANCH

T D H

TEXAS DEPARTMENT OF HEALTH

Asbestos Programs Sections:

- Licensing
- Notification
- Enforcement
- Training Provider Licensing
- Public Information

Licensing:
- 13 licensing categories
- license 6,013 per year

Notifications:
- 20,000 Notifications rcvd per year
- 8,250 Projects Notified per year

Enforcement:
- Process 852 Cases per year
- Hold 713 Settlement Conferences per year

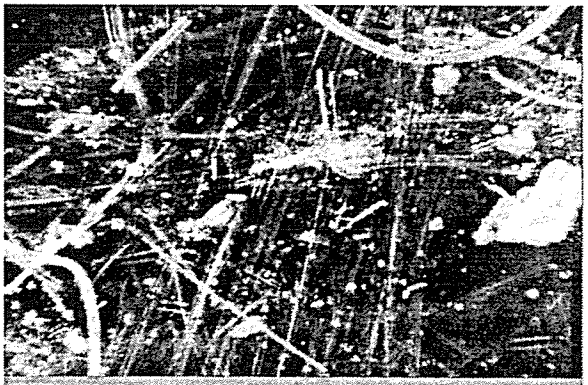
Training Providers:
- License 38 Training Providers per year

Public Information:
- Process 235 Open Records Requests per year
- Attend 13 Trade Shows/Group Meetings per year
- Mail Tri-Annual Bulletin to 9,000 licensees per year

History
Texas Asbestos Health Protection Rules

- House Bill 36, Article 4477-3a passed 9/1/87
  - licensing of workers, contractors & supervisors
  - inspection of licensees by Department
- Rule amended - effective 2/1/89
  - licensing of O&M supervisors
  - entitled Asbestos Exposure in Public Buildings
- Senate Bill 1341 & House Bill 79 effective 9/1/91
  - established training provider licensing & monitoring
  - expanded licensing to 12 categories
  - Resilient Floor Covering Institute licensing exemption

- TAHPR effective 10/20/92
  - added notification section
  - expanded enforcement section
- Senate Bill 1045, House Bill 1680 & 1826
  - effective 9/1/93
  - inspections to include NESHAP compliance
  - MOU with TNRCC for enforcement of NESHAP
- Section 295.71 - Texas Board of Health added section
  - enforce NESHAP demolition & renovation activities
- TAHPR amended 9/22/94
  - state examination was added
  - notification section to collect fees
  - administrative penalties were raised to maximum

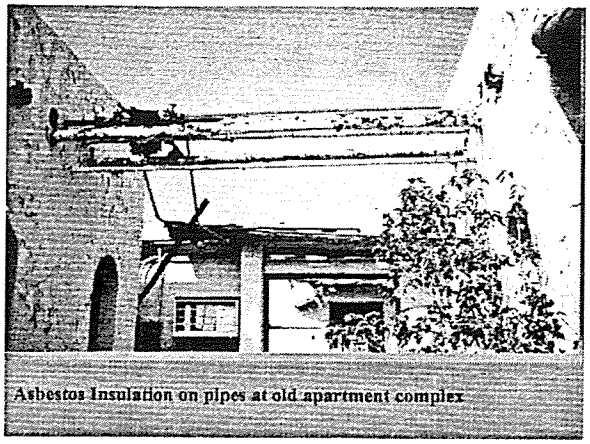


Asbestos Fibers

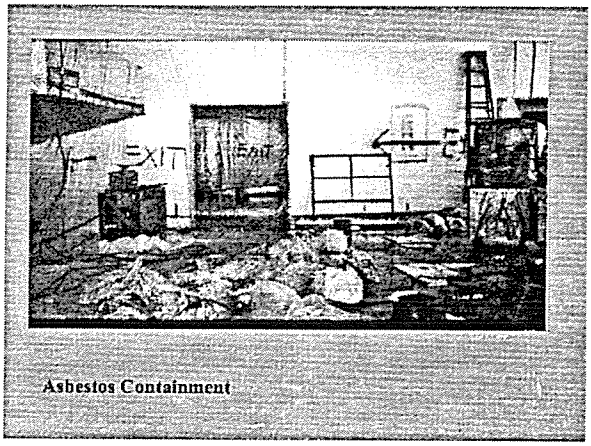
Asbestos Diseases:

- Asbestosis – scarring of the lungs
- Lung Cancer
- Mesothelioma – cancer of the chest cavity lining

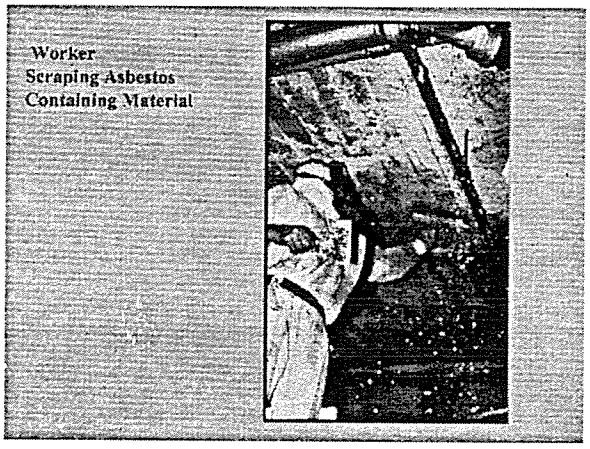
Asbestos is a KNOWN carcinogen



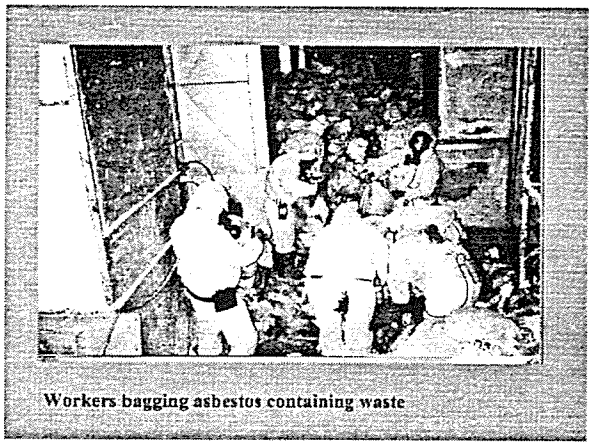
Asbestos Insulation on pipes at old apartment complex



Asbestos Containment



Worker
Scraping Asbestos
Containing Material



Workers bagging asbestos containing waste

TDH
ENVIRONMENTAL
LEAD BRANCH

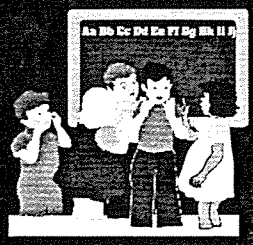
T D H

ENVIRONMENTAL LEAD BRANCH SECTIONS

- CERTIFICATION
- TRAINING
- NOTIFICATION
- COMPLIANCE & ENFORCEMENT
- LEAD SURVEILLANCE
- PUBLIC INFORMATION

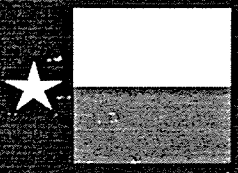
WHAT FACILITIES ARE COVERED???

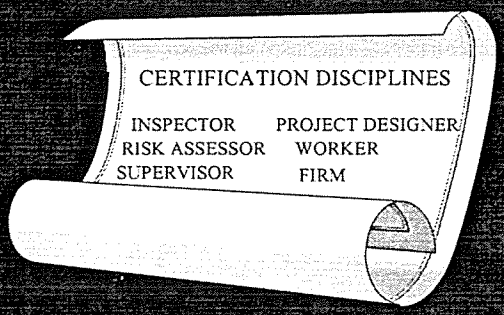
- LEAD ACTIVITIES IN TARGET HOUSING AND CHILD-OCCUPIED FACILITIES MUST BE CONDUCTED BY CERTIFIED PERSONS



CERTIFICATION

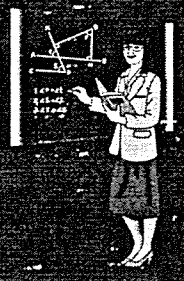
- CERTIFICATIONS ARE ISSUED TO PERSONS WHO WISH TO CONDUCT LEAD ACTIVITIES
- APPLICATIONS MUST BE SUBMITTED ALONG WITH EXPERIENCE AND EDUCATION REQUIREMENTS
- TEXAS HAS CERTIFIED OVER 1,000 PERSONS AND FIRMS





TRAINING

- TRAINERS MUST SUBMIT AN APPLICATION FOR ACCREDITATION
- TEXAS HAS ACCREDITED 34 LEAD TRAINERS
- TO BECOME CERTIFIED, COURSES MUST BE TAKEN FROM AN ACCREDITED TRAINER



NOTIFICATION

- TDH MUST BE NOTIFIED 10 DAYS BEFORE LEAD ABATEMENT IS CONDUCTED
- A NOTIFICATION FORM MUST BE COMPLETED FOR EACH PROJECT
- A FEE OF $50 IS ASSESSED FOR EACH PROJECT

COMPLIANCE & ENFORCEMENT

- TDH INSPECTORS CONDUCT SITE VISITS DURING ABATEMENT JOBS
- PROVIDE TECHNICAL ASSISTANCE TO THE PUBLIC RELATING TO ABATEMENT & PUBLIC HEALTH
- PARTICIPATE IN SETTLEMENT CONFERENCES AND ADMINISTRATIVE HEARINGS



ENVIRONMENTAL LEAD SURVEILLANCE SECTION

- PERFORM INSPECTIONS WHEN A CHILD HAS AN ELEVATED BLOOD LEAD LEVEL
- MAINTAIN X-RAY FLUORESCENCE ANALYZERS (XRFs)
- PROVIDE TECHNICAL ASSISTANCE RELATING TO LEAD EXPOSURE FROM THE ENVIRONMENT



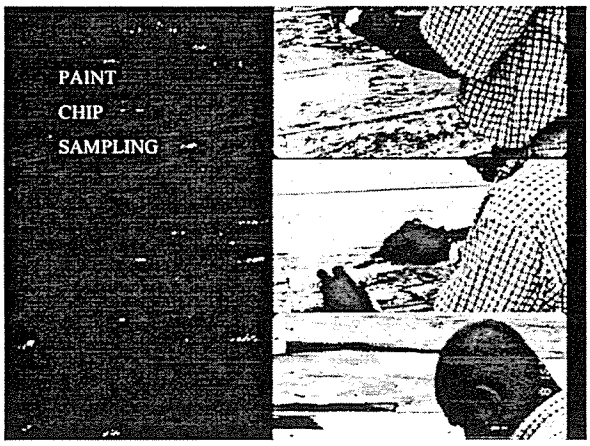
PUBLIC INFORMATION

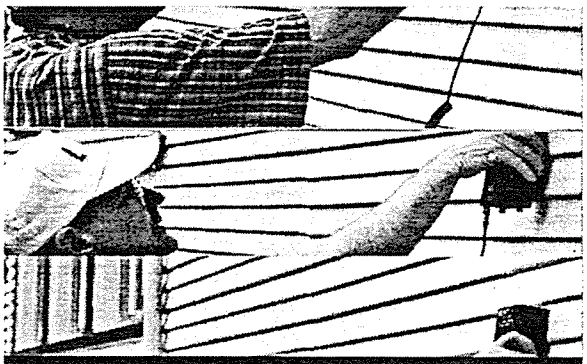
- PROVIDE TECHNICAL ASSISTANCE RELATING TO LEAD
- PARTICIPATE IN TRADE SHOWS AND HEALTH FAIRS
- MAINTAIN BRANCH WEB PAGE AT http://www.tdh.state.tx.us/bch/web.htm



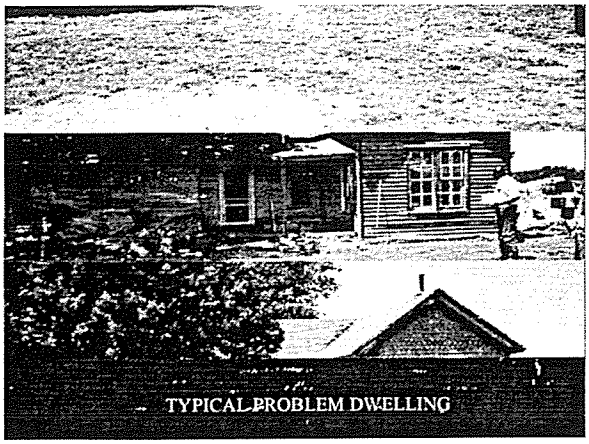
LEAD-BASED PAINT IN POOR CONDITION

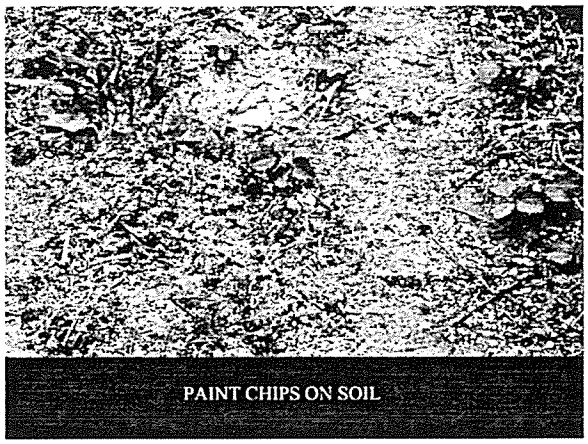
PAINT CHIP SAMPLING





X-RAY DIFFRACTION TESTING


TYPICAL PROBLEM DWELLING


PAINT CHIPS ON SOIL

TDH
HAZARD
COMMUNICATION
BRANCH
T D H

Hazardous Chemical Right-to-Know

Right-to-Know Includes

- Hazardous Chemical Inventory Reports for community planners, emergency responders and citizens
- Hazardous Chemical information, training and protective equipment for public employees

About Hazardous Chemicals

- > 650,000 in use today
- Defined as physical or health hazard
- Facilities may store large quantities
- Possibility for accidents







Emergency Planning & Community–Right-to-Know Act (EPCRA)

Requirements:

- Emergency Planning
- Emergency Notification
- Toxic Chemical Release Reporting
- Community Right-to-Know Reports





Community Right-to-Know in Texas

- 1986, Texas Department of Health, Hazard Communication Branch was designated to chemical inventory reports
- 1988, Texas Tier Two reporting requirements added to existing state law
- 1993, Law revised into three Texas Community Right-to-Know Acts (TCRAs)

Texas Tier Two Report

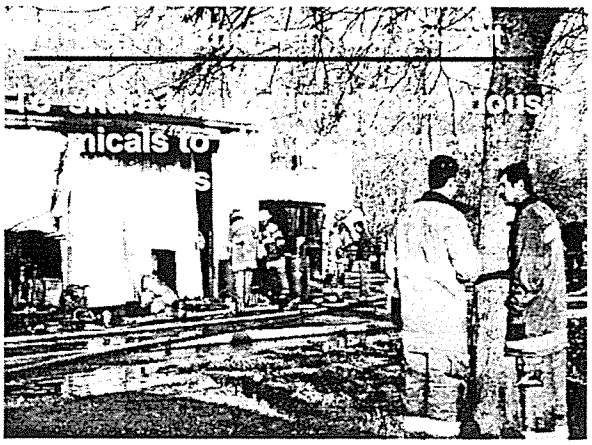


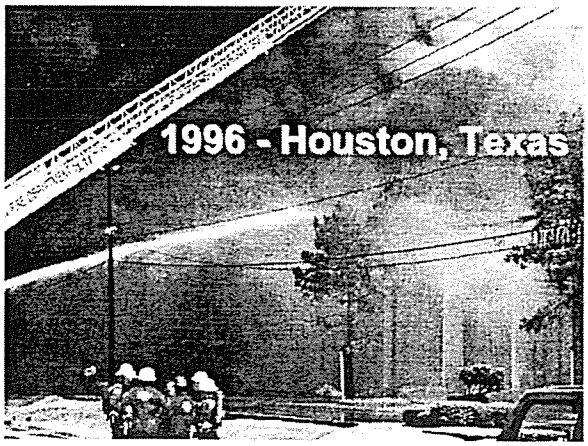
- an annual chemical inventory
- submitted by facilities which store significant quantities of hazardous chemicals

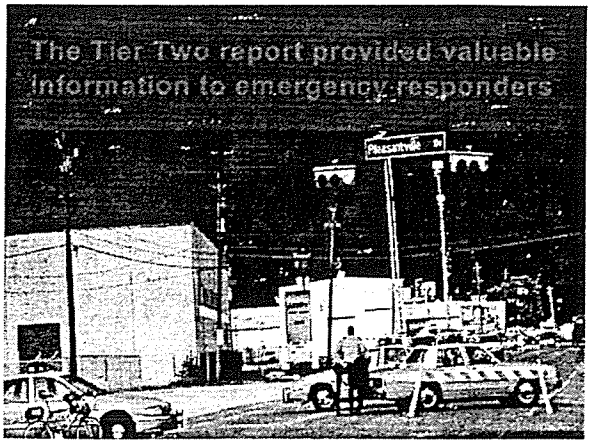
Information is shared with

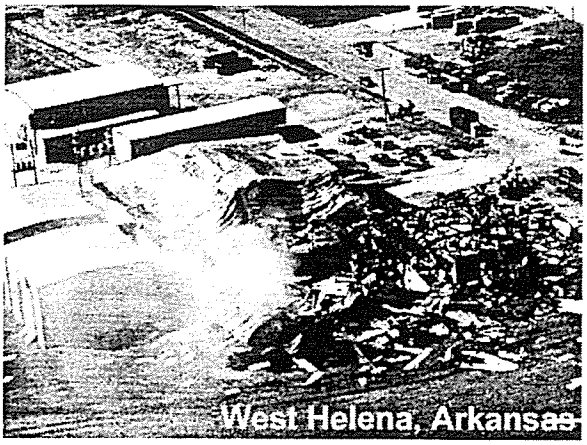
- state/local emergency planners
- emergency responders
- interested citizens

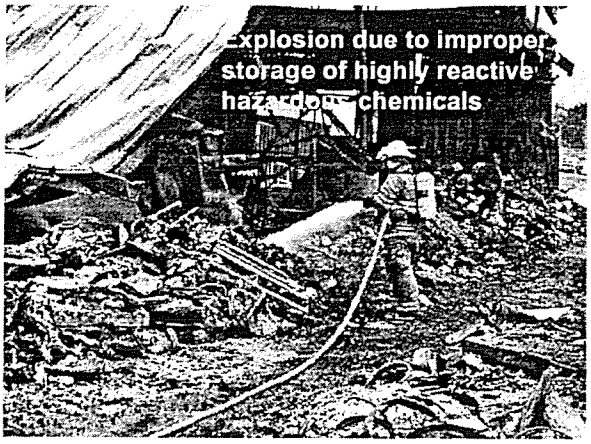














TDH

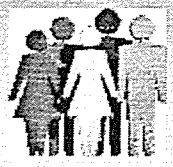
Hazard Communication Branch

Telephone Hotline

TDH
INDOOR AIR
QUALITY BRANCH

T D H

The EPA ranks indoor air pollution among the top five environmental health risks to the public.



There are approximately 3,500 to 6,500 deaths annually attributed to exposure to indoor air pollutants.



Why IAQ Problems Today?

- More time spent indoors - 90%
- Tighter buildings
- New products/chemicals

Indoor Air Quality Program

Consultative

Customers

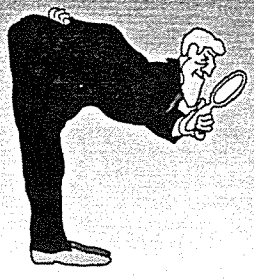
- Public Schools
- State & Local Agencies
- Health Departments
- Private Residents
- Small Business

INFORMATIONAL ASSISTANCE

Answer questions regarding health hazards of air contaminants, their sources, and possible remedial actions.

- Fact Sheets.
- Public seminars and meetings.
- Information on other resources.

ON-SITE INVESTIGATIONS

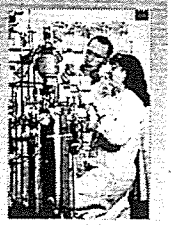


- Interview building occupants
- Survey for possible pollution sources
- Collection of samples for lab analysis
- Recommend solutions
- No charge

LABORATORY IAQ SAMPLES

- Formaldehyde
- VOCs
- Pesticides
- Mold
- Dust

1700 Samples



IAQ surveys performed in 1997

- 28 Public schools
- 112 Public Building
- 85 Residences







IAQ GUIDELINES FOR PUBIC SCHOOLS

- VOLUNTARY
- Provide general directional guidance
- Covers the major conditions that affect IAQ in schools.

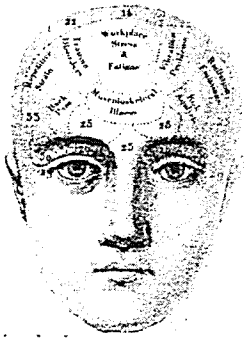
EXPECTED RESULTS OF GUIDELINES

- Better health
- Higher attendance
- Improved learning environment
- Higher test scores

TDH
INDUSTRIAL
HYGIENE BRANCH

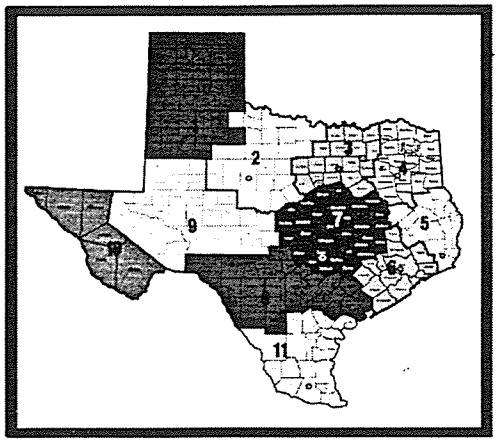
T D H

INDUSTRIAL HYGIENE



INDUSTRIAL HYGIENE ***(A SCIENCE and an ART),*** **Devoted to** the *anticipation*, ***recognition, evaluation, and control*** of those environmental factors or stresses arising in or from the workplace that may cause sickness, impaired health and well-being, or significant discomfort among workers or among the citizens of the community.

INDUSTRIAL HYGIENISTS, Occupational health professionals concerned primarily with the ***control of environmental stresses*** or ***occupational health hazards*** that arise as a result of or during the course of work.



Primary Concern --

Solving Occupational Health Problems

Three-Step Approach:

1) Recognition of the Problem,
2) Evaluation of the Environmental Factors, &
3) Application of Control Measures.

TERMINOLOGY

Many extremely *toxic* compounds are used daily in the occupational environment completely without *hazard*.

Distinction between *toxicity* and *hazard* is very important.

The *toxicity* of a substance describes the nature, degree and extent of undesirable effects.

Hazard **describes the likelihood of this toxicity to affect a human (a worker).**

MORE TERMINOLOGY

In evaluating the *hazard* of a particular substance, it is necessary to know:
its *toxicity*, its physical and chemical properties, & the manner and quantity in which it is to be used.

These factors which determine how much enters the body, by what route, how frequently and for how long -- all of which can be described simply as ***EXPOSURE.***

Possiblities: (depending on *EXPOSURE)*

High degree of *hazard* with a low order of *toxicity;*

Low degree of *hazard* with a high order of *toxicity.*

Three-Step Approach:

I. Recognition -- become familiar with the operations of interest in the occupational environment.

II. Evaluation -- P*reliminary* and E*nvironmental Surveys* are used to evaluate the existing environmental conditions.

EVEN MORE TERMINOLOGY

Understanding the toxic nature of chemicals encountered is useful in interpreting the degree of hazard.

Also, distinguish between *acute & chronic* toxic effects.

Sudden exposure to high concentrations may lead to immediate *acute* effects (such as asphyxia, unconsciousness, burning of the eyes, fits of coughing, etc.)

Chronic effects arise from repeated exposure to low concentrations (and may not become obvious for months or years, i.e., asbestosis, silicosis, etc.)

II. Evaluation --

A. Preliminary Survey:

a) scopes the extent of work needed,
b) documents important environmental conditions, &
c) reviews:
  (1) raw materials, products and by-products,
  (2) sources of air contaminants,
  (3) types of physical agents, and
  (4) control measures in use.

Environmental samples must represent the worker's exposure or the condition to be evaluated.

The INDUSTRIAL HYGIENIST must decide:

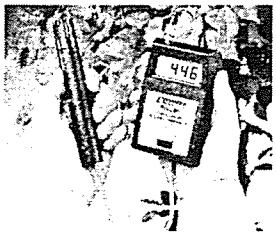
(1) where to sample
(2) what to sample
(3) sample duration
(4) number of samples
(5) sampling period (i.e., day or night, summer or winter).

1. Types of Field Sampling Instruments

The choice of a particular sampling instrument depends upon a number of factors including:

(1) whether grab or continuous samples are needed,
(2) portability and availability,
(3) efficiency of the instrument or method, &
(4) reliability of the equipment under various field conditions.

PRELIMINARY SCREENING

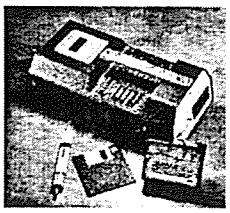


TEMPERATURE and RELATIVE HUMIDITY

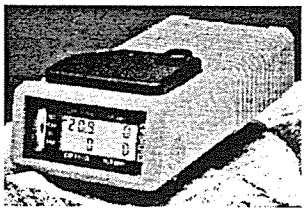


DETECTOR TUBES

ATMOSPHERIC MONITORING



MERCURY ANALYZER



MULTI-GAS METER
Oxygen, Carbon Monoxide, Hydrogen Sulfide, Combustible Gases

ORGANIC COMPOUND DETECTION

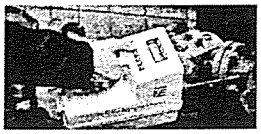


PHOTO IONIZATION

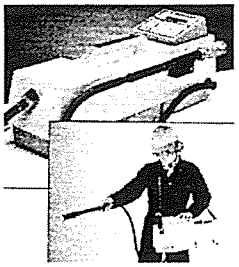


FLAME IONIZATION

AIR SAMPLING



DUST



VOLATILE ORGANIC COMPOUNDS (VOCs)

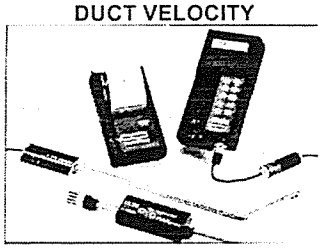
VENTILATION ANALYSIS

VOLUMETRIC FLOW



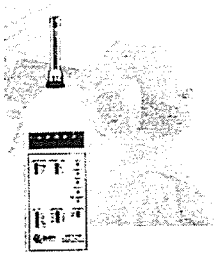
BALOMETER

DUCT VELOCITY

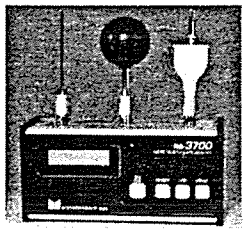


THERMOANEMOMETER

PHYSICAL AGENT ANALYSIS

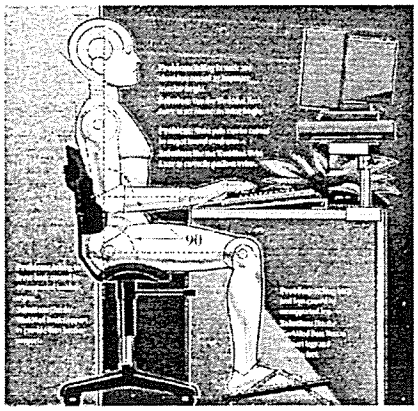


NOISE MONITORING



HEAT STRESS MONITORING

ERGONOMICS





2. *Comparison of Results with Standards* with accepted occupational health standards such as:

- American Conference of Governmental Industrial Hygienists (ACGIH)
- Occupational Safety & Health Administration (OSHA)
- American National Standards Institute (ANSI)
- National Institutes of Occupational Safety and Health (NIOSH)
- American Industrial Hygiene Association (AIHA)
- National Academy of Science-National Research Council (NAS-NRC)
- Threshold Limit Value (TLV), Ceiling Values
- Permissible Exposure Limits (PEL)
- Time-Weighted Average, Ceiling Values
- Time-Weighted Average, Short-Term Limits
- Emergency Exposure Limit, Hygienic Guides
- Short-Term Public Limits, Public Emergency Limits

3. *Interpretation of Results* -- final step in evaluating the environment is interpretation of results.

Before the decision is made that an individual or group of workers is exposed to a hazard(s) injurious to health, the following facts should be known:

(1) nature of the chemical or physical agent,
(2) intensity and duration of exposure,
(3) the susceptibility of the person(s) exposed.

III. Control Techniques -- After survey completion and the results calculated are compared with appropriate standards, the decision must be made as to the need for environmental controls.

The types of controls and practical examples from several industries are classed into 8 categories:

- *Substitution*
- *Isolation*
- *Enclosure*
- *Local Exhaust Ventilation*
- *Dilution Ventilation*
- *Wet Methods*
- *Good Housekeeping*
- *Personal Protective Devices*

SUMMARY

Whether the occupational environment is a hazard to workers can only be determined after a *detailed environmental survey*.

Thoughtful *interpretation of results* in relation to many factors, including acceptable concentrations, should be done prior to recommending *control techniques*.

The *control methods* cover, in one form or another, substitution, isolation, enclosure, local exhaust ventilation, dilution ventilation, wet methods, good housekeeping, and use of personal protective devices.

ADDITIONAL PROGRAMS ADMINISTERED BY THE IH BRANCH

• TOXIC SUBSTANCES CONTROL ACT PROGRAM
(Under EPA Contract -- Enforces Federal TSCA Regs)

-- PolyChlorinated Biphenyls [PCBs]

-- Asbestos Hazard Emergency Response Act [AHERA] (better known as the "Asbestos in Schools Rule")

• MEDICAL WASTE TREATMENT TECHNOLOGY REVIEW PROGRAM

-- Texas Marketing Approval for Manufacturers

TDH
ENVIRONMENTAL
TOXICOLOGIST

T D H



Toxicology most simply is :
the Study of Poisons and Poisoning

Purpose

-Anticipate Hazards
-Recognize Hazards
-Evaluate Exposures
&
-Help Eliminate and Control Exposures





Environmental Health Toxicologist

...and a Bit More

Toxic Substance Control Division
Keller A. Thormahlen, MS

Activities

-Provides toxicological and biomedical support for central office and regional TDH staffs

-Answers requests for information and responds to concerns from citizens, public employees, and other health authorities

-Performs field investigations independently and in workgroups

Toxic Substances Control Division

Hazard Communications

Industrial Hygiene

Asbestos Programs

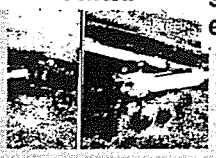
Indoor Air Quality

Environmental Lead

Local Emergency Planning Committees- LEPC's
- Identifying Hazardous Chemical Risks
- Educating the Communities about Chemical Risks
- Planning for Chemical Releases to Reduce Injuries and Deaths

LEPC
HOUSTON

Truck carrying acid crashes near Sonora



Interstate spill leads to evacuation

Natalia fire dies; residents go home

Toxic metal cleanup rattles Texarkana

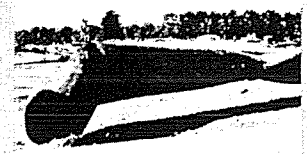


Emergency Responders
Firefighters
Citizens in Communities

I-10 expected to be closed another two days because of spill







3 Major Pipelines Released
Unleaded Gasoline
Diesel
Crude Oil



With Lots of
Smoke
and Oily Soot

Mercury found in beauty cream

MMWR

MORBIDITY AND MORTALITY WEEKLY REPORT

Mexican beauty cream linked to mercury poisoning in U.S.

Calomel Beauty Cream Poisonings Discovered by Environmental Health Investigators

Beauty product poses threat

Health department links face cream to 2 poisoning cases

Mexican beauty cream "Manning" causes mercury poisoning to county residents

Accent ON HEALTH

Lead Hazards
to Children from
Imported Vinyl Miniblinds



~~Blinds only latest~~
in lead dangers

John A. Jacobi
Chief, Bureau of Environmental Health
Texas Department of Health
(512) 834-6640
jjacobi@tdh.state.tx.us

Mr. Jacobi has been with the Texas Department of Health since October, 1996, when he assumed responsibility for the Bureau of Environmental Health. The Bureau's largest Division - Toxic Substances Control - is comprised of the Asbestos Program, the Lead Program, Indoor Air Quality, Industrial Hygiene, Hazardous Communication and Environmental Toxicology. In addition, the Bureau includes the General Sanitation Division (Institutional Sanitation & Vector Control, Summer Youth Camps, Pools & Spas, Migrant Labor Housing, Public Lodging, and Sanitarian & Code Enforcement Officer Registration) and the Product Safety Program (Hazardous Consumer Products, Playground Safety, Field Investigations, Inhalant Abuse, and Bedding).

Immediately prior to joining the Texas Department of Health, Mr. Jacobi was an independent legal and environmental consultant. His background includes several years as a private environmental consultant specializing in site characterization and remediation, major project management, Natural Resource Damage Assessment, and business development; several years managing various technical, strategic and environmental functions for a large diversified multinational public corporation; several years as in-house environmental and safety counsel to an interstate natural gas pipeline company and its parent; and ten years with the U.S. Army Materiel Command including five years as Chief Engineer at the largest small arms ammunition plant in the free world.

Mr. Jacobi is a Registered Professional Engineer and a licensed Attorney in both Texas and Florida. He has been a member of the ABA Section of Natural Resources, Energy and Environmental Law for almost 20 years. He is also a member of the ABA Section of Law Practice Management, the Environmental and Natural Resources Section of the Texas Bar and the Environmental and Land Use Law Section of the Florida Bar.

A former Presidential Exchange Executive, Mr. Jacobi received his Bachelor of Science in Mechanical Engineering (with Honors) from Rose-Hulman Institute of Technology, his Master of Science in Industrial Engineering from Texas A & M University, and his Juris Doctorate from the University of Missouri - Kansas City.

Mr. Jacobi currently represents the Texas Department of Health on the Texas Groundwater Committee and the Kelly Air Force Base Restoration Advisory Board. In his spare time, he enjoys flying, golf and bridge.

T D H
TEXAS DEPARTMENT OF HEALTH

The Texas Environmental Lead Reduction Rules (TELRR) were promulgated by the Texas Department of Health (TDH) on February 19, 1996. These rules cover several areas of lead-based paint activities in target housing (housing constructed prior to 1978), including the training and certification of persons conducting lead inspections, risk assessments, abatements, and project design. The rules require that lead training providers be accredited by the TDH and also set standards for conducting lead-based paint activities. On May 10, 1998, the rules were amended to also require that lead activities performed in child-occupied facilities such as day cares, preschools, kindergarten classrooms, and possibly other structures be conducted by certified persons.

The purpose of the Texas Environmental Lead Reduction Rules is to establish the means to control and minimize public exposure to lead by regulating lead-based paint activities in target housing and child-occupied facilities. As a result of the TELRR, it will now be possible for all Texans to utilize properly trained and certified persons to conduct lead activities in their pre-1978 homes, and owners of child-occupied facilities will be required to use certified persons. By using trained and certified persons, one can be sure that the lead activities are being conducted properly, and that both children and adults are protected from exposure to lead. TDH has certified over 1,000 persons and firms to conduct lead activities, so properly qualified persons and firms should be available statewide.

Approximately 220,000 housing units in Texas have chipped and peeling lead-based paint or elevated dust levels that are occupied by children under 7 years of age. Families who are renovating older structures and low-income families living in dilapidated housing are especially at risk, and parents and homeowners can unintentionally poison children by disturbing lead-based paint when renovating.

The rules require that all lead-based paint activities in target housing and child-occupied facilities be performed by certified individuals. Exclusions to the rules are housing for the elderly or persons with disabilities, unless a child younger than six years of age resides or is expected to reside in that housing, nor do the rules apply to target housing with zero bedrooms. These rules also do not apply to homeowners performing lead-based paint activities in dwellings which they own, unless the dwelling is occupied by a person or persons other than the owner or the owner's immediate family while the lead activities are being performed.

For more information concerning the Texas Environmental Lead Reduction Rules or to obtain a list of certified persons and firms, please contact the Texas Department of Health's Environmental Lead Branch at (512) 834-6612 or 1-888- 778-9440, or access our home page at http://www.tdh.state.tx.us/beh/web.htm.

TDH
TEXAS DEPARTMENT OF HEALTH

Texas Department of Health

William R. Archer III, M.D.
Commissioner of Health

http://www.tdh.state.tx.us

1100 West 49th Street
Austin, Texas 78756-3199
512/ 458-7111

Patti J. Patterson, M.D., M.P.H.
Executive Deputy Commissioner

NEW ASBESTOS RULES IN THE WORKS FOR ADOPTION IN FALL 1998

TDH has proposed rule changes implementing the Texas Asbestos Health Protection Act, 25 TAC §295.31 et. seq., that would bring the Texas asbestos rules in line with the EPA Model Accreditation Plan (MAP), 40 CFR Pt. 763, Subpt. E, App. C, in order for Texas to obtain EPA delegation for its asbestos program. The MAP currently requires that persons working in both commercial and public buildings as asbestos workers, contractors/supervisors, inspectors and designers take accredited (approved) training courses that cover specific topics. Currently the Texas asbestos rules require that asbestos personnel only in public buildings take accredited courses. Under the proposed rule changes, personnel working in commercial buildings would also have to take accredited asbestos training courses.

The TDH proposed rules were published in the *Texas Register* on May 29, 1998 followed by a 30 day comment period and a series of public hearings. The comments are currently under review. The proposed final rules will be submitted to the Board of Health in September and, if approved, should become final in October after publication in the *Texas Register*. The proposed changes are consistent with EPA rules already in place and do not impose any requirements more stringent than federal law on those performing asbestos activities in commercial buildings. There are been considerable public support for the proposed rules.

Under the new rules, all asbestos work in commercial as well as public buildings must be done by personnel who have completed accredited courses to ensure proper training. The rule changes do not affect state licensing requirements. Asbestos work in public buildings must continue to be done by personnel who are licensed by TDH. Asbestos personnel working exclusively in non-public buildings do not have to be licensed by either TDH or EPA.

The new rules will allow TDH inspectors to verify that asbestos personnel working in commercial buildings have proper training by asking them to produce copies of accreditation certificates. TDH currently inspects commercial buildings to determine NESHAP compliance with various asbestos work practice standards. Commercial buildings are broadly defined by EPA to include virtually all buildings that are not public. Federal government buildings and industrial buildings where industrial or manufacturing operations occur are included. Also, under the new rules, TDH will be able to accredit trainers and courses without requiring the training providers to seek approval in another state as is now the case.

TDH believes that the proposed rules make the following positive changes:

-lower costs related to training because of in-state approval
-clarification of the rules including new definitions
-reduced TDH notification fees from $10,000 to $3,000 per project
-responsibility for notifying TDH of asbestos projects to become the duty of the asbestos abatement contractor as well as the building owner.

For further information on the asbestos rules, contact the TDH Asbestos Branch at 512-834-6610.

CISS/Doc 44862

CAROLYN WRIGHT

Litigation Section, Office of General Counsel
Texas Department of Health
(512) 458-7236
carolyn.wright@tdh.state.tx.us

Ms. Wright has been practicing law since 1984 with a focus on environmental, land use and public health issues. She has been with TDH since September, 1997 and works primarily with the Bureau of Environmental Health which enforces statutes on asbestos, lead based paint, hazard communication and community right to know laws. She is also involved with programs regulating indoor air quality, industrial hygiene, medical waste and general sanitation. Ms. Wright provides counseling to TDH programs on enforcement issues, participates in rulemaking, and represents the agency in administrative hearings before SOAH and the Office of Hearings Examiners.

Before joining TDH, Ms. Wright was the Director of Environmental Affairs at the University of Texas System and was with the Austin firm of Bickerstaff, Heath and Smiley. Before moving to Austin in 1991, Ms. Wright worked for the EPA in New York City where she focused on Clean Air Act and Superfund cases.

Ms. Wright is licensed to practice in Texas, New York and New Jersey. She has written on a wide variety of environmental topics and has spoken at several conferences in Texas and New York.

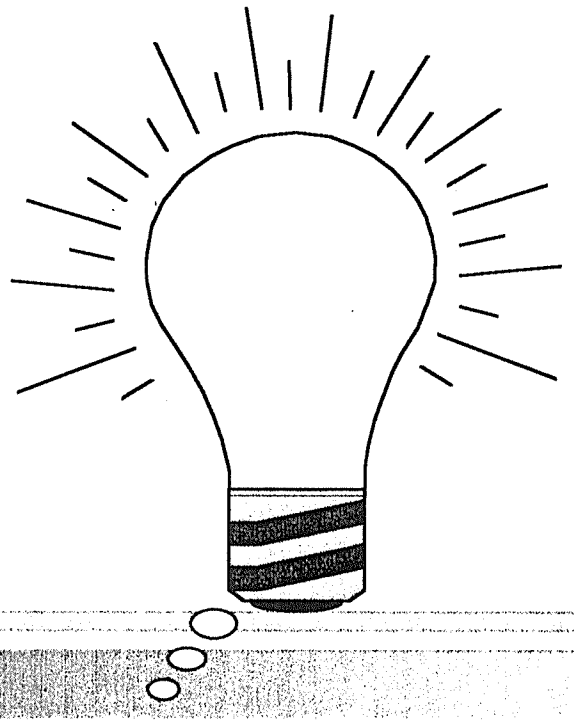
A *cum laude* graduate of Pace University School of Law in White Plains, N.Y., Ms. Wright has an undergraduate English degree *cum laude* from the University of California, Santa Barbara.

STRATEGIES FOR ENVIRONMENTAL PERMITTING AND ENFORCEMENT

MARTHA MARTIN

Strategies for Environmental Permitting & Enforcement

Martha H. Martin, P.E.
Martin Environmental Group
Houston, TX



GOALS OF THE PERMIT NEGOTIATOR:

- Project Positive Environmental Image
- Maximize Operational Flexibility
- Enable Comfortable Compliance
- Minimize Costs

NEGOTIATIONS STRATEGY:

- Identify Objectives & Evaluate Risk
- Use A Win-Win Style
- Help Write the Draft
- Persistently Negotiate Final Specifics
- Ensure Compliance is Possible Before Issuance

'WIN-WIN' STYLE

- Building Trust
- Gaining Commitment
- Managing Opposition

<u>Goal: Acceptable</u>

<u>Gain By All Parties</u>



SEP: SUPPLEMENTAL ENVIRONMENTAL PROJECT

- TNRCC developed "as an innovative approach to resolving enforcement actions"
- Program Goal: Direct Environmental Benefit to The Local Community

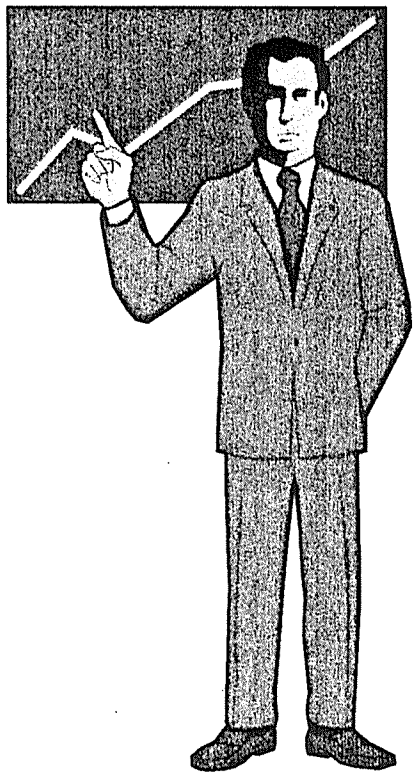


WHO IS ELIGIBLE?

- "A respondent in an enforcement action may negotiate an agreement to perform a SEP in return for a reduction in the administrative penalty."
- The "respondent" could be an industry or a government entity

WHY PERFORM A SEP?

- An alternative to paying penalties that could be reportable to stockholders
- Enhance community rapport
- Generate positive publicity
- Trademark protection



KEY FEATURES OF A SEP

- Up to 50% penalty reduction for industry;
  Up to 100% for governmental entity
- 1:1 ratio for direct benefit projects
- Higher ratios for indirect benefits or projects which directly benefit owner
- Not available to achieve legal compliance
- Preference for local community

SIX TYPES OF SEP's

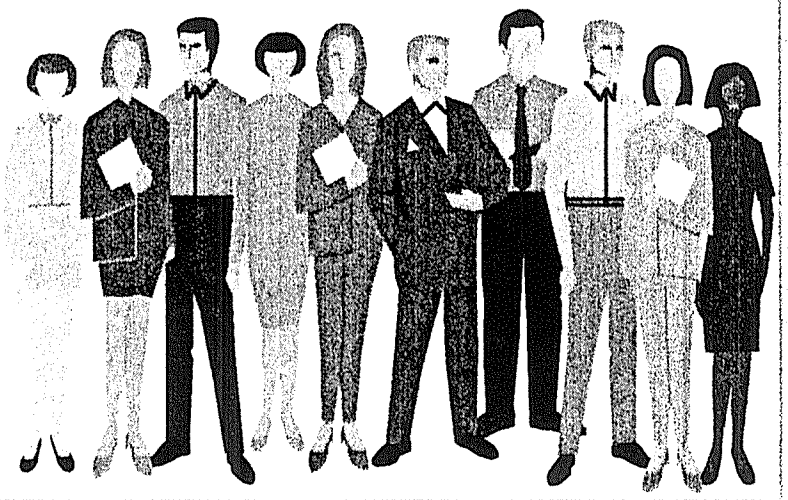
- Pollution prevention or remediation
- Environmental restoration (beyond repair) to enhance environment in vicinity of the respondent's facility
- Technical assistance to other TNRCC regulated entities faced with hardship

SIX TYPES OF SEP's

- Environmental education/engineering assistance to regulated community or public
- Funding public works for a nearby city beyond ordinary compliance
- Projects to clean up illegal municipal or industrial solid waste dumps

DIRECT ENVIRONMENTAL BENEFIT EXAMPLES:

- Household Hazardous Waste Drop-off
- Donation to 3rd Party Cleanup Effort
- Development of Closed Loop to Reduce Waste Generation
- Park or Beach Cleanup

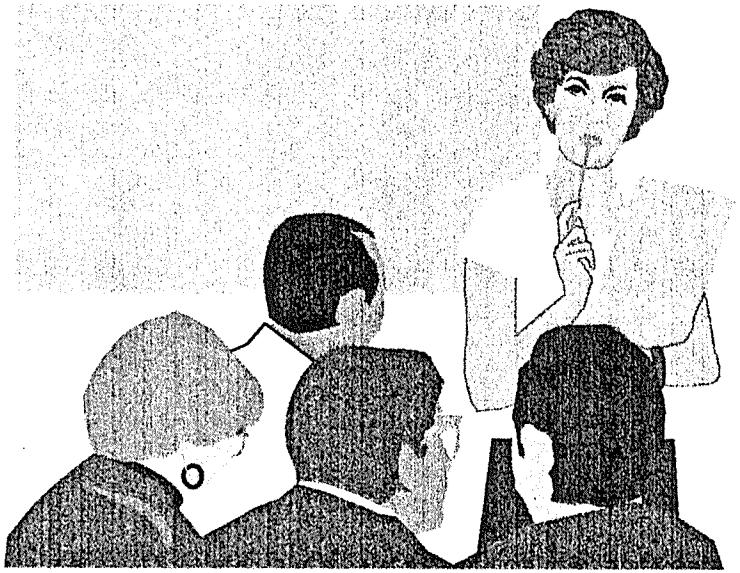


3rd PARTY SEP PROJECTS

- Nature Conservancy replacement of damaged or destroyed ecosystems
- Scenic Galveston re-establishment of wetlands along I-45 South
- County Rural Housing Office grants to low income families to upgrade on-site septic
- Harris County Inmate Bayou Cleanup

SUCCESS FORMULA

- Development of a sound project
- Buy-in from your management
- Time and leadership commitment
- Local involvement
- TNRCC approval



MARTIN ENVIRONMENTAL GROUP

1121 Cheshire Lane, Suite 100
Houston, TX 77018

Telephone: (713) 957-3337
Facsimile: (713) 957-4028
e-mail: mhmpe@wt.net

August 5, 1998

Welcome Texas Environmental Superconference Participant!

Martin Environmental Group is proud to participate in the 10th Annual Texas Environmental Superconference to be held August 6-7, 1998 in Austin, TX. This event consistently draws 300-400 environmental attorneys, engineers, regulators, industry personnel and other environmental stakeholders.

I would like to take this opportunity to introduce Martin Environmental Group to you. We offer the following environmental engineering services to attorneys, industry and government:

- **Environmental compliance audits**
- **Multimedia engineering studies, assessments and reports**
- **Environmental permitting and enforcement negotiations**
- **Environmental training and presentations**
- **Start-up and trouble-shooting for pollution control system operations**
- **Business development and marketing for environmental projects**
- **Pollution control tax abatement assistance**
- **Planning and implementation of TNRCC's Supplemental Environmental Projects**
- **Expert witness testimony and forensic engineering**

Martin Environmental Group offers a full complement of environmental professionals to meet a broad range of projects. Our Group provides multimedia consulting expertise to meet industry's needs for air, water, wastewater, solid and hazardous waste needs at a reasonable cost. We are particularly skilled at planning and executing technical projects within time and budget constraints.

As a Principal of Martin Environmental Group, I have attached a copy of my resume detailing my qualifications and experience. I have extensive experience working with legal professionals, including permit and enforcement negotiations, compliance audits, forensic engineering services and expert witness testimony in trial and during arbitration proceedings. I will be happy to provide references from attorneys and Fortune 500 clients regarding these experiences.

I hope you enjoy and benefit from this year's Superconference on beautiful Town Lake. Please feel free to visit with me at the Superconference, or call (713) 957-3337 to discuss opportunities to be of service to you.

Sincerely,

Martha H. Martin

Martha H. Martin, P.E.

PROFESSIONAL PROFILE

Martha H. Martin, P.E.

1121 Cheshire Lane, Suite 100
Houston, Texas 77018
Telephone: (713) 957-3337
Facsimile: (713) 957-4028, E-mail: mhmpe@wt.net

REGISTRATION:

Professional Engineer in States of Texas and Florida
Corrective Action Project Manager in State of Texas

EDUCATION:

University of Notre Dame, M.S. Environmental Health Engineering
Civil Engineering Research Grant Recipient from USEPA

Western Kentucky University, B.S. Environmental Science
Magna Cum Laude Graduate & Scholarship Recipient

Continuing Education, Project & Business Management, Marketing & Presentations, Computer Software, Team Building, Interpersonal Skills, Air Permitting & Environmental Auditing Courses

HONORS:

1998 Award for outstanding service as 1997-98 WEAT President
1992 Gascoigne Medal from the Water Environment Federation for design excellence
1988 Outstanding Performance Award from Camp Dresser and McKee, Inc.

PROFESSIONAL EXPERIENCE:

Principal, Martin Environmental Group
Houston, Texas

♦ Environmental consulting services provider to municipal and industrial concerns. Projects include permit negotiations, compliance strategies, project development and implementation for various industrial clients. Strategic teaming and business development activities have resulted in successful completion of joint venture projects.

Senior Engineer with The Coca-Cola Company's Minute Maid Division, Corporate Headquarters
Houston, Texas

♦ Environmental Responsibilities for Eleven Manufacturing Plants in five states, Canada & Puerto Rico. Projects include wastewater treatment, design & engineering; hazardous waste, solid waste & recycling; evaluation, selection & contracting of technical consultants; and environmental permit negotiations. Team leader for strategic planning & environmental budgets exceeding $5 million annually with goal of proactive solutions to eliminate or reduce environmental risk, resulting in cost avoidance and trademark protection. Due Diligence and Environmental Compliance Audits were completed in accordance with certified training. Multiple real estate transactions included continuing UST remediation projects. Customized Environmental Training for Associates was developed and conducted at both plant and corporate levels. Responsibilities included Program Development for Clean Air Act Compliance to address Title V and PSD. Emission inventories were completed, followed by operating permit application, cost analyses and strategy development to reduce impact of regulations. Initiated Solid Waste Management Program Division-wide to: track and properly handle hazardous/nonhazardous waste and unsaleable product resulting in cost reduction, reduced Superfund risk and maximized recycling revenues. Routinely Teamed with Other Departments such as Packaging and Quality to achieve environmental goals for the Division.

Project Manager with ERM-Southwest, Inc.
Houston, Texas

♦ Business Development Responsibilities included writing $1.3 million in priced proposals to existing and prospective industrial clients. Resulting contract awards exceeded $1 million, including significant follow-on work and repeat client business. 1992 Engineering Management and Technical Direction of 28 industrial projects worth over $730K involved site investigation & remediation. wastewater treatment

design, regulatory compliance and waste management. Effective team leadership resulted in On Time/Within Budget products of consistently high quality. Pollution Prevention Plans were completed for power/ petrochemical industries in accordance with SPCC, OPA, NPDES Storm Water, US Coast Guard and Texas GLO regulations. RCRA Part B Permit Amendments were prepared for petrochemical clients, followed by strategy development for lagoon closure and alternative treatment systems. EPA NPDES (including 1990 Storm Water Regulations) & State Permits for more than 30 industrial sites required the preparation of applications & amendments, including technical representation during permit and enforcement negotiations.

Project Manager with Camp Dresser and McKee, Inc.
Austin, Texas

- Business Development and Management Accomplishments included proposal preparation and presentations for municipal and industrial water and wastewater projects. Preliminary and Final Design for a series of municipal wastewater plant expansions from 18 to 38 to 60 MGD for Austin, TX. Project responsibilities included plant hydraulics, process design & equipment selection, direction of engineers/drafting and bid document preparation. Innovative Conversion of Sludge Thickening Operations Provided High Value in terms of cost effectiveness, improved performance & ease of operation for Austin, TX. Project earned a national design and operating award, and has been showcased on public tours. Forensic Engineering, Including Expert Witness Courtroom Testimony, for development of technical strategies, hydraulic and constructability analyses on behalf of several clients. Feasibility Study at EPA Superfund Site with affected soil and ground water required development of and cost estimates for remediation alternatives.

Project Engineer with PQA Engineering Company
Riverdale, New Jersey

- Design of Wastewater Treatment Facilities for 0.1 - 14 MGD plants including: influent/effluent pumping, septage and sludge handling facilities, flow equalization, odor control, disinfection & chemical feed systems. Construction services were provided. Sewer System Rehabilitation for Newark, DE required preparation of plans and specifications for inspection, *air* testing, sewer repair and replacement Financial Management Projects included team direction in design and implementation of Rate Study to recover $10 million in annual user charges from 16 communities receiving services in Cape May County, New Jersey.

PUBLICATIONS AND PRESENTATIONS:

- "Strategies for Environmental Permitting and Enforcement", 10th Annual Environmental Superconference, Austin, TX, 1998.
- "Supplemental Environmental Projects", 15th Annual Gulf Coast Environmental Management Symposium, Houston, TX, 1998.
- "Environmental Programs Implementation Course", Internal training program presented to management and plant personnel at Coca-Cola corporate and operating levels, 1994-96.
- "Zen and the Art of Permit Negotiation", National Food Processors Association Annual Engineering Conference, Santa Fe, NM, 1996.
- "EPA's New Storm Water Regulations: Strategies for Group, Individual and General Permit Coverage for Industries", Water Environment Association of Texas Annual Conference, Dallas, TX, 1992.
- "More Mileage from Gravity Sludge Thickeners", Water Environment and Technology, July, 1991.

PROFESSIONAL ASSOCIATIONS:

Water Environment Federation
Water Environment Association of Texas President (1997-98)
Pretreatment Streamlining Committee (1996-97)
Annual Solid and Hazardous Waste Management Symposium
Program Chair (1992 and 1993) and Conference Chair (1994)

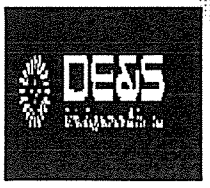
References And Detailed Experience Summary Available Upon Request

The Use of Modeling in Environmental Cases

Jerry Grisak

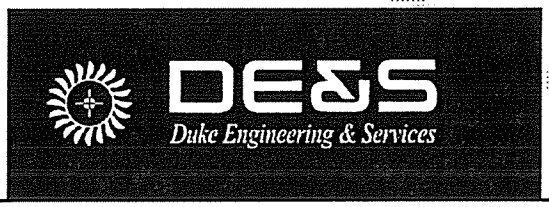
The Use of Modeling in Environmental Cases

Gerry Grisak
Tricia Johnson
John Avis
Duke Engineering & Services
9111 Research Boulevard
Austin, Texas 78758
512-425-2000



The Use of Modeling in Environmental Cases

Gerry Grisak
Tricia Johnson
John Avis



Modeling in Litigation

- Who's cheating who
  - which model is more representative (nobody's 'right')
- Who's being true
  - consistent with external data & observations
- Who's doing right
  - internally consistent: from one model representation to another: eg. parameters and scaling methods
- Who don't even care anymore
  - baffled juries and crusty experts

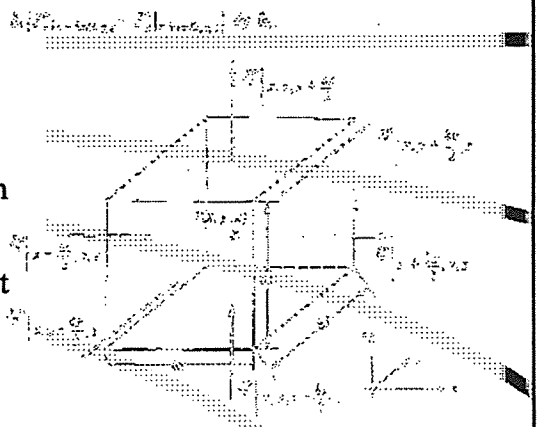


•Modeling

- Scientific
- Engineering
- Regulatory
- Litigation

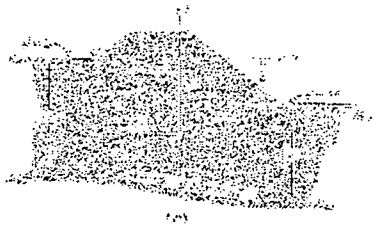
Scientific Modeling

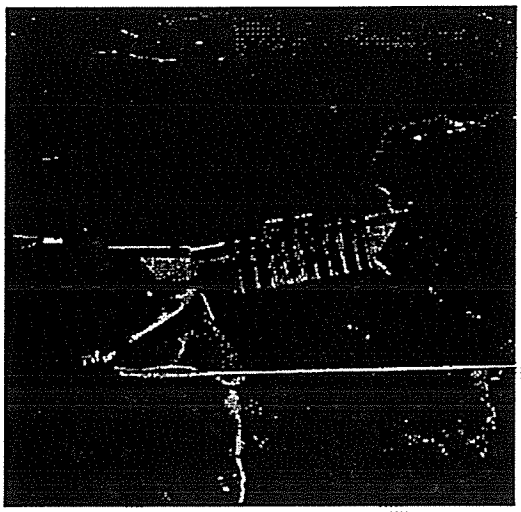
- Processes
- Constitutive relationships
- Conservation mass/momentum
- Groundwater flow
- Contaminant fate and transport
- Equilibrium geochemistry



Engineering Modeling

- Construction - dams/dewatering
- Water supply
- Geothermal Energy
- Energy Storage





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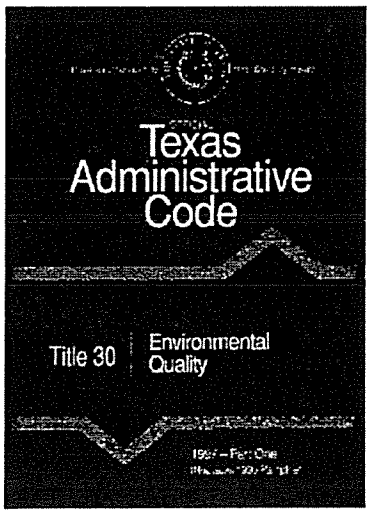
Regulatory Modeling



- Permitting
- Compliance
- Remedy Selection
- Technical Impracticability

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6

Regulatory Modeling

- Air Permitting (NAAQS,PSD,RCRA)
- Deep well injection
- Radioactive waste disposal
- Contaminant source identification (CERCLA/RCRA)
- Remediation feasibility/design/predictions
- Fate & transport - natural attenuation and risk-based closures

Litigation Modeling

- Scientifically valid and robust
- Consistent with field data and observations
- Consistent with engineering applications and empirical relationships

Modeling in Litigation

- Offense
  - assumptions
  - boundary conditions
  - initial conditions
  - numerical solution
  - numerical error
  - representative of data
- Defense
  - minimize with data
    - distant/relevance
    - forensics/realistic
    - stable and robust
    - quantified
    - reproduces what we see

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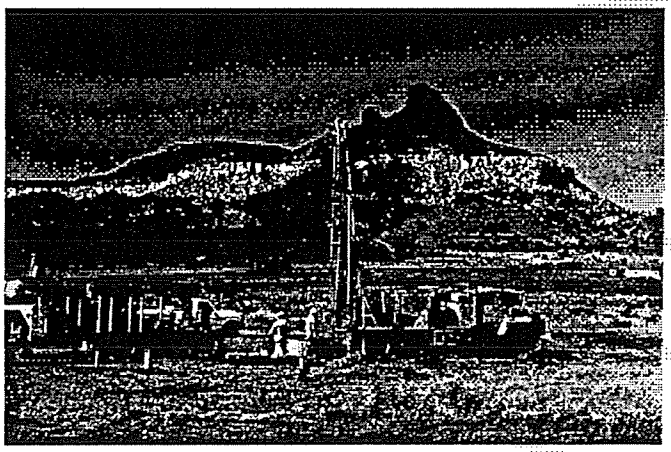

•Litigation modeling starts with field data and interpretations

•Groundwater models usually rely on borehole data for geology

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Geologic Interpretations



- Sometimes boreholes and geologic logs just aren't enough to convince the experts

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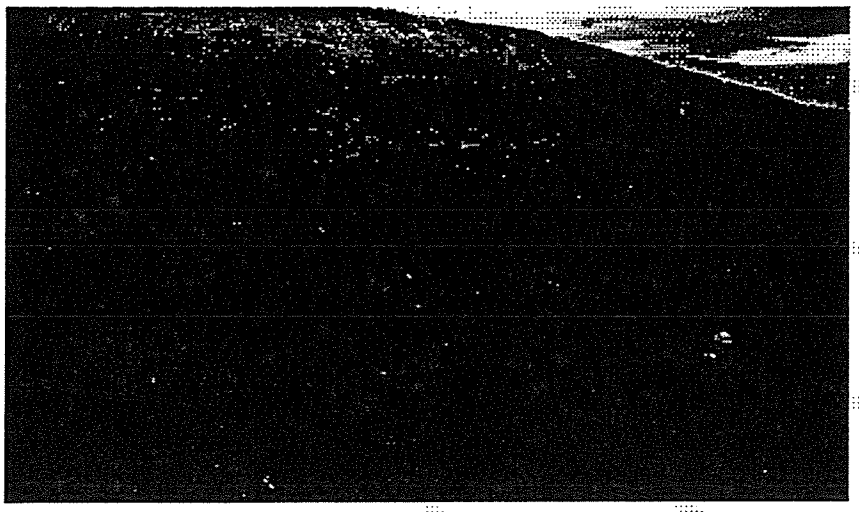
Geologic Model



•50.000 yds of excavation to develop a defensible geologic model

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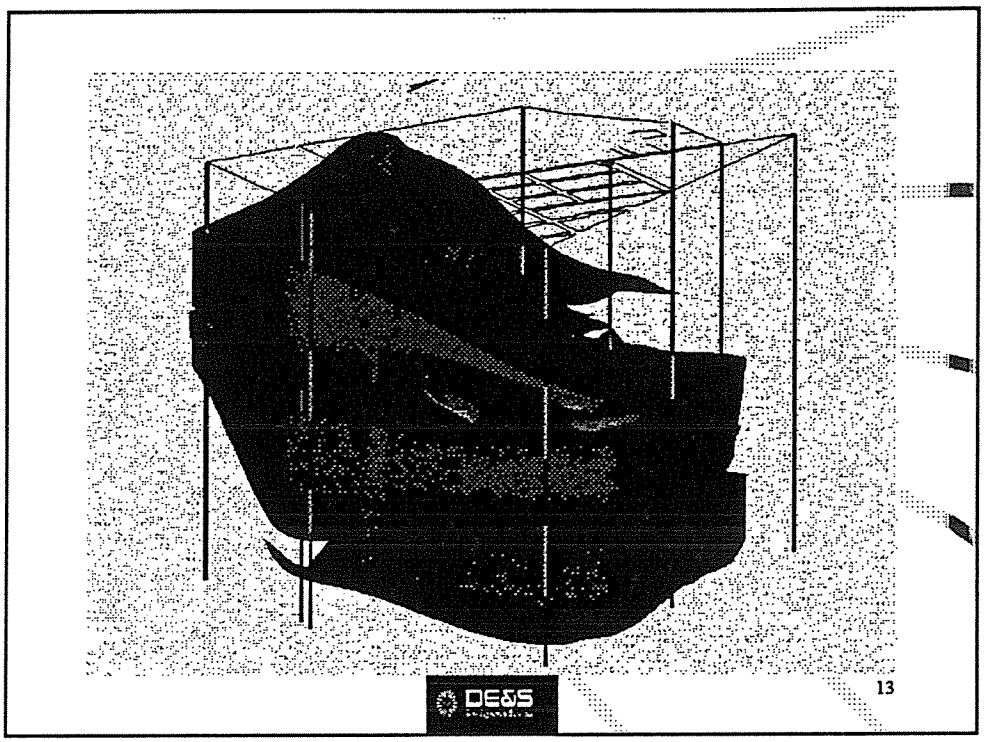
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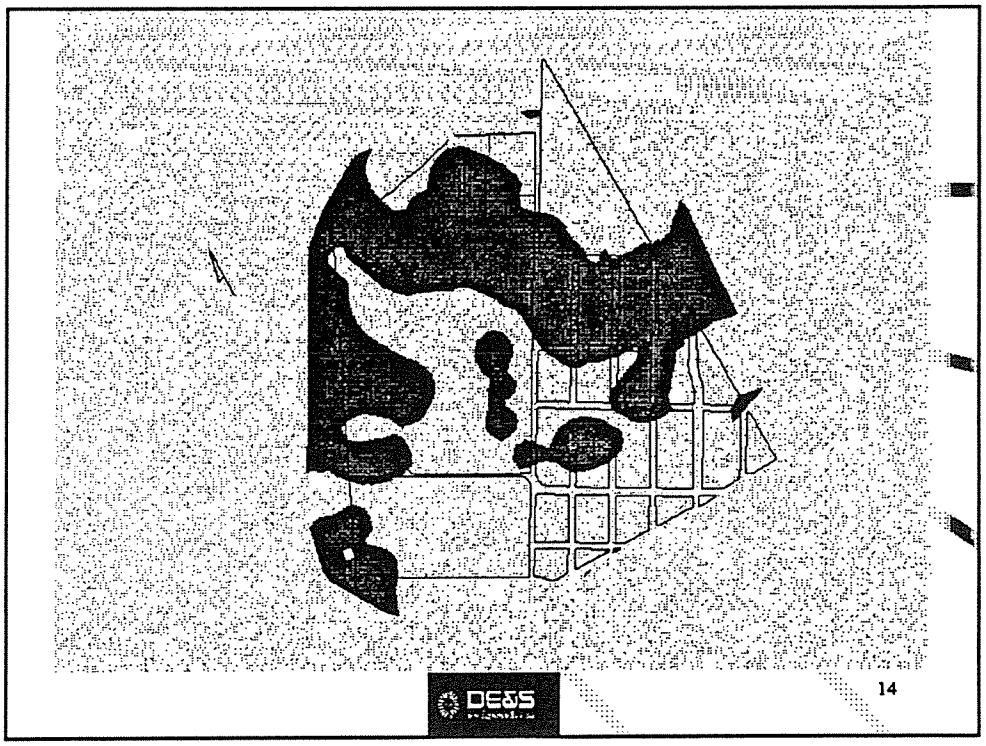
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•Plume Development 1963 to 1990



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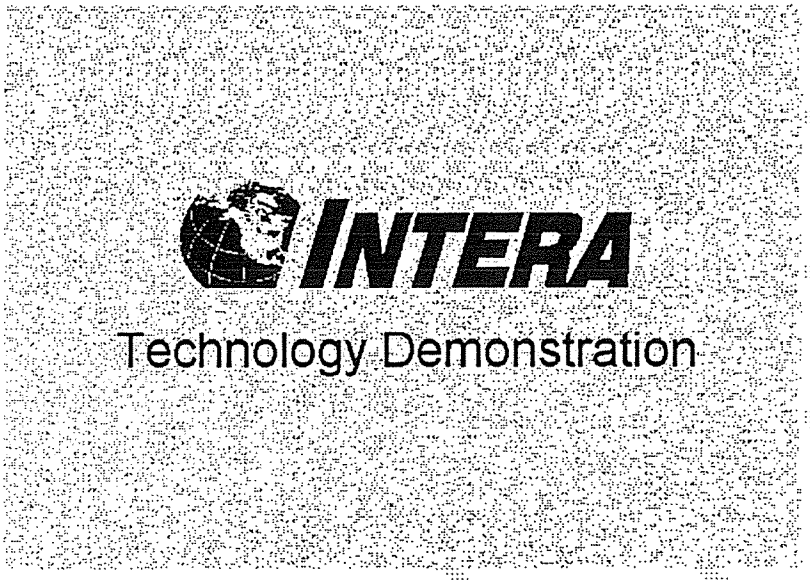
•Source Removal and Biodegradation



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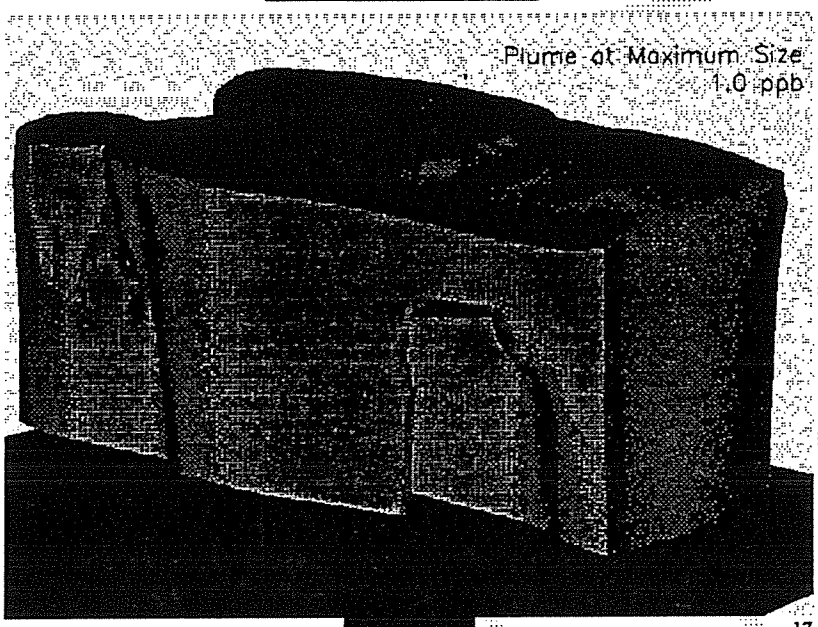
•Plume Concentration



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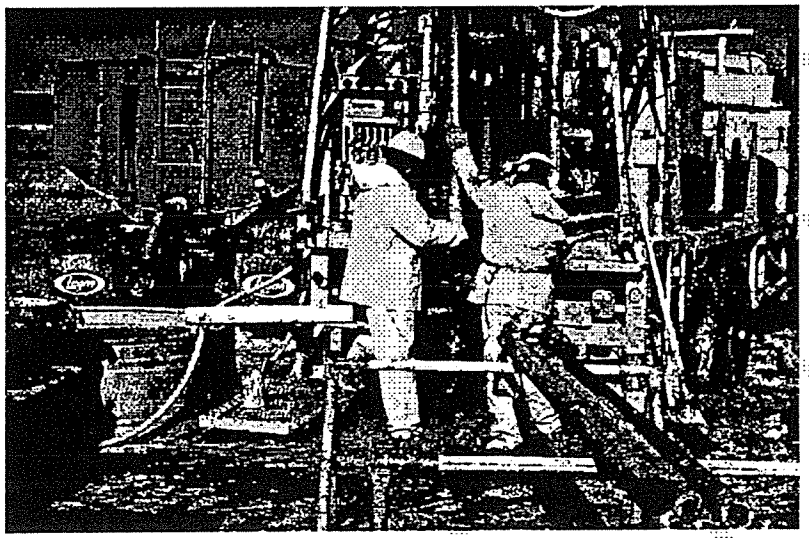

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Education:

- M.Sc., 1973, Hydrogeology, University of Waterloo
- B.Sc., 1971, Geology, University of Alberta

Credentials:

- Professional Geologist (#20689), Association of Professional Engineers, Geologists, and Geophysicists of Alberta
- Professional Hydrogeologist (#1031), American Institute of Hydrology
- Certified Ground Water Professional (#339), Association of Ground Water Scientists and Engineers, NGWA
- Member (#075470-5), Society of Petroleum Engineers
- Member (#1345618), Geological Society of America

Experience Summary:

Mr. Grisak's professional experience includes hydrogeology, geology, and interdisciplinary geoscience investigations, as well as litigation support and expert testimony. He has developed major technical investigation programs for several national radioactive waste programs (U.S., Canada, Switzerland) and has conducted field and numerical evaluation of numerous incidences of ground-water contamination. RCRA/CERCLA experience includes Part B Permitting, Compliance and Regulatory support for industrial facilities, Risk Based Corrective Action (RBCA) analyses for industry and government clients, and Principal in Charge of INTERA's Multi Site Texas State Superfund contract and Texas State multi region UST contract. DOE experience encompasses Yucca Mountain, Hanford, INEL, Savannah River, the Waste Isolation Pilot Plant (WIPP) and Paducah. DOD experience includes Armstrong Laboratories (Tyndall AFB), Hill AFB, Plant 4, and Portsmouth. Mr. Grisak is familiar with geologic and hydrogeologic characterization methods and analyses and ground-water remediation, including *in situ* immobilization. He is experienced in DNAPL/LNAPL enhanced remediation by solubilization, pump and treat, air sparging, and vacuum extraction, and is specialized in contaminant hydrogeology in porous and fractured media.

Professional History:

1981 to date: **INTERA Inc.** — **Austin, Texas**
Senior Hydrogeologist and Vice President/Principal
Hydrogeologic field and modeling investigations of ground-water contamination. Responsible for commercial waste management business area, including DNAPL remediation and hazardous/radioactive waste management projects.

1977-1981: **Environment Canada** — **Ottawa, Ontario**
Head, Contaminant Hydrogeology
Research and development in field and theoretical contaminant hydrogeology methods. Developed and managed Canadian Hydrogeologic Research Program for geologic disposal of radioactive waste (1978-81). Implemented field and theoretical research programs on ground-water flow, heat, and contaminant transport in porous and fractured geologic media.

1974-1977: **Alberta Environment** — **Lethbridge, Alberta**
Regional Hydrogeologist
Contaminant hydrogeology at agricultural and chemical plants, site characterization for green fields siting of regional and municipal landfills, applied research on dispersion in granular media and field methods for direct measurement of ground-water velocity.

Project Experience: ***Site Investigation/Characterization***

- *RCRA Hazardous Waste Landfill, Dryden, Texas.* Geologic and hydrogeologic supervision of RCRA hazardous waste landfill field investigation of 600 feet of unsaturated/indurated alluvium and limestone and upper 400 feet of Edwards Trinity Plateau aquifer. Supervised Geology and Groundwater Part B permit application and provided regulatory and community representation. Over 5000 feet of borehole drilling/instrumentation using reverse air rotary downhole percussion hammer and reverse air surface hammer. Borehole geophysics (neutron, EM, E-logs), borehole TV, surface geophysics (microgravity EM), geologic mapping at local and regional scale, structural geology, cavern stability analysis, ground-water modeling and solute transport through unsaturated and saturated porous and fractured media, and landfill monitoring design.

- *State Superfund RI/FS Investigations, Texas.* Principal in Charge of TNRCC contract for RI/FS investigations at State Superfund sites. Ground-water flow, ground-water contamination, air quality, surface-water hydrology, risk assessment, feasibility studies. Contract includes immediate removal and transport of hazardous waste as required.

- *No-Migration Petitions for Hazardous Waste Injection Wells, U.S.* Senior scientific guidance and technical input to U.S. EPA Underground Injection Control Program "no migration" petitions. Over 20 successful "no migration" petitions, including recent modifications based on numerical analysis of variable density injectate.

- *Chemical Waste Management, Inc., Port Arthur Facility, Texas.* Hydrogeologic evaluation of a major hazardous waste management facility in Texas. Hydraulic testing and analysis, geologic and hydrostratigraphic interpretation, geostatistical assessment of hydrogeologic properties, three-dimensional flow and transport modeling in the context of detection monitoring programs.

- *Waste Isolation Pilot Plant (WIPP) Site, New Mexico.* Hydrogeologic analyses of the WIPP site, including hydraulic testing, analysis, and interpretation, ground-water flow and transport modeling. Design and analysis of sorbing and nonsorbing tracer tests. Application of GTFM and INTERPRET well-test analysis codes, and SWIFT II, TOUGH, and TOUGH2 three-dimensional flow and transport, saturated, and variably saturated codes.

- *Gulf Resources Sour Gas Plant Decommissioning, Pincher Creek, Alberta.* Hydrogeologic and contaminant transport evaluation for decommissioning of the Pincher Creek gas plant in Alberta. Evaluation of potential for *in situ* degradation of organics by the indigenous microbial population, sterile sampling using sidewall cores, and laboratory feasibility study.

- *Gloucester Special Waste Disposal Site, Ottawa, Ontario.* Hydrogeologic characterization of the Gloucester site, a Defense Department shallow burial/incineration site for organic chemicals. Evaluation included installation of wells, piezometers, and multi-level point samplers, flow system interpretation, field tracer tests for the organic sorptive properties of the aquifer, flow and transport modeling, pump-and-treat remediation system optimization using cost and concentration as objective functions.

- *Oracle, Arizona.* Fractured rock flow and transport evaluation. Developed multiple packer/transducer systems for borehole testing, surface data acquisition systems, field hydraulic tests for single-well and multiple-well hydraulic characteristics, field tracer tests for transport parameters in fractured media using fluorinated benzoic acids. Field HPLC analyses.

- *DOE In Situ Coal Gasification, Wyoming.* Characterization of flow and heat transport characteristics of fractured coal/shale deposits. Tracer tests using fluorinated benzoic acids and non-halogenated, biodegradable acetic acids. Field chemical analyses using HPLC and GC. Transport characterization focused on fracture flow and matrix storage of heat and solutes.

- *NAGRA (Swiss Cooperative for Radioactive Waste Disposal).* Appointed consulting hydrogeologist to the NAGRA borehole drilling, testing, and site characterization program. Designed and supervised deep (2000 meter) borehole hydraulic testing program using Lynes/Baker tools in northern Switzerland. Developed GTFM hydraulic testing interpretive model, incorporating borehole pressure/temperature history and variable fluid properties. Installed deep (1800 m) single borehole multi-level packer monitoring system. Interpreted all long-term pressure monitoring data and all borehole hydraulic tests. Designed and constructed geochemical sampling probe for deep pressurized borehole samples retaining dissolved gases for isotopic analyses.

- *Chino Mines Site Characterization, Kennecott Corporation.* Designed and conducted I/Br/Cl multi-well tracer test of proposed dam site to be used to retain seepage from upstream electroplating site. Designed monitor well system for main tailings area. Installed monitor wells and supervised/interpreted geophysical logging of monitor well boreholes. Monitoring and tracer test data incorporated in three-dimensional predictive model of ground-water contamination and natural restoration.

Remediation

- *Illinois Department of Nuclear Safety.* Regulatory support for IDNS for remediation of former thorium processing facility. Developed groundwater protection standards for hazardous and radioactive constituents. Technical and regulatory assistance for overall site remediation to unrestricted release standards.

- *Noranda Aluminum, New Madrid, Missouri.* PCB soils and groundwater investigations. Delineation of extent of PCB soil contamination for excavation/removal. RBCA (Risk Based Corrective Action) analyses of residual PCBs at depth, modeling demonstration of minimal health risk.

- *State of Texas UST Program.* Principal in charge of multi-region state contract for UST Remediation Engineering and Remediation O&M contracts at approximately 25 UST sites currently active.

- *Col-Tex Refinery, State Superfund Site, Colorado City, Texas.* Immediate removal of three 80,000-barrel product storage tanks. Demolition, transport, and disposal of tanks, removal and transport for recycling of 10,000 barrels of residual asphaltic product. Excavation and on-site bioremediation of subtank soils and residual product.

- *Tricon State Superfund Site, Crowley, Texas, RI/FS.* Soils, ground water, and residuals characterization of a former industrial facility. Drilling, geophysical logging, plume mapping, trench mapping, EM geophysical survey, sampling, and statistical characterization of drummed residual material. Baseline Risk Assessment and application of Risk Reduction Standards.

- *Jensen Drive State Superfund Site, Houston, Texas, RI/FS.* Characterization of PCB/organic contaminated soils and ground water. Remedial investigation, borehole drilling, geophysical logging, well installation, and sampling. Removal/disposal/recycling scope and costing. Baseline Risk Assessment and feasibility study of on-site corrective action. Application of Risk Reduction Standards.

- *Fabsteel State Superfund Site, Waskom, Texas.* Immediate removal transport and disposal of waste and contaminated soils from a paint/industrial facility. Evaluation of extent of contamination using borehole drilling, wells, piezometers, and trenching.

- *Bio Ecology Federal Superfund Site, Grand Prairie, Texas.* Operation and maintenance of on-site closure of hazardous waste landfill. Leachate monitoring, collection and off-site transport and disposal.

- *Geologic Disposal of Spent Nuclear Fuel, Granitic Rock Masses.* Developed and implemented, with a team of 15 geoscientists, hydrogeologic characterization programs of granitic rock sites in Canada. Developed borehole packer testing tools and analytical capabilities that extended the low permeability testing range several orders of magnitude. Developed borehole geochemical probe for *in situ* flow through measurements of pH, Eh, Temp, TDS, Cl, Br at depths up to 1,500 meters. Conducted field tracer tests for ground-water velocity, dispersion, sorption, and matrix diffusion properties in fractured granites. Managed Canadian hydrogeologic research program for deep geologic disposal for four years.

- *International Joint Commission (IJC) Transborder Environmental Impact of Poplar River Coal-Generating Station.* Joint field and modeling project with U.S. Geological Survey on behalf of Environment Canada. Field program included piezometer/well installation and sampling, soil sampling, hydrologic analyses. Developed ground water/surface water model to predict downstream water quality impacts of thermal release and ash pile drainage, particularly heavy metals.

- *Shallow Radioactive Waste Management Site in Glacial Terrain.* Field investigation of Chalk River Nuclear Laboratories, Ontario, and Whiteshell Nuclear Research Establishment, Manitoba, shallow low-level radioactive waste management sites. Well/ piezometer multi-level sampler installation, hydrogeochemical sampling/analysis/ interpretation, flow system evaluation, flow and transport modeling, isotope geochemistry (radioactive and stable), radioactive and stable-element tracer tests. Reviewed all low-level radioactive waste management sites in Canada and co-authored *Hydrogeologic Factors and Processes Involves in Shallow Subsurface Radioactive Waste Management in Canadian Terrain*, Environment Canada Scientific Series No. 84, 194 p.

- *Pincher Creek Regional Landfill, Alberta.* Sited Alberta's first regional landfill serving multiple communities using regional and local constraint mapping geology/hydrogeology, geologic mapping, soils mapping, wells/piezometers, and three-dimensional flow system interpretation and modeling.

Litigation Support

- *Industrial organic ground-water contamination.* Buffalo - Niagara Falls Area. Technical evaluation and depositions in U. S. District Court on behalf of Ontario government on numerous industrial facilities with ground-water contamination along the Niagara Frontier. Included Love Canal, Hooker/Oxy S-Area, and others.

- *Nitrogenated organics large scale industrial ground-water contamination.* Florida. Historical data evaluation of plume development and quantitative flow and transport modeling for history-matching and forward predictions. Evaluation of microbiological degradation potential and natural attenuation as a remedial alternative. Preparation of exhibits, data visualization.

- *Organics and metals in regional ground-water system.* Industrial Landfill, California. Evaluation of contamination of the Santa Clara basin aquifer due to disposal of liquid hazardous wastes in a municipal/industrial landfill - pre-landban situation. Contaminant transport modeling.

- *Chromium ground-water contamination.* Texas. Independent technical evaluation of geology, ground-water flow, and contaminant transport. Expert testimony on soils, ground-water contamination, and geology.

- *Hydrocarbon contamination.* Texas Gulf coast. Hydrocarbon contamination, free phase and dissolved hydrocarbons, in the vicinity of the Corpus Christi Ship Channel. Independent technical evaluation of geology, ground water, and hydrocarbon contamination at numerous contiguous industrial facilities. Evaluation of hydrocarbon sources and fingerprinting. Expert testimony anticipated in 1997.

- *State Superfund Multi-Site contract.* Texas. Contracted by the State of Texas to provide RI/FS services as well as litigation support and expert testimony as required.

- *Arsenic in soils and ground water.* Texas. Independent technical evaluation of soil and ground-water arsenic contamination related to operation of arsenic-based pesticide plant. Expert testimony on site-specific soils, geology, and arsenic contamination, as well as fate and transport of arsenic in the subsurface.

- *Arsenic in ground water.* Washington State. Technical and litigation support services in the site characterization, design, and implementation of ground-water remediation system pursuant to Consent Order.

Scientific Advisory/Peer Review

- *Department of Energy - Yucca Mountain Hydrology Research Program, 1984.* Independent Scientific Peer Review for the hydrology scientific program conducted and funded by the U.S. Department of Energy. Scientific areas included unsaturated and saturated groundwater flow and contaminant transport, water balance, regional and local groundwater flow systems, geophysics, predictive modeling, and regulatory requirements.

- *Department of Energy Yucca Mountain Hydrology Research Program, 1990.* Independent Scientific Peer Review of the unsaturated zone hydrology research program. Review of research conducted by DOE and DOE contractors, including national labs (Sandia, Los Alamos, Lawrence Berkeley, Argonne) and universities. Research included unsaturated zone hydrology and contaminant transport, infiltration and recharge, geomechanics, thermomechanics, predictive modeling and regulatory requirements.

- *Chemical Waste Management, Dryden Texas Hazardous Waste Management Permit, 1991 - 1993.* Coordinated and chaired internal (to client) Scientific Peer Review Panel on karst hydrology and contaminant transport, geochemistry, structural stability, prediction modeling, suitability for permitting. Coordinated external scientific Peer Review on behalf of Chemical Waste Management and the regulatory permitting process.

- *Atomic Energy of Canada, Geoscience Research Program, 1993.* Independent Scientific Review for the Canadian geoscience research program for disposal of spent fuel in a geologic repository in plutonic rock. Review areas included regional and local groundwater flow systems in fractured rock, contaminant transport in fracture media, surface and borehole geophysics, structural geology, and predictive modeling.

- *Crandon Mining, Base Metal Underground Mine, Wisconsin, 1994.* Independent peer review for the predicted ground water impacts of mine development and dewater modeling for predictions on mining impact on local and regional scale ground water systems.

Publications:

Meinardus, H.W., N.A. Jasek, G.E. Grisak, and G.J. Saulnier, Jr., 1993. Offset Shotholes in West Texas: Evidence for Neotectonics, Stress Relief, or Blasting Phenomenon? Association of Engineering Geologists, 36th Annual Meeting, *El Agua y La Tierra*, San Antonio, Texas, October 9-16.

Meinardus, H.W., N.A. Jasek, G.E. Grisak, and G.J. Saulnier, Jr., 1993. Offset Shotholes in West Texas: Evidence for Neotectonics, Stress Relief, or Blasting Phenomenon? *Bulletin of the Association of Engineering Geologists,* Vol.XXX, No. 4, 1993, pp 427-442.

Haug, A. and G.E. Grisak, 1993. Circulation Cells and their Importance to No-Migration Demonstrations. Proceedings of the 1993 Ground-Water Modeling Conference, Colorado School of Mines, Golden, Colorado.

Haug, A., and G.E. Grisak, 1992. Numerical Simulation of Variable Density Contaminant Transport over Ten Orders of Magnitude. Proceedings of the Interdisciplinary Approaches in Hydrology and Hydrogeology Conference, American Institute of Hydrogeology, October 17-22, pp. 195-208.

Grisak, G.E., N. Jasek, G.J. Saulnier, and F.J. Pearson, Jr., 1992. Geologic and Hydrogeologic Characteristics of a Commercial Landfill in Carbonate Terrain in Trans-Pecos Texas. Proceedings of the 26th Annual Meeting of the South-Central Section of the Geological Society of America and Associated Societies, Houston, Texas, February 24-25.

Haug, A., G.E. Grisak, and F.G. Wolf, 1992. Dynamic Coupling - A New Tool for Three-Dimensional Flow and Transport Simulations. Proceedings of the Fifth International *Solving Ground-Water Problems with Models* Conference, NGWA, February 11-13, pp. 71-84.

Grisak, G.E., A. Haug, F.J. Pearson, Jr., K. Slaughter, and W.V. Walls, 1991. Aquifer Protection Characteristics of a Commercial Landfill in Carbonate Terrain in Trans-Pecos Texas. Invited paper presented at Seminario International Sobre Aguas Subterràneas, La Universidad Autònoma de San Luis Potosí, Mexico, September.

Grisak, G.E., A. Haug, and R.E. Jackson, 1991. Aquifer Remediation and Partial Cleanup: A Case for Aquifer Protection. Invited paper presented at Seminario International Sobre Aguas Subterràneas, La Universidad Autònoma de San Luis Potosí, Mexico, September 25-27.

Haug, A., G.E. Grisak, and F.G. Wolf, 1991. Numerical Simulation of Aquifer Remediation in Arsenic-Contaminated Shallow Aquifers. In Proc. American Institute of Hydrology Conference, Hydrology and Hydrogeology in 90s, AIH, November 3-7, In Press.

Haug, A., R.H. Petrini, G.E. Grisak, and K. Klahsen, 1990. Synthetic Semivariograms - A Novel Approach to Assessing Positions and Spacing of Ground-Water Monitoring Wells in *Minimizing Risk to the Hydrologic Environment*, A. Zaporozec (Editor), Kendall/Hunt Publishing Company, Dubuque, Iowa, pp. 224-233.

Haug, A., R.H. Petrini, G.E. Grisak, and K. Klahsen, 1990. Geostatistical Assessment of Numerically Simulated Ground-water Flow in the Upper Chicot Aquifer Near Port Arthur, Texas. *Proceedings of the international conference on Calibration and Reliability in Ground-water Modeling*, K. Kovar, Editor, IAHS Press, Oxfordshire (G.B.), IAHS Publication #195, pp. 427-437.

Haug, A., R.H. Petrini, G.E. Grisak, and K. Klahsen, 1989. The Hydrogeological Properties of the Gulf Coast Upper Chicot Aquifer Near Port Arthur, Texas. Proceedings of the New Field Techniques for Quantifying the Physical and Chemical Properties of Heterogeneous Aquifers conference, NWWA, March 20-23, 1989, Dallas, pp. 629-650.

Haug A., R.H. Petrini, G.E. Grisak, and K. Klahsen, 1989. Application of Geostatistical Methods to Assess Positions and Spacing of Ground-Water Monitoring Wells. Proceedings of the Petroleum Hydrocarbons and Organic Chemicals in Ground Water conference, NWWA, November 15-17, 1989, Houston, pp. 159-174.

Petrini, R.H., A. Haug, G.E. Grisak, and K. Klahsen, 1989. Application of Geostatistical Methods to Assess Direction, Magnitude, and Uncertainty of Ground Water Flow. Proceedings of the Petroleum Hydrocarbons and Organic Chemicals in Ground Water conference, NWWA, November 15-17, 1989, Houston, pp.535-548.

Grisak, G.E., J.D. Avis, D.W. Granger, and W.V. Walls, 1988. Loosed from the Shackles of Slug Tests; or Comprehensive Hydraulic Testing of Small Diameter Monitoring Wells. Hazmat West 88, November, Invited Paper.

Grisak, G.E., 1988. Computer Modeling in Environmental Programs - Groundwater. 1988 Texas Environmental Super Conference, August 4-5, Austin, Texas, Invited Paper.

Pickens, J.F., G.E. Grisak, J. D. Avis and D. W. Belanger, 1987. Analysis of Borehole Hydraulic Tests in Deep Boreholes: Principles, Model Development and Applications. *Water Resources Research*, Vol. 23, No. 7, pp.1341-1375.

Pickens, J.F. and G.E. Grisak, 1987. Reply to T.-C.J. Yeh Comment on "Modeling of scale-dependent dispersion in hydrogeologic systems." Water Resources Research, Vol. 23, No. 3, p. 523.

Grisak, G.E., and J.F. Pickens, 1985. A Synthesis of Tracer and Hydraulic Testing Methods with Emphasis on Hydrologic Characterization for Nuclear and Hazardous Waste Management. Abstract in *EOS Transactions*, AGU, Vol. 66, No. 46, p.895, presented at AGU Fall meeting, San Francisco, California, December 9-11.

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March 19, 1998

Clean Air Responsibility Enterprise (CARE) Advisory Committee

Concept Paper:
Draft Voluntary Emissions Reduction Plan for the Permitting of Existing Significant Sources

I: Integration of Federal Requirements
II: Application Process
III: Amnesty Element
IV: Small Business Incentives
V: Incentives

Options Relating to Concept Paper

In House Bill 3019, the 75th Legislature directed the TNRCC to develop a voluntary emissions reduction plan for the permitting of existing significant sources. To this end, the Commission appointed an eleven-member advisory panel to provide recommendations as to how this might best be achieved. This committee, entitled the Clean Air Responsibility Enterprise Advisory Committee, met several times in the fall of 1997, and provided the Commission with a set of recommendations at the December 18, 1997 Commissioners' Work Session. At that time, the Commission directed staff to develop a draft proposal based on the Committee's recommendation.

The staff proposal would provide a limited time option of reduced permit requirements. This option would be sunsetted in 2001, which is the start of the 77th Legislature. This would allow the Legislature to review the participation in and effectiveness of the program, and either extend the program or make necessary changes. Permits issued under this program would be incorporated into the body of air permits issued by the state, and would be renewed under the same standard.

The plan should include several elements. At a minimum, the plan should address the issues of application process, control technology requirements, public participation, and the review of health effects. The Clean Air Responsibility Enterprise Committee also recommended that the plan should include incentives such as tax abatements and emissions trading, as well as the availability of amnesty for participants in the permitting program.

I. INTEGRATION OF FEDERAL REQUIREMENTS

The CARE Committee made one recommendation with respect to federal requirements. This recommendation was that permits issued under this program include a schedule that synchronizes the permit requirements with the implementation of federal rules and requirements. Other than this, the Committee did not directly address the issue of how federal requirements should be incorporated into the program. Given the fact that Texas has received delegation for several federal programs, however, it is assumed that applicable federal requirements would be a floor for CARE permit requirements. For instance, if a facility were subject to Reasonably Available Control Technology (RACT) requirements

under the state implementation plan, those requirements would constitute the minimum level of controls required under the permit. Thus, participation in this program does not change, delay or otherwise affect a source's obligation to comply with otherwise applicable requirements.

Given, however, the CARE Committee's recommendation, state requirements would be integrated with applicable federal requirements, so that the timing of a facility's control technology obligations would be based on applicable RACT and Maximum Achievable Control Technology (MACT). For example, the first requirements for a utility boiler in a non-attainment area would occur at the time the RACT requirements were implemented. The balance of control technology requirements would follow. Companies would have the option of implementing state and federal requirements simultaneously, as is most efficient. A certain date such as 2005 should be chosen by which all of the permits should be completely implemented.

II. APPLICATION PROCESS

The CARE Committee made no detailed recommendation regarding the application process for a permit. However, the Committee made general recommendations that the process be streamlined to the extent possible, and that the agency should encourage companies to volunteer as early as possible.

Given these very general criteria, it is recommended that entry into the program would require the submission of an application. Given the permit nature of the authorization, the application should be similar to the one now used in New Source Review. This application would be reviewed using a streamlined version of the current New Source Review process. The elements of this process would include a review of control technology and health effects, and an opportunity for public participation. In addition, the process would borrow from the state's Title V program by using an optional, abbreviated, initial application, or "permit shield."

A. "Permit Shield" Concept

As noted above, the CARE Committee recommended that the agency encourage the early commitment to the program. In addition, the Committee recommended a program of limited amnesty for voluntary applicants. Given these interests, the voluntary permitting program could use an optional, brief, initial application based on the permit shield concept now in use in the state's Title V program. Due to the magnitude of applications expected, the Texas Title V program developed a short initial application requiring minimum information. This brief application will then be followed by an expanded application providing the balance of the information required for the permit.

This concept could be used to provide the agency with the information required to better manage the permitting workload that could result from the voluntary program. Such an approach could also encourage early commitments, and provide at an early date, information needed for SIP planning, and allow the Legislature full information as to the effectiveness of the program. Finally, by offering early protection of amnesty, this would encourage applicants to commit to the program earlier than would otherwise be the case.

The "permit shield" approach could work as follows: for a limited period at the beginning of the program, the TNRCC would accept a brief application identifying the company, the facility and the minimum volume, type and timing of reductions that could be expected to result from the permit application. In return, the applicant would be assured an opportunity to avail itself of the limited-time program, as well as any available amnesty. The TNRCC could then either establish a schedule for submission of the full application, or provide a deadline by which all applications would be due. Failure to complete an

application, or provide a deadline by which all applications would be due. Failure to complete an application and obtain a permit would result in loss of these opportunities.

This "permit shield" concept also could be expanded to further encourage early commitment to the program by allowing those companies making early commitments additional implementation time. As an example of how this would work, a company wishing to enter the program that failed to submit a "permit shield" application would be required to submit a complete application for either a regular permit, a flexible permit or a permit available under the plan by December 31, 2000. These late applications would be processed first, with the result that permit requirements would be imposed first. On the other hand, if the company chose to submit a commitment by December 31, 1999, the company would be called in to submit the complete application after all late applications had been processed.

B. Control Technology

The CARE Committee made no recommendations regarding levels of emissions control technology other than to assume that facilities must be "well controlled." Given this, it is recommended that the CARE program use the Best Available Retrofit Technology (BART) concept derived from the EPA's regional haze program. BART is defined as "an emission limitation based on the degree of reduction achievable through the application of the best system of continuous emission reduction for each pollutant which is emitted by an existing stationary facility." BART is established taking into consideration factors such as the pollution control technology available, the costs of installing pollution control technology, any pollution control equipment in use or in existence at the source, the remaining useful life of the source and the amount of emission reductions which may reasonably be anticipated to result from the use of such technology.

The BART determination for the program would be made in two stages: (1) an initial source category determination and (2) a case-by-case analysis to consider factors specific to individual facilities.

Source Category Determination. Prior to the start of the program, a permit committee could identify categories of grandfathered sources, such as storage tanks, combustion devices and loading racks. The committee would identify technically practicable control strategies for each category taking into account the age of the facilities (which will be greater than 27 years). BART for each source category could be determined by economic analysis of the options. This determination would then be the starting point for the case-by-case analysis that would be conducted for an individual source. A source-specific BART determination for any source categories not addressed during this stage would be made during permit review.

Case-by-Case Determination. BART for those facilities that are unable to meet the initial source category BART due to specific circumstances could be determined by the agency's engineering staff. This analysis would be performed on a case-by-case basis to determine technical practicability and economic reasonableness. The analysis of technical practicability would examine the feasibility of installing at the individual facility the recommended technology, as well as other control technology options.

The analysis of economic reasonableness would be required to take into account any pollution control equipment currently in use at the source, any other applicable control requirements such as those for the state implementation plan (RACT, e.g.) and control of hazardous air pollutants (MACT), and the net amount of emission reductions which may reasonably be anticipated to result from the use of any additional controls. The analysis of economic reasonableness also could take into account such factors as the remaining useful life of the facility and impact on the local economy and environment. However, all applicant representations would have to be well supported, verifiable and enforceable. If no technically

practicable and economically reasonable control technology could be found for a specific source, then the level of control technology would be determined by the health effects review. It should be noted, however, that in no case could BART be less stringent than applicable federal statutes or rules.

C. Public Participation

The CARE committee made two recommendations regarding public participation. These recommendations, which follow, should form the basis of the program's public participation element.

1. For facilities that will obtain an authorization under a current program, notice will be the same as is normally required for that type of authorization. In other words, if a company applied for a flexible permit, the public participation would be the same as that now required for a flexible permit.

2. For facilities that will obtain a CARE permit under the voluntary plan, public participation should take the form of the notice and opportunity for comment described in the operating permits rules.

D. Permit Renewals

The CARE Committee made no recommendations regarding the issue of permit renewals. It is therefore recommended that permits issued under this program would be incorporated into the body of air permits issued by the state. These permits would be subject to the normal ten-year renewal cycle. The standard of review on renewal would be that found in Section 382.055, Health and Safety Code.

E. Fees

The CARE Committee recommended that the Commission review the existing fee structure to see if opportunities exist for incentives for permitting. Given this recommendation, it would be preferable to assess no fees or reduce the fees for permit applications under this program. However, the presence or level of application fees for the program should depend on a review of feasibility, based on the volume and complexity of applications expected.

F. Health Effects Review

The CARE Committee recommended that a company seeking a CARE permit should be required to undergo an abbreviated health effects review. Given this recommendation, it is proposed that this review would provide for a review of the following elements: level of proposed control technology, location of the facility, and use of monitoring technology. If the facility failed to demonstrate protection of health based on these elements, the facility would undergo a qualitative health effects review.

G. Compliance History

Issuance of a permit will allow the TNRCC to more effectively enforce emission limits and rules applicable to a given facility. This fact is of particular importance with respect to grandfathered facilities that have had difficulty complying with existing regulatory requirements. Therefore, compliance history should not preclude a company from obtaining a permit under the CARE program. In fact, the CARE program should enable the TNRCC to better identify special controls and operating procedures which will assist an applicant in addressing past compliance problems.

III. AMNESTY ELEMENT

The CARE Committee recommended a two-year, limited amnesty period for facilities modified "inadvertently." This proposal could encourage companies with concerns over past changes made at a facility to make reductions and correct deficiencies at that facility.

Timing of Amnesty. The amnesty period was intended by the CARE Committee to be an incentive for companies to obtain permits by ensuring that a company does not apply voluntarily for a permit, only to become the subject of an enforcement action. The Committee agreed that the program should include a two-year amnesty period, but did not discuss precisely what was meant by that term. However, the Committee agreed that the period, which was intended to allow the identification and permitting of modified facilities, should be available for applications submitted within two years following adoption of the program rules by the TNRCC. Thus, a facility would have two years in which to submit an application. In order to be effective, the amnesty should extend during the pendency of the application. If a violation is discovered before submission of an application, amnesty would not be available. Similarly, if an application is withdrawn or voided for lack of response, the facility would forfeit amnesty.

Application of Amnesty. Amnesty would only apply to violations arising from the failure to obtain a permit required under Section 382.0518(a), Health and Safety Code, due to a change made that was a modification. In order to avoid federal delegation issues, such a program should be limited to state requirements only. In other words, if it was discovered that a modification that would trigger federal NSPS requirements had been made, the company would still be subject to enforcement for a federal violation. Similarly, even if a grandfathered facility applied for a permit, that facility would not be eligible for amnesty for violations such as the failure to keep required records or pay emissions fees.

Definition of Inadvertent. The dictionary definition of inadvertent is, with respect to an action, "unintentional." Strictly speaking, it is unlikely that any company could make a "physical or operational change" unintentionally. Therefore, the requirement that the modification be inadvertent should mean that amnesty should not be available where the company knew that the change probably would be a modification. A statute or rule making amnesty unavailable for modifications made "knowingly or intentionally" would make this clear. As for enforcement, this is similar to the many difficult questions of intent already in the system. To show that amnesty is not available, the agency would have to provide evidence either of behavior, such as concealment, or documentation showing knowledge that the change would be a modification.

IV. SMALL BUSINESS INCENTIVES

The plan should include a system of standard permits and permits by rule for small businesses with minimal emissions. Some grandfathered facilities may already be eligible to utilize an existing standard exemption. Use of the standard exemption in such cases should be encouraged. In addition, the agency should seek to develop permits by rule for very small existing sources.

Second, the agency should develop a system of standard permits for existing facilities whose emissions are minimal, but not insignificant. This system should be modeled on the standard exemption and standard permit system currently in place, whereby the agency sets criteria and emission limitations for use of the authorization, with which a facility must comply. This system should require registration and, possibly, a minimal level of notice for those facilities availing themselves of the authorization.

V. INCENTIVES

The CARE Committee made a number of recommendations on incentives. These recommendations can be grouped into two major categories: flexibility and financial incentives. The Committee recommended that the TNRCC consider such flexibility incentives as emissions reduction credits and extra-plant caps. The Committee also recommended that the agency consider developing for legislative consideration a tax abatement program for permitting of existing facilities. Taken together, these recommendations provide an array of incentives that could appeal to a variety of facility types, sizes and locations.

A. Increased Flexibility

The CARE Committee recommended enhanced flexibility in two areas: emissions trading and inter-plant emissions caps. Analysis of the CARE report suggests three basic concepts which should govern these enhancements. First, the Committee was very clear in recommending that increased flexibility should not result in a shifting of risk to communities. This is easily achieved by a requirement that any cap or trading program result only in reductions. Second, the Committee recommended that increased flexibility should not adversely affect efforts to attain the National Ambient Air Quality Standards. This could be achieved by providing incentives such as the weighting of reductions in affected areas. Finally, the Committee recommended that the program should continue to provide appropriate protection of health effects. This could be implemented by using, again, a weighted approach which takes into account location and nature of pollutants.

1. Multiple Plant Permits

The CARE Committee recommended that the agency examine the possibility of developing a multiple-plant permit modeled after the current flexible permit program. At present, the Texas Clean Air Act allows companies to obtain flexible permits allowing the trading of emissions on an intra-plant basis. These permits require that companies install control technology such that emissions plant-wide are reduced to the levels that would result if all facilities had best achievable control technology installed. The company may choose to vary the levels of control technology among facilities, so long as the BACT-determined cap is respected plant-wide.

While the flexible permit program has been successful in many respects, its emphasis on intra-plant trading has made it less useful for companies that have a limited number of sources at one site. Companies may have multiple sites between which emissions could be traded. However, a flexible permit only allows trading within the bounds of one property. A multiple plant permit program would address this limitation. As for a flexible permit, an initial analysis would be done to determine what the total emissions of each type of pollutant for the plants involved would be if a given level of technology were installed. This level would be the cap for the plants involved.

This type of flexible permit-inspired program would allow companies to make reductions most efficiently. For instance, a utility company with generating units in six locations in a given county could obtain a permit by calculating the cap, and then choosing how best to achieve the reductions. Thus, the company could install technology at all facilities, or it could control a few very large facilities beyond the level required and average that reduction with several small units.

Because it is necessary for federal law to ensure that risks are not shifted between communities, such a permit should specify that actual emissions at any given site will not increase. This type of permit should encourage companies to make reductions in areas where they will have the greatest health benefit such as residential areas, non-attainment areas or areas of influence. This type of permit would need to incorporate a special health effects review to ensure that no facilities included in the permit will adversely

impact public health.

2. Emissions Reductions Credits

An emission-trading program could be used to create opportunities for growth without adverse impacts on regional air quality. As is the case for multiple plant permits, such a program should encourage companies to make reductions in areas where they will have the greatest health benefit. By generating revenue for sources reducing emissions, such a program would help offset the cost of installing control technology. Using a trading strategy would also result in monetary credit where emission reductions are generated and sold. Market conditions would drive the cost of the reduction while maintaining the targeted level of emissions for groups of sources. Additional sources wishing to enter the market area would "buy" into the program using credits. Sources achieving greater reductions than their target rate would create credits which could then be sold to those sources which cannot achieve their targeted reductions.

Another opportunity in the trading area would be to allow large sources to fund controls for smaller sources and credit that part of the emission reduction over what is otherwise required to their own reduction goal. This would ensure that the reduction is still achieved while providing flexibility to the large source. It also could allow some small sources to reduce their emissions to a level that would be advantageous to them but which they could not afford to do on their own. This strategy could also allow smaller sources to group together to purchase volume reductions from a larger source. To be effective, the agency should minimize transactions costs, including the costs of identifying potential sources of reductions.

In development of a regional trading strategy, consideration should be given to the scope of the trading area. Trading areas could be established consistent with attainment status, or could be delineated according to any area of influence/area of violation concept used in the state implementation plan. Rules for the emissions trading incentive should also account for control strategies that may increase certain pollutants at the expense of others that are being reduced. For example, combustion of volatile organics results in an increase in nitrogen oxides and carbon monoxide.

Discrete Emissions Reductions Credits (DERC). The plan could include a system of discrete emission reduction credits. Discrete emissions reductions credits are credits of finite amount or duration. For example, a company could create DERCs if it chose to make reductions at a facility two years in advance of the effective date of an applicable MACT requirement. In this case, the facility could have credits the amount of reductions made over those two years. This type of credit program could be structured to allow recipient companies to vary the time period over which the credits are used. Again, for example, if a company over two years generated a total of 500 tons of reductions, the receiving company could choose to apply 50 tons of credits per year over 10 ten years, or it could utilize the entire amount over the first year.

These credits could be bought, sold or traded in the same manner as regular emissions reductions credits. In addition, these credits could be transferred between plant sites owned by the same company. Another use which could be authorized for these credits is their trading in time. For example, if a company makes an enforceable reduction in emissions of a pollutant in 1998, the company could then apply the resulting credit to reductions it would have to make under a flexible permit in the year 2000.

Such a program would be useful for several reasons. First, by allowing temporal trading, discrete emissions reductions credits could be used to reward early reductions and participation in the governor's

volunteer program with delayed implementation following receipt of a permit. Second, by allowing companies to purchase credits, such a program would allow companies leeway in the timing of expensive improvements required under a permit. Finally, the sale of credits would provide some companies a financial incentive to make early reductions.

B. Tax Abatements

The CARE Committee recommended that the agency include as part of the plan a system of tax abatements for certain existing facilities. A tax abatement program modeled on the economic development abatements now contained in Chapter 312 of the Tax Code would allow counties with a high concentration of grandfathered facilities to provide appropriate financial incentives for reductions. In such a program, a county not in attainment of one or more National Ambient Air Quality Standards could in its discretion grant a tax abatement on existing facilities for the installation of emissions control technology. The following limitations would be advisable:

- Abatements only could be given where substantial actual reductions of the criteria pollutant or pollutants for which the county is non-attainment will result, and the abatement could not extend to the full value of the property.
- As is required for economic development abatements, counties would have to adopt guidance as to the availability of and requirements for the abatement.
- Abatements could only be issued for a period of between two and eight years, and the abatement could not become effective until construction has begun.
- The county and recipient of the abatement would have to execute a binding agreement including at a minimum the amount of reductions to be achieved, the relevant times and the penalties for failure to comply with the terms of the agreement.
- The written agreement must at a minimum specify that failure to comply with the terms of the agreement will render the agreement void, with the recipient being liable for taxes and interest which would have been owed had the agreement not been in place.
- Such agreements should include a requirement that the facility, if unpermitted, obtain a permit or flexible permit under Section 382.0518, Health and Safety Code, from the Texas Natural Resource Conservation Commission.
- The Commissioner's Court of the county would be required to hold a hearing to determine the value of benefits and the costs to the county of a proposed agreement.
- The emission control equipment installed for purposes of the abatement could not be removed from the facility upon expiration of the abatement.

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March 19, 1998

Clean Air Responsibility Enterprise (CARE) Advisory Committee

Options Relating to Concept Paper

Concept Paper:Draft Voluntary Emissions Reduction Plan for the Permitting of Existing Significant Sources

Question 1. How should the permit application process be structured?

Option 1. Use the existing NSR application process.

Pros: Applicants likely will already be familiar with the application process.

Cons: Because this process requires substantial amounts of work prior to submission of an application, this will preclude some companies from submitting early applications, which may have an adverse impact on the information-gathering process for the SIP.

Option 2. In conjunction with the usual application process, use the "permit shield" concept as discussed in the concept paper.

Pros: This concept could provide the agency with the information required to better manage the permitting workload from the voluntary program. This also could encourage early commitments and would provide information needed for the SIP in a timely manner. This would also aid the Legislature by providing early information as to the effectiveness of the program.

Cons: This would add an optional, additional step at the beginning of the process. Use of this option would require an early analysis and commitment on the part of companies.

Question 2. What level of emissions control technology should be required for permits issued under the program?

Option 1. Best Available Control Technology (BACT).

Pros: This would provide the highest level of reductions for facilities choosing to enter the voluntary program. This type of analysis does provide for consideration of economic reasonableness and technological practicability. Use of this standard is consistent with practices under the Texas and Federal Clean Air Acts. Standards of BACT exist for most categories of facilities.

Cons: Use of this standard could discourage many companies from obtaining a permit and making reductions due to the substantial costs of installation. This may reduce the overall effectiveness of the program.

Option 2. Reasonably Available Control Technology (RACT).

Pros: Because this would require no reductions beyond that already in place under the SIP for facilities located in nonattainment areas, this standard would make entry into the program very easy for facilities covered by SIP requirements. Such a standard likely would require some reductions of facilities not presently covered by the SIP.

Cons: This would result in less substantial reductions for facilities entering the program than would be the case for the other options. This standard might provide a strong incentive for companies to obtain permits. Standards might have to be developed for some categories of facilities. If this standard is used, the bulk of reductions will occur outside nonattainment areas.

Option 3. Best Available Retrofit Technology (BART).

Pros: This standard requires consideration of technical practicability and economic reasonableness, including the age and useful life of a facility. Because this standard initially recognizes age of the facility, this would likely be a more attractive option than BACT for most older facilities. Because it is more likely to encourage participation, it should achieve more widespread reductions than BACT. For individual facilities, the standard would probably yield more reductions than would a RACT standard.

Cons: This would be a new standard, and implementation would require the wholesale development of recommended technology for categories of facilities. This standard generally would not yield the same level of reductions as would a BACT standard.

Question 3. What type of public participation should be required of entrants into the program?

Option 1. Follow the CARE Committee recommendation for a two-track process of existing requirements for existing authorizations, and a notice and comment process for a CARE permit.

Pros: This recommendation was agreed to by the committee members, and strikes a balance between eliminating and expanding the contested case process. This process also would be consistent with the committee's general emphasis on a streamlined process, while assuring an opportunity for public participation.

Cons: This recommendation would eliminate the opportunity for evidentiary hearings in some cases.

Option 2. Eliminate the requirement of an opportunity for contested case hearings for all grandfathered facilities.

Pros: This would be consistent with the public policy argument that these facilities have in many cases been in existence for years, and their continued existence implies that they pose

no public concern. This would provide an incentive for obtaining a permit under the program, and would streamline the process. In addition, this option could include a blanket requirement of a notice and opportunity for comment process.

Cons: This option would limit public participation beyond that now available, and beyond that offered in Option 1.

Option 3. Require notice and an opportunity for an evidentiary hearing for all permits for grandfathered facilities.

Pros: This would provide the maximum opportunity for public participation possible.

Cons: This would provide a disincentive for many companies to enter the program and make reductions.

Question 4. By what process should permits issued under the program be renewed?

Option 1. Integrate CARE permits into the existing program, and process renewals using the same standard and on the same 10-year cycle as for preconstruction permits.

Pros: This approach would allow for a seamless body of permits and permit renewals, which would minimize agency and applicant administrative costs. The facilities for which CARE permits are designed have been in existence for some time without demonstrated adverse impacts, so the standard review on renewal is appropriate.

Cons: Depending on the outcome of other questions, CARE permits may be available with reduced requirements for control technology, health effects review and public participation. This might argue for a higher level of scrutiny on renewal.

Option 2. Use the renewal language in effect prior to passage of Senate Bill 1125, which states, "The board shall impose as a condition for renewal of a preconstruction permit those requirements determined to be economically reasonable and technically practicable considering the age of the facility and the effect of its emissions on the surrounding area."

Pros: This approach would allow for a slightly expanded review on renewal of facilities which are otherwise subject to reduced requirements. This standard is one designed for existing facilities and is generally familiar to the regulated community and to the agency.

Cons: This extended review would reduce the certainty of the renewal process, which could discourage companies from obtaining permits and making reductions.

Question 5. Should application fees be assessed, and on what basis?

Option 1. No application fees should be assessed for applications for CARE permits.

Pros: This approach would provide an additional incentive for companies to obtain permits and make reductions. This also could be argued to conserve money for installation of control technology.

Cons: If a large volume of permits is received, this approach could impose a substantial burden on the New Source Review program. This burden could result in delays in the processing of the division's normal permit workload, which in turn could impose burdens on other applicants.

Option 2. The need for application fees should be assessed, and the authority sought from the Legislature if necessary.

Pros: This approach would allow the imposition of fees if the failure to do so would otherwise result in delays in the processing of NSR's normal permit workload.

Cons: This option would not provide an additional incentive for obtaining a permit and making reductions.

Question 6. How should health effects review be conducted?

Option 1. Health effects review would allow a facility to show protectiveness based on the level of control technology and location or use of monitoring technology. If a facility did not qualify for exclusion under one of those criteria, it would undergo a qualitative health effects review.

Pros: This streamlined approach is consistent with the committee's recommendation of a streamlined review given the type of facility. The streamlined nature should provide an incentive for companies to enter the program and make reductions. The approach provides for an examination of how the public health and environment is affected by the facility.

Cons: This approach is not as thorough as that now in use for new source permits.

Option 2. Include consideration of compliance history or require regular health effects review if protectiveness is not shown through other means.

Pros: This approach will result in a more thorough review than Option 1. The health effects review now in place does include opportunities to avoid modeling requirements.

Cons: This more thorough and therefore lengthy approach will discourage some companies from entering the program and making reductions.

Option 3. Omit consideration of whether the facility will install BACT.

Pros: This will eliminate special consideration for facilities that install BACT.

Cons: This will eliminate an additional opportunity for a facility to curtail health effects review, as well as eliminating an additional incentive for reductions.

Question 7. Should an amnesty period for facilities which voluntarily seek to obtain permits be included in the plan?

Option 1. Include in the plan a limited amnesty period as described in the concept paper.

Pros: This should provide an incentive for companies who are uncertain of their compliance

status to obtain a permit and make reductions. The limitations proposed should prevent the use of the permit application for shielding unrelated violations or spurious applications.

Cons: Critics will argue that amnesty rewards bad actors. The exclusion for intentionally bad actors will be difficult to prove.

Option 2. Include in the plan a limited amnesty period as described in the concept paper, but omit the exclusion for intentional bad acts.

Pros: Such a process is clearer because all violations relating to the permit requirement for existing facilities would be covered. This could encourage additional companies to enter the program.

Cons: This approach would not be consistent with the CARE Committee recommendations. Such an approach also might preclude the TNRCC from taking enforcement action where clear evidence of intentional violations of the permitting requirement exists.

Option 3. Do not include in the plan an amnesty period.

Pros: This would eliminate a special preference for existing facilities.

Cons: This approach may discourage facilities who are uncertain of their compliance status from entering the program.

Question 8. Should the plan include a recommendation to the Legislature for multiple plant caps?

Option 1. As described in the concept paper, include in the plan a recommendation to the Legislature to establish a system that would allow companies to establish caps that extend to multiple sites owned by a company.

Pros: This option would allow companies the flexibility to make reductions where they are most cost-effective. This approach also would extend the benefits of the flexible permit regime to companies with a limited number of facilities at a given site. If a weighted approach is adopted, this option could encourage companies to make reductions where they are most cost-effective. By requiring that flexibility be available only for decreases in actual emissions, such a program would ensure that surrounding communities are not adversely impacted.

Cons: This option represents a substantial departure from the present command-and-control strategy under which air quality is regulated. If a weighted approach is not utilized, a multiple-plant cap system could result in no reductions being made where they are most beneficial to air quality. Such a system could be difficult to administer and enforce.

Option 2. Omit the recommendation for caps that extend to multiple sites.

Pros: Traditional plant or facility caps may be easier to enforce and administer.

Cons: This approach would continue the limitation on the use of the flexible permit concept

to large sites with multiple facilities, and would limit the opportunity of companies to select the most cost-effect pollution reduction strategies.

Question 9. Should the plan include a program of emissions reductions credits and discrete emissions reductions credits?

Option 1. Include a program of emissions reductions credits beyond that already available.

Pros: Inclusion of additional opportunities for emissions reductions credits would provide additional incentives for companies to volunteer to obtain permits and make reductions. This program would supplement the existing system to allow trading outside the nonattainment areas. By allowing for the sale of reductions, the credit system allows companies to make decisions as to the most efficient use of resources. If weighted, these credits would provide an incentive to make reductions where most needed by the state.

Cons: Administration of a reductions credit system is complex.

Option 2. Include a system of discrete emissions reductions credits in the plan.

Pros: Such a system would provide an incentive for companies to make reductions before they are required to do so under the MACT, RACT or a permit. This approach, if applied retroactively, also could be used to reward companies who volunteered or will volunteer in 1997 or 1998.

Cons: As with any credit program, this would be complex to administer.

Option 3. Utilize the existing system of emission reduction credits.

Pros: This system is already in place, and encourages reductions in nonattainment areas.

Cons: This option would not provide additional incentives for facilities to obtain permits and make reductions.

Question 10. Should the plan provide for the weighting of reductions for purposes of emissions credits and caps?

Option 1. For purposes of emissions credits and caps, weight reductions according to the distance of the facility from the nearest school or residence.

Pros: This approach would allow businesses to allocate resources efficiently, given public concerns for health and environment. By encouraging the reduction of impacts on nearby receptors, such an approach would help the state to receive the most health bang for the reductions buck. Because it targets reductions in areas of greater population density, this approach may also cause additional reductions in nonattainment areas. A system of weighting of reductions already is in place for nonattainment areas.

Cons: Weighting of reductions will add complexity to an already complex approach.

Option 2. For purposes of emissions credits and caps, weight reductions according to the location

f the facility in an attainment area, area of influence or, if in a nonattainment area, according to the classification of the area.

Pros: This approach would allow businesses to allocate resources efficiently, while taking into account the public concern for achieving compliance with the federal Clean Air Act. This approach also will encourage reductions in areas where they are needed. Such an approach could be an extension of the existing program in nonattainment areas.

Cons: By focusing exclusively on attainment status, this approach does not accord the same treatment for health impacts of non-criteria pollutants.

Option 3. Do not weight reductions for purposes of emissions credits and caps.

Pros: This approach would be the simplest to administer and would allow businesses to allocate resources without regard for state concerns.

Cons: This approach may encourage reductions to be made in areas where they are minimally useful to the state in terms of health impacts and compliance with the federal Clean Air Act.

Question 11. Should the plan include a recommendation to the Legislature for the availability of limited tax abatements for nonattainment counties?

Option 1. As recommended by the CARE Committee, include in the plan a recommendation that the Legislature consider authorizing nonattainment or near-nonattainment counties to offer tax abatements for reductions of nonattainment pollutants.

Pros: This approach could provide counties with a powerful incentive to encourage facilities to make reductions. If adopted, the limitations outlined in the concept paper, combined with a county's natural interest in maintaining its tax base, should ensure that abatements are granted only where a substantial improvement in air quality will result.

Cons: Tax policy is outside the normal scope of agency expertise.

Option 2. Omit any recommendation to the Legislature regarding tax abatements.

Pros: This option would avoid involving the agency in the issue of tax abatements, an area which has been subjected to substantial criticism in recent years. This also would keep the agency from becoming involved in an area outside its normal purview.

Cons: This option could eliminate consideration of what could be a powerful incentive for reductions in nonattainment and near-nonattainment counties.

Question 12. What process should the staff use for obtaining public comment?

Option 1. Schedule public meetings for the receipt of comment with one commissioner in attendance at each meeting.

Pros: This would provide maximum direct public input to the commission in areas with the highest concentrations of grandfathered facilities.

Cons: This might require a number of days out of the commissioners' combined schedules. Moreover, the direction currently given staff is to attempt to have hearings completed by May, which provides at best six weeks in which to schedule five hearings.

Option 2. Schedule public meetings for the receipt of comment with staff to conduct the meetings.

Pros: This will allow maximum input to the agency, while minimizing scheduling difficulties.

Cons: This will not provide for direct input to commissioners. The addition of other locations will add to the expense of hearings.

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Clean Air Responsibility Enterprise (CARE) Advisory Committee

CARE Committee Final Report

Creation and Meetings of the Committee
Background on Grandfathered Facilities
Recommendations

I. Creation and Meetings of the Committee

Creation and Charge of the Committee

The Clean Air Responsibility Enterprise Advisory Committee was created by a resolution of the Texas Natural Resource Conservation Commission on September 2, 1997. The Committee was principally charged with providing recommendations to the Commission regarding a voluntary emissions reduction plan for the permitting of existing significant sources of air contaminants.

In creating the Committee, the Commission noted that the Governor had identified emissions from exempt significant sources of air contaminants as an issue of importance to the citizens of Texas, and the need for a voluntary program to permit such facilities; and that the 75th Legislature passed House Bill 3019, requiring the Texas Natural Resource Conservation Commission ("Commission") to develop a voluntary emissions reduction plan for the permitting of existing significant sources of air contaminants. The Commission also noted that it desired to seek the collective business, environmental, and technical expertise and experience of the members to be appointed to the advisory committee.

Meetings of the Committee

The Committee met in Austin at the TNRCC on the following dates:

September 19, 1997
October 2, 1997
October 14, 1997
October 27, 1997
November 11, 1997.

The September 19 meeting was devoted to the organization of the Committee, the adoption of rules, and the presentation by Commissioner Marquez, Mr. John Howard of the Governor's Office and staff of information relating to the Committee's charge. At the October 2 meeting, the Committee appointed four subcommittees to address major issues relating to the voluntary plan. A list of the subcommittees and their charges are attached. These subcommittees reported back to the full committee on October 14. At the October 14 meeting, the subcommittee reports were presented and discussed and areas of consensus

or disagreement were established. The meeting held October 27 was devoted to the receipt of oral and written comment from the public. At the recommendation of some committee members, a facilitator was employed for the November 11 meeting to develop areas of consensus for inclusion in the final report. This meeting resulted in a consensus that staff should prepare for the committee a draft report based on the recommendations on which the committee had reached consensus.

Public Input

In addition to any informal input received by Committee members, the Committee at its October 27 meeting formally accepted oral and written public comment. The Committee had instructed staff to prepare a document outlining areas of preliminary consensus, and requested public comment on that document. Notice of the meeting and the opportunity for comment was provided by fax to likely interested parties, by publication in the *Texas Register* and by posting on the TNRCC web site. At the meeting, twenty-eight people presented oral comments. Numerous written comments were also received by mail, fax and E-mail. These comments, which are included as an attachment to this report, were copied and forwarded to the members of the Committee for their consideration.

II. Background on Grandfathered Facilities

Types of Facilities

The term "grandfathered" means that a facility is exempted from having to obtain a state preconstruction permit, and from the associated requirements of best available air pollution control technology, public notice and a review of the facility's impact on public health. The "grandfathered" category includes a diverse group of sources. The exemption only distinguishes between facilities based on their age and lack of changes resulting in significant increases in emissions. It does not distinguish facilities based on size, industry, level of control technology, region or the nature of the surrounding area. Only one generalization can therefore be made. Because by definition a grandfathered facility must date from before 1971, these facilities tend not to occur in newer industries, or industries which have experienced significant changes in manufacturing technology. Thus, industries such as computer and chip manufacturing which are of relatively recent origin have almost no grandfathered facilities. On the other hand, mature industries which have been present in the state for a very long time, such as oil and gas production, refining, electricity generation and pulp and paper manufacturing tend to have both grandfathered and permitted facilities.

Other than this, generalizations regarding grandfathered units are difficult. The term "grandfathered" may apply to very small or very large units. It encompasses both units that stand alone and units that are part of a much larger plant. Grandfathered units are found in urban, ozone nonattainment areas and in unpopulated locations hundreds of miles from the nearest nonattainment area. A cotton gin in Fort Stockton and a tank or catalytic cracking unit in a refinery on the Houston Ship Channel may equally claim grandfathered status. Thus the Committee found that grandfathered units may have almost no emissions, or that an individual unit may have thousands of tons of emissions per year.

While grandfathered facilities need not obtain a permit, install best available control technology or undergo health effects review, they must comply with other state and federal requirements. These include emissions reporting requirements and fee requirements. In some cases, grandfathered facilities may be subject to monitoring requirements, and grandfathered sources in nonattainment areas of the state may be subject to reasonably available air pollution control technology requirements. Many grandfathered facilities also may have to install some level of emissions control technology because of new federal

hazardous air pollutant standards. Operators of some grandfathered facilities may also have chosen to install pollution control technology for business reasons. For example, some companies have chosen to reduce emissions to avoid where possible the new federal Title V operating permit requirement.

History

The grandfathered exemption was created in 1971 as part of a major expansion of the Texas Clean Air Act. The Act created a permitting requirement which included a mandate that facilities emitting air pollution install best available technology for controlling air pollution emissions. The Legislature exempted from this permitting requirement facilities already in existence on the effective date of the Act. This exemption was not, however, of infinite duration. In the exemption, the Legislature also provided that when a change that resulted in a significant increase in air contaminant emissions or in the emission of a new air contaminant was made to an existing facility, the facility would have to come in, obtain a permit, undergo a review of the facility's effect on the surrounding area, and install control technology.

In 1985, the Sunset Commission as part of its Review of the Texas Air Control Board examined the issue of existing facilities. The Sunset Commission at that time made two recommendations aimed at limiting the existence of indefinitely authorized facilities. First, it recommended that the practice of issuing air permits of infinite duration be replaced with a system of term permits, and that renewals be required of previously permitted facilities. Second, it recommended that the Legislature add a 1995 expiration date in subsection (g) of Section 382.0518. Of these, the full Legislature adopted only the first. However, the Legislature added a requirement that any facility claiming grandfathered status register with the Air Control Board, and provide an analysis of its emissions. This registration process was complete by 1986, and the agency consolidation legislation of 1991 removed the requirement from the books. As originally proposed, the consolidation legislation also would have ended the grandfathered exemption for facilities located in nonattainment regions. However, the final document extended the 1971 exemption.

In 1994 an agency workgroup developed a concept embodied in the TNRCC's flexible permit, which offered existing facilities additional flexibility in return for overall reductions in emissions. In 1995, the Legislature, in part to provide an incentive to reduce grandfathered emissions, amended the definition of "modification" to provide that well-controlled grandfathered facilities could trade reductions at a plant site. In the fall of 1996, the TNRCC convened an ad hoc industry workgroup to develop a plan for the voluntary permitting of grandfathered facilities. Despite intense efforts by workgroup members, the group could not reach a consensus, and the group was discontinued. In June of 1997, the Governor signed House Bill 3019 which directed the TNRCC to develop a "voluntary emissions reduction plan for the permitting of existing significant sources of air contaminants."

Legal Basis for the Exemption

A facility commonly referred to as "grandfathered" is one exempt from the requirement in subsection (a) of Section 382.0518, Health and Safety Code, of obtaining a state preconstruction permit, and from the other requirements associated with a permit found in subsection (b). Specifically, subsection (g) of Section 382.0518 provides that a facility which was in existence prior to September 1, 1971 is not required to obtain a permit unless the facility is modified after that date.

The term "modification" is defined in Section 382.003(9), Health and Safety Code, as a physical change in, or change in the method of operation of, a grandfathered facility that results in an increase in emissions. Section 382.0512, Health and Safety Code, clarifies that as a general rule, the question of whether an increase in emissions (and thus a modification) will occur must be answered as if no control

technology is installed. However, paragraph (E) of Section 382.003(9), along with subsection (b) of Section 382.0512 taken together provide that the prohibition on consideration of reductions attributable to control technology will not apply to a grandfathered facility that has installed best available control technology equivalent to that which would have been required in a permit issued in the last ten years.

The final statute providing the legal basis for the grandfathered exemption is Section 382.057, Health and Safety Code, which authorizes the commission to allow changes resulting in insignificant increases at permitted and grandfathered facilities. A parallel provision is found in Section 382.003(9)(a), which excludes from the definition of modification changes made under Section 382.057 exemptions. Therefore, if a change is made pursuant to an adopted standard exemption, that change will not constitute a modification.

Issues Relating to Grandfathered Facilities

At the initiation of the committee process, the TNRCC identified several issues to be addressed in developing a voluntary emissions reduction plan for the permitting of existing significant sources of air contaminants. These issues were the following:

- How to assure that the plan adequately protects public health and the environment.
- How to provide the meaningful public participation appropriate to a voluntary permit and emissions reduction effort.
- What level of air pollution control technology is appropriate to a voluntary program.
- How impending federal requirements may be integrated with the plan.
- What incentives are necessary or appropriate to encourage voluntary permitting and emissions reductions.
- What changes would be required in rule or law to implement the plan.

In the course of the Committee's deliberations, a number of additional issues relating to grandfathered facilities arose.

An issue which was much discussed was the question of the degree to which emissions of air pollution from grandfathered facilities are now reduced by control technology. Some members of the committee pointed out that certain industries or facilities might have an unjustifiable reputation for having uncontrolled emissions because they are grandfathered. Even though facilities may have installed control technology due to other requirements or for business reasons, these facilities were not required to obtain permits. It was noted that in some cases, the requirements imposed on some grandfathered facilities by the State Implementation Plan (the SIP) for reducing ozone could be the same as current best achievable control technology required for a new facility. For example, the reasonably achievable control technology (RACT) requirements imposed on storage tanks by the SIP would be the same as the best available control technology now required for a new tank. It also was noted that other requirements may apply to grandfathered facilities aside from those related to ozone standards. Such requirements could include emissions inventory reporting, emissions fees and monitoring requirements under TNRCC regulations, sulfur dioxide emissions reductions under the federal acid rain program, maximum achievable control technology and continuous emissions monitoring under the federal operating permits program. In addition to such requirements, some companies may have installed control technology on grandfathered facilities either for business or other reasons. Reasons may include concern for the legal consequences of releases, avoidance of the federal Title V certification requirement, to zero emissions for new construction under the state implementation plan, to conserve raw materials, for public relations purposes and to allow a company to avail itself of flexibility under Senate Bill 1126.

However, it was also pointed out that some grandfathered facilities are essentially uncontrolled. Thus, while the SIP requirements may be equivalent to current BACT in some cases, for other types of equipment such as boilers, the requirements may result in reductions nowhere near those that would be achieved by installation of BACT. It was also pointed out that for some types of equipment no SIP requirements have ever been developed, and that equipment located in an attainment area would not be covered by the state implementation plan requirements. Moreover, while the SIP requirements, if applicable, could require substantial reductions in volatile organic compounds or oxides of nitrogen, the controls might yield no reductions in other pollutants such as sulfur dioxide or hydrogen sulfide. It also was pointed out that the acid rain requirements apply only to utilities, and that most Texas utilities comply with these requirements without making any reductions in emissions. It was also noted that for many companies, the business reasons for making voluntary reductions might not be sufficient to compel the expenditure of large sums of money. Thus, it was argued, while some facilities may have made dramatic improvements, others continue to operate at the same rate of emissions as they did prior to passage of the permitting requirement in 1971.

There was considerable discussion of the economic disruption that could be caused by the imposition of control technology requirements that exceeded a company's financial resources. The particular example given was of a company operating on a narrow profit margin. It was noted that in many small towns in the state, such a company might be the largest employer. It was argued that if such a company were required to install the best available control technology (BACT) now required of a new facility, the company might be forced to close. This in turn would be likely to cause great economic distress in the area in which the facility was located. Another example given was that of a grandfathered facility operating in an industry with a narrow profit margin. It was argued that such a facility would already have difficulty complying with existing requirements, and that participation in a voluntary program involving upgrades in control technology would be cost-prohibitive.

Another issue raised was the question of whether and how the health of citizens living in communities downwind of grandfathered facilities is adequately protected. It was noted that most grandfathered facilities had never gone through a review of their effects on public health because such reviews are required only for facilities obtaining permits. These grandfathered facilities as a rule have never been subjected to the modeling of emissions and toxicological analysis of the effects of the resulting exposure to air toxics. In addition, it was argued, in many cases the public has never had the opportunity to review information on health effects because grandfathered facilities often have not had to go through the public notice and opportunity for hearing required for a permit. It was also pointed out that where grandfathered facilities are part of a larger site, the effects from any grandfathered facilities would add to the effects of permitted facilities. In response to these points, it was noted that grandfathered facilities have been in existence for at least several decades, and that any health effects would have become evident by now. It also was pointed out that the TNRCC maintains data on emissions from larger nonpermitted sources, and that the agency has the authority to review the effects of those emissions on the surrounding population. It was also pointed out that the TNRCC operates a statewide ambient air monitoring program that reviews air quality and the impacts of air pollution.

Another item of discussion was the fact that the exemption from permitting requirements could result in a competitive advantage to older facilities over newer facilities. It was pointed out that this disadvantage also applies to existing facilities who have chosen to either obtain permits or voluntarily install control technology to reduce emissions are at a disadvantage. For this reason, it was argued that one of the goals of the program should be to provide a "level playing field" for industries.

Another item discussed was the effect impending federal standards may have on grandfathered facilities. It was noted that the effects of such standards could take two forms. First, the upcoming hazardous air pollutant requirements and the new ambient air quality standards may result in many grandfathered facilities will be required to install additional emissions control technology. Second, these requirements could differ or even conflict with technology which might be used for reductions under a voluntary program.

III. Recommendations

Recommendations on Program Goals:

1. A goal of the program is to encourage the maximum participation of entities with grandfathered sources to achieve the maximum amount of emission reductions possible, on a case by case basis.
2. A goal of the program is to achieve meaningful, quantifiable reductions.

Recommendation on the Measurement of Emission Reductions: Any one or a combination of the following should be used on a case-by-case basis to measure real reductions.

- Volume of reductions
- Percentage of emissions reduced
- Reduction in potential health impacts
- Emissions control technology installed.

Recommendation on Credit for Past Emission Reductions: The TNRCC should give consideration to giving credit for prior (or past) emission reductions in determining permit requirements.

Recommendations on Incentives for Participation:

1. An enforcement amnesty period of two years from program adoption for facilities inadvertently modified in the past, not to include willful violations.
2. A facility that agrees to participate in the voluntary program should be allowed increased flexibility beyond what the permit systems currently allow. Such flexibility might include an abbreviated health review as appropriate.
3. The existing flexible permit program should be reviewed to see if it might be enhanced in any way to encourage more companies to enter the program.

Recommendations on Flexibility and Establishment of Pollution Caps:

A. Recommendations on Flexibility Assumptions

1. The program should include a flexible pollution prevention/abatement option.
2. The program should allow the company to use their engineering talent to take the most cost-effective approaches.
3. The program should include a flexible permit option. The TNRCC's current regulations on flexible permits (30 TAC Section 116.710 et seq.) should be reviewed and modified, as appropriate, in order to encourage voluntary participation in the permitting program by grandfathered facilities.
4. Permits issued under this program should have the option of using the pollution cap approach for emissions limits.

B. Recommendations on General Concepts for Flexibility in Permits Issued Under the Program

1. The system should reward well-controlled facilities and encourage less well-controlled facilities to enter the voluntary program.
2. There should be quantifiable emission reductions over time.
3. Flexibility may be afforded to sources which are already well controlled or are committed to a control strategy.
4. Innovative technology and pollution prevention could/should be encouraged.
5. Sources that have already opted for a traditional flexible permit could be given consideration in the outcome of the voluntary program.
6. Non-attainment areas need special emphasis.

C. Recommendations on Flexibility-Related Incentives:

1. The flexible permit program designed by the TNRCC along with major stakeholders and environmental groups can be used as the starting point for the generation of additional flexibility concepts. The primary incentives offered under the current flexible permit program for grandfathered sources are as follows:
   a. Time is given for the implementation of controls at the same time that operational flexibility is afforded such that the company can generate capital to offset the cost of controls.
   b. The health effects review can usually be streamlined by demonstrating improvement in air quality.
   c. Sources are given the ability to manage their own operations while not exceeding their emission cap.
   d. Some modifications are peer-reviewed by the state allowing businesses to better schedule activities and minimize delays due to the process.

2. The flexible permit program should be reviewed to identify enhancements to encourage more companies to participate, including the following:
   a. Regional trading between sources participating in the voluntary program, excluding trading that would shift the risk from one community to another.
   b. Allowing for future growth of the source within the emission cap, provided that any growth above the cap would be subject to new source review.
   c. Other environmental contributions such as allowing large sources to purchase controls for small businesses, resulting in a regional reduction in emissions.
   d. Tax credits.
   e. Permit fee restructuring.
   f. Emissions fee restructuring.

D. Recommendation on Methods for Establishing the Pollution Cap: The pollution cap could be set by one or more of the following methods

1. Quantify the maximum emission rate over a representative period such as 10 years.
2. Establish emission limits at a percentage of number 1 above.
3. Continue the current TNRCC approach used to address the baseline and reduction goals in the flexible permit program.
4. Consideration could also be given to allowing for setting of caps on a basis broader than plant-wide. Group applications for similar types of emissions sources, even with different

owners, could be encouraged or permitted. (Similar types of facilities such as dry cleaners could collectively file an application. If emissions reductions are required, a group could apply controls to those facilities that would be most cost-effective.) Most small businesses lack the necessary resources and source mix to take the most cost-effective approach on their own. Trade organizations or ad hoc groups could also be considered to facilitate group approaches.

E. Recommendations on Additional Flexibility-Related Incentives:

1. Permits issued under this program could have the option of using the pollution cap for an entire facility or group of facilities for purposes of establishing emission limits so long as emissions at any one site are not increased.
2. Consideration could also be given to expanding the plant-wide limit concept contained in the current flexible permit program (e.g., use of state-wide/region-wide/group-wide caps with specified level of reductions from caps and no actual increase) taking into consideration airshed status.

Recommendations on Protectiveness Review:

1. A protectiveness review for the voluntary program should be conducted by the TNRCC staff at a level consistent with the facility's
   - reductions to which the facility commits on entering the program
   - technological practicability and engineering review of the proposed emission control
   - toxicological impact of the proposed level of emission from the facility
2. Compliance history should be considered only where relevant to protectiveness.

Recommendations on Public Participation:

1. If a facility enters the program using the existing permit, standard permit, standard exemption or flexible permit system, the facility would be required to comply with the notice and opportunity for hearing procedures now required for that type of authorization.
2. If entrance into the program is by another method, public notice should be given in a newspaper in an abbreviated notice format as appropriate, and any hearing request granted will follow the notice and comment process similar to that used for federal operating permits.

Recommendations on Additional Incentives:

A. Consideration can also be given to allowing banking and trading of emission reductions achieved through the permitting process.

B. **Recommendations on Tax incentives:** The commission should recommend that the legislature consider the following tax incentives:

   1. A reduction in state franchise tax for those grandfathered facilities that agree to obtain a permit and commit to emission reduction could be considered.
   2. The TNRCC could consider recommending creation of a tax abatement program modeled on Chapter 312 of the Tax Code under which counties not in attainment of one or more National Ambient Air Quality Standards could grant a tax abatement to facilities for the installation of emissions control technology. The following limitations could be considered for inclusion in such a program.
      a. The opportunity for abatements could be limited to counties which have not attained one or more of the National Ambient Air Quality Standards.

b. Abatements could be given where substantial actual reductions of the criteria pollutant or pollutants for which the county is nonattainment will result.
c. Consider granting abatements for periods of between two and eight years; also consider authorizing abatements only on or after the time that constructions has actually commenced.
d. The county and recipient of any abatement could be required to execute a binding agreement including, at a minimum, the amount of reductions to be achieved, the relevant times and penalties for failure to comply with the terms of the agreement.
e. The written agreement also could specify that failure to comply with the terms of the agreement could render the agreement void, with the recipient being liable for taxes and interest which would have been owed had the agreement not been in place.
f. Such agreements could also include a requirement that a facility seeking to utilize a tax incentive must, if unpermitted, obtain a permit or flexible permit from the Texas Natural Resource Conservation Commission.
g. The Commissioner's Court of the county could also consider holding a hearing to determine the value of benefits and costs to the county of a proposed agreement/tax incentive.
h. The authorization to receive potential tax incentives could also include a provision that emission control equipment installed for purposes of an abatement cannot be removed upon expiration of the abatement.

Additional recommendations:

1. Permits issued under this program should allow an extended time line for implementation.
2. Permits issued under this program should include a schedule that synchronizes the permit requirements with the implementation of federal rules and requirements
3. Small emitters as well as significant emitters should be eligible for the program.
4. Entities interested in participating in the program should be encouraged to submit letters of intent to the TNRCC by December, 1998.
5. The TNRCC is encouraged to continue its study of the protectiveness of standard exemptions.

Items on Which Consensus Was Not Reached

The committee did not reach consensus on the following recommendation, but a majority of the committee members supported the concept: In establishing the emissions cap, the facility's potential to emit should be quantified for use as a baseline.

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January 23, 1998

Clean Air Responsibility Enterprise (CARE) Advisory Committee

Minority Report

Summary
Key Issues not Discussed by the Committee
Proposed Voluntary Permitting Program
Citizen Testimony

This report was written and signed by Ramon Alvarez, George Smith, Patricia Gomez.

Summary

The CARE Committee majority report is comprised of very general statements, with which, for the most part, we agree. However, these statements are an inadequate product of the committee's deliberations and provide only minimal guidance to the Commission, considering the time and resources of both committee members and TNRCC staff consumed in this process. In hindsight, we could have agreed with most of the general statements contained in the above report through a written survey.

We are particularly disappointed that the CARE Committee never considered or proposed a tangible, voluntary plan for the permitting of grandfathered facilities. It is apparent that the failure of the CARE process to provide meaningful recommendations is attributable to three main reasons.

First, the Committee was not balanced, with six members representing industrial or business interests and only three members representing the citizens of the State of Texas. This imbalance prohibited open, in-depth discussion of critical issues of concern to the general public. Important matters, such as the testimony from the public hearing, disincentives for entities who choose to retain their grandfathered status, health impacts, and a firm deadline for entering the voluntary program, were never seriously considered by the Committee.

As an example of the business bias of the committee, a majority of committee members favored setting emissions limits in new permits on the basis of a facility's "potential to emit." This proposal recklessly disregards the possibility that ACTUAL emissions from a grandfathered facility could INCREASE, while the facility could claim an emissions decrease on paper. We believe that a voluntary permitting program for grandfathered facilities should result in a decrease in ACTUAL emissions from current levels.

Second, the Committee's deliberations were characterized by a lack of continuity. This was evidenced by the disregard for key Committee decisions, including changes made to both the agenda and ground rules without even consulting (much less obtaining the approval of) all the Committee members.

The third, and perhaps most important, reason for the failure of the CARE process to provide meaningful

recommendations was the wide gulf between the environmental and industry representatives as to the actual contribution of "grandfathered" facilities to local and regional air pollution problems in Texas.

We believe the evidence is very clear that:

- Grandfathered plants are a major source of air pollution in Texas. TNRCC's emissions inventory shows that at least 1.29 million tons of pollutants were released in 1995 by unpermitted facilities. Generally, these unpermitted sources emit pollution at markedly higher rates than permitted facilities. Little progress is evident in the 11 years since 1986, when the Texas Air Control Board (TNRCC's predecessor) calculated that grandfathered facilities accounted for 1.6 million tons per year of air pollution.

- The work of this committee is of critical importance to the public health of more than 14 million Texans who live in areas that violate or are close to violating ambient air quality standards for ozone, particulate matter or carbon monoxide. Many grandfathered facilities are in, or in very close proximity of, those nonattainment areas or near-nonattainment areas. Moreover, communities in close proximity to grandfathered facilities will only benefit from meaningful reductions in emissions of hazardous air pollutants (air toxics) as well as the several criteria pollutants.

- Companies with grandfathered facilities enjoy an unfair advantage over new competitors who must meet much stricter pollution limits. The work of this committee represented an opportunity to "level the playing field" and spur the development and adoption of newer, cleaner technologies.

We strongly disagree with the position of those industry representatives on the Committee who maintain that grandfathered facilities are neither impacting air quality nor affecting public health in urban areas. This difference in perception about the extent and impact of the "grandfather problem" determines how one designs an **effective** voluntary permitting program for grandfathered facilities. The Committee was unable to make progress toward developing a permitting program because industry representatives would not even acknowledge that a problem exists, choosing instead to argue that many grandfathered facilities are already well-controlled, and are unjustly stigmatized by the "grandfather" label.

We recognize that the legislature requested a voluntary permitting plan from TNRCC, but it is apparent from citizen testimony that patience is wearing thin. The support of permanent loopholes for old, grandfathered plants has run out. We encourage the Commission to consider our proposal below in developing a permitting program that is flexible and provides incentives to rejuvenate, and reduce emissions from, grandfathered facilities in Texas.

Key Issues not Discussed by the Committee

TNRCC staff provided the CARE Committee with a good base of information from which to begin its deliberations. However, the abbreviated time frame and unbalanced composition of the committee prohibited the discussion of many key issues. Such discussion would have been invaluable in the committee's deliberations and helpful in drafting an effective permitting program. Some of the unaddressed issues are listed below. At the very least, these issues should be considered before the TNRCC drafts a voluntary program, and should also be a part of the report to the legislature.

We believe that consideration of the following issues is critical to the design of an appropriate, meaningful, and effective voluntary permitting program:

- The total number and geographic distribution of, and emissions from, grandfathered facilities.
- The extent to which emissions from grandfathered facilities are transported into nonattainment and near-nonattainment areas in Texas. (This analysis does not require full modeling, but could simply use meteorological data already on the TNRCC web site overlayed on a map of grandfathered facilities to estimate the impact.)
- The comparative costs of meeting SIP requirements by reducing emissions at permitted facilities versus the costs of making comparable emissions reductions at grandfathered facilities in the same nonattainment area or upwind of a nonattainment area (in the same airshed).
- The validity in 1997 of equitability arguments made in 1971 about grandfathered facilities, including the age of these facilities and the extent to which they are depreciated. (This is a simple survey process.)
- The extent to which grandfathered facilities are affecting visibility at Big Bend National Park. (This involves merely looking at the National Park Service data about transport from geographic regions, and weighting the impact of grandfathered facilities.)
- The extent to which reducing emissions at grandfathered facilities through new technologies might contribute to multiple environmental benefits such as simultaneous reductions in ozone, particulate matter, mercury and other air toxics, carbon dioxide, as well as improved visibility.
- The costs and benefits of a mandatory permitting program for grandfathered facilities; the design of a voluntary program is in part tied to the costs and benefits of avoiding an alternative regulatory scheme.

Finally, although the CARE committee set aside an entire day for public testimony and received scores of additional written comments, it failed to consider any of this input in its subsequent deliberations. The Commissioners should review and carefully consider the fears, anxieties, and life experiences of the public with respect to the health impacts of air pollution – as expressed in both their verbal and written comments -- before drafting its permitting program.

Proposed Voluntary Permitting Program

The Committee never considered nor proposed a tangible permitting plan. We proposed (but the Committee never considered) the following outline of a program which is voluntary, flexible, and provides incentives, and will assure meaningful and measurable reductions in harmful air emissions in Texas.

1. **Distinguish between major and minor grandfathered sources.**

   Offer a simplified standard permit to minor sources with good compliance history and no complaints from citizens in the area. This will not result in major emissions reductions but will provide better data for the emissions inventory, a better basis for future pollution control efforts, and the opportunity for periodic permit renewal.

   Medium and large sources that are at or close to BACT emissions limits, have demonstrated good compliance history, and for which there is no record of citizen complaints in the area may also

obtain a simplified, standard permit. TNRCC should retain the option to require a health effects review, as appropriate. Public comment could be limited to notice and comment only.

The remaining large, poorly controlled sources, which account for the vast majority of grandfathered emissions, may obtain a conventional operating permit or a flexible permit.

2. Minimum Conditions for Flexible Permit.

In return for the benefits of flexible permits, companies choosing this option must commit to continuously phased-in, measurable emissions reductions.

The TNRCC should conduct appropriate health effects modeling based on baseline emissions and projected decreases, taking into consideration the type of facility and emissions profile.

Actual emissions must not increase from current actual levels at any time in the future, except through the normal permit and offset requirements. A majority of committee members favored setting emissions limits on the basis of a facility's "potential to emit," in reckless disregard for the possibility that actual emissions from the facility could increase.

Companies choosing the flexible permit option must install BACT beginning as soon as practicable, continuously each year, but no later than 5 years after permitting, as appropriate.

Companies choosing this option must conduct stack testing before obtaining a permit to verify the emissions baseline, with periodic testing thereafter to insure progress in achieving reductions.

Companies choosing this option should institute a community involvement program modeled after the Chemical Manufacturers of America's "Responsible Care" program.

Flexible permits should include full opportunity for public participation. (See below)

3. Public Participation.

Because the permitting of grandfathered facilities represents the first time that many facilities will come under review, citizens must be given every opportunity to fully participate in the permitting process for all types of permits, but particularly for the large, poorly-controlled facilities.

If public participation is to be meaningful, neighborhood groups must be provided appropriate resources. TNRCC should also institute an outreach program on its permitting process.

4. Incentives for Companies to Voluntarily Seek Permits.

Companies under this program can receive flexible permits which allow operation under a facility-wide emissions cap for key pollutants, without requiring an individual permit with emissions limitations for each source within the facility.

Companies under this program would be eligible for existing tax abatements for new pollution control equipment.

The TNRCC should increase the fees assessed on a per ton basis to grandfathered sources that do

not enter the permitting program.

The TNRCC should recommend that the Legislature remove the maximum amount of emissions on which fees can be assessed at grandfathered facilities.

Major, unpermitted sources should lose the option of obtaining a flexible permit after two years.

The TNRCC should require the installation of continuous emissions monitors at major grandfathered facilities after two years from the start of the program.

The TNRCC should publish an annual report on emissions from remaining unpermitted plants (plant by plant), and distribute the report to neighborhood groups near such plants.

5. **Propose New Legislation.**

The TNRCC should recommend that the legislature pass legislation establishing a deadline for all facilities to be permitted. We suggest the year 2001, which is 30 years after the enactment of the Clean Air Act, and 16 years after a Sunset Commission recommended a 1995 expiration of the grandfather exemption (this recommendation was never adopted by the Legislature).

6. **Address Cumulative Impacts.**

TNRCC must require cumulative health impact analysis at a company site when granting permits where large quantities of toxic emissions are evident or complaints from neighbors have occurred.

TNRCC must perform Prevention of Significant Deterioration (PSD) reviews of all major facilities within 750 miles of Class I areas, in order to address the well-established effects of long-range pollution transport.

TNRCC should give special attention to areas of concentrated industrial activity and conduct monitoring and modeling for cumulative impacts in response to citizen health concerns.

7. **Revisit Standard Exemptions and Illegal Grandfathering.**

TNRCC should review the use of standard exemptions, especially to determine if they are being stockpiled at individual plants to the point that exempted emissions represent a significant source of pollution. Any such plants should be required to get a permit or face penalties.

TNRCC should establish a team of inspectors to identify facilities that are falsely claiming grandfathered status. These are facilities that may have been modified since 1971 without satisfying the state permitting requirements. TNRCC should consider a limited, 2 year amnesty program to encourage such facilities to voluntarily undergo permitting, if the facility agrees to a permit or BACT upgrade within five years. If identified after the amnesty period, such facilities would be subject to the per day penalties of existing law.

Citizen Testimony

The legislature requested a voluntary plan from TNRCC, but it is apparent from citizen testimony that patience is thin. The support of permanent loopholes for old plants has run out. Therefore, it makes sense

r TNRCC to submit to the legislature a voluntary program for permitting grandfathered sources, along with a time deadline that triggers mandatory permitting requirements. The BACT-based emission reduction goals proposed above were overwhelmingly supported by citizen testimony and present companies the opportunity to increase efficiency as they reduce emissions.

Citizen testimony clearly pointed out the need for all grandfathered facilities to be brought up to today's standards and the need for all grandfathered plants to participate fully in the effort to clean up the air in nonattainment and near-nonattainment areas.

The TNRCC Commissioners should review and carefully consider the citizen testimony before drafting its voluntary permitting program. We respectfully remind you that one of the accepted goals of the entire CARE Committee was that this process result in a win-win situation for all affected parties. There must be an equivalent concern for the public health of the citizens of Texas as there is for the economic success of the business community.

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January 22, 1998

Clean Air Responsibility Enterprise (CARE) Advisory Committee

Response to the Minority Report

This report was written by Mary Miksa, Texas Association of Business and Chambers of Commerce and Cindy Morphew, Texas Oil and Gas Association.

We are responding to what we believe is the most significant concern voiced in the Minority Report, that is, that their ideas, individually enumerated in the Minority Report, were not appropriately considered by the CARE Advisory Committee.

In an attempt to make an orderly response, we have extracted or paraphrased language from the Minority Report which is shown either by underlining or by quotation marks. Where appropriate, we have included dates when issues were discussed by either a subcommittee (as reflected in a subcommittee report) or the full committee (as reflected in TNRCC meeting summaries).

A. Consideration Of General Concepts In The Minority Report

Grandfathered plants are the major source of air pollution in Texas.

Testimony from TNRCC staff at the Sept. 19 and Oct. 2 CARE AC meetings indicated that information about emissions from grandfathered facilities in Texas is limited, since, historically, data has been compiled on the basis of "permitted" and "non-permitted" emissions. Data for non-permitted emissions include a variety of emissions that are not associated with grandfathered facilities. Thus, the information that is currently available is not reliable. The revised TNRCC Emission Inventory results, scheduled to be released in the spring of 1998, should provide a more complete picture of the amount of emissions from grandfathered facilities.

Further analysis needed before designing a voluntary program.

In response to the Minority Report's suggestion that more research is needed "before designing an appropriate and meaningful voluntary program," we agree that, in the best of all possible worlds, more time, more study, more research would be an advantage when designing a complex program like the one contemplated here. The committee, however, was charged with producing recommendations for a voluntary program to permit grandfathered facilities with a deadline of December 31, 1997. We believe all the task force members have done their best to meet that deadline in a manner that would encourage maximum participation and maximum emission reductions from grandfathered facilities.

B. Consideration Of Minority Report's "Voluntary Plan"

1. Abbreviated health review/distinguish between major and minor grandfathered sources.

   These concepts and related ideas were discussed in an Oct. 10 meeting of the Subcommittee on Incentives. After discussion, the consensus of the subcommittee was to recommend the following statement:

   "We all agreed that a facility with a clean record (good compliance history) should be allowed to have increased flexibility, basically an 'easier go' than the existing permit structure allowed. This might include an abbreviated health review for certain emission reductions as would be appropriate. Whatever flexibility allowed in this program should include an appropriate review that would be protective of public health and the environment."

   The full committee agreed with this approach and general language was adopted on Oct. 14, as reflected in item 2 under Recommendations on Incentives for Participation in the Draft Final Report.

   Regarding the size of grandfathered emission sources, the full committee addressed the concept during the Oct. 2 meeting. At this meeting, the committee agreed that the voluntary program should be primarily designed for sources listed in the TNRCC's Emissions Inventory (EI), but that it also allow other (smaller) sources to participate. The committee reasoned that since the EI requires reporting of emissions only above specific thresholds, many small sources are not required to report their emissions. In the desire to allow participation in the voluntary program by small emitters as well as large grandfathered sources, the full committee agreed not to differentiate between emission sources by size.

2. Minimum conditions for flexible permit.

   At a number of times in its deliberations, the committee discussed the possibility of creating some kind of minimum permit for facilities with good compliance records. Most of the discussion occurred during the Oct. 14 meeting when the full committee discussed the report of the Subcommittee on Incentives.

   Under current law, any grandfathered facility has the option now of obtaining a flexible permit. The CARE AC was charged with trying to encourage *greater participation* by grandfathered sources in the permitting process by enhancing currently available permit options and/or designing a new permit program. The approach suggested by the Minority Report adds restrictions to the permit process and would make the current flexible permit program much less attractive to companies considering the permitting of their grandfathered facilities. Therefore, rather than serving as an incentive for entities to voluntarily permit their grandfathered emissions, the suggestion advanced by the Minority Report would be a *barrier to participation* in the voluntary program.

3. Public participation.

   Public participation was a subject of considerable discussion by the Subcommittee on Health Impacts and Public Participation. The level of public participation was discussed by the subcommittee in their teleconferences of Oct. 7 and 13. Following that discussion, the subcommittee agreed that the voluntary program should require "adequate public participation." Further, the subcommittee agreed that a facility entering the permitting program under current law should use the public participation level required by Chapter 116

of the Texas air quality regulations. If a facility enters the permitting program by another means, such as the voluntary program eventually proposed by the TNRCC, then public notice should follow the requirements of Chapter 122, which includes provisions for a hearing. Finally, to enhance public notice, the subcommittee recommended that notice of the permit application be published in the *Texas Register*. On Oct. 14, the full committee discussed and agreed with all of the recommendations from the subcommittee. In addition, the full committee increased public participation by recommending that abbreviated notice of the proposed permit be published in a newspaper of general circulation.

4. Incentives for companies to voluntarily seek permits.

- Flexible permits/facility wide emission cap.

  This provision of the Minority Report is already current law and required no action by the CARE Advisory Committee.

- Property tax abatements/pollution control equipment.

  This provision of the Minority Report is already current law and required no action by the CARE Advisory Committee.

- Increasing emission fees/removing emission fee cap.

  On Oct. 14 when discussing the report of the Subcommittee on Incentives, the full committee discussed applying both concepts--increasing fees assessed on a per ton basis and removing the cap on emission fees--to grandfathered facilities that do not enter the permitting program. A majority of the committee believed that this would be a negative incentive and would decrease participation in the permitting program. The CARE AC, however, did recommend that the TNRCC should consider the need for emission fee restructuring and included this as the fourth bullet under recommendation C (2), Recommendations on Flexibility-Related Incentives.

- Phased in-reductions/Two-year deadline to obtain flexible permit.

  The Minority Report advances the concept that in return for the benefits of flexible permits, "companies must commit to continuously phased in, measurable emission reductions." This issue was discussed by the committee on Nov. 11 and adopted as recommendation B (2) by the full committee.

  The Minority Report also suggests adopting a recommendation that major unpermitted sources should not be allowed to obtain a flexible permit after two years and be mandated to obtain a standard permit at the end of that period. On Oct. 10, the Subcommittee on Incentives discussed the concept "that the flexible permit program should not be allowed for non-permitted facilities after a five year period, thereby encouraging companies to permit earlier rather than later." The subcommittee further discussed the concept that if these facilities were not "permitted after five years, the flexible permit program would not be an option." The subcommittee failed to reach consensus on limiting the time allowed for a grandfathered facility to obtain a flexible permit.

On Oct. 14, the full committee discussed this issue during consideration of subcommittee reports. The full committee also failed to support a cutoff date for the use of the flexible permit by grandfathered sources.

- Annual report on emissions from unpermitted sources.

  We feel this comment has been addressed by the revision of the TNRCC Emissions Inventory, due out in the spring of 1998, and, thus, required no action by the CARE Advisory Committee.

5. Propose new legislation.

   The Minority Report suggests establishing a deadline for all facilities to be permitted by 2001. The full committee discussed this deadline on Oct. 14, but reached no consensus, and, therefore, this item is not included in the CARE AC final recommendations.

6. Address cumulative impacts.

   We believe this suggestion is outside the charge of the CARE Advisory Committee.

7. Revisit standard exemptions and illegal grandfathering.

   The CARE AC discussed the issue of standard exemptions at grandfathered facilities at their meeting on Oct. 14. Several members of the committee pointed out that TNRCC staff is currently engaged in a study of the protectiveness of current standard exemptions. The committee consensus was to allow TNRCC the opportunity to complete their study of standard exemptions, and this consensus is reflected in the Committee's recommendations under "Additional Recommendations".

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ENVIRONMENTAL

Patricia Finn Braddock, Partner — Austin

A partner since 1992, Pat Braddock resides in the Austin office of Fulbright & Jaworski L.L.P. She focuses on permitting and enforcement matters before federal and state regulatory agencies, primarily in air pollution control, as well as in water and hazardous waste matters. From 1974 to 1978, Ms. Braddock was a Staff Attorney and Assistant Director of Enforcement at the Texas Water Quality Board and later was an Assistant General Counsel of the Texas Department of Water Resources. From 1978 through 1987, Ms. Braddock was Senior Staff Attorney for the Texas Air Control Board and was responsible for reviewing and approving all work of the Enforcement Counsel Section of the Legal Division.

Ms. Braddock is certified by the Texas Board of Legal Specialization in Administrative Law and is a contributing author of the *Texas Environmental Law Handbook*, which is published by Government Institutes. Included in *The Best Lawyers in America* and *Who's Who in American Law*, she is a member of Travis County Bar Association and the State Bar of Texas. After receiving a B.A. in 1971 from the American University and a J.D. in 1974 from St. Mary's University of San Antonio, Ms. Braddock was admitted to practice in Texas in 1974.

NOTES

E.G. Fiesinger
Solutia Inc.

Ed Fiesinger is a Fellow, Environmental Safety & Health with Solutia Inc. (formerly Monsanto's chemical businesses) at the Alvin, Texas plant. Employed by Monsanto/Solutia since 1966
(18 years experience in manufacturing operations, 13+ years in environmental and regulatory affairs). Responsible for all air issues at the Alvin plant including permitting, compliance, and regulatory advocacy; for submittal of the plant's SARA TRI releases and annual TNRCC air emissions inventory. Member of the Air & Waste Management Association currently serving as Southwest Section Vice-Chair, and Chair of the Texas Chemical Council's Air Permitting Subcommittee representing the chemical industry on the Grandfather permit issue and implementation of Title V in Texas.

NOTES

Jeffrey A. Saitas, P.E.

Texas Natural Resource Conservation Commission

On May 21, 1998, Jeffrey A. Saitas was named Executive Director of the Texas Natural Resource Conservation Commission (TNRCC). He is currently the Deputy Director, Office of Air Quality of the TNRCC. Prior to becoming Deputy Director of Air Quality, Mr. Saitas served as a permit engineer in the Chemical Section of the New Source Review Program (air permitting); section manager of the Chemical Section of NSR; and ultimately, director of NSR.

Mr. Saitas holds a Bachelor of Science degree in Mechanical Engineering from the Georgia Institute of Technology and a Master of Science degree in Engineering from the University of Texas at Austin. He has received certification as a registered Professional Engineer in Texas. Mr. Saitas was previously employed by Exxon Company USA in Houston, Texas and spent several years in various engineering positions in the oil and gas industry before joining the Texas Air Control Board, one of the predecessor agencies of the TNRCC, in April 1989.

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LAND USE/ENVIRONMENTAL EQUITY

PANEL DISCUSSION

JIM BLACKBURN
DAVID DUNCAN
ROLIFF PURRINGTON
JOHN WORRALL

NOTES

JIM BLACKBURN
SHORT BIOGRAPHY

Jim Blackburn is an environmental lawyer and scientist living in Houston, Texas. He is a partner in the law firm of Blackburn & Carter and is a lecturer in environmental law and planning in the Environmental Science and Engineering Department at Rice University. He received B.S. (history, 1969) and J.D. (law, 1972) degrees from the University of Texas and an M.S. in environmental science from Rice University (1974).

Mr. Blackburn's private practice involves innovative legal and technical strategies for environmental improvement. Blackburn & Carter's practice is restricted to environmental law, concentrating upon protection of the environment and neighborhoods. Mr. Blackburn is currently involved in federal litigation to protect the Columbia Bottomlands wetland system, in citizen protests before the state environmental agency involving solid waste disposal and in toxic tort litigation associated with hazardous air pollution. Mr. Blackburn also is developing an air pollution control project for the Houston region under contract with the City of Houston and is working under an innovative settlement agreement with Formosa Plastics to develop a sustainable development plan for Formosa's Point Comfort complex.

Mr. Blackburn's teaching at Rice University is primarily in the Environmental Science and Engineering Department, where he teaches U.S. and global environmental law and sustainable development. Mr. Blackburn has also taught in the architecture school (environmental planning) and the economics department (environmental economics) at Rice. In 1997, Mr. Blackburn helped organize the Delange*Woodlands Conference on Sustainable Development at Rice. His principal research area is sustainable development and collaboration.

Mr. Blackburn is also active in community issues. He is co-chair of the Galveston Bayou Conservation and Preservation Association and is on the Board of Directors of Trees for Houston and The Texas Center for Policy Studies. Mr. Blackburn is the founding chairman of the Galveston Bay Foundation and is helping form the Matagorda Bay Foundation. Mr. Blackburn was awarded the Robert C. Eckhardt Lifetime Achievement Award of the General Land Office of the State of Texas in 1998 and has been awarded the Jesse L. Walls award for work in preserving waterways.

6/24/98

Environmental Equity and Title VI of the Civil Rights Act of 1964

EPA's New Guidance and Related Topics

Paper presented at the
Tenth Annual
Environmental Superconference
August 6, 1998

David D. Duncan
Senior Attorney
Texas Natural Resource
Conservation Commission
Environmental Law Division

The opinions contained in this paper are those of the author alone, and do not represent the position of the TNRCC, its Executive Director, or Commissioners.

I. Introduction

The two most important social movements of the twentieth century have been in civil rights and protection of the environment. Of the two, the civil rights movement is more important.[1]

It is hard to disagree with the foregoing statement no matter how you are affected by the issue of environmental equity.[2] The disagreements have been, and will continue to be, regarding the exact methods for quantifying and addressing alleged instances of environmental inequity by entities receiving federal funding. It is this group of state agencies, local governments, and others that are the subject of a recently released and hotly debated EPA policy document. That document, titled the "Interim Guidance for Investigating Title VI Administrative Complaints Challenging Permits" ("Interim Guidance" or "Guidance")[3] has reinvigorated debate and discussion of environmental equity. The Interim Guidance and the controversies surrounding its

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[1]This paraphrased statement is generally attributed to James M. Seif, Secretary of the Pennsylvania Department of Environmental Protection, at a meeting of the Environmental Council of the States (ECOS) in late March of 1998. Seif, after giving the statement, was the only state representative to vote against an ECOS resolution asking EPA to withdraw and rewrite their Environmental Justice Guidance document.

[2] Several terms are used to describe this unique area of law and social science. "Environmental justice" is the term widely used by EPA and other federal sources, as well as some environmental and civil rights groups. "Environmental injustice", "environmental racism" and "environmental inequity" are terms used by some civil rights advocates. The term environmental equity is used by many states and other agencies subject to the regulations (including TNRCC), and will be used throughout this paper as a catch-all phrase meant to encompass all developments in the area.

[3]This document, provided for reference as Attachment 1, was officially released by EPA on February 4, 1998. A teleconference was scheduled with state officials that day to announce the document, and to offer a comment period of 90 days. EPA stated, however, that the document would still be "used" by the agency during that period for the processing of complaints. They have subsequently tempered that position with the convening of an advisory committee, discussed *infra* at footnote 43 and accompanying text. In recent speeches regarding the document, EPA officials have been careful to point out that it is strictly an internal agency document meant for use of EPA staff in their processing of these complaints.

release and use by EPA are the subject of this paper. The paper will also give some flavor of related cases and issues in the Title VI arena, present a summary of all complaints filed in Texas and some from other states, note TNRCC's efforts regarding environmental equity, and point out some of the key questions that remain unanswered relating to EPA's efforts in this area.

II. Applicable Statutes and Rules

A. The Civil Rights Act of 1964, Title VI

The Civil Rights Act of 1964 ("Act")[4] was passed in the frenzy of legislative activity after the death of President John F. Kennedy. It was an attempt to ensure that government was not in the business of spending money to discriminate based on "race, color or national origin." The basic language of the statute is very simple and short:

> No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance.[5]

The following section of the Act allows agencies to promulgate regulations to enforce the intent of the Act:

> Each Federal department and agency which is empowered to extend federal assistance to any program or activity . . . is authorized and directed to effectuate the provisions of section 2000d of this title with respect to such program or activity. . ..[6]

The language in section 601 of the Act has been used by civil rights activists for years to address

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[4] 42 U.S.C. § 2000d.

[5] Id. This section is generally referred to using the original numbering system for the bill - section 601 of the Civil Rights Act.

[6] 42 U.S.C. 2000d-1, more commonly known as section 602 of the Civil Rights Act.

numerous instances of racial bias in federally funded programs.[7] While there is no specifically stated private right of action under that section, one has been found to exist by the federal courts.[8] In general, to prove a violation actionable under Title VI, a plaintiff must prove discriminatory intent.[9] Although this is generally the case, one very important recent federal circuit court decision held that plaintiffs could use the "discriminatory intent" regulations promulgated by EPA pursuant to section 602 of the Act (discussed below) to prove a violation of Title VI.[10]

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[7] Cases arise in employment (Afro American Patrolman's League v. Duck, 503 F.2d 294 (6th Cir. 1974), upheld injunction of a facially neutral promotion policy demonstrated to have a racially discriminatory impact), highway siting (Coalition of Concerned Citizens Against I-70 v. Damian, 608 F. Supp. 110 (S.D. Ohio 1984), *prima facie* violation of Title VI where Federal Highway Administration regulations displaced 75% minorities on highway project), housing (Shannon v. U.S. Dept. Of Housing and Urban Dev't, 436 F. 2d 809, *prima facie* violation of Title VI where discriminatory segregative effect of housing shown), and education (Larry P. V. Riles, 793 F.2d 969 (9th Cir. 1984), *prima facie* Title VI violation where nonvalidated IQ tests placed 15% of African American students in "retarded" category, only 2% of whites) to name only a few regulatory arenas.

[8] Cannon v. University of Chicago, 441 U.S. 677 (1979). Although this was a case interpreting Title IX of the Civil Rights Act, numerous courts have noted that Congress patterned Title VI after Title IX, and have consistently applied the Cannon case to allow a private right of action under Title VI. See, e.g., Neighborhood Action Coalition v. Canton, 882 F.2d 1012 (6th Cir. 1989); Montgomery Improvement Assn. V. U.S. Dept. of Housing and Urban Dev't, 645 F.2d 291 (11th Cir. 1981).

[9] This reading of the statute was made by the U.S. Supreme Court in Guardian's Assn. V. Civil Service Commission of the City of New York, 463 U.S. 582 (1983).

[10] Chester Residents Concerned for Quality Living v. Seif, 132 F.3d 925 (3d Cir. 1997), cert. granted, ___U.S.___ (1998). The Supreme Court's decision in this case will be a significant milestone in the environmental equity arena. If the Court should decide that the private right of action can be brought based on disparate impact alone, it is far less likely that complainants will press their claims before EPA, since they need not exhaust their administrative remedies prior to bringing the lawsuit. Cannon, supra footnote 8, 441 U.S. at 706-08 n. 41. On the other hand, if the Court should decide that a plaintiff must prove intentional discrimination to bring a successful suit in federal court, EPA will be the primary venue for environmental equity claims of disparate impact discrimination.

B. EPA's Regulations

EPA promulgated their regulations based on the Act in 1984.[11] As will be more apparent later in this paper, these rules form the regulatory basis and backbone of the recently promulgated EPA Guidance. The regulations, located at 40 CFR Part 7, contain definitions, and subparts on racial, national origin and sexual discrimination, discrimination based on handicap, and general requirements for recipients of federal funds.[12] The rules also designate the Office of Civil Rights ("OCR") within EPA as the agency's office for handling issues related to environmental equity. The crucial language of the prohibitions section of the rules reads:

> A recipient [of federal funds from EPA] shall not use criteria or methods of administering its program which will have the **effect** of subjecting individuals to discrimination because of their race, color, national origin, or sex . . ..[13]

The regulations contain language requiring certifications of compliance by agencies receiving funds from EPA, requiring posting of notices of nondiscrimination, and maintenance of records demonstrating compliance. A grievance procedure is to be maintained by agencies having more than 15 full time employees, and intimidation and retaliation against those filing complaints is specifically prohibited.[14]

Finally, and for purposes of this discussion most importantly, Subpart E of the regulations contains the "Agency Compliance Procedures" for federal fund recipients. This section of the

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[11] 49 Fed. Reg. 1659 (Jan. 12, 1984).

[12] 40 C.F.R. Subparts A through D. Importantly, the definition of "assistance" is written very broadly to include any monetary funding, in kind help, or personnel services provided by EPA to a recipient. Id. § 7.25.

[13] Id. § 7.35(b) (emphasis added). This language is generally consistent with language promulgated by other federal agencies, and is generically referred to as a "discriminatory effect" rule.

[14] Id. Subpart D.

regs contains procedures for the filing, processing and resolution of complaints filed with EPA containing allegations of discrimination. There are rules for compliance determinations by EPA as part of the award process both before and after issuance of assistance. The rule allows for anyone to file a complaint if they believe "he or she or a specific class of persons has been discriminated against in violation" of the rules.[15] The regs then state "Where, when and how to file a complaint", specifying that OCR handles the complaints, which can be filed at any EPA office. The complaint must be filed within 180 days of the alleged discriminatory acts, but this time limit can be waived for good cause. EPA OCR is required to notify the recipient agency and the complainant within five days of receiving the complaint.[16]

Within 20 days of acknowledging receipt of the complaint, EPA OCR is required to review the complaint, and decide whether to accept or reject it, or refer it to another agency for processing.[17] If the complaint is accepted, OCR must notify the complainant, the "Award Official" (the person at EPA responsible for approving or overseeing the federal assistance at issue), and the funds recipient. Along with this notification, the recipient is given an opportunity to file a "written submission responding to, rebutting, or denying the allegations raised in the complaint."[18] The section closes with a general directive that EPA OCR should attempt to resolve all complaints

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[15] Id. § 7.120(a). A flowchart representing EPA's system for processing Title VI administrative complaints under these regs is provided as Attachment 2.

[16] Id. § 7.120(c). This requirement has often been overlooked by EPA OCR. On one complaint pending against TNRCC, the agency received press inquiries before any EPA correspondence was sent. The complaint in that case had been filed several weeks before the press inquiry (in April 1996), and the TNRCC first received correspondence from EPA when they requested additional information from the complainant in May of 1997.

[17] Id. § 7.120(d)(1)(I). This is another time frame that EPA has missed considerably on many pending complaints. The most egregious example on a complaint pending against TNRCC is one filed in April of 1996 where the EPA has still not decided whether to accept, reject or refer. In fairness, EPA is often forced to seek further information from complainants, mostly seeking clarification tying recipient actions to specific examples of discriminatory effect.

[18] Id. § 7.120(d)(1).

through informal means, but should move to more formal mechanisms if this is not successful.

The final sections of the rule deal with the sanctions available to EPA if they find a recipient's programs have resulted in discriminatory effects, and no resolution has been found. The primary sanction available is termination or refusal to continue the assistance. Such termination is preceded by a notice and opportunity for hearing before an EPA Administrative Law Judge, with appeal to the Administrator of EPA. If the Administrator makes a final finding supporting annulment or suspension of assistance, she must report the finding to "the Committees of the House and Senate having legislative jurisdiction over the program or activity involved."[19] This decision is final, and presumably subject to appeal in federal court. Lawyers in the Civil Rights Division of the Office of General Counsel at EPA headquarters have quoted a section of the rules which states "EPA may also use any other means authorized by law to get compliance, including referral of the matter to the Department of Justice" as authority for the agency to obtain civil penalties or injunctive relief against state agencies.[20]

C. Presidential Executive Order

On February 11, 1994, President Bill Clinton issued an Executive Order entitled "Federal Actions to Address Environmental Justice in Minority Populations and Low-Income Populations."[21] The Order requires each federal agency to "make environmental justice part of its mission by identifying and addressing, as appropriate, disproportionately high and adverse human health or environmental effects of its programs, policies, and activities on minority

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[19] Id. § 7.130(b)(3).

[20] Id. § 7.130(a). This assertion seems to fly in the face of the guarantees of state sovereignty provided by the Tenth and Eleventh Amendments to the U.S. Constitution. But, of course, these arguments will have to await the actual filing of such a claim by bold litigators from USDOJ.

[21] Executive Order 12898, 59 Fed. Reg. 7629 (Feb. 11, 1994) (provided as Attachment 3).

populations and low income populations."[22] The guidance also creates an interagency workgroup to be convened by EPA, composed of EPA and seventeen other agencies of the federal government. The mission of that group was to provide guidance on assessing disparate impacts, coordinate among the agencies to ensure consistency among the agencies, coordinate data collection, and develop interagency models for projects in the field. The Order directs each agency to "develop an agency-wide environmental justice strategy" by reviewing policies, programs, rules, and the like that should be revised to attain the goals of the Order.[23] The Order also requires the agencies to meet certain milestones at specific dates following the issuance of the Order, including a mandate that all agencies have their environmental justice strategies finalized within 12 months after the issuance date.

D. Cases and Application

In a lengthy, scholarly CLE paper such as this, one would expect this section to be filled with numerous examples of contentious EPA decisions in this area, perhaps linked with discussions of the federal district and appellate court decisions that would probably flow from them. However, this area of regulation has no decisions. Despite having 51 cases filed, some dating as far back as 1993[24], EPA has yet to render even a proposed decision in one of the cases. Throughout this time EPA has maintained staff for handling these cases, including a section of lawyers within its Office of General Counsel.

All of this is not to say that EPA has done nothing in this area. In addition to the new guidance

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[22] Id. § 1-101.

[23] Id. § 1-103.

[24] In Texas, one of the first Title VI administrative complaints (see list below in section IV.D.) was filed in March, 1994 and accepted for processing in May of that year. The last piece of correspondence received on the case was dated August, 1994, with EPA informing TNRCC that they had "assigned additional staff to process the complaints filed under Title VI. . .." A complete list of pending Title VI complaints pending with EPA's OCR, arranged according to status and noting which state and EPA region the complaint is in, is appended as Attachment 4.

discussed at length below, EPA has sent out correspondence on many of these cases, has developed other more technical guidance and documentation, and has even performed some preliminary analyses that have found their way into the public domain. One prominent example is the Shintech case in Louisiana. That case involves a proposed vinyl chloride monomer and polyvinyl chloride plant in St. James Parish, on the Mississippi River. The facility is proposed to be located within five miles of eleven other industrial facilities (nine of which are major sources on Louisiana's emission inventory system for toxic releases), ranging from a sugar coop to a major refinery. Also within a five mile radius of the proposed site are residential areas, including several which are between 48 and 100% populated by African Americans.

EPA has performed a draft demographic analysis, released in January of this year, for the Shintech complaint.[25] That demographic analysis does not draw any conclusions or make recommendations, but simply reports and correlates the demographic data for the areas near the proposed Shintech plant. EPA is rumored to have performed a corresponding environmental impacts analysis for the plant as well, but copies of that document are not as readily available.[26] The complaint in this case was filed by students with the Tulane University Environmental Law Clinic, on behalf of certain residents in the area of the proposed plant. The permit at issue in that filing was the Title V federal Operating Permit required under the Clean Air Act. In a letter to EPA Administrator Carol Browner dated September 8, 1997, Louisiana's Secretary for the Department of Environmental Quality, J. Dale Givens, wrote that LaDEQ would voluntarily reopen the Shintech permit for further consideration, including "dialogue with concerned individuals and groups [to] address issues that may involve the concept of environmental justice." Browner's response letter formally grants citizen petitions on the Title V permit based

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[25] "Title VI Administrative Complaint re: Louisiana Department of Environmental Quality/Shintech Permit; Draft Demographic Analysis", U.S. EPA Office of Civil Rights, January 1998. This document, including graphic representations of the findings, is available on EPA's Region 6 website at http://www.epa.gov/region6/shintech/.

[26] Some environmental practitioners in the Washington, D.C. area are rumored to have received leaked copies of the impacts analysis.

on certain technical issues.[27] The letter goes on to say that EPA is "encouraged" by the letter mentioned above in light of the apparent willingness to address environmental justice issues. EPA has set several dates by which it expected to release a final decision on the Shintech complaint, but all have passed without action.[28]

E. Congressional proposals on environmental equity

In addition to administrative developments such as the EPA Guidance, lawmakers have made some attempts at breaking new ground in this area. One example is the amendments to the Low Level Waste Compact offered by Minnesota Senator Paul Wellstone. In a section of the Compact entitled "Conditions on Consent to Compact", Wellstone added provisions that the Compact must "not be implemented . . . in any way that discriminates against any community (through disparate treatment or disparate impact) by reason of race, color, national origin, or income level."[29] The one obvious addition to Title VI is income level, but otherwise the prohibition contained in the amendment fairly mirrors Title VI. The enforcement of the amendment adds some novel features, like enforcement by the U.S. Attorney General, and broadens the potential affected community to any person who resides or has a business located in a community that is adversely affected by implementation of the Compact. Some have speculated that this could include persons on the shipping routes of the low level wastes from Manie and Vermont to Texas. The amendment was dropped in a conference committee on the bill, and that conference version passed the House. Senator Wellstone has promised to use any

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[27] There exists a common misconception that EPA withheld approval of the Shintech permit based entirely or partially on the basis of environmental equity issues. News stories in both the mainstream and environmental trade press headlined that erroneous conclusion.

[28] EPA Administrator Browner and her staff have variously stated that the new Guidance (see section III, below) is in use and complaints are being processed, and that the Guidance will not be used pending the outcome of the Advisory Committee (see *infra* footnote 43 and accompanying text) recommendations on the "Interim" Guidance. This Catch-22 may be what is forestalling the release of a final decision in the case. In the meantime, however, Shintech still has not received their Title V permit.

[29] S. 270, Amendment 2277, April 1, 1998.

and all procedural maneuvers to prevent the bill's passage without his amendment.

Another Congressional proposal that added environmental equity language to a bill was a proposal to reauthorize CERCLA in the "Children's Protection and Community Cleanup Act of 1998", sponsored by Representative Pallone.[30] That bill contained an entire title on "environmental justice", including provisions for designating "Special Priority Areas" which are defined as "geographic areas in which residents face a high degree of economic distress or social disenfrachisement."[31] This concept is further refined to be based on poverty rate, voting percentages, higher than average incidence of cancer, and areas with more than 50% minorities. The bill goes on to require special listings and cleanup schedules for Superfund sites that are located in such areas.

III. The New EPA Guidance

A. Summary

The Interim Guidance "is intended to provide a framework for the processing by EPA's Office of Civil Rights (OCR) of complaints filed under Title VI. . .."[32] With that applicability backdrop, the Guidance goes on to give a general background and history of environmental equity regulations and statutes, along with EPA's efforts in the area. The Guidance then moves on to a step-by-step framework for processing the complaints, closely following EPA's regulations discussed above.

The most important and most often debated sections of the Guidance follow, with EPA attempting to define for the first time many of the uncertain or ambiguous sections of the

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[30] H.R. 3262.

[31] Id. § 401(f)(2).

[32] EPA Interim Guidance, Introduction, *supra* note 3 at 1.

regulations, and adding interpretations of their intended methods for receiving and deciding these complaints. The first issue addressed is "timeliness of complaints", with EPA setting forth a policy that the 180 day limit of 40 CFR § 7.120(b)(2) generally begins to run with "issuance of the final permit."[33]

The next two sections are very important. EPA takes the position that the Act and their regulations will be applied to all new permits, amendments which "result in a net increase in pollution impacts", and all permit renewals. On the issue of renewals, EPA states that they "should be treated and analyzed as if they were new permits."[34] Regarding permit modifications, EPA limits applicability to "the modified operation", going on to say that the "complaint must allege and, to establish a disparate impact OCR must find, adverse impacts specifically associated with the modification."[35] Even with an entire section devoted to this, it is still somewhat unclear whether EPA intends to apply the rules to the incremental increase of the modification, or the new total emissions that would be allowed under the proposed modification, although it appears logical that they would be interested in the new total.

The next section of the guidance contains what will undoubtedly be several key points for court appeals should EPA ever decide to deny a permit or rescind assistance based on their environmental equity rules. In describing the types of impacts that will be cognizable and redressable under the Guidance, they state that "OCR will accept for processing only those Title VI complaints that include at least an allegation of a disparate impact concerning the types of impacts that are relevant under the recipient's permitting program."[36] This language would lead one to believe that EPA will limit their inquiry to issues a state could have considered within the

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[33] Id. at 7.

[34] Id. at 8 (emphasis added).

[35] Id. (emphasis added).

[36] Id. at 9 (emphasis added).

context of their existing legal authority. However, a very important caveat exists in the footnote accompanying the above-quoted text. Footnote 12 reads as follows:

> Even where a recipient's authority to regulate is unclear concerning cumulative burden or discriminatory permitting scenarios . . ., OCR will nonetheless consider impacts measured in these terms because Title VI is a Federal cross-cutting statute that imposes independent, nondiscrimination requirements on recipients of Federal funds. As such, Title VI, separate from and in addition to the strictures of state and local law, both authorizes and requires recipients to manage their programs in a way that avoids discriminatory cumulative burdens and distributional patterns. Thus, while Title VI does not alter the substantive requirements of a recipient's permitting program, it obligates recipients to implement those requirements in a nondiscriminatory manner as a condition of receiving Federal funds.

This footnote provides a key insight into EPA's vision of their role in enforcing Title VI. Advocating a complete federal preemption of state authority - stating that Title VI exists above all state and local requirements - gives EPA the authority to find a recipient in violation even if that governmental entity was constrained by their existing legal authority to make the decision they did. Interestingly, several EPA decisions regarding challenges to permits have held that the President's Executive Order establishes no new legal rights or remedies, and that permit appellants must show the agency erred within the framework of EPA's enabling statutes and regulations.[37] One federal appeals court even went so far as to say ". . . it is well established that a licensing relationship is insufficient to itself give rise to wholesale governmental responsibility for the actions taken by a private licensee."[38]

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[37] See In re Shintech, Petition on Permit Nos. 2466-VO, 2468-VO (EPA Sept. 10, 1997)(Clean Air Act); In re Envotech, L.C., UIC Appeal Nos. 95-2 through 95-37 (EAB February 15, 1996)(Underground Injection Control Act); In re Chemical Waste Management of Indiana, Inc., RCRA Appeal Nos. 95-2 and 95-3 (EAB June 29, 1995)(RCRA).

[38] Gannett Satellite Information Network, Inc. v. Berger, 894 F.2d 61, 67 (3d Cir. 1990).

Next in the guidance comes the five step framework for determining whether a disparate impact exists. The five steps are identifying the affected population, determining the demographics of the affected population, determining the universe(s) of facilities and total affected population (impacts analysis), conducting a disparate impact analysis, and determining the significance of the disparity. All of the steps contain interesting practical questions which are not answered by the guidance. In identifying the affected population, what is "an adverse impact from the proposed facility"? EPA says that proximity will generally be the key indicator, but how close? Any air dispersion modeler can explain that proximity is not a good indicator of impact where large emissions from tall stacks drive the impacts analysis - the highest impacts can be well downwind. In the demographics section, EPA suggests the use of GIS technology, but the most recent census data is now almost ten years old, and some have raised serious questions regarding the sampling accuracy of those data as well.

Perhaps the most interesting questions are raised by the part of the analysis where the universe of facilities is compared with the total affected population. In this section, EPA provides an insight into their thinking on the issue of environmental equity. After explaining that, in general, the universe of facilities will be determined by comparing the allegations of the complaint to the facilities at issue, EPA goes on to say "Ordinarily, OCR will entertain cases only in which the permitted facility is one of several facilities, which together present a cumulative burden or which reflect a pattern of disparate impact."[39] This sentence is followed by a footnote, which says:

> In some rare instances, EPA may need to determine whether the impacts of a single permit, standing alone may be considered adequate to support a disparate impact claim. While such a case has not yet been presented to EPA, it might, for example, involve a permitted activity that is unique (*i.e.*, "one of a kind) under a recipient's program.[40]

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[39] Id. at 10.

[40] Id. footnote 13.

Clearly EPA has expressed a clear intention to only pursue cases of "cumulative impact" in the environmental equity realm. This is interesting in light of the dearth of consensus on accurate and reliable methods for assessing such impact, at least in the area of air emissions. One is also left to wonder whether EPA's footnote means they have never been forced to perform an impacts analysis on a unique facility, or whether no complaint has ever been filed regarding such a facility. One clear example of a complaint filed against a unique facility is the Low Level Radioactive Waste Disposal Authority (LLRWDA) site proposed for Sierra Blanca in south Texas. A complaint was filed complaining of that proposed permit, but it was dismissed as not yet ripe since the TNRCC had not yet finally considered the permit. The proposed LLRWDA is legislatively designed (at both the state and federal levels) to be a unique facility, and the complaint on that facility was filed almost a year prior to issuance of the Guidance.

The final two steps of the analysis relate to the technical comparisons used to actually quantify the relative disparity. The brevity of these sections belies the enormous complexity of questions surrounding this type of statistical analysis. EPA has promulgated separate documents (discussed later in section D.) which attempt to give more scientific structure to these concerns. At the end of these analytical sections, EPA notes that if they find an impact to be significant, OCR may make a *prima facie* finding of disparate impact, subject to a recipient's opportunity to rebut under EPA's rules.

The guidance closes with methods for recipients to address situations where EPA has made such a preliminary finding. In the event they are unable to rebut the finding, states can still offer "mitigation" or "justification" to avoid rescission of federal funding. Mitigation is generally some sort of offsetting "good" for the "bad" environmental equity impact. EPA says it will consult with complainants in deciding whether to accept mitigation proposals, but EPA will entertain "supplemental mitigation projects (SMPs)" if they are "sufficient to address the disparate impact."[41] The Guidance specifically notes that permitting authorities should look to

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[41] Id. at 11.

the concerns raised by the complaint, and attempt to find solutions even if "they are outside those considerations ordinarily entertained by the permitting authority."[42] One interesting question which has is raised but not answered by the guidance is whether EPA would accept employment of members of the "affected population" as "mitigation" of an otherwise unacceptable impact. When the question is put directly to EPA, their answer is that the facts of every case are different, and mitigation is something that must be considered case-by-case.

Finally, the guidance offers recipients the option of "justifying" the disparate impact. While noting that demonstrations of compliance with existing statutes will not generally be sufficient, EPA takes the position that the seriousness of the impact, whether the permit is a renewal (with demonstrated benefits) or a new facility (with more speculative benefit), and whether any of the benefits flow to the affected community (as with the above discussion of jobs) are relevant considerations. EPA notes that it will not accept justifications if a less discriminatory alternative to the proposed permitting action exists. This begs the question of "alternative" analysis for states without any authority to question siting decisions of applicant (surely the vast majority of state permitting programs).

B. Comments and reactions to the guidance and EPA response

In the months following the issuance of the guidance, EPA received a large number of formal comments. While the Guidance is not the subject of a rulemaking, EPA did offer states and other interested parties the chance to comment in the three months following the original issuance. As of a recent account, EPA received 115 comments from various governmental entities, trade associations, government advocacy groups, and individuals. By all accounts, the overwhelming majority of the comments opposed the Guidance, with most advocating its withdrawal and a negotiated second issuance. Among the commentors opposing the Guidance were several states, the Environmental Committee of the States (ECOS), the Association of State and Territorial

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[42] Id. This language harkens back to EPA's opinion on the reach of Title VI as potentially beyond the limits of a state's standard permit considerations. See *supra*, note 36 and accompanying text.

Solid Waste Management Officials (ASTSWMO), the National Association of Governors, the National Association of Attorneys General, the U.S. Conference of Mayors, the Western Governor's Association, the National Association of Counties, the National Association of Manufacturers, the U.S. Chamber of Commerce, and the National Black Chamber of Commerce.

Without spending the many, many pages these organizations do in questioning EPA's proposal, I will attempt to point out some recurring themes from the comments. Most note that the Guidance does little to give recipients real and concrete assistance in addressing and avoiding complaints. A lack of peer reviewed science to back up the Guidance was another common complaint. Most commentors complain about the lack of specificity on both the finding of a disparate impact and methods for states to avoid or respond to such a situation. Many felt that EPA had overstepped both their legal authority and the language and intent of President Clinton's Executive Order by saying their Title VI authority exceeds and controls over any state limitations. A common theme is that both Brownfield redevelopment and/or federal Clean Air Act initiatives to keep areas pristine are in conflict with the Guidance. Some commentors felt that EPA had clearly promulgated a "rule" in this document without going through the required federal APA proposal and adoption steps. Other comments have been discussed as questions throughout this paper, including reliance on 1990 census data, the reality of assessing cumulative exposure, and the erroneous assumption that proximity always equals impact.

Another response of sorts to the Guidance was a move by Congress to limit EPA's funding for processing of Title VI complaints using their new document. In an amendment to a House Appropriation Committee's bill funding EPA and several other agencies, EPA was limited in their use of funds provided under the bill to handling only the 15 complaints presently listed as pending and unresolved. The limitation would essentially limit EPA from handling any new cases under the Guidance after the proposed effective date of October 1, 1998. As of the writing of this paper, the amendment had not passed the House.

EPA's response to the widespread criticism of the Guidance was the formation of an advisory

committee under the Federal Advisory Committee Act ("FACA").[43] This group is generally referred to as the Title VI FACA of the Title VI Advisory Committee. The group is comprised of members from a variety of disciplines and backgrounds, including state representatives, public interest groups, academia, corporate, and Native American organizations. TNRCC Chairman Barry McBee is one of the members of the FACA. Members were chosen by EPA and will serve throughout the term of the FACA process. The goal of the FACA is to provide EPA with a more widely acceptable strategy for the implementation of EPA's regulations under Title VI. The group was given a mere six months by EPA in which to accomplish this Herculean task, and they have held two meetings since the group was chartered, with several future meetings in the planning stages. The FACA has broken their membership into three subgroups, each of which will consider the following three issues: assessment, operation, and mitigation. The groups are to identify points of agreement, points on which more discussion is needed, and points of clear disagreement. One very contentious issue from the first moments of the FACA's deliberations was the membership of state representatives (including Barry McBee) when those states are the subject of Title VI complaints. Citizen group members demanded the removal of those representatives, or, at a minimum, corresponding representation from people who had filed pending administrative complaints. Susana Almanza of the Austin citizen group PODER[44] was added to the FACA at their second meeting July 27 and 28, along with an attorney involved in Brownfield work.

C. Use and application - EPA's pending cases, and the six "test cases" + Shintech

Although, as noted earlier, EPA has not rendered decisions on any Title VI administrative complaints, they have made some efforts on specific cases. Near the end of 1996 EPA and President Clinton began receiving pointed criticisms due to the length of time dozens of Title VI complaints had been pending at EPA without resolution or apparent movement. Critics included

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[43] 5 USCA Appendix 2, §§ 1-16. The list of the original members of the FACA, along with their affiliations, is provided as Attachment 5.

[44] See the summary of pending Title VI complaints below, at section IV.D.5.

civil rights and environmental groups, and eventually expanded to include the Congressional Black Caucus and other civic leaders. Under that pressure, EPA Administrator Browner announced in December of 1996 that the agency would decide a select group of six of the pending complaints.[45] The team assigned to this task included EPA staff, at least some of them attorneys, and staff of the Department of Justice. The stated purpose of the exercise was to not only decide the selected complaints, but to develop a "manual" to assist in future decisionmaking on these issues. A deadline of February, 1997 was announced and eagerly awaited by all interested parties. It of course passed without announcement of decisions, and a date later in 1997 was set - it also passed without action. EPA maintains that these six complaints, along with the Shintech dispute, will be the first announced and decided.

D. Related EPA documents of interest

EPA headquarters and regional offices have been actively issuing guidance and proposals on this issue for many years. There have been environmental equity guidance documents of various types from EPA Regions 2, 5, 6, 8, and 9. One formidable example is the Environmental Justice Index Methodology produced by EPA Region 6.[46] The most recent version this author has obtained is dated September, 1996, with an original issuance date of July, 1994. This document is a technical manual for the statistical demographic analysis of potential or alleged environmental equity situations. The basic formula set forth is:

> Environmental Justice Index = Exposure (population exposed/population in community x population density) x Hazard (degree of impact x degree of vulnerability)[47]

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[45] Although the names of the six cases was at one time a closely-held secret, the list contained in Attachment 4 notes three of the cases being reviewed with asterisks, one of which is from Texas. The other three remain a mystery, but many who follow this field believe at least one of them is a Texas complaint.

[46] "Environmental Justice Index Methodology, September, 1996" ("EJ Index Methodology"), EPA Region 6 Enforcement Division, Office of Planning & Coordination.

[47] Id., at 2.

The Methodology goes on to explain each of the subfactors, and notes that each is given a numeric score on a sliding scale (generally a higher number meaning more impact or more minority population) . The document is related to a computer program designed to assist in the evaluation of these situations. The factors include consideration of the minority population relative to minority concentrations throughout the state, percent of the neighborhood near a proposed site impacted by that site, and the differential impacts of the site on minorities or low income populations. One of the most interesting parts of the document comes with the explanation of the "degree of vulnerability" from the above calculation. That factor is said to be comprised of "the minority, economic status, age, pregnancy, lifestyle factors, and pre-existing disease subfactors."[48] The wide ranging and highly personal matters contemplated by this ranking raise serious questions regarding the availability and accuracy of such data.

As this guide attempts to explain the appropriate use of the data, it explains the use of the tool as a ranking system. While stating that some factors (percent minority/economically depressed, and population density) are more important, the discussion states that in drawing conclusions "the methodology user should realize that even an index ranking of zero can have significant environmental justice concerns. For example, an unpopulated study area will rank zero, but the land can be owned or adjacent to land owned by minority and/or low income groups."[49] The implications of that statement for this field of inquiry are staggering. If there is no number below which it can be said or assumed there is no environmental equity problem, the entire evaluation would appear to be a wasted exercise. As was complained by many of the commentors on the EPA Guidance, there is no certainty or specificity in EPA's attempts to regulate this area.

E. Enforcement and application

Serious questions remain surrounding the Guidance and what EPA could or would do with a proposed finding of noncompliance with Title VI if one were ever rendered and not rebutted,

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[48] Id.

[49] Id. at 11.

mitigated, or justified. Are EPA's lawyers correct in their assertion that a state could be subject to civil penalties or injunctive relief? More importantly for the typical (non-governmental) environmental law practitioner, could a permit be withheld by EPA pending resolution of a determination? If the answer is no, as many high-powered lawyers have stated (many on behalf of trade associations) why exactly hasn't the Shintech Title V Operating Permit been issued and sent back to EPA? It is possible that the mere intimation of a Title VI problem may be enough to stymie a proposed permit or amendment.

An example of this phenomenon (although not, strictly speaking, a Title VI complaint) is the Louisiana Energy Services ("LES") plant permit. LES had proposed to build a uranium enrichment plant near Homer, in Claiborne Parish, Louisiana. As part of the licensing process by the Nuclear Regulatory Commission ("NRC"), a hearing was held before their Atomic Safety and Licensing Board. The permit was sent back for further staff processing, in large part based on environmental equity issues. The full NRC overturned their decision, stating that the Board's decision had "no clear legal basis or discernable objective . . . notwithstanding the worthy intentions that motivated it."[50] Despite this reversal, LES eventually withdrew their application and abandoned the project, citing the delays caused by the environmental equity dispute as the primary reason.

IV. Texas' Experience with Title VI

A. TACB/TWC Joint Study and guidance

In January of 1993, with the merger of their two agencies looming on the horizon, the then-chairmen of the Texas Air Control Board ("TACB") and the Texas Water Commission ("TWC") (Kirk Watson and John Hall, respectively) established the Environmental Equity and Justice Task Force ("Task Force"). The group was made up of representatives of local government,

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[50] In the Matter of Louisiana Energy Services (Claiborne Enrichment Center), Docket No. 70-3070-ML (U.S. Nuclear Regulatory Comm'n, April 3, 1998) at 13.

civil rights organizations, citizen groups, industry, academia, and state government. "The purpose of the Task Force was to ensure that public benefits resulting from the work of the new consolidated environmental agency will be fully and equitably realized by low-income communities and communities of color, taking into account the greater degree of hazard to which some communities are already exposed."[51] With that mission statement, quoted from the Task Force's final report ("Task Force Report" or "Report"), the group set about developing recommendations for the new Texas environmental superagency. Without setting forth their entire report, the general findings were that some factors, such as historic patterns of zoning and general lack of political power, tended towards situations where environmental equity problems might occur. On the other hand, they found that Texas' environmental laws and regulations are neutral on their face and moving in a direction favorable to such communities, including risk-based decisionmaking. There were also a number of findings which point out the difficulties of attempting to address alleged instances of environmental inequity - namely that zoning decisions are locally made, environmental laws and regulations do not generally allow for consideration of socioeconomic or ethnic makeup of communities surrounding proposed facilities, and that the border presents unique and interesting challenges. The major areas of discussion and debate (dividing the Task Force into subcommittees) were facility location standards, agency sensitivity to community risk, local governments, citizen access to agencies, and border issues.

After considering each area, the Task Force voted on recommendations put forth by the subcommittees for each topic. The adopted recommendations made up the final slate of findings delivered by the Task Force to the TNRCC. There were 43 recommendations presented, and one which was not adopted presented as the "contested recommendation." That disputed finding was an argument in favor of expanding the role of the agency's Public Interest Counsel ("PIC") by making the PIC a separate agency, with its own executive, staff, and budget. There were also recommendations that the PIC be allowed to appeal TNRCC decisions, and be allowed to

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[51] "Texas Environmental Equity and Justice Task Force Report", TNRCC Publication CTF-1, August 1993, at 1.

coordinate pro bono legal services in conjunction with the State Bar of Texas. Finally, the contested recommendation pushed for an increase in staffing and resources for the PIC.

There were also two minority reports presented with the final Task Force findings. One was authored by the three industry representatives, and stated their disagreement with the conclusion that "environmental inequity exists in Texas."[52] In support of their position, they disagreed with certain studies and premises put forth to support that assertion. The other minority report came from the opposite end of the spectrum - the citizen representatives. They questioned the exclusion of more forcefully worded and affirmative recommendations, and also disagreed strongly with the industry position. The citizen representatives said that environmental inequity exists throughout Texas and that the Task Force was provided with ample proof through testimony and studies provided to them.

The recommendations of the Task Force continue to be implemented by the TNRCC. Most have been completed, some are ongoing.

B. Environmental Equity Section at TNRCC

The Office of Public Assistance ("OPA") at TNRCC houses the agency's Environmental Equity Section. Carol Marshall is the senior staff member of that office, which will be adding more staff in the near future. The office acts as a conduit for issues of environmental equity, making use of other staff in OPA or specific programs as necessary. A primary responsibility of the section is to monitor the implementation of the Task Force recommendations. Reports on the progress of these recommendations are made to the full commission, and recommendations for further progress on the recommendations is sought.

The Environmental Equity section also conducts meetings throughout the state in communities where environmental equity issues are raised. The office has also sought and received funding

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[52] Id. Minority Report - Industry, at A-2.

through several partnership grants from EPA, some of which was forwarded to target communities in 1997 and 1998. A staff member serves on the City of Austin Environmental Justice Task Force, which is responsible for developing an plan on these issues for the city. The staff of the office also monitor agency activities and makes suggestions for programs to address environmental equity issues in rules and other agency actions.

C. McBee positions and activities

The Chairman of the TNRCC, Barry R. McBee, has been an active force on the issue of environmental equity. He is a member of the ECOS committee on this issue, and as mentioned earlier was chosen as a member of the Federal Advisory Committee on the EPA Guidance. Chairman McBee is frequently asked to speak on this issue, including providing testimony before Congress this week on August 5, and has attended numerous conferences and meetings on the subject. He will no doubt continue to be a national figure in the growing debate over environmental equity in the months and years to come.

D. Summary of Title VI complaints pending

As mentioned earlier, TNRCC has been the subject of seven Title VI administrative complaints pending before EPA's OCR. They are briefly summarized below (in order of receipt by the agency, with complainant name, permittee name (if any), location, and EPA docket number).

1. Lanell Anderson/American Envirotech, Inc., Channelview, Harris County, 2R-94-R6. This complaint was filed in January of 1994 and accepted in March of 1994, and alleges discriminatory impact by TNRCC's issuance of a permit for the AEI incinerator project proposed for Channelview. The TNRCC response disputing the allegation was filed by the Texas Attorney General since there was a pending appeal in district court filed by the same person. The facility has never been built and principals are in litigation.

2. Garden Valley Neighborhood Association/TXI Sakrete Plant, Austin, Travis County, 3R-94-R6. This complaint, filed in March of 1994 and accepted by EPA in April of that year, relates to

a permit issued to the TXI Sakrete plant on highway 183 near the Colorado River in East Austin. The TNRCC response, sent soon after the complaint was filed, noted that demographic information from the 1990 census showed that, at all relevant distances, the population is majority Caucasian. Of interest, the company filed a lengthy brief on the issues in this case, requesting permission from EPA to do so along with their filing. EPA refused their request, but presently admits that all interested parties, including the permittee, should be allowed to submit arguments on the issues.

3. Mothers Organized to Stop Environmental Sins(MOSES)/Gibraltar, Winona, Smith County, 5R-94-R6. Complaint regarding permitting and enforcement issues surrounding the referenced RCRA/UIC plant, filed in June of 1996, accepted in October of that year. TNRCC filed a response disputing allegations. The plant was sold to different operator, which has significantly curtailed operations there.

4. People Against Contaminated Environments(PACE) and American G.I. Forum of Texas(AGIT)/Corpus Christi Ship Channel, Corpus Christi, Nueces County, 2R-95-R6. Filed in November of 1994, accepted in April of 1996, this complaint relates to the entire industrial development corridor on the ship channel in Corpus. The complainants raised general issues of permitting and enforcement laxity by TNRCC, and zoning issues against the City of Corpus Christi. TNRCC filed a voluminous response (55 single-spaced pages with five volumes of attachments) strongly disputing the allegations raised by the complaint.

5. People in Defense of Earth and her Resources(PODER)/East Austin, Travis County, 1R-96-R6. This complaint, filed in October of 1995, accepted in November of 1997, uses the Tokyo Electron air permit matter to make allegations regarding the permitting and standard exemption systems at TNRCC, and also complains of accessibility of information under the Public Information Act. The complaint is also against the City of Austin, and only the complaints pending against the City have been accepted for processing, so no TNRCC response has been prepared. This complaint is one of the six EPA has assigned to their "task force" for decision.

6. Jackson/Mahon Neighborhood Association/West Texas Wilbert Vault, Lubbock, Lubbock County, 2R-96-R6. This complaint was filed in April of 1996, and remains pending. It was filed regarding issuance of a standard exemption by the commission to a concrete specialty plant which manufactures burial vaults (that plant is limited to a total usage of three cubic yards of concrete a day). EPA has sent requests for clarification of the complaint, but has not yet accepted any allegations in this complaint.

7. Save Sierra Blanca/LLRWDA, Sierra Blanca, Hudspeth County, 7R-97-R6. This complaint against the low level radioactive waste disposal site was dismissed by EPA as untimely since no final action has been taken by TNRCC on the permit. A PFD has been issued but has not yet been formally presented to the commission.

E. Contested TNRCC permits where the issue has been raised

1. Skyline - a proposed major expansion of an existing landfill just south of Dallas, this permit matter underwent a significant and long running hearing. One of the issues explicitly raised was environmental equity (the landfill is in a predominantly African American community). TNRCC and the protestants put on witnesses on the issue, which was discussed in the PFD but not recommended as a basis for decision, citing the dearth of legal authority for doing so. The PFD recommended denial of the permit, in part based on "land use incompatibility", but the permit was ultimately granted by vote of the TNRCC.

2. BMFS - Another landfill, this one in Houston. A proposed class IV (construction waste) project in a predominantly white west Houston area. The permit was ultimately denied by the commission citing land use incompatibility. The applicant's attorney pressed for a finding in the commission order on environmental equity, but his request was denied.

3. Low Level Radioactive Waste Disposal Authority - The proposed low level site in Sierra Blanca generated some testimony on the issue of environmental equity, but only as an issue peripheral to the statutorily required consideration of the "socioeconomic impact" of the

proposed site. That specific testimony is mentioned in the PFD, but is not used as an explicit reason for that document's recommendation of denial.

V. Conclusion: Where We May Be Going With All of This, Practically Speaking

After all is said and done, this area of environmental law may seem rather tame compared to other subcategories in the field - there are no administrative decisions, few court decisions and appeals, and most of the energy is spent arguing over EPA's internal Guidance document. However, a careful assessment of the issue will reveal to most environmental practitioners that the field contains numerous land mines, just waiting to delay or completely derail a client's key environmental permitting matter. So how does one avoid this? Where do we go from here?

The answers to these questions may seem appallingly simple, but they are repeatedly shown to be true. Good community relations before, during, and long after permits are sought is the key to avoiding even the mention of the subject relating to a plant. The same holds true, on a larger scale, for agencies like TNRCC. The TNRCC is moving toward earlier and more effective public participation - a key element to addressing citizen concerns. EPA has even hinted that they might accept a well organized, progressive environmental equity program as a sort of "defense" to Title VI administrative complaints.[53] While this concept has yet to be fleshed out, states have latched on to it and are beginning to discuss development of a "model" environmental equity outreach programs.[54]

Stay tuned - it should be an interesting ride.

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[53] EPA representatives have stated that perhaps a state with such a program could enjoy a sort of rebuttable presumption that would act as an additional hurdle for Title VI complaints against that state.

[54] TNRCC is hopeful that its Environmental Equity office will be considered as a progressive example when any model is developed.

ATTACHMENT 1

INTERIM GUIDANCE FOR INVESTIGATING TITLE VI ADMINISTRATIVE COMPLAINTS CHALLENGING PERMITS

Introduction

This interim guidance is intended to provide a framework for the processing by EPA's Office of Civil Rights (OCR) of complaints filed under Title VI of the Civil Rights Act of 1964, as amended (Title VI),[1] alleging discriminatory effects resulting from the issuance of pollution control permits by state and local governmental agencies that receive EPA funding.

In the past, the Title VI complaints filed with EPA typically alleged discrimination in access to public water and sewerage systems or in employment practices. This interim guidance is intended to update the Agency's procedural and policy framework to accommodate the increasing number of Title VI complaints that allege discrimination in the environmental permitting context.

As reflected in this guidance, Title VI environmental permitting cases may have implications for a diversity of interests, including those of the recipient, the affected community, and the permit applicant or permittee. EPA believes that robust stakeholder input is an invaluable tool for fully addressing Title VI issues during the permitting process and informally resolving Title VI complaints when they arise.

Background

> *No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance.*
> – Title VI

On February 11, 1994, President Clinton issued Executive Order 12,898, "Federal Actions To Address Environmental Justice in Minority Populations and Low-Income Populations." The Presidential memorandum accompanying that Order directs Federal agencies to ensure compliance with the nondiscrimination requirements of Title VI for all Federally-funded programs and activities that affect human health or the environment. While Title VI is inapplicable to EPA actions, including EPA's issuance of permits, Section 2-2 of Executive Order 12,898 is designed to ensure that Federal actions substantially affecting human health or the environment do not have discriminatory effects based on race, color, or national origin. Accordingly, EPA is committed to a policy of nondiscrimination in its own permitting programs.

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[1] 42 U.S.C. §§ 2000d to 2000d-7.

Title VI itself prohibits intentional discrimination. The Supreme Court has ruled, however, that Title VI authorizes Federal agencies, including EPA, to adopt implementing regulations that prohibit discriminatory *effects*. Frequently, discrimination results from policies and practices that are neutral on their face, but have the *effect* of discriminating.[2] Facially-neutral policies or practices that result in discriminatory effects violate EPA's Title VI regulations unless it is show that they are justified and that there is no less discriminatory alternative.

EPA awards grants on an annual basis to many state and local agencies that administer continuing environmental programs under EPA's statutes. As a condition of receiving funding under EPA's continuing environmental program grants, recipient agencies must comply with EPA's Title VI regulations, which are incorporated by reference into the grants. EPA's Title VI regulations define a "[r]ecipient" as "any state or its political subdivision, any instrumentality of a state or its political subdivision, any public or private agency, institution, organization, or other entity, or any person to which Federal financial assistance is extended directly or through another recipient ...."[3] Title VI creates for recipients a nondiscrimination obligation that is contractual in nature in exchange for accepting Federal funding. Acceptance of EPA funding creates an obligation on the recipient to comply with the regulations for as long as any EPA funding is extended.[4]

Under amendments made to Title VI by the Civil Rights Restoration Act of 1987,[5] a "program" or "activity" means all of the operations of a department, agency, special purpose district, or other instrumentality of a state or of a local government, any part of which is extended Federal financial assistance.[6] Therefore, unless expressly exempted from Title VI by Federal statute, all programs and activities of a department or agency that receives EPA funds are subject to Title VI, including those programs and activities that are not EPA-funded. For example, the issuance of permits by EPA recipients under solid waste programs administered pursuant to Subtitle D of the Resource Conservation and Recovery Act (which historically have not been grant-funded by EPA), or the

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[2] Department of Justice, Attorney General's Memorandum for Heads of Departments and Agencies that Provide Federal Financial Assistance, *The Use of the Disparate Impact Standard in Administrative Regulations Under Title VI of the Civil Rights Act of 1964*, (July 14, 1994).

[3] 40 C.F.R. § 7.25 (1996). Title VI applies to Indian Tribes as EPA recipients only when the statutory provision authorizing the Federal financial assistance is not exclusively for the benefit of Tribes. Otherwise, Tribes are exempt from Title VI.

[4] 40 C.F.R. § 7.80(a)(2)(iii)(1996).

[5] Pub. L. No. 100-259, 102 Stat. 28 (1988); S. Rep. No. 64 at 2, 11-16, 100th Cong., *reprinted in* 1988 U.S. Code Cong. & Admin. News at 3-4, 13-18.

[6] 42 U.S.C. § 2000d-4a.

actions they take under programs that do not derive their authority from EPA statutes (*e.g.*, state environmental assessment requirements), are part of a program or activity covered by EPA's Title VI regulations if the recipient receives any funding from EPA.

In the event that EPA finds discrimination in a recipient's permitting program, and the recipient is not able to come into compliance voluntarily, EPA is required by its Title VI regulations to initiate procedures to deny, annul, suspend, or terminate EPA funding.[7] EPA also may use any other means authorized by law to obtain compliance, including referring the matter to the Department of Justice (DOJ) for litigation.[8] In appropriate cases, DOJ may file suit seeking injunctive relief. Moreover, individuals may file a private right of action in court to enforce the nondiscrimination requirements in Title VI or EPA's implementing regulations without exhausting administrative remedies.[9]

Overview of Framework for Processing Complaints

While this guidance is directed at the processing of discriminatory effects allegations, as a general proposition, Title VI complaints alleging either discriminatory intent and/or discriminatory effect in the context of environmental permitting will be processed by OCR under EPA's Title VI regulations at 40 C.F.R. Part 7. The steps that the Agency will follow in complaint processing are described below. EPA's Title VI regulations encourage the informal resolution of all complaints with the participation of all affected stakeholders (see step 8 below).

1. Acceptance of the Complaint

Upon receiving a Title VI complaint, OCR will determine whether the complaint states a valid claim. If it does, the complaint will be accepted for processing within twenty (20) calendar days of acknowledgment of its receipt, and the complainant and the EPA recipient will be so notified. If OCR does not accept the complaint, it will be rejected or, if appropriate, referred to another Federal agency. 40 C.F.R. § 7.120(d)(1).

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[7] 40 C.F.R. §§ 7.115(e), 7.130(b)(1996); Id. at 7.110(c).

[8] 42 U.S.C. § 2000d-1; 40 C.F.R. § 7.130(a).

[9] Chester Residents Concerned for Quality Living v. Seif, No. 97-1125, U.S. App. LEXIS 36797 (3d Cir. Dec. 30, 1997).

2. Investigation/Disparate Impact Assessment

Once a complaint is accepted for processing, OCR will conduct a factual investigation to determine whether the permit(s) at issue will create a disparate impact, or add to an existing disparate impact, on a racial or ethnic population. If, based on its investigation, OCR concludes that there is no disparate impact, the complaint will be dismissed. If OCR makes an initial finding of a disparate impact, it will notify the recipient and the complainant and seek a response from the recipient within a specified time period. Under appropriate circumstances, OCR may seek comment from the recipient, permittee, and/or complainant(s) on preliminary data analyses before making an initial finding concerning disparate impacts.

3. Rebuttal/Mitigation

The notice of initial finding of a disparate impact will provide the recipient the opportunity to rebut OCR's finding, propose a plan for mitigating the disparate impact, or to "justify" the disparate impact (see step 4 below regarding justification). If the recipient successfully rebuts OCR's finding, or, if the recipient elects to submit a plan for mitigating the disparate impact, and, based on its review, EPA agrees that the disparate impact will be mitigated sufficiently pursuant to the plan, the parties will be so notified. Assuming that assurances are provided regarding implementation of such a mitigation plan, no further action on the complaint will be required.

4. Justification

If the recipient can neither rebut the initial finding of disparate impact nor develop an acceptable mitigation plan, then the recipient may seek to demonstrate that it has a substantial, legitimate interest that justifies the decision to proceed with the permit notwithstanding the disparate impact. Even where a substantial, legitimate justification is proffered, OCR will need to consider whether it can be shown that there is an alternative that would satisfy the stated interest while eliminating or mitigating the disparate impact.

5. Preliminary Finding of Noncompliance

If the recipient fails to rebut OCR's initial finding of a disparate impact and can neither mitigate nor justify the disparate impact at issue, OCR will, within 180 calendar days from the start of the complaint investigation, send the recipient a written notice of preliminary finding of noncompliance, with a copy to the grant award official (Award Official) and the Assistant Attorney General for Civil Rights. OCR's notice may include recommendations for the recipient to achieve voluntary compliance and, where appropriate, the recipient's right to engage in voluntary compliance negotiations. 40 C.F.R. § 7.115(c).

6. Formal Determination of Noncompliance

If, within fifty (50) calendar days of receipt of the notice of preliminary finding, the recipient does not agree to OCR's recommendations or fails to submit a written response demonstrating that OCR's preliminary finding is incorrect or that voluntary compliance can be achieved through other steps, OCR will issue a formal written determination of noncompliance, with a copy to the Award Official and the Assistant Attorney General for Civil Rights. 40 C.F.R. § 7.115(d).

7. Voluntary Compliance

The recipient will have ten (10) calendar days from receipt of the formal determination of noncompliance within which to come into voluntary compliance. 40 C.F.R. § 7.115(e). If the recipient fails to meet this deadline, OCR will start procedures to deny, annul, suspend, or terminate EPA assistance in accordance with 40 C.F.R. § 7.130(b) and consider other appropriate action, including referring the matter to DOJ for litigation.

8. Informal Resolution

EPA's Title VI regulations call for OCR to pursue informal resolution of administrative complaints wherever practicable. 40 C.F.R. § 7.120(d)(2). Therefore, OCR will discuss, at any point during the process outlined above, offers by recipients to reach informal resolution, and will, to the extent appropriate, endeavor to facilitate the informal resolution process and involvement of affected stakeholders. Ordinarily, in the interest of conserving EPA investigative resources for truly intractable matters, it will make sense to encourage dialogue at the beginning of the investigation of complaints accepted for processing. Accordingly, in notifying a recipient of acceptance of a complaint for investigation, OCR will encourage the recipient to engage the complainant(s) in informal resolution in an effort to negotiate a settlement.

Rejecting or Accepting Complaints for Investigation

It is the general policy of OCR to investigate all administrative complaints that have apparent merit and are complete or properly pleaded. Examples of complaints with no apparent merit might include those which are so insubstantial or incoherent that they cannot be considered to be grounded in fact.

A complete or properly pleaded complaint is:[10]

1) in writing, signed, and provides an avenue for contacting the signatory (*e.g.*, phone number, address);

2) describes the alleged discriminatory act(s) that violates EPA's Title VI regulations (*i.e.*, an act of intentional discrimination or one that has the effect of discriminating on the basis of race, color, or national origin);

3) filed within 180 calendar days of the alleged discriminatory act(s)[11]; and

4) identifies the EPA recipient that took the alleged discriminatory act(s).

EPA's Title VI regulations contemplate that OCR will make a determination to accept, reject, or refer (to the appropriate Federal agency) a complaint within twenty (20) calendar days of acknowledgment of its receipt. 40 C.F.R. § 7.120(d)(1). Whenever possible, within the twenty-day period, OCR will establish whether the person or entity that took the alleged discriminatory act is in fact an EPA recipient as defined by 40 C.F.R. § 7.25. If the complaint does not specifically mention that the alleged discriminatory actor is an EPA financial assistance recipient, OCR may presume so for the purpose of deciding whether or not to accept the complaint for further processing.

Timeliness of Complaints

Under EPA's Title VI regulations a complaint must be filed within 180 calendar days of the alleged discriminatory act. 40 C.F.R. § 7.120(b)(2). EPA interprets this regulation to mean that complaints alleging discriminatory effects resulting from issuance of a permit must be filed with EPA within 180 calendar days of issuance of the final permit. However, OCR may waive the 180-day time limit for good cause. 40 C.F.R. § 7.120(b)(2).

OCR will determine on a case-by-case basis whether to waive the time limit for good cause. EPA believes that, in order to encourage complainants to exhaust administrative remedies available under the recipient's permit appeal process, thereby fostering early resolution of Title VI issues, it is appropriate to consider in making a good cause determination a complainant's pursuit

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[10] EPA's Title VI regulations require that the complaint be in writing, describe the alleged discriminatory acts that violate the regulations, and be filed within 180 calendar days of the alleged discriminatory act(s). 40 C.F.R. § 7.120(b)(1),(2). The criteria listed above satisfy these regulatory requirements.

[11] Also, see discussion below on Timeliness of Complaints.

of its Title VI concerns through the recipient's administrative appeal process. Under such circumstances and after considering other factors relevant to the particular case, OCR may waive the time limit if the complaint is filed within a reasonable time period (*e.g.*, 60 calendar days) after the conclusion of the administrative appeal process.

In addition, it is OCR's policy not to reject automatically complaints challenging permits where such complaints are filed prior to final permit issuance by the recipient. Rather, OCR should provide the recipient with the information contained in the complaint for consideration in the permit issuance process. OCR also may notify the complainant that the complaint is premature, but that OCR is keeping the complaint on file in an inactive status pending issuance of a final permit by the recipient. Should the recipient issue a final permit, OCR could initiate an investigation if OCR or the complainant believe that issuance of the final permit may be discriminatory.

Permit Modifications

EPA believes that permit modifications that reduce adverse impacts and improve the environmental operation of the facility should be encouraged. Similarly, the Agency does not want to discourage merely administrative modifications, such as a facility name change, or otherwise beneficial modifications that are neutral in terms of their impact on human health or the environment. Because such modifications do not cause or add to adverse impacts, Title VI discriminatory effects claims based on them are likely to be dismissed.

Permit modifications that result in a net increase of pollution impacts, however, may provide a basis for an adverse disparate impact finding, and, accordingly, OCR will not reject or dismiss complaints associated with permit modifications without an examination of the circumstances to determine the nature of the modification.

In the permit modification context (as opposed to permit renewals), the matter under consideration by the recipient is the modified operation. Accordingly, the complaint must allege, and, to establish a disparate impact OCR must find, adverse impacts specifically associated with the modification.

Investigations of Allegedly Discriminatory Permit Renewals

Generally, permit renewals should be treated and analyzed as if they were new facility permits, since permit renewal is, by definition, an occasion to review the overall operations of a permitted facility and make any necessary changes. Generally, permit renewals are not issued without public notice and an opportunity for the public to challenge the propriety of granting a renewal under the relevant environmental laws and regulations.

Impacts and the Disparate Impact Analysis

Evaluations of disparate impact allegations should be based upon the facts and totality of the circumstances that each case presents. Rather than use a single technique for analyzing and evaluating disparate impact allegations, OCR will use several techniques within a broad framework. Any method of evaluation chosen within that framework must be a reasonably reliable indicator of disparity.

In terms of the types of impacts that are actionable under Title VI in the permitting context, OCR will, until further notice, consider impacts cognizable under the recipient's permitting program in determining whether a disparate impact within the meaning of Title VI has occurred. Thus, OCR will accept for processing only those Title VI complaints that include at least an allegation of a disparate impact concerning the types of impacts that are relevant under the recipient's permitting program.[12]

The general framework for determining whether a disparate impact exists has five basic steps.

Step 1: Identifying the Affected Population

The first step is to identify the population affected by the permit that triggered the complaint. The affected population is that which suffers the adverse impacts of the permitted activity. The impacts investigated must result from the permit(s) at issue.

The adverse impacts from permitted facilities are rarely distributed in a predictable and uniform manner. However, proximity to a facility will often be a reasonable indicator of where impacts are concentrated. Accordingly, where more precise information is not available, OCR will generally use proximity to a facility to identify adversely affected populations. The proximity analysis should reflect the environmental medium and impact of concern in the case.

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[12] Even where a recipient's authority to regulate is unclear concerning cumulative burden or discriminatory permitting pattern scenarios (see step 3 below), OCR will nonetheless consider impacts measured in these terms because Title VI is a Federal cross-cutting statute that imposes independent, nondiscrimination requirements on recipients of Federal funds. As such, Title VI, separate from and in addition to the strictures of state and local law, both authorizes and requires recipients to manage their programs in a way that avoids discriminatory cumulative burdens and distributional patterns. Thus, while Title VI does not alter the substantive requirements of a recipient's permitting program, it obligates recipients to implement those requirements in a nondiscriminatory manner as a condition of receiving Federal funds.

Step 2: Determining the Demographics of the Affected Population

The second step is to determine the racial and/or ethnic composition of the affected population for the permitted facility at issue in the complaint. To do so, OCR uses demographic mapping technology, such as Geographic Information Systems (GIS). In conducting a typical analysis to determine the affected population, OCR generates data estimating the race and/or ethnicity and density of populations within a certain proximity from a facility or within the distribution pattern for a release/impact based on scientific models. OCR then identifies and characterizes the affected population for the facility at issue. If the affected population for the permit at issue is of the alleged racial or ethnic group(s) named in the complaint, then the demographic analysis is repeated for each facility in the chosen universe(s) of facilities discussed below.

Step 3: Determining the Universe(s) of Facilities and Total Affected Population(s)

The third step is to identify which other permitted facilities, if any, are to be included in the analysis and to determine the racial or ethnic composition of the populations affected by those permits. There may be more than one appropriate universe of facilities. OCR will determine the appropriate universe of facilities based upon the allegations and facts of a particular case. However, facilities not under the recipient's jurisdiction should not be included in the universe of facilities examined.

If in its investigation OCR finds that the universe of facilities selected by the complainant is not supported by the facts, OCR will explain what it has found and provide the complainant the opportunity to support the use of its proposed universe. If the complainant cannot adequately support the proposed universe, then OCR should investigate a universe of facilities based upon the facts available and OCR's reasonable interpretation of the theory of the case presented. Once the appropriate universe(s) of facilities is determined, the affected population for each facility in the universe should be added together to form the Total Affected Population.

Ordinarily, OCR will entertain cases only in which the permitted facility at issue is one of several facilities, which together present a cumulative burden or which reflect a pattern of disparate impact.[13] EPA recognizes the potential for disparate outcomes in this area because most permits *control* pollution rather than prevent it altogether. Consequently, permits that satisfy the base public health and environmental protections contemplated under EPA's programs nonetheless

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[13] In some rare instances, EPA may need to determine whether the impacts of a single permit, standing alone, may be considered adequate to support a disparate impact claim. While such a case has not yet been presented to EPA, it might, for example, involve a permitted activity that is unique (*i.e.*, "one of a kind") under a recipient's program.

bear the potential for discriminatory effects where residual pollution and other cognizable impacts are distributed disproportionately to communities with particular racial or ethnic characteristics. Based on its experience to date, the Agency believes that this is most likely to be true either where an individual permit contributes to or compounds a preexisting burden being shouldered by a neighboring community, such that the community's cumulative burden is disproportionate when compared with other communities; or where an individual permit is part of a broader pattern pursuant to which it has become more likely that certain types of operations, with their accompanying burdens, will be permitted in a community with particular racial or ethnic characteristics.

Step 4: Conducting a Disparate Impact Analysis

The fourth step is to conduct a disparate impact analysis that, at a minimum, includes comparing the racial or ethnic characteristics within the affected population. It will also likely include comparing the racial characteristics of the affected population to the non-affected population. This approach can show whether persons protected under Title VI are being impacted at a disparate rate. EPA generally would expect the rates of impact for the affected population and comparison populations to be relatively comparable under properly implemented programs. Since there is no one formula or analysis to be applied, OCR may identify on a case-by-case basis other comparisons to determine disparate impact.

Step 5: Determining the Significance of the Disparity

The final phase of the analysis is to use arithmetic or statistical analyses to determine whether the disparity is significant under Title VI. OCR will use trained statisticians to evaluate disparity calculations done by investigators. After calculations are informed by expert opinion, OCR may make a *prima facie* disparate impact finding, subject to the recipient's opportunity to rebut.

Mitigation

EPA expects mitigation to be an important focus in the Title VI process, given the typical interest of recipients in avoiding more draconian outcomes and the difficulty that many recipients will encounter in justifying an "unmitigated," but nonetheless disparate, impact. In some circumstances, it may be possible for the recipient to mitigate public health and environmental considerations sufficiently to address the disparate impact. The sufficiency of such mitigation should be evaluated in consultation with experts in the EPA program at issue. OCR may also consult with complainants. Where it is not possible or practicable to mitigate sufficiently the public health or environmental impacts of a challenged permit, EPA will consider "supplemental mitigation projects" (SMPs), which, when taken together with other mitigation efforts, may be viewed by EPA as sufficient to address the disparate impact. An SMP can, for example, respond

to concerns associated with the permitting of the facility raised by the complainant that cannot otherwise be redressed under Title VI (*i.e.*, because they are outside those considerations ordinarily entertained by the permitting authority).

Justification

If a preliminary finding of noncompliance has not been successfully rebutted and the disparate impact cannot successfully be mitigated, the recipient will have the opportunity to "justify" the decision to issue the permit notwithstanding the disparate impact, based on the substantial, legitimate interests of the recipient. While determining what constitutes a sufficient justification will necessarily turn on the facts of the case at hand, OCR would expect that, given the considerations described above, merely demonstrating that the permit complies with applicable environmental regulations will not ordinarily be considered a substantial, legitimate justification. Rather, there must be some articulable value to the recipient in the permitted activity. Because the interests of a state or local environmental agency are necessarily influenced and informed by the broader interest of the government of which it is a part, OCR will entertain justifications based on broader governmental interests (*i.e.*, interests not limited by the jurisdiction of the recipient agency). While the sufficiency of the justification will necessarily depend on the facts of the case at hand, the types of factors that may bear consideration in assessing sufficiency can include, but are not limited to, the seriousness of the disparate impact, whether the permit at issue is a renewal (with demonstrated benefits) or for a new facility (with more speculative benefits), and whether any of the articulated benefits associated with a permit can be expected to benefit the particular community that is the subject of the Title VI complaint.

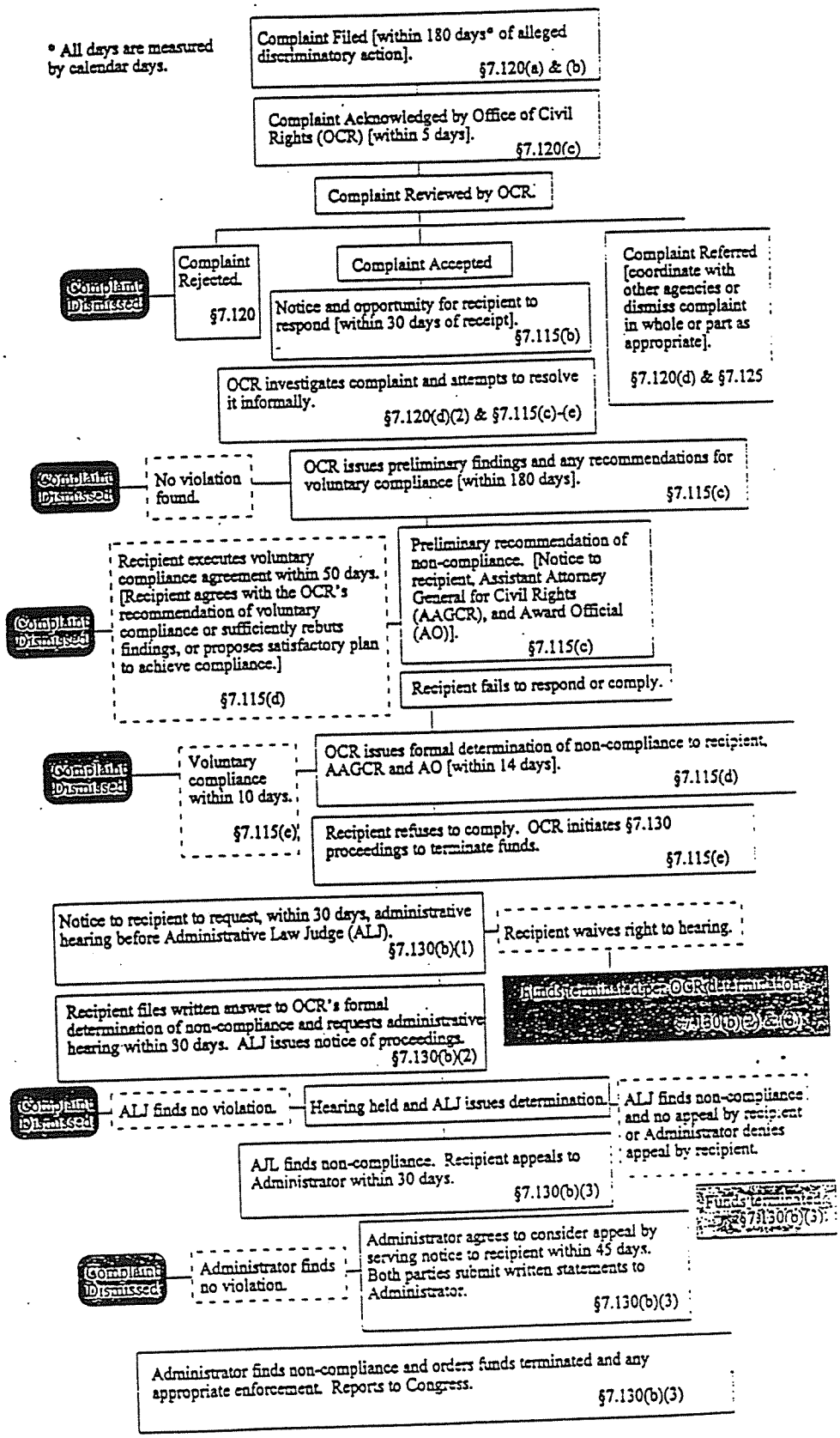
Importantly, a justification offered will not be considered acceptable if it is shown that a less discriminatory alternative exists. If a less discriminatory alternative is practicable, then the recipient must implement it to avoid a finding of noncompliance with the regulations. Less discriminatory alternatives should be equally effective in meeting the needs addressed by the challenged practice. Here, again, mitigation measures should be considered as less discriminatory alternatives, including additional permit conditions that would lessen or eliminate the demonstrated adverse disparate impacts.

* * * * * *

The statements in this document are intended solely as guidance. This document is not intended, nor can it be relied upon, to create any rights enforceable by any party in litigation with the United States. EPA may decide to follow the guidance provided in this document, or to act at variance with the guidance, based on its analysis of the specific facts presented. This guidance may be revised without public notice to reflect changes in EPA's approach to implementing the Small Business Regulatory Enforcement Fairness Act or the Regulatory Flexibility Act, or to clarify and update text.

ATTACHMENT 2

TITLE VI COMPLAINT PROCESS
40 CFR Part 7



ATTACHMENT 3

Federal Register
Vol. 59, No. 32
Wednesday, February 16, 1994

Presidential Documents

Title 3—

The President

Executive Order 12898 of February 11, 1994

Federal Actions To Address Environmental Justice in Minority Populations and Low-Income Populations

By the authority vested in me as President by the Constitution and the laws of the United States of America, it is hereby ordered as follows:

Section 1–1. IMPLEMENTATION.

1–101. *Agency Responsibilities.* To the greatest extent practicable and permitted by law, and consistent with the principles set forth in the report on the National Performance Review, each Federal agency shall make achieving environmental justice part of its mission by identifying and addressing, as appropriate, disproportionately high and adverse human health or environmental effects of its programs, policies, and activities on minority populations and low-income populations in the United States and its territories and possessions, the District of Columbia, the Commonwealth of Puerto Rico, and the Commonwealth of the Mariana Islands.

1–102. *Creation of an Interagency Working Group on Environmental Justice.* (a) Within 3 months of the date of this order, the Administrator of the Environmental Protection Agency ("Administrator") or the Administrator's designee shall convene an interagency Federal Working Group on Environmental Justice ("Working Group"). The Working Group shall comprise the heads of the following executive agencies and offices, or their designees: (a) Department of Defense; (b) Department of Health and Human Services; (c) Department of Housing and Urban Development; (d) Department of Labor; (e) Department of Agriculture; (f) Department of Transportation; (g) Department of Justice; (h) Department of the Interior; (i) Department of Commerce; (j) Department of Energy; (k) Environmental Protection Agency; (l) Office of Management and Budget; (m) Office of Science and Technology Policy; (n) Office of the Deputy Assistant to the President for Environmental Policy; (o) Office of the Assistant to the President for Domestic Policy; (p) National Economic Council; (q) Council of Economic Advisers; and (r) such other Government officials as the President may designate. The Working Group shall report to the President through the Deputy Assistant to the President for Environmental Policy and the Assistant to the President for Domestic Policy.

(b) The Working Group shall: (1) provide guidance to Federal agencies on criteria for identifying disproportionately high and adverse human health or environmental effects on minority populations and low-income populations;

(2) coordinate with, provide guidance to, and serve as a clearinghouse for, each Federal agency as it develops an environmental justice strategy as required by section 1–103 of this order, in order to ensure that the administration, interpretation and enforcement of programs, activities and policies are undertaken in a consistent manner;

(3) assist in coordinating research by, and stimulating cooperation among, the Environmental Protection Agency, the Department of Health and Human Services, the Department of Housing and Urban Development, and other agencies conducting research or other activities in accordance with section 3–3 of this order;

(4) assist in coordinating data collection, required by this order;

(5) examine existing data and studies on environmental justice;

(6) hold public meetings as required in section 5–502(d) of this order; and

(7) develop interagency model projects on environmental justice that evidence cooperation among Federal agencies.

1–103. *Development of Agency Strategies.* (a) Except as provided in section 6–605 of this order, each Federal agency shall develop an agency-wide environmental justice strategy, as set forth in subsections (b)–(e) of this section that identifies and addresses disproportionately high and adverse human health or environmental effects of its programs, policies, and activities on minority populations and low-income populations. The environmental justice strategy shall list programs, policies, planning and public participation processes, enforcement, and/or rulemakings related to human health or the environment that should be revised to, at a minimum: (1) promote enforcement of all health and environmental statutes in areas with minority populations and low-income populations; (2) ensure greater public participation; (3) improve research and data collection relating to the health of and environment of minority populations and low-income populations; and (4) identify differential patterns of consumption of natural resources among minority populations and low-income populations. In addition, the environmental justice strategy shall include, where appropriate, a timetable for undertaking identified revisions and consideration of economic and social implications of the revisions.

(b) Within 4 months of the date of this order, each Federal agency shall identify an internal administrative process for developing its environmental justice strategy, and shall inform the Working Group of the process.

(c) Within 6 months of the date of this order, each Federal agency shall provide the Working Group with an outline of its proposed environmental justice strategy.

(d) Within 10 months of the date of this order, each Federal agency shall provide the Working Group with its proposed environmental justice strategy.

(e) Within 12 months of the date of this order, each Federal agency shall finalize its environmental justice strategy and provide a copy and written description of its strategy to the Working Group. During the 12 month period from the date of this order, each Federal agency, as part of its environmental justice strategy, shall identify several specific projects that can be promptly undertaken to address particular concerns identified during the development of the proposed environmental justice strategy, and a schedule for implementing those projects.

(f) Within 24 months of the date of this order, each Federal agency shall report to the Working Group on its progress in implementing its agency-wide environmental justice strategy.

(g) Federal agencies shall provide additional periodic reports to the Working Group as requested by the Working Group.

1–104. *Reports to the President.* Within 14 months of the date of this order, the Working Group shall submit to the President, through the Office of the Deputy Assistant to the President for Environmental Policy and the Office of the Assistant to the President for Domestic Policy, a report that describes the implementation of this order, and includes the final environmental justice strategies described in section 1–103(e) of this order.

Sec. 2–2. FEDERAL AGENCY RESPONSIBILITIES FOR FEDERAL PROGRAMS. Each Federal agency shall conduct its programs, policies, and activities that substantially affect human health or the environment, in a manner that ensures that such programs, policies, and activities do not have the effect of excluding persons (including populations) from participation in, denying persons (including populations) the benefits of, or subjecting persons (including popu-

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lations) to discrimination under, such programs, policies, and activities, because of their race, color, or national origin.

Sec. 3–3. RESEARCH, DATA COLLECTION, AND ANALYSIS.

3–301. *Human Health and Environmental Research and Analysis.* (a) Environmental human health research, whenever practicable and appropriate, shall include diverse segments of the population in epidemiological and clinical studies, including segments at high risk from environmental hazards, such as minority populations, low-income populations and workers who may be exposed to substantial environmental hazards.

(b) Environmental human health analyses, whenever practicable and appropriate, shall identify multiple and cumulative exposures.

(c) Federal agencies shall provide minority populations and low-income populations the opportunity to comment on the development and design of research strategies undertaken pursuant to this order.

3–302. *Human Health and Environmental Data Collection and Analysis.* To the extent permitted by existing law, including the Privacy Act, as amended (5 U.S.C. section 552a): (a) each Federal agency, whenever practicable and appropriate, shall collect, maintain, and analyze information assessing and comparing environmental and human health risks borne by populations identified by race, national origin, or income. To the extent practical and appropriate, Federal agencies shall use this information to determine whether their programs, policies, and activities have disproportionately high and adverse human health or environmental effects on minority populations and low-income populations;

(b) In connection with the development and implementation of agency strategies in section 1–103 of this order, each Federal agency, whenever practicable and appropriate, shall collect, maintain and analyze information on the race, national origin, income level, and other readily accessible and appropriate information for areas surrounding facilities or sites expected to have a substantial environmental, human health, or economic effect on the surrounding populations, when such facilities or sites become the subject of a substantial Federal environmental administrative or judicial action. Such information shall be made available to the public, unless prohibited by law; and

(c) Each Federal agency, whenever practicable and appropriate, shall collect, maintain, and analyze information on the race, national origin, income level, and other readily accessible and appropriate information for areas surrounding Federal facilities that are: (1) subject to the reporting requirements under the Emergency Planning and Community Right-to-Know Act, 42 U.S.C. section 11001–11050 as mandated in Executive Order No. 12856; and (2) expected to have a substantial environmental, human health, or economic effect on surrounding populations. Such information shall be made available to the public, unless prohibited by law.

(d) In carrying out the responsibilities in this section, each Federal agency, whenever practicable and appropriate, shall share information and eliminate unnecessary duplication of efforts through the use of existing data systems and cooperative agreements among Federal agencies and with State, local, and tribal governments.

Sec. 4–4. SUBSISTENCE CONSUMPTION OF FISH AND WILDLIFE.

4–401. *Consumption Patterns.* In order to assist in identifying the need for ensuring protection of populations with differential patterns of subsistence consumption of fish and wildlife, Federal agencies, whenever practicable and appropriate, shall collect, maintain, and analyze information on the consumption patterns of populations who principally rely on fish and/or wildlife for subsistence. Federal agencies shall communicate to the public the risks of those consumption patterns.

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4–402. *Guidance.* Federal agencies, whenever practicable and appropriate, shall work in a coordinated manner to publish guidance reflecting the latest scientific information available concerning methods for evaluating the human health risks associated with the consumption of pollutant-bearing fish or wildlife. Agencies shall consider such guidance in developing their policies and rules.

Sec. 5–5. PUBLIC PARTICIPATION AND ACCESS TO INFORMATION. (a) The public may submit recommendations to Federal agencies relating to the incorporation of environmental justice principles into Federal agency programs or policies. Each Federal agency shall convey such recommendations to the Working Group.

(b) Each Federal agency may, whenever practicable and appropriate, translate crucial public documents, notices, and hearings relating to human health or the environment for limited English speaking populations.

(c) Each Federal agency shall work to ensure that public documents, notices, and hearings relating to human health or the environment are concise, understandable, and readily accessible to the public.

(d) The Working Group shall hold public meetings, as appropriate, for the purpose of fact-finding, receiving public comments, and conducting inquiries concerning environmental justice. The Working Group shall prepare for public review a summary of the comments and recommendations discussed at the public meetings.

Sec. 6–6. GENERAL PROVISIONS.

6–601. *Responsibility for Agency Implementation.* The head of each Federal agency shall be responsible for ensuring compliance with this order. Each Federal agency shall conduct internal reviews and take such other steps as may be necessary to monitor compliance with this order.

6–602. *Executive Order No. 12250.* This Executive order is intended to supplement but not supersede Executive Order No. 12250, which requires consistent and effective implementation of various laws prohibiting discriminatory practices in programs receiving Federal financial assistance. Nothing herein shall limit the effect or mandate of Executive Order No. 12250.

6–603. *Executive Order No. 12875.* This Executive order is not intended to limit the effect or mandate of Executive Order No. 12875.

6–604. *Scope.* For purposes of this order, Federal agency means any agency on the Working Group, and such other agencies as may be designated by the President, that conducts any Federal program or activity that substantially affects human health or the environment. Independent agencies are requested to comply with the provisions of this order.

6–605. *Petitions for Exemptions.* The head of a Federal agency may petition the President for an exemption from the requirements of this order on the grounds that all or some of the petitioning agency's programs or activities should not be subject to the requirements of this order.

6–606. *Native American Programs.* Each Federal agency responsibility set forth under this order shall apply equally to Native American programs. In addition, the Department of the Interior, in coordination with the Working Group, and, after consultation with tribal leaders, shall coordinate steps to be taken pursuant to this order that address Federally-recognized Indian Tribes.

6–607. *Costs.* Unless otherwise provided by law, Federal agencies shall assume the financial costs of complying with this order.

6–608. *General.* Federal agencies shall implement this order consistent with, and to the extent permitted by, existing law.

6–609. *Judicial Review.* This order is intended only to improve the internal management of the executive branch and is not intended to, nor does it create any right, benefit, or trust responsibility, substantive or procedural,

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enforceable at law or equity by a party against the United States, its agencies, its officers, or any person. This order shall not be construed to create any right to judicial review involving the compliance or noncompliance of the United States, its agencies, its officers, or any other person with this order.

William J. Clinton

THE WHITE HOUSE,
February 11, 1994.

[FR Doc. 94-3685
Filed 2-14-94; 3:07 pm]
Billing code 3195-01-P

Editorial note: For the memorandum that was concurrently issued on Federal environmental program reform, see issue No. 6 of the *Weekly Compilation of Presidential Documents.*

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ATTACHMENT 4

OCR TITLE VI EJ COMPLAINTS

Case # & Reg.	State	Complainant	File:	Reject:	Accept:	Dismiss:	Reason:
FILED (6)							
2R-95-R9*	CA	Residents of Sanborn Court	8/95				
2R-96-R6	TX	Jackson/Mahon Civic Assoc.	4/96				
3R-96-R6	LA	Oakville Community Action Grp. (OCAG)	5/96				
13R-97-R6	CA	Lucha Ambiental de la ComunidadHispania	11/97				
14R-97-R5	IL	S. Cook Co. Envt'l Action Coalition	12/97				
Held In Abeyance Pending State Action							
1R-98-R3	PA	NAACP	3/98				No state action.
REJECTED (28)							
2R-94-R4	AL	Coalition for Envt'l Consciousness	11/93	12/93			No finan. assist.
3R-94-R4	AL	Munchus	12/93	1/94			No finan. assist.
4R-94-R4	AL	Munchus	1/94	4/94			No finan. assist.
4R-94-R6	LA	Gulf Coast Tenants Assoc.	2/94	4/94			Insuff. allegations
7R-94-R4	GA	Newtown Florist Club	2/94	4/94			Insuff. allegations
5R-94-R4	AL	Munchus	3/94	4/94			No finan. assist.
6R-94-R4	AL	Munchus	3/94	7/94			Insuff. allegations
1R-95-R6	TX	Herold	11/94	11/94			No finan. assist.
1R-95-R4	AL	Yerkwood Citizens Against Envt'l Racism	3/95	9/95			No factual basis
1R-95-R2	PR	Velez et al.	5/95	6/95			No factual basis
2R-95-R4	AL	Thompson	8/95	2/96			No factual basis
3R-95-R4	AL	Gunter et al.	8/95	5/97			Insuff. allegations
1R-95-R5	IL	SS COPE	9/95	10/97			Moot
1R-95-R3	VA	N. Back River Rd. Assoc.	10/95	1/96			Insuff. allegations

Case # & Reg.	State	Complainant	File:	Reject:	Accept:	Dismiss:	Reason:
1R-96-R3	MD	Cox	7/96	10/96			Insuff. allegations
2R-96-R9	CA	Envt'l Health Coalition	9/96	9/96			In litigation
1R-97-R9	CA	Alviso Community in Action	2/97	5/97			No finan. assist.
2R-97-R6	TX	ROPL v. TX A&M	2/97	5/97			Untimely/In litigation
3R-97-R9	CA	Mothers of E. L.A.	3/97	4/97			Untimely
9R-97-R4	SC	Citizens of Helena v. Newberry Co.	3/97	10/97			No finan. assist./No factual basis
5R-97-R1	ME	Penobscot Indian Nation	5/97	10/97			Complaint w/drawn
6R-97-R6	OK	Whitehead v.Hardage	5/97	7/97			No finan. assist.
7R-97-R6	TX	Save Sierra Blanca	5/97	7/97			Untimely
11R-97-R9	CA	Manzanar Action Comm'e	8/97	10/97			Untimely
12R-97-R3	VA	N. Back River Rd. Civic Assoc.	11/97	12/97			No finan. assist./fact. basis/Insuff. allegs.
15R-97-R4	AL	Boateng/Garad/ALSierraC/SAFE/CWWG	12/97	1/98			Untimely
2R-98-R4	AL	Jefferson Co. Black Chamber/Munchus	4/98	4/98			Insuff. allegations
3R-98-R6	AR	Colen	3/98	4/98			Insuff. allegations
ACCEPTED (15)							
1R-93-R6	LA	Juror Jackson	9/93	--	10/93		
2R-94-R6	TX	Anderson	1/94	--	3/94		
3R-94-R6	TX	Garden Valley Neighborhood Assoc.	3/94	--	4/94		
8R-94-R4	GA	Hyde/Aragon Park Improvement Comm'e	5/94	--	6/94		
1R-94-R2	NY	Assemblyman Bianchi	6/94	--	6/94		
5R-94-R6	TX	MOSES	6/94	--	10/94		
1R-94-R5	MI	St. Francis Prayer Ctr. (12/92)	7/94	--	1/95		
9R-94-R4	FL	N.W. Civic Assoc.	8/94	--	10/94		
2R-95-R6	TX	PACE/AGIT	11/94	--	4/96		
1R-95-R9*	CA	Padres Hacia una Vida Mejor	12/94	--	7/95		
1R-96-R6*	TX	PODER/MANIC	10/95	--	11/97		
1R-96-R1	CT	ONE/CHANE	4/96	--	11/96		

Case # & Reg.	State	Complainant	File:	Reject:	Accept:	Dismiss:	Reason:
4R-97-R6†	LA	St. James Citizens for Jobs & the Env't	5/97	--	8/97		
8R-97-R9	CA	Chester St. Block Club Assoc.	6/97	--	9/97		
10R-97-R9	CA	CBE, NAACP, La Causa	7/97	--	10/97		
DISMISSED (2)							
1R-93-R4	MS	Af.-Ams. for Envt'l Justice	9/93	--	10/93	3/97	Permit application inactive
2R-94-R3	PA	Lewisburg Prison Project	3/94	--	4/94	12/94	Permit application w/drawn



* Under review by EPA Title VI Task Force.
† Under review by EPA Shintech Title VI Task Force

ATTACHMENT 5

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KEY

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ENVIRONMENTAL RACISM: IS A NASCENT SOCIAL SCIENCE CONCEPT A SOUND BASIS FOR LEGAL RELIEF?

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The charge of environmental racism—the claim that the burden of environmentally-polluting facilities and practices falls most heavily on lower income and minority groups—is an increasingly common underpinning for major environmental lawsuits. These types of suits have become more frequent and visible, serving not just as potential vehicles for monetary recovery or other relief, but also as forums for publicizing minority concerns.

But because environmental racism is still a developing social science concept, its use as a basis for legal relief presents several procedural and evidentiary problems that, if not carefully addressed, create much confusion. The difficulties inherent in adjudicating these cases are perhaps most clearly illustrated when environmental racism claims collide with increasingly stringent requirements governing expert qualifications and expert testimony admissibility in judicial proceedings.

The concept of environmental racism has numerous positive implications from a social science perspective. It focuses attention on the possibility of a striking inequality: that the poorer and more powerless individuals in society suffer disproportionately from polluting activities. The allegation of environmental racism encourages more intense scrutiny of industrial facility siting, more careful regulation of existing facilities in poor and minority neighborhoods, and more pressure on companies with facilities in those neighborhoods to operate and maintain the facilities in a way that not only protects these populations but gives something tangible to their communities to acknowledge and compensate for the burden they suffer.

The concept of environmental racism further suggests the existence of the right to a pollution-free environment. In this respect, the concept signifies an emerging ethic that will benefit not just low-income and minority groups but all of society. The concept is gaining ascendancy during a time of globalization and increased industrial and economic development in emerging nations. Thus, it may play an important part in avoiding some of the industrial facility siting and operating mistakes that the more industrialized countries have made. Because environmental racism is a more developed concept in industrialized nations, multinational companies are likely to take this sensitivity with them as they participate in emerging markets.

But the doctrine is not without significant problems, even as a social science concept. The American Sociological Society does not yet recognize environmental racism as an area of specialty or concentration. The number of rigorous studies performed in the field is limited, and, in those few studies analyzing whether polluting activities disproportionately burden low income and minority groups, the anticipated bias of the group sponsoring the study may correlate with the study's outcome. For instance, while some major studies sponsored by minority groups suggest that the burdens are disproportionate,[1] studies supported by waste management companies and other industries suggest that the burdens are not disproportionate, or, surprisingly, that the burdens disproportionately fall on white, blue-collar workers.[2]

William R. Kelly, a sociologist at the University of Texas at Austin, who has served as Deputy Editor of *Demography* and Associate Editor of the *American Sociological Review*, has noted as follows:

> Environmental racism is not an officially recognized substantive, teaching or research area in sociology. Environmental racism is not recognized by the American Sociological Association as an area of teaching or research.

> In addition much of the environmental racism research that I have reviewed...has not been subject to rigorous evaluation by the scientific community prior to publication...
>
> I am concerned by what is, in my professional opinion, either very poor social science or, and this is more troubling, research that is not value free.[3]

John Alford, a political scientist at Rice University, agreed, observing as follows:

> At present social science research on the topic of environmental racism is new and immature. Nothing approaching a consensus has been reached in the literature in regard to the standards or methodologies that should be employed to make a judgment about a claim of environmental racism. To argue that research on environmental racism has reached a conclusion on a topic that it has only recently started to explore is a serious mischaracterization. An appropriate methodology for defining, objectively assessing, or measuring environmental racism, or even for defining it, has yet to be established.[4]

The doctrine is also problematic due to the serious nature of the charges underlying it. Environmental racism implies that industrial or governmental actors have intentionally placed polluting facilities in poor and minority neighborhoods. This places a conspiratorial spin on what may simply be an economic decision. The cheapest land is usually located near the most undesirable land uses. Likewise, poorer individuals buy the cheaper land. Industry also may situate facilities near the property of low income or minority groups, *not because* those groups reside in the area but because the land is cheaper in low-income areas and the land uses are mixed—residential, vacant, industrial, and commercial—and thus do not present the same expense and land use compatibility problems that exist in other areas. Thus, environmental racism may be more reflective of the age-old plight of poorer people than it is of prejudice against minority populations. To the extent minorities are disproportionately affected, the problem may be that some minorities unfairly find themselves at the lower end of the economic spectrum, suggesting a deeper societal problem of which the environmental pollution component

is but a symptom. Given this uncertainty, the use of environmental racism as a legal doctrine to apportion blame and to redistribute economic resources through the legal system is troublesome.

Even if social scientists have yet to agree upon the concept, the current Administration has made steps toward a policy stance. President Clinton's Executive Order No. 12,898[5] acknowledges the existence of environmental inequity and directs employees of the Executive Branch—environmental regulators, those responsible for rulemaking, permitting and enforcement, agency lawyers, and others—to include environmental equity in their decision-making calculus. Further, the Order encourages them to breathe environmental equity into their interpretations of existing regulations and statutes.

But Order No. 12,898 is largely toothless. It is neither a law nor a regulation. It is a guidance document to Executive Branch employees and is not enforceable in the traditional legal sense, even as to them. It is also not, standing alone, the basis for any action within or by the judiciary. There may indeed be no federal statute or constitutional provision that expressly establishes environmental equity or avoidance of environmental racism as a legal requirement.

Nonetheless, citizens' groups have filed numerous lawsuits throughout the United States in recent years against major corporations, governmental entities, and elected and appointed officials, alleging environmental racism and seeking significant money damages and injunctive relief. Often these lawsuits find support both inside and outside the courtroom, in the press, and elsewhere and become celebrated symbols of deeper societal ills.

To date, no plaintiff in any court in the United States has been successful on the merits in a lawsuit based on environmental racism, at least not in a decision resulting in a published opinion. The judicial record of environmental racism suits usually reflects the plaintiff's efforts to find a legal basis for the claim to avoid summary dismissal. These efforts have been largely

unsuccessful, and only a handful of courts have suggested in reported opinions that there is a legal basis for an environmental racism claim.[6] In these reported opinions, the plaintiffs usually rely on one of several statutes to provide legal support for their claims. Until very recently, the most frequently cited was 42 U.S.C. § 1983, originally enacted by Congress in 1871, which provides, in part, as follows:

> Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory or the District of Columbia, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress...

Environmental racism plaintiffs typically cast their Section 1983 claims as alleged violations of the Equal Protection Clause, but it is far from clear that decisions regarding the location of a facility are the types of acts that fall within the scope of Equal Protection Clause analysis. The Equal Protection Clause provides that no State shall "deny to any person within its jurisdiction the equal protection of the laws," meaning essentially that all persons similarly situated should be treated the same.[7] In an environmental racism case, however, the plaintiff does not allege that a statute enacted by the State grants or withholds benefits on account of membership in a particular racial or ethnic group or some other characteristic. Instead, the allegation in an environmental racism case is that there is a distinction between residents in close proximity to the facility at issue and those who live farther away. Such a classification, inherent any time the government decides where to locate a facility or to permit a facility to be located, is similar to that made in zoning cases and may not be within the purview of the Fourteenth Amendment.[8]

Even if siting a facility could be considered a classification for equal protection purposes, plaintiffs face a heavy burden of proof. To establish a violation, a plaintiff must prove both

discriminatory impact and discriminatory intent on the part of the governmental entity.[9] Further, the nature of the intent required is more than volition or awareness of consequences.[10] The claimant must prove that the decision maker selected or reaffirmed a particular course of action at least in part "because of," not merely "in spite of," its adverse effects upon an identifiable group.[11] In the context of an environmental racism claim, this requires proof of intent to site a facility or to pollute in proximity to minority residents with the further intent to cause them to suffer a disproportionate and negative impact. This is a difficult hurdle, as indicated in practically all of the reported Section 1983 environmental racism cases.[12]

Specifically, to establish discriminatory intent or purpose, the plaintiff must find, develop, and present credible direct or circumstantial evidence of the following:

a. That the defendant who decided to site the facility at the location in question intended to impose a disproportionate, harmful impact on the plaintiff minority group members;

b. That the defendant would not have done so "but for" the site's proximity to and prospective disproportionate impact on the plaintiffs; and

c. That the facility will cause or has caused a materially negative impact on the plaintiff minority group materially worse than its impact on non-minority groups.

As to the first requirement, it is often difficult to find direct evidence that a decision maker acted with the requisite intent. Absent an admission or "a smoking gun document," it is hard to know the decision maker's state of mind at the time of the decision other than as subsequently stated by the decision maker in testimony at trial or by affidavit in support of a motion for summary judgment. Circumstantial evidence provides limited help.[13]

As to the second requirement, while it is difficult to prove that proximity to a minority community affected the decision, it is more difficult to prove that the defendant would not have

chosen the site for the facility "but for" its proximity to the minority group and that the site was chosen with specific intent to cause the group harm. This arguably requires proof that there were no good reasons — location, inexpensive land, good access, proximity to related uses — to select a particular site and construct the facility. And if one or more of the plaintiffs bought his or her property after the facility was announced or after it had been operating for some time, proving intent becomes even more problematic.

Finally, proof of the third element may be the most perplexing aspect of an environmental racism case. How does the fact finder determine whether the activity disproportionately affects the minority group? For instance, if there are twenty minority residents within a half mile of a facility and seventeen non-minority residents, is there a disproportionate impact? What if more of the non-minority residents are closer? What if the facility produces a noxious odor and minority residents are downwind for 60% of the year? What if the primary impact is diminution of fair market value of real estate and three non-minority residents within a half mile own 52% of the land, the 60 minority residents own 48%, and the land is proportionately valued?

To try to meet these burdens, plaintiffs often retain the services of an environmental racism expert. Designating an expert is one thing — establishing that the expert is qualified to testify is another, particularly given the increasingly stringent requirements governing expert testimony. *Daubert v. Merrell Dow Pharmaceuticals, Inc.* sets forth factors considered in determining the admissibility of expert testimony in federal court.[14] Those factors are as follows:

a. Whether the theory or technique in question can be tested;

b. Whether the theory or technique has been subjected to peer review and publication;

c. The technique's known or potential rate of error and the existence and maintenance of standards controlling the technique's operation; and

d. Whether the theory or technique has attracted widespread acceptance within a relevant scientific community.[15]

Given the newness of the environmental racism concept even in social science, it is unlikely an environmental racism expert could qualify to give expert testimony under *Daubert*.

Moreover, if an environmental racism expert were to qualify as such, to what can he or she testify? An expert conclusion, based on a review of the facts surrounding a facility's siting, that the decision evidenced racial intent is subject to challenge as an inadmissible legal conclusion. Such an expert opinion is also subject to challenge under Rule 702 of the Federal Rules of Evidence because it does not assist the finder of fact to understand the evidence or to determine a fact in issue.

More importantly, the dearth of peer-reviewed literature on environmental racism would limit any expert's testimony. Other situations and history would have no relevance to the case at hand, unless perhaps if the same decision maker were involved. Dr. Kelly has commented as follows:

> [T]he research fails to establish a persistent pattern of siting noxious facilities in minority areas with the intent to discriminate based on race. The research does not provide a valid, reliable assessment or test that supports the conclusion of a persistent pattern of siting noxious facilities in minority areas with the intent to discriminate based on race. The research suffers from a variety of statistical and methodological flaws. . . . .
>
> Moreover, even if the research did demonstrate a persistent pattern of siting noxious facilities in minority areas with the intent to discriminate based on race (and the research clearly does not establish that), it is inappropriate on methodological, statistical, scientific, and logical grounds to generalize from that research to any particular situation or circumstance.[16]

Dr. Alford appears to concur as follows:

> Central to all of modern social science is the tension between covariation and causation. This literature has barely scratched the surface in terms of exploring the degree to which covariation exists between race and the location of noxious facilities. Establishing causation is a vastly more complex task. In fact, even if causation had been established in certain prior siting decisions, it would not necessarily follow that causation, much less intent, existed in any other single decision. [17]

Without literature on which to rely, it may be difficult to identify what an environmental racism witness could offer in the traditional context of expert testimony at trial short of an inadmissible legal conclusion. While a sociologist or other social scientist might study the decision-making environment or conduct a sociological impact study to illustrate the facility's negative or disproportionately negative impact, such an expert could not likely merge these two studies or otherwise express or imply any opinion as to the presence of discriminatory intent.

As an alternative to a Section 1983 claim based on the Equal Protection Clause, some plaintiffs have attempted to bring environmental racism claims under Title VI of the Civil Rights Act of 1964[18] and its implementing regulations or the pertinent provisions of the Fair Housing Act.[19]

Section 601 of Title VI provides "No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance."[20] A private right of action exists under Section 601, but a plaintiff must still prove discriminatory intent.[21]

Meanwhile, Section 602 of Title VI authorizes agencies that distribute federal funds to promulgate regulations implementing Section 601.[22] The EPA has promulgated such

regulations, prohibiting a recipient from using "criteria or methods of administering its program which have the effect of subjecting individuals to discrimination because of their race, color, national origin, or sex, or have the effect of defeating or substantially impairing accomplishment of the objectives of the program with respect to individuals of a particular race, color, national origin, or sex.[23] Unlike the statute, this regulation expressly incorporates a discriminatory effect standard. [24]

Going further, the Third Circuit recently held in *Chester Residents Concerned for Quality Living v. Seif* that an implied private right of action exists to enforce the regulation.[25] But the decision may have a short life. The Third Circuit relied in large part upon *Guardians Ass'n v. Civil Service Comm'n of New York*, 463 U.S. 582 (1983), finding that a close reading of that opinion indicates that five Justices agreed that injunctive and declaratory relief might be available in a discriminatory effect case.[26] But the *Guardians* case did not explicitly address whether a *private right of action* exists under the regulations implementing Section 602, and four of the five Justices the Third Circuit cited are no longer sitting on the Supreme Court.[27] The current Supreme Court has granted certiorari, is expected to hear the case in the fall, and may well reverse the decision.[28]

Regardless of what the Supreme Court does, it is not clear that Section 602 of Title VI and the corresponding regulations provide a fertile basis for private environmental racism claims. The logical remedy under Section 602 is termination of funding, and private plaintiffs do not have authority to compel a termination of federal funding.[29] Accordingly, Title VI may ultimately be of limited assistance to environmental racism claimants.

Nor does the Fair Housing Act appear to be a sound basis for environmental racism claims. The pertinent portion of that act provides that it is unlawful "to discriminate against any

person in the terms, conditions, or privileges of sale or rental of a dwelling, or in the provision of services or facilities in connection therewith, because of race, color, religion, sex, familial status, or national origin.[30]

But an environmental racism claim does not relate to the terms, conditions, or privileges of sale or rental of a dwelling or in the provision of services of facilities in connection therewith. Plaintiffs may allege that the presence of a polluting facility might decrease property values. But a decrease in property values does not affect the availability of housing to minorities within the scope of the Fair Housing Act.[31] In fact, the courts have held that the Fair Housing Act does not protect homeowners' "intangible interests in [their] already-owned property."[32] Accordingly, the Fair Housing Act does not appear to provide an avenue for environmental racism claims.

So, what is the likely future of the doctrine of environmental racism? The social science concept, assuming it survives sufficient peer review, may well have a positive purpose and ultimately gain acceptance. But as a basis for assertions of legal liability, recovery of damages, and equitable relief, it should be approached by the judiciary with great caution. It introduces inflammation, emotionalism, and social conflict, untethered to a precise legal doctrine or precedent. With as yet only a tenuous scientific basis, environmental racism is not clearly compatible with concepts such as guilt, fault, and intent that are usually integral to legal proceedings relating to alleged discrimination and awards of money damages and other relief. Accordingly, claims of environmental racism might now be more appropriately addressed in the political and legislative realms than in the judicial system.

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[1] *See e.g.*, Rev. Benjamin F. Chavis, Jr. *Forward, in Confronting Environmental Racism: Voices From the Grass Roots* 3 (Rubert D. Bullard ed., 1993).

[2] *See e.g.*, Charles J. McDermott, *Balancing the Scales of Environmental Justice*, 21 FORDHAM URB. L.J. 689, 697 (1994).

[3] Report of William R. Kelly, Ph.D. of Aug. 29, 1997 at 2, *Residents Opposing Pigs and Livestock v. Texas A&M Univ., et al.*, No. 95-4113 (S.D. Tex. filed Aug. 15, 1995).

[4] Report of John R. Alford, Ph.D. of Sept. 1, 1997 at 1-2, *Residents Opposing Pigs and Livestock*, No. H-95-4113.

[5] EXEC. ORDER NO. 12,898, 59 FED. REG. 7,629 (1994).

[6] *E.g., Chester Residents Concerned for Quality Living v. Seif*, 132 F.3d 925, 937 (3rd Cir. 1997) (finding implied cause of action under Title VI implementing regulations), *cert. granted*, 141 L.Ed.2d 156 (1998); *Bean v. Southwestern Waste Management Corp.*, 482 F. Supp. 673, 677 (S.D. Tex. 1979) (recognizing claim but denying plaintiffs' request for preliminary injunctive relief).

[7] *City of Cleburne, Tex. v. Cleburne Living Ctr.*, 473 U.S. 432, 440 (1979).

[8] *City of Highland Park v. Train*, 519 F.2d 681, 696 (7th Cir. 1975), *cert. denied*, 424 U.S. 927 (1976).

[9] *Personnel Adm'r of Massachusetts v. Feeney*, 442 U.S. 256, 273-79 (1979).

[10] *Id.* at 279

[11] *Id.*

[12] *See Laramore v. Illinois Sports Facilities Auth.*, No. 89 C 1067, 1991 WL 153672 (N.D. Ill. Apr. 1, 1996) (granting summary judgment for defendant based on plaintiff's failure to show discriminatory intent); *R.I.S.E., Inc. v. Kay*, 768 F. Supp. 1144, 1149 (E.D. Va. 1991) (entering judgment for defendant county supervisors following bench trial, because plaintiffs failed to prove county supervisors' decision to authorize construction and operation of landfill was based on discriminatory intent); *East Bibb Twiggs Neighborhood Ass'n v. Macon-Bibb County Planning & Zoning Comm'n*, 706 F. Supp. 880, 884 (M.D. Ga. 1989) (entering judgment for defendant commission following bench trial, as evidence did not establish that commission members were motivated by discriminatory intent in approving use of property for landfill); *Bean*, 482 F. Supp. at 680 (denying preliminary injunctive relief, because plaintiffs failed to establish substantial likelihood of proving state agency's decision to grant landfill permit was based on discriminatory intent).

[13] Examples of circumstantial evidence plaintiffs have attempted to offer in environmental racism cases include evidence of the racial composition of the populations near proposed facilities; past facility siting decisions by the governmental body involved; and studies by the governmental body recognizing persistent discriminatory treatment of minorities. *See R.I.S.E., Inc.*, 768 F. Supp. at 1148-49; *East Bibb Twiggs*, 706 F. Supp. at 883-87.

[14] 509 U.S. 579, 593-94 (1993).

[15] *Id.*

[16] Report of William R. Kelly, Ph.D. at 2, *Residents Opposing Pigs and Livestock*, No. H-95-4113.

[17] Report of John R. Alford, Ph.D. at 2, *Residents Opposing Pigs and Livestock*, No. H-95-4113.

[18] 42 U.S.C. §§ 2000d to d-1 (1994).

[19] 42 U.S.C. § 3604 (1988).

[20] 42 U.S.C. § 2000d (1994).

[21] *See Alexander v. Choate*, 469 U.S. 287, 293 (1985).

[22] 42 U.S.C. § 2000d-1 (1994).

[23] 40 C.F.R. § 7.35(b) (1997).

[24] *See Alexander*, 469 U.S. at 293.

[25] *Chester Residents Concerned for Quality Living v. Seif*, 132 F.3d at 937.

[26] *Id.* at 929-30.

[27] *Id.*

[28] 141 L.Ed.2d 156 (1998).

[29] *Chester Residents Concerned for Quality Living v. Seif*, 132 F.3d at 934 n.14.

[30] 42 U.S.C. § 3604(b) (1988).

[31] *See Jaimes v. Toledo Metro. Hous. Auth.* 758 F.2d 1086, 1102 (6th Cir. 1985).

[32] *Southend Neighborhood Improvement Ass'n v. County of St. Clair*, 743 F.2d 1207, 1210 (7th Cir. 1984); *see also Campbell v. City of Berwyn*, 815 F. Supp. 1138, 1143 (N.D. Ill. 1993).

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Legal Times of Washington, D.C., September 12, 1994, "Putting Justice Into the Calculus"

Austin Business Journal, March 24-30, 1995, "Property Protection Legislation Poorly Crafted"

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Submitted for publication, March 1997, "Environmental Infrastructure in Latin America: The Project Finance Problem"

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Presentation at the TNRCC Texas Municipal Solid Waste Options Conference - 1995, "1995 Legislative Developments Affecting Municipal Solid Waste."

Corporate Counsel Institute; Speaker - Dallas, Texas 1995

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Analytic review of *City of Abilene v. Likes*; *The Houston Lawyer*; March-April 1998.

Analytic review of *Reno v. Bossier Parish School Board*; *The Houston Lawyer*; July-August 1997.

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· North County Type IV Facility	League City
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CONFIDENTIALITY AND PRIVILEGE ISSUES ARISING FROM MODERN ELECTRONIC COMMUNICATIONS

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I. INTRODUCTION

This outline is just that: an outline. It cannot go into all of the detail and subtle distinctions that can arise during practice. It is not legal advice upon which you should rely, but rather presents the issues and a viewpoint.

It is based upon an earlier article being published in the American Intellectual Property Law Association's Selected Papers for 1998. A more comprehensive article on the Internet will be published in the next Georgetown Journal of Legal Ethics.

II. THE ETHICAL DUTY OF CONFIDENTIALITY AND ITS LIMITS

A. Introduction.

Lawyers often state that their role is to zealously represent their clients. Unlike a football game, however, there are three sides to the adversary system, not two. As a result, the lawyer's duties as an Officer of the Court and Member of the Bar can require the lawyer to subordinate the interests of the client to interests such as judicial integrity, honesty, and avoiding serious injury to third-parties. Under some circumstances the ethical duty of confidentiality -- perhaps the cornerstone of the attorney-client relationship -- gives way to these other interests.

B. Choice of Law.

This outline primarily analyzes the Texas Disciplinary Rules of Professional Conduct (the "Texas Rules"), which while unique in many respects, are typical of the ethical standards governing confidentiality. There is no uniformity in this area, however, and the Texas Rules do not control in federal court in Texas. *In re American Airlines, Inc.*, 972 F.2d 605 (5th Cir. 1992).

C. Texas Rule 1.05.

Texas Rule 1.05 is extraordinarily complex, especially compared to its counterpart in the ABA Model Rules of Professional Conduct (the "Model Rules"): Model Rule 1.6 has four provisions; Texas Rule 1.05 has *twenty six* sub-parts and incorporates three other rules; it creates three different categories of client information; it proscribes certain use of that information, the precise scope of such prohibition depending not only upon the category of information at issue, but also on whether the client is a current or former client; and it sets out several circumstances in which the lawyer *must* disclose client confidences.

1. What Information is Protected? Texas Rule 1.05 defines three types of information which are entitled to varying degrees of protection:

a. Texas Rules.

(1) "'Confidential Information' includes both 'privileged information' and 'unprivileged client information.'" Thus, "confidential information" includes both other types of information:

(a) "'Privileged information' refers to the information of a client protected by the lawyer-client privilege of Rule 503 of the Texas Rules of Evidence or of Rule 503 of the Texas Rules of Criminal Evidence or by the principles of attorney-client privilege governed by Rule 501 of the Federal Rules of Evidence for United States Courts and Magistrates." *Id.*

(b) "'Unprivileged client information' means all information relating to a client or furnished by the client, other than privileged information, acquired by the lawyer during the course of or by reason of the representation." *Id.*

b. *Texas Case Law*. Some Texas courts have taken a seemingly broad view of what constitutes "confidential information." For example, in *Clarke v. Ruffino*, 819 S.W.2d 947, 950 (Tex. App.-- Houston [14th Dist.] 1992, writ dism'd w.o.j.), the court reasoned that the Texas Rule's definition of "confidential information" "certainly expands on the former definition" of the prior Texas Code. Likewise, the Texas Supreme Court has stated that "virtually any information relating to a case should be considered confidential...." *Phoenix Founders*, 887 S.W.2d at 834.

2. The Ethical Duties of Non-Disclosure and Non-Use.

Texas Rule 1.05 creates different ethical duties regarding the (1) disclosure of and (2) use of confidential information. It also contains exceptions concerning when a lawyer *may* or *must* disclose client confidences.

a. Ethical Duties of Confidentiality Vary, Depending on Whether the Client is a Current or Former Client:

(1) No Disclosure. A lawyer generally has a duty not to reveal "confidential information" of either a current or former client. Tex. R. 1.05(a).

(2) No Misuse. The misuse rules vary depending on whether the client is a (a) current or (b) former client. As to current clients, a lawyer may not knowingly use "confidential information of a client to the disadvantage of the client unless the client consents after consultation." Tex. R. 1.05(b)(2). Likewise, a lawyer may not knowingly use "privileged information of a client for the advantage of the lawyer or of a third person, unless the client consents after consultation." Tex. R. 1.05(b)(4). As to former clients, a lawyer may not knowing use "confidential information of a former client to the disadvantage of the former client... unless the former client consents... or the confidential information has become generally known." Tex. R. 1.05(b)(3). *Cf.* Model Rule 1.9(c)(1).

D. Permissive Disclosure.

1. When and To Whom *May* a Lawyer Reveal Confidential Information?

a. With Client's Express Authority. If the lawyer has been expressly authorized to disclose confidential information to carry out the representation of the client. Tex. R. 1.05(c)(1).

b. With Client's Consent. If the client consents after consultation. Tex. R. 1.05(c)(2).

c. Within Firm. To any agent of the client or to lawyers and employees within the law firm, unless the client instructs otherwise. Tex. R. 1.05(c)(3).

d. To Comply with Law. "When the lawyer has reason to believe it is necessary to do so in order to comply with a court order, a Texas Disciplinary Rule of Professional Conduct, or other law." Tex. R. 1.05(c)(4). *Cf.* Model Code DR 4-101(C)(2).

e. To Enforce Claim or Defend Against Client. "To the extent reasonably necessary to enforce a claim or establish a defense on behalf to the lawyer in a controversy between the lawyer and client." Tex. R. 1.05(c)(5). *See generally*, Tex. Professional Ethics Comm. Op. No. 464 (Aug. 10, 1989) (discussing 1.05(c)(5)). *Cf.* Model Code DR 4-101(C)(4); Model Rule 1.6(b)(2).

f. To Defend Self. To defend a criminal charge, civil claim, or disciplinary claim against the lawyer or his firm. Tex. R. 1.05(c)(6).

g. To Prevent Client's Crime or Fraud. "When the lawyer has reason to believe it is necessary to do so in order to prevent the client from committing a criminal or fraudulent act." Tex. R. 1.05(c)(7). *See Volcanic Gardens Management Co. v. Paxson*, 847, S.W.2d 343, 347 (Tex. App. -- El Paso 1993, no writ). Note that the lawyer *may* disclose confidences where there is "reason to believe" it is necessary to prevent a crime or fraud, a different standard than that for the mandatory disclosure provision, discussed below. "Belief denotes that the person involved actually supposes the fact in question to be true." Tex. Professional Ethics Comm. Op. No. 504 (Aug. 9, 1994).

h. To Rectify Past Frauds or Crimes Made Through Lawyer's Services. "To the extent revelation reasonably appears necessary to rectify the consequences of a client's criminal or fraudulent act in the commission of which the lawyer's services had been used." Tex. R. 1.05(c)(8).

2. When, In Addition, May a Lawyer Reveal *Unprivileged* Information?

a. With Implied Authority from Client. When impliedly authorized to do so to carry out the representation. Tex. R. 1.05(d)(1). *See id.*, cmt. 6. *Cf.* Model Rule 1.6(a). (The structure of Rule 1.05(d) suggests that a lawyer may not reveal *privileged* information if merely "impliedly authorized" to do so; instead, he must have been "expressly authorized." *Compare* Tex. R. 1.05(c)(1) *with* Tex. R. 1.05(d)(1).).

b. To Carry Out Representation, Sue Client, or Defend Self. When the lawyer has reason to believe it is necessary to carry out the representation; to defend the lawyer or his firm against a claim of wrongful conduct; to respond to allegations concerning the lawyer's representation of the client; or to prove the value of services rendered in an action over fees. Tex. R. 1.05(d)(2).

E. Mandatory Disclosure.

1. The "Knowingly" Requirement. The Texas Rules define "knowingly" as denoting "actual knowledge of the fact in question." Tex. R. Preamble. However, a "person's knowledge may be inferred from the circumstances." *Id. See* Tex. Comm. Professional Ethics Op. 482 (Feb. 1994) ("Until the [client] definitely manifests an intention to commit perjury... the firm cannot disclose the confidential information."). *See generally,* Edward L. Kimball, *When Does a Lawyer "Know" Her Client Will Commit Perjury?*, 2 Geo. J. Legal Ethics, 579, 581 (1988).

2. When *Must* a Lawyer Reveal Confidential Information? Mandatory disclosure of client confidences is a sensitive issue. The Texas Rules balance the client's need for confidentiality against competing interests. When the competing interests are (a) the integrity of judicial proceedings or (b) the physical safety of third parties, the ethical duty of confidentiality can be overridden. *See* Tex. R. 1.05, cmt. 9.

a. The Ethical Obligation to Disclose Confidential Information to Prevent Physical Harm to Third-Parties. "When a lawyer has confidential information clearly establishing that a client is likely to commit a criminal or fraudulent act that is likely to result in death or substantial bodily harm to a person, the lawyer shall reveal confidential information to the extent revelation reasonably appears to be necessary to prevent the client from committing the criminal or fraudulent act." Tex. R. 1.05(e) (emphasis added).

(1) A Suspicion of Wrong-Doing is Not Enough. A lawyer is required to disclose confidential information under 1.05(e) only if the confidential information clearly establishes the danger. Tex. R. 1.05, cmt. 19. *See also* Tex. Comm. Prof. Eth. Op. 482 (Feb. 1994); *In re Grievance Committee of the United States District of Connecticut,* 847 F.2d 57, 63 (2d Cir. 1988) ("if any standard less than actual knowledge was adopted... serious consequences might follow."); *Quadrozzi v. City of New York,* 127 F.R.D. 63, 82 (S.D.N.Y. 1989) ("attorney must 'clearly know,' rather than suspect...."). Under some circumstances, however, deliberate ignorance of readily accessible facts may be equated with knowledge. *See United States v. Maniego,* 710 F.2d 24, 28 (2d Cir. 1983).

(2) Financial Harm or Property Damage Are Not Enough. A lawyer is required to disclose information only where death or substantial bodily injury will result. "When the threatened crime or fraud is likely to have the less serious result of substantial injury to the financial interests or property of another, the lawyer is not required to reveal preventive information but may do so in conformity to paragraph [1.05](c)(7)." Tex. R. 1.05, cmt. 19. *See Bernstein v. Portland Savings & Loan Assoc.*, 850 S.W.2d 694, 704 (Tex. App. -- Corpus Christi 1993, writ denied).

(3) The Crime or Fraud Must Have Been Committed During the Representation. Information provided by a client concerning a crime or fraud that occurred prior to the representation is privileged, and is not within this exception by the terms of the Texas Rule. *See also In re Grand Jury Proceedings,* 680 F.2d 1026 (5th Cir. 1982); ABA Comm. on Ethics and Prof. Resp. Informal Op. 1470 (1981) ("Information... as to the client's past crime is privileged and should not be divulged.").

b. The Ethical Obligation to Disclose Confidential Information to Courts or Tribunals to Avoid Assisting Crimes or Frauds. Disclosure is required when, but for revelation of the confidential information, the lawyer would knowingly "fail to disclose a fact to a tribunal when disclosure is necessary to avoid assisting in a criminal or fraudulent act." Tex. R. 3.03(a)(2); *see* Tex. R. 1.05(f).

c. The Ethical Obligation to Correct False Evidence Offered to or Used by a Court. "If a lawyer has offered material evidence and comes to know of its falsity, the lawyer shall make a good faith effort to persuade the client to correct or withdraw the false evidence. If such efforts are unsuccessful, the lawyer shall take reasonable measures, including the disclosure of the true facts." Tex. R. 3.03(b). *See* Tex. R. 1.05(f).

d. The Ethical Obligation to Disclose Confidential Information to Avoid Having the Lawyer Become a Party to the Client's Crimes or Frauds. When, but for revelation of the confidential information, the lawyer would knowingly "fail to disclose a material fact to a third person when disclosure is necessary to avoid making the lawyer a party to a criminal act or knowingly assisting a fraudulent act perpetrated by a client." Tex. R. 4.01(b). *See* Texas Rule 1.05(f).

F. Scope of Disclosure.

1. Limit Scope of Information Disclosed. Where disclosure is required or permitted, it should only be as broad as is reasonably necessary to achieve the purpose for which disclosure is authorized by the rules. *See* Tex. Prof. Eth. Comm. Op. 495 (Oct. 1994) ("Because of the fiduciary relationship involved, any disclosure by the lawyer should be as *protective* of the client's interests as possible.") (citing Tex. R. 1.05, cmts. 14 & 15) (emphasis in original). While Rule 1.05(c)(7) "provides the law firm with the latitude to prevent a criminal or fraudulent act from being committed, the exception does not allow blanket disclosure of confidential communications." Tex. Professional Ethics Comm. Op. No. 482 (Feb. 1994).

2. Limit to Whom Information is Disclosed. If the client intends to commit perjury or to offer false evidence and the lawyer deems to disclose confidential information, any disclosure should be to the court, and only to the parties if necessary to prevent the fraud from occurring. Tex. Comm. Prof. Eth. Op. 482 (Feb. 1994). Likewise, the obligation under Texas Rule 3.03 to disclose a fact to a tribunal when it is necessary to avoid assisting in criminal or fraudulent conduct "does not contemplate disclosure to parties to the lawsuit." *Id.*

III. Confidentiality and Privilege in High-Tech Communications.

A. Introduction.

This section ultimately addresses whether information that otherwise would be privileged or confidential would not be considered privileged or confidential merely by reason of being transmitted over the Internet. It first analyzes the privacy and privilege laws and expectations associated with more traditional means of communication and then applies that analysis to communications over the Internet. That is how the courts approach the issues relating to hi-tech lawyer-client communications.[1]

At the outset, it should be noted that it is clear that lawyers should *not* (a) give legal advice to

[1] *E.g., United States v. Maxwell*, 43 Fed. R. Serv. 24 (U.S.A.F. Ct. Crim. App. 1995); *United States v. Smith*, 978 F.2d 171 (5th Cir. 1992), *cert. denied*, 113 S. Ct. 1620 (1993); South Carolina Bar Advisory Op. 94-27 (Jan. 1995). This section is based upon authorities collected in and some of the reasoning suggested by an excellent paper by Peter R. Jarvis and Bradley F. Tellam, entitled *High-Tech Ethics and Malpractice Issues*, and delivered at the 22nd National Conference on Professional Responsibility, on May 30, 1996 in Chicago, Illinois. However, this section reaches conclusions somewhat at odds with that paper and identifies several issues not addressed by those authors. This was previously published in substantially similar form in the ABA publication *The Professional Lawyer* and also in the *Texas Bar Journal*. However, it has been expanded and updated.

unknown third parties over the Internet; (b) post personal opinions on publicly-accessible "bulletin boards" or "user groups" that could harm or embarrass a client; or (c) post trade secrets or client confidences on publicly-accessible bulletin boards or user groups.[2] Beyond those bright lines, much grey subsists.

B. Framing the Issues: (1) Waiver or Loss of Privilege and (2) Loss of Confidentiality.

Transmitting information over the Internet has potential impact upon both waiver of the attorney-client privilege and breach of the lawyer's duty to take reasonable care not to reveal a client's confidential information, absent consent.

1. Waiver or Loss of Privilege.

Because waiver of privilege could arise in a number of jurisdictions, only the most general legal principles can be assumed to apply. One frequently cited summary of the attorney-client privilege is from John H. Wigmore, 8 *Evidence* § 2292 (McNaughton rev. 1961), which defines the attorney-client privilege as follows:

> (1) Where legal advice of any kind is sought (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal adviser, (8) except the protection be waived.

The key elements of the privilege implicated by transmission of attorney-client privileged material over the Internet are "(4) made in confidence" and "(8) except the protection be waived."

Transmission of a communication of any kind by telephone does not likely result in a loss of confidence or effect a waiver of privilege. Federal law, in the form of the wiretap statutes, expressly provides that interception of a phone call -- whether it is being transmitted over a land-based phone line, a cordless phone or a cellular phone, and whether or not the transmission contains voice or data, and whether the interception is intentional or inadvertent or even authorized -- does not waive any otherwise available privilege.[3] Although this statute has not been fully tested in the courts, and its inartful drafting creates some uncertainties in limited respects, it seems highly unlikely that the interception of lawyer-client communications transmitted by any kind of phone or by Internet e-mail will have any impact on an *otherwise* valid claim of privilege.

Conversations by telephone are not deemed "privileged" merely by reason of being a private telephone conversation. Instead, "otherwise privileged" "means privileged other than by virtue of their character as private telephone conversations."[4] Under Section 2517(4), state law defines the scope of any underlying privilege.[5] Consequently, there is a fundamental choice of law issue any time an e-mail message has been intercepted: suppose, for example, that the message is sent from a state where the corporate privilege governs only "control group" communications,[6] and

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[2] *See, e.g., Castano v. American Tobacco Co.*, 896 F. Supp. 590 (D.E. La. 1995) (documents not privileged when available on Internet); William Freivogel, *Communicating With or About Clients on the Internet: Legal, Ethical, and Liability Concerns*, ALAS Loss Prevention J. 17 (Jan. 1996) (advising to avoid disclosing client-related or client-sensitive information on public areas of Internet, such as bulletin boards or chat rooms); Joan C. Rogers, *Malpractice Concerns Cloud E-Mail, On-Line Advice*, ABA/BNA Manual on Prof. Conduct (March 6, 1996) (discussing dangers of giving legal advice on-line).

[3] 18 U.S.C. § 2517(4).

[4] *United States v. Turner*, 528 F.2d 143, 155 (9th Cir. 1975), *cert. denied*, 96 S.Ct. 426 (1976).

[5] *See Turner*, 528 F.2d at 155.

[6] For example, Texas, until recently. *See Ford Motor Co. v. Leggat*, 904 S.W.2d 643 (Tex.

is then intercepted in a router (discussed below) located in a state which adopts the "subject matter" approach,[7] and finally, ends up in a state with a still third approach to the issue.[8] Because Section 2517(4) only protects "otherwise privileged" electronic transmissions, then the threshold question must be whether the communication is "otherwise privileged," and the initial inquiry there is: what law determines the issue. In some instances, choice of law could be outcome determinative as to whether the communication is "otherwise privileged."

This choice of law issue as well as other issues regarding interpretation by the ECPA to "stored communications," creates some uncertainty regarding waiver of privilege by communicating on the Internet.[9] However, this affects the margins, not the core. As a general principle, otherwise privileged information does not lose its privileged character merely by being intercepted or reviewed while being transmitted as an electronic communication over the Internet.

2. Duty of Confidentiality.

Waiver of the attorney-client privilege is not the only concern raised by transmission of client confidences over the Internet. Even if the formal evidentiary privilege is not waived, the mere disclosure of information -- even of unprivileged information -- could harm a client. For this reason, the ethical rules require attorneys to protect not just privileged information, but other "confidences" as well.[10] Therefore, the privilege waiver issue aside, the question remains as to whether, absent the client's consent after consultation, a lawyer may transmit client communications over the Internet without violating the duty of confidentiality to the client.

C. Confidentiality and Traditional Land-Line, Non-Cordless Telephone Calls.

Traditional land-line telephone conversations are confidential: a lawyer's use of a land-based phone to talk to a client does not waive any privilege because such communications are made under circumstances which reasonably ensure their confidentiality.[11] There are objective facts as well as legal protections supporting the conclusion that lawyer-client communications over a land-based phone line are considered as being made with a reasonable expectation of privacy. On an objective level, phone calls are not often inadvertently overheard by others, and if a phone call is misdirected, the person making the call knows instantly, before any information is disclosed. Calls cannot generally be intercepted without equipment designed to intercept land-based phone calls and such equipment is illegal to possess (as shown below).

Still, people who want to intercept land-based phone calls can do so; telephone company errors can put an unauthorized listener in the middle of others' conversations; someone may, without the knowledge of any participant to a phone call, pick up an extension telephone and listen in;[12] telephone companies are authorized to monitor phone calls to

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1995).

[7] For example, Michigan. *See Ford Motor Co.*, 904 S.W.2d at 646, citing *Fruehauf Trailer Corp. v. Hagelthorn*, 528 N.W.2d 778, 781 (Mich. App. 1995) for the proposition that Michigan applies the "subject matter test," not the control group test, to determine privilege in the corporate context.

[8] *See generally, Upjohn Co. v. United States*, 449 U.S. 383, 386 (1981) (while expressly rejecting "control group" test, court refused to adopt "subject matter" test).

[9] For an exampe of the "stored communications" exception, *see Steve Jackson Ganes Inc. v. U.S. Secret Service*, 36 F.3d 457 (5th Cir. 1994).

[10] *See, e.g.*, Texas Rule 1.05, discussed above.

[11] *See* Jarvis & Tellam, *supra*, note 1 at p. 7.

[12] *See* Jarvis & Tellam, *supra*, note 1 at p. 7-8.

ensure quality and performance;[13] and law enforcement authorities can obtain permission to conduct lawful wiretaps of telephone conversations, and others may do so illegally.[14]

Thus, as an objective matter, there is no guarantee that land-based phone conversations cannot be overheard, misdirected, or intercepted, whether lawfully or not. Confidentiality is not guaranteed.

The legal protections afforded land-based phone calls are strong.[15] Such calls are subject to Fourth Amendment protection against unreasonable search and seizure.[16] In addition, federal statutes protect land-based telephone calls,[17] expressly providing that interception does not waive any otherwise available privilege.[18] Finally, federal law provides a civil damage remedy for any person whose oral communication is intercepted, disclosed, or intentionally used in violation of federal law,[19] and illegally intercepted communications may not be admitted as evidence even if they are not privileged.[20]

Despite the actual risk of misdirection or interception, discussion of client confidences during land-based telephone calls does not violate the duty of confidentiality because the required expectation of confidentiality need *not* be a guarantee or absolute expectation. It needs to be a *reasonable* expectation.

D. Confidentiality and *Cordless* Telephone Calls.

The objective expectations of confidentiality concerning privacy over cordless phone calls (not cellular phones--*cordless* phones) vary dramatically from those involving land-based phone lines; the current legal rules governing interception do not.

The technological distinction between a call made over a cordless phone and one made over a land-based phone arises from the *broadcast* made between the handset and the base station of the typical cordless phone was recently described by the Fifth Circuit as follows:

> In one sense, the cordless telephone is just what the name implies, a telephone. It looks and sounds like a normal land line telephone. When you use a cordless phone, you dial a telephone number and talk to the party on the other end of the line. In actual operation, however, the cordless phone actually uses a radio signal. The typical cordless phone consists of a base unit, attached to the

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[13] A telephone conversation is a wire communication under the federal wiretap statutes. *Forsyth v. Barr*, 19 F.3d 1527, 1534 (5th Cir. 1994). Under 18 U.S.C. § 2511(2)(a)(i), it is not unlawful for a switchboard operator, or an employee or agent of a provider of wire or electronic communication service, "whose facilities are used in the transmission of a wire or electronic communication, to intercept, disclose, or use that communication in the normal course of his employment while engaged in any activity which is a necessary incident to the rendition of his service or to the protection of the rights or property of the provider of that service, except that a provider of wire communication service to the public shall not utilize service observing or random monitoring except for mechanical or service quality control checks."

[14] *See* 18 U.S.C. §§ 2518 & 2703.

[15] *See* Jarvis & Tellam, *supra,* note 1 at p. 8-10.

[16] *See, e.g., Katz v. United States*, 389 U.S. 347 (1967) (call from phone booth intercepted by listening device placed on outside of booth subject to Fourth Amendment protection).

[17] *See* 18 U.S.C. § 2511 (criminal penalties for intentional interception). Several states have similar laws.

[18] 18 U.S.C. § 2517(4).

[19] 18 U.S.C. § 2520(a).

[20] 18 U.S.C. § 2515.

land-based telephone line, and a mobile unit which transmits and receives the radio signals that carry the actual conversation to and from the base unit.[21]

Obviously, any interception of the call once the transmission is being carried through land-based phone lines would be governed by the law and expectations set forth above regarding land-based phone calls. Merely because a person knows that the cordless broadcast might be intercepted does not mean they do not expect the land-line to be protected.[22] The critical issue, then, is whether the fact that a cordless phone *broadcasts* the conversation over FM radio frequencies destroys any reasonable expectation of confidentiality.

As a factual matter, the broadcast of a cordless telephone call can far more readily be intentionally intercepted or inadvertently overheard than a land-based call.[23] "Inadvertent interceptions have occurred frequently with cordless phones, which transmit on a normal FM frequency within radio range. Using a cordless phone is like operating a radio station and broadcasting your message. Anyone within range could receive the communication."[24]

Probably as a result of this fact, a number of court and ethics opinions have concluded that broadcasts by cordless telephones are not subject to a reasonable expectation of privacy in terms of the attorney-client privilege, the pre-1994 federal wiretap statutes, or the Fourth Amendment.[25] Such decisions were based in part upon the fact that the broadcasts could be more easily intercepted than land-line transmissions, and also upon the then-lacking statutory prohibitions against interception of broadcasts sent by the handsets of cordless phones.[26] Even so, there were decisions to the contrary in which courts found that a reasonable expectation of privacy did accompany cordless phone broadcasts under state law or under some circumstances.[27]

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[21] *Smith,* 978 F.2d at 177 (whether a cordless phone call carries a reasonable expectation of privacy depends upon many factors, including the range of the broadcast).

[22] *Cf. McKamey v. Roach,* 55 F.3d 1236, 1240 (6th Cir. 1995).

[23] *See* Jarvis & Tellam, *supra,* note 1 at p. 12-13.

[24] Albert Gidari, *Privilege and Confidentiality in Cyberspace,* 13 No. 2 Computer 1, L. 1, 133 (Feb. 1996). *See generally, State v. Cartson,* 913 P.2d 709 (Or. 1996).

[25] *See generally, People v. Chavez,* 44 Cal. App. 4th 1144, *mod.,* 1996 WL 271524 (Cal. App. 1996) (collecting cases); *McKamey,* 55 F.3d at 1239; N.Y. City Bar Ass'n Comm. Prof. & Jud. Ethics Op. No. 1994-11 (Oct. 1994); Washington State Bar Association Rules of Professional Conduct Comm. Informal Op. 91-1 (Oct. 1991); Illinois Bar Association Comm. on Professional Conduct Op. 90-7 (1990).

[26] *See, e.g., McKamey,* 55 F.3d at 1238-39; *In re Askin,* 47 F.3d 100, 103-04 (4th Cir. 1995); *Tyler v. Berodt,* 877 F.2d 705, 706 (8th Cir. 1989), *cert. denied,* 493 U.S. 1022 (1990); *State v. Smith,* 438 N.W.2d 571, 575-76 (Wis. 1989); *State v. Delaurier,* 488 A.2d 688, 694 (R.I. 1985).

[27] *See, e.g., United States v. Smith,* 978 F.2d 171, 180 (5th Cir. 1992), *cert. denied,* 113 S. Ct. 1620 (1993) (with improved cordless technology, there may now be reasonable expectation of privacy under the Fourth Amendment); *State v. Faford,* 910 P.2d 447 (Wash. 1996) (relying on state law to exclude evidence obtained by police as result of private citizen's illegal monitoring of cordless telephone calls); *State v. McVeigh,* 620 A.2d 133 (Conn. 1993) (upholding state law prohibiting interception of cordless telephone conversations and suppressing them); *State v. Mozo,* 665 So.2d 1115 (Fla. 1995) (same); *State v. Bidinost,* 644 N.E.2d 318 (Ohio 1994) (same); *People v. Fata,* 559 N.Y.S.2d 348, 350-51 (N.Y. App. 1990) (same); *People v. Stevens,* 40 Cal. Rptr.2d 92, 96 (Cal. App. 1995) (upholding criminal conviction of defendant who intentionally intercepted cordless telephone conversations in violation of state law).

The cases and ethics opinions finding no expectation of privacy, however, do not (or could not) take into account the 1994 amendments to 18 U.S.C. § 2510(1) and 2512(A), which now protect cordless telephone broadcasts as a matter of federal law in the same manner as land-based telephone calls.[28] Under 18 U.S.C. § 2517(4), as now amended, privilege is not lost as a result of innocent or intentional interception of such a broadcast; and the substance of unlawfully intercepted cordless telephone broadcasts cannot be introduced in evidence even if they are *not* otherwise subject to any claim of privilege.[29] The legal protections afforded to cordless phone broadcasts are identical to those protecting land-based calls.

The recent adoption of federal criminal and civil prohibitions against the interception and use of cordless broadcasts and of limitations on the uses to which intercepted conversations can be put "does not, of course, make it technologically more difficult for someone to intercept" or inadvertently receive them.[30] Thus, although it is now illegal to intercept cordless broadcasts, it is still more common for inadvertent interception to occur, and such unintended interception can occur through devices which are legal to own -- namely, other cordless phones, FM radios, and baby monitors.

Consequently, whether a lawyer should use a cordless phone to discuss confidential information -- even though privilege is almost certainly not waived -- probably depends on whether the disclosure of the transmitted information would likely be detrimental to a client: does the risk outweigh the benefit? Where it clearly does, the use of cordless phones to discuss identifiable confidential information should probably be avoided absent a controlling decision holding otherwise, unless the client consents after being apprised of the attendant risks.

E. Confidentiality and *Cellular* Telephone Communications.

Cellular phones have only been legal to use in the United States only for the last fifteen years.[31] Like cordless phones, cellular phones *broadcast* conversations over the airwaves to receiving stations, which then transmit the calls over land-based phone lines. Thus, once the transmission is in the land-based phone line, interception is governed by the rules and expectations concerning land-based phone lines, discussed above.[32] As with cordless phones, the fact that a radio broadcast occurs before the communication reaches the land-based phone lines raises distinct issues regarding the expectation of privacy.

The expectations of privacy concerning cellular phones are evolving as cellular technology changes, and as judicial understanding of that technology changes. "[U]ntil recently, courts considered cellular transmissions to be ordinary radio waves wandering along the public airwaves, not subject to legal protection from interception."[33] While cordless phones may still easily be intercepted or inadvertently overheard, the "same is not true for cellular phones, however. While they use part of the spectrum for transmission, they do not transmit within a range or frequency capable of inadvertent interception by commercial users of the air waves or listeners.[34] Since 1993, the scanners that must be used to intercept cellular communications may not be marketed in the United

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[28] *See generally, McKamey*, 55 F.3d at 1238-40 (discussing amendment).

[29] 18 U.S.C. § 2515.

[30] *See* Jarvis & Tellam, *supra,* note 1 at p. 12.

[31] Jose L. Nunez, *Regulating the Airwaves: The Governmental Alternative to Avoid Cellular Uncertainty on Privacy and the Attorney-Client Privilege*, 6 St. Thomas L. Rev. 479, 483 (Spring 1994).

[32] *See* note 23, *supra,* and accompanying text.

[33] Nunez, *supra,* note 32 at p. 484.

[34] Gidari, *supra,* note 25. *See* Jarvis & Tellam, *supra,* note 1 at p. 13.

States.[35] Thus, unlike cordless phones, cellular phones may not be readily overheard by mass-market consumer appliances, such as other cordless phones.

Nonetheless, it is still lawful to own a scanner sold before 1993, and other scanners can be purchased that can be modified to monitor cellular phone frequencies by someone with certain skills, even though that is illegal. In any event, it is *not* illegal to own a cellular phone, and it is not unusual for someone using a cellular phone to overhear portions of another party's cellular phone call (although the newer digital cellular phones appear to lessen that likelihood).[36] In addition, the *range* of a cellular broadcast is generally much greater than the range of a typical cordless phone, which are generally no more than 600 feet. Moreover, the media has reported the existence of cellular pirates, who actively seek to intercept information related to litigation and financial transactions and to sell it to interested parties.[37]

As a legal matter, the legal protections afforded to cellular phone broadcasts have been identical to those for land-based phones since 1986: interception is a federal crime, and privilege is not lost by interception.[38] Thus, there are strong legal protections over cellular phone broadcasts. Nonetheless, a number of state bar ethics opinions have stated that lawyers should not transmit confidences over cellular telephones.[39] These conclusions were based primarily upon the recognition that such broadcasts were easily overheard by third parties.

Although improvements in cellular technology may soon, or may have already, created a reasonable expectation of privacy, the law in this area is not well developed and has not yet taken such improvements nor the 1986 and 1993 changes in federal law adequately into account. Some risk exists that a sensitive communication over a cellular phone may be overheard by an unintended person. Consequently, disclosure of client identity or any identifiable confidential information which would likely be detrimental to the client (even if no privilege waiver is deemed to have occurred) should be avoided during cellular phone calls, absent client consent given after discussing these risks.

F. Confidentiality and Communications By Computer.

This section applies the foregoing analysis to communications between lawyer and client sent by computer.

1. Direct Lawyer-Client Computer Communications.

If a lawyer's computer and a client's computer communicate directly over land-based telephone lines, the fact that the lawyer and the client are communicating digitally rather than by voice cannot affect the expectation of

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[35] *See* Nunez, *supra,* note 32 at p. 486, discussing the Telephone Disclosure and Dispute Resolution Act of 1993, Pub. L. 102-556, 106 Stat. 4181.

[36] *See* Nunez, *supra,* note 32 at p. 479.

[37] *See, e.g.*, Jarvis & Tellam, *supra,* note 1, *citing* James J. Harrison, *Cellular Phones are Weakest Security Link,* Legal Times, Jan. 25, 1993, at 27; Robert Jesse, *How Not to Protect Communications,* N.Y. Times, Sept. 13, 1986, at 27, col. 2. *See also United States v. Carr,* 805 F. Supp. 1266, 1270 (E.D.N.C. 1992).

[38] Today, all cellular calls are protected, whether or not they ever are transmitted over land-based lines. *See State v. Tango,* 671 A.2d 186, 187-88 (N.J. App. 1996) (discussing statutes). This was not the case prior to 1986. *See id*; Jarvis & Tellam, *supra,* note 1 at p. 13.

[39] *See, e.g.*, Mass. Ethics Op. No. 94-5 (1994); N.H. Ethics Op. No. 1991-92/6 (1992); N.Y. City Bar Ass'n. Op. No. 1994-11 (1994); Iowa Ethics Op. No. 90-44 (1991); Ill. St. B. Ass'n. Op. No. 90-7 (1990).

confidentiality. This seems indisputable.[40] For example, faxes are subject to attorney-client privilege, and faxes are electronic, computer-to-computer digital communications. Although a *misdirected* fax may lose its privilege, no one argues that the use of a fax machine or the possibility of misdirection destroys any claim of privilege.[41] It follows that the existence of a reasonable expectation of privacy for digital communications transmitted over a land-based phone line is as clear as it is for oral communications transmitted by the same means.

2. "Private Network" Communications.

Private network transmission of client confidences is common. First, some lawyers use computers to communicate with their clients' computers over a closed, private network, typically called a "local area network" or "LAN," which is a network that can be accessed internally, such as a corporation's internal e-mail system, by which in-house counsel communicate with their corporate client. Second, lawyers often discuss attorney-client information within their law firms over similar networks. Finally, some law firms have networks that, when a lawyer wants to send an e-mail to a client, the lawyer's network dials that client's network directly over land-based phone lines and transmits the message, or vice versa (in which case it can be an "extranet"). Such communications are entirely over land-based phone lines, and the former two circumstances do not even use external phone lines. Thus, both computer-to-private-network-to-computer communications and computer-to-private-network-to-land-based-phone-line-to-client's-network communications would plainly appear subject to a reasonable expectation of privacy.[42]

3. "Semi-Public Network" Password Protected or Encrypted Communications.

Though less certain, electronic communications sent from a computer over land-based phone lines and then *wholly within* an external, semi-public e-mail provider that has reasonable security and network access security should be considered to be confidential. Such networks probably include America Online, CompuServ, and MCI Mail, for example. The *practical* distinction between such external semi-public on-line services and internal, closed networks (such as the in-house network described above) is that any member of the public can have access to an on-line service, so long as he pays a fee. A person who subscribes to such a service may use a computer to communicate over a direct, land-based phone connection to that network. The person can transmit e-mail from their own "mailbox" -- access to which requires a password -- to another password-protected mailbox.

The critical *legal* distinction between a private network and a semi-public network is that everyone with access to an internal, private network, as an agent of the employing firm or company, has a duty of confidentiality to their employer; but most of those who are members of semi-public on-line services do not owe any similar duty to the sender of any e-mail. Thus, inadvertent transmission or intentional interception within a closed network has no effect on confidentiality: if, for example, a message on such a network in a law firm is transmitted to the wrong person, no waiver or other legal harm occurs *per se* because all lawyers and personnel owe a duty of confidentiality to every

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[40] *See* Jarvis & Tellam, *supra,* note 1 at p. 14-15.

[41] *See id.*, citing ABA Formal Op. Nos. 94-382 (1994) & 92-368 (1992) (faxes can lose privilege if misdirected).

[42] Internal electronic mail messages sent between in-house counsel and the client can be privileged. Jarvis & Tellam, *supra*, note 1 at p. 14-15, citing *State v. Canady*, 460 S.E.2d 677 (W.Va. 1995); *National Emp. Serv. Corp. v. Liberty Mut. Ins. Co.*, 3 Mass. L. Rptr. 221 (Mass. Super. Ct. 1994) (internal e-mail generated by in-house lawyers subject to privilege); *see also In re Grand Jury Proceedings*, 43 F.3d 966 (5th Cir. 1994) (analyzing e-mail messages along with other documents for work product analysis); *United States v. Keystone Sanitation Co.*, 903 F. Supp. 803, 808 (M.D.Pa 1995) (privilege waived over inadvertently produced e-mail).

firm client. In contrast, inadvertent transmission on a semi-public network *does* effect confidentiality, because the recipient most likely does not owe any duty whatsoever to the sender or its principal.

However, the question is not whether there is the *possibility* of misdirection, but whether there is a reasonable expectation of confidentiality; and public access to the network does not equate to public access to the information stored in a private place on that network. "For the Fourth Amendment protects people, not places. What a person knowingly exposes to the public, even in his own home or office is not subject of Fourth Amendment protection . . . . *But what he seeks to preserve as private, even in an area accessible to the public, may be constitutionally protected.*"[43] Applying this principle, the court in *United States v. Maxwell* recently held that e-mail stored on America Online -- a semi-public on-line service, like that described above -- was subject to a reasonable expectation of privacy, reasoning:

> In our view, appellant clearly had an objective expectation of privacy in those messages stored in computers which he alone could retrieve through the use of his own assigned password. *Similarly, he had an objective expectation of privacy with regard to messages he transmitted electronically to other subscribers of the service who also had individually assigned passwords.* Unlike transmissions by cordless telephones, or calls made to a telephone with six extensions, or telephone calls which may be answered by anyone at the other end of the line, there was virtually no risk that appellant's computer transmissions could be received by anyone other than the intended recipients.[44]

Thus, an e-mail sent on a semi-public on-line service accessible only to the recipient with a password is subject to a reasonable expectation of privacy -- even though that message is technically "broadcast" over the publicly accessible network and even though there is the potential for misdirection or theft. In light of the foregoing, a lawyer who is a member of such a semi-public on-line service could send a message to a client *who is also a member of such service* and not waive any privilege.

There is contrary authority, however. The South Carolina Bar Association Ethics Advisory Committee analyzed whether a lawyer could provide legal advice over a "on-line service" without violating the duty of confidentiality, among other things.[45] That committee reasoned in full as follows:

> The attorney must obtain sufficient information to identify his client in order to make a complete conflicts inquiry. He should also consider the provisions of Rule 3.6 regarding trial publicity.
>
> The attorney must consider his ability to engage in privileged communications with his client via electronic media. *Even assuming that such communications occurred through private electronic mail rather than through public notices on electronic bulletin boards, the very nature of on-line services is such that the system operators of the on-line service may gain access to all communications that occur on the on-line service.* Thus, the confidentiality requirements of Rule 1.6 are implicated by any confidential communication which occurs across electronic media, absent an express waiver by the client.
>
> While no authorities directly on point have been located, the committee finds that prior discussions of confidential

[43] *Katz v. United States,* 389 U.S. 347, 351 (1967) (emphasis added).

[44] *United States v. Maxwell,* 43 Fed. R. Serv. 24 (U.S.A.F. Ct. Crim. App. 1995) (emphasis added).

[45] South Carolina Bar Advisory Op. 94-27 (Jan. 1995).

> communications via cellular telephone have applicability here by way of analogy. The Ethics Advisory Committees of at least three jurisdictions have stated that a lawyer should not use a cellular telephone to discuss confidential information with clients, absent informed client consent, where there is a risk the conversations may be overheard.
>
> *Thus, it is the opinion of the committee that unless certainty can be obtained regarding the confidentiality of communications via electronic media, that representation of a client, or communication with a client, via electronic media, may violate Rule 1.6, absent an express waiver by the client.*[46]

The South Carolina Bar Committee opinion never mentioned password protection and it assumed that by its "very nature" system operators of on-line services have access to *all* communications that occur on-line. Its analysis seems more accurate if viewed as analyzing the confidentiality of information on "chat rooms" or "bulletin boards."[47] While access may be true in theory -- an on-line operator could, theoretically, read every single message sent within its system -- it is unlawful to do so. Under federal law, a provider of electronic communication services may intercept messages only if it is "in the normal course of his employment while engaged in any activity which is a necessary incident to the rendition of his service or to the protection of the rights or property of the provider of that service, except that a provider of wire communication service to the public shall not utilize service observing or random monitoring except for mechanical or service quality control checks."[48] It is clear that an on-line service is a "wire communication service."[49] Thus, on-line service operators are prohibited from using even service observing or random monitoring except to assure quality control and to conduct mechanical checks; surely it would be unlawful for them to monitor every communication. An on-line service operator can not intercept, disclose, or use a communication unless it is a "necessary incident to the rendition of his service or to the protection of the rights or property of the provider of that service . . . ."[50] At least one on-line service provider has publicly recognized that monitoring the content of private e-mail is unlawful.[51]

More critically, if the South Carolina Bar opinion is interpreted to mean that this sort of monitoring as a matter of law precludes information from being confidential, then telephone conversations over land-based phone lines are not confidential because the telephone company is expressly authorized to conduct the identical amount of monitoring as are on-line operators.[52] The South Carolina opinion is not the last word on whether a lawyer can communicate with a client

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[46] *Id.* at p. 2 (emphasis added, citations omitted).

[47] *See* note 2, *supra.*

[48] 18 U.S.C. § 2511(2)(a)(i), quoted in note 14, *supra.*

[49] 18 U.S.C. § 2510(1) defines a wire communication as "any communication made in whole or in part through the use of facilities for the transmission of communications by the aide of wire, cable, or the like connection between the point of origin and the point of reception furnished or operated by any person engaged as a common carrier in providing or operating such facilities for the transmission of interstate or foreign communications."

[50] 18 U.S.C. § 2511(2)(a)(i), quoted in note 14, *supra.*

[51] Prodigy has done so. *See* Anne Wells Branscomb, *Anonymity, Autonomy, and Accountability: Challenges to the First Amendment in Cyberspace*, 104 Yale L.J. 1639, 1651 (1995).

[52] *See* note 14, *supra.*

wholly within a semi-public on-line service without affecting confidentiality.

4. Internet Communications.

a. Background: How the Internet Works.

What we now refer to as the Internet grew out of an experimental project of the Department of Defense.[53] Today, "the Internet" describes "a collection of more than 50,000 networks linking some nine million host computers in ninety countries . . . ."[54] "It is estimated that as many as forty million individuals have access to the information and tools of the Internet, and that figure is expected to grow to 200 million by the year 1999."[55]

The subjective expectations concerning Internet e-mail security vary wildly. "It is common currency in the popular press that nothing is secure or private on the Internet."[56] Some say that sending an Internet e-mail is like sending a postcard, not a sealed envelope.[57] These subjective beliefs could be significant because they demonstrate how courts and ethics committees will likely approach transmission of client confidences over the Internet. For the purposes of this article, it suffices to say that there is a wide-range of subjective expectations of confidentiality.

The critical objective distinction between an e-mail sent between a lawyer's computer to a semi-public on-line service (like America Online) and directly to a password-protected mailbox and an e-mail sent over the Internet is this: e-mail sent over the Internet does not go directly from the sender's computer over a land-based line to the password-protected "mailbox" of the recipient.[58] Instead, there are stops along the way: an Internet communication goes from the sender's computer through several intermediate computers -- each of which is owned by third parties -- before reaching the recipient's mailbox.[59] In addition, the e-mail can be replicated and split into separate "packets" of information as it is being transmitted: thus, multiple copies can exist at any given time, but they may each be but a portion of the whole.[60]

For example, many law firms have Internet "host" computers. "Hosts" are gateways to the Internet. There are several million "host" computers.[61] Each host computer has a unique Internet "address" for sending and receiving e-mail

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53 *Shea on Behalf of American Reporter v. Reno*, 930 F. Supp. 916, 925 (S.D.N.Y. 1996).

54 *Id.*

55 *Id.* at 926.

56 Gidari, *supra*, note 25 at p. 133.

57 Robert L. Jones, *Client Confidentiality: A Lawyer's Duties With Regard to Internet E-Mail* (available on the World Wide Web at http://www.kuesterlaw.com). *See* Michael Swaine, *Protecting Your Privacy Online*, MacUser (Nov. 1996) at p. 135 ("E-mail is about as private as a conversation on a bus.").

58 *See* Jarvis & Tellam, *supra,* note 1 at p. 15.

59 *See* Jarvis & Tellam, *supra,* note 1 at p. 15. Various combinations can occur. For example, a lawyer could use his computer to send a message over the Internet to a client's password-protected America Online account. Those variations do not, however, effect this analysis.

In addition, normally a message is not sent and received as one continuous piece of electronic data. Instead, an e-mail is usually broken into separate "packets" during transmission, and is re-assembled by the recipient's host . *Shea*, 930 F. Supp. at 926. The original purpose of this method was to ensure that the message would get through even if part of the Internet had been damaged by enemy attack. *Id.*

60 *Shea*, 930 F. Supp. at 926.

61 *MTV Networks v. Curry*, 867 F. Supp. 202, 204 n.1 (S.D.N.Y. 1994).

to the subscribers of that host.[62] But, the hosts are not the only computers on the information highway. Most e-mail does not go directly from the transmitter's host to the recipient's host (and then to the password protected mailbox). Instead, Internet e-mail is sent from the host through one or more "routers." Routers are computers -- owned by various third-parties -- which help to distribute e-mail over the Internet. An e-mail message, or portions of it, may go through a dozen (or more) intermediate computers during transmission over the Internet.

Those intermediate, third-party computers create distinct practical and legal issues concerning confidentiality and the Internet.[63] Although an Internet e-mail cannot be intercepted when it is traveling on a phone line any easier (or any more lawfully) than could a voice phone call, an Internet e-mail message could be intercepted while temporarily stored in (in order to be routed through) one of these intermediate computers. Equally significant, an Internet provider may intercept, disclose, or use e-mail sent through its system to the extent necessary to render the service or protect its rights.[64] The Internet provider may not, however, use "service observing or random monitoring except for mechanical or service quality control checks."[65] Internet providers may, to that extent, monitor e-mail being transmitted through a router.

In a sense, just as with cellular and cordless phones, there is a "broadcast" of a message over the Internet to the "public" -- consisting of those who are lawfully monitoring a router at a particular moment. It is important to focus on the nature of that "broadcast" in order to assess the reasonableness of the expectation of confidentiality. Foremost, unlike a cordless phone or cellular phone broadcast, an Internet e-mail is not broadcast over the open air waves in a certain radius, but through land-based phone lines and the intermediate computers. When an Internet e-mail message is being transmitted over a land-based phone line, it is subject to the same protections and difficulties of interception associated with a land-based oral phone call: "To intercept an Internet communication . . . requires a wiretap. *Thus, there is no greater insecurity when the Internet communication is in transit over the phone lines* than there is with an ordinary phone call."[66] There is no public transmission through the airwaves of a message that can be inadvertently picked up through lawfully available equipment, *except* that the routers may be monitored by their owners to the extent permitted by law.

Consequently, the distinction between an e-mail message sent over the Internet and a land-based phone call boils down to this: Internet e-mail messages are temporarily stored in, and so can be accessed through, the routers.[67] An employee of the

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[62] *Id.* Hosts actually have two addresses: one which is purely numeric (such as 123.456.123.56) and an alphanumeric "domain name" (such as, for Baker & Botts, "bakerbotts.com." or, for America Online, "aol.com"). *Id.* The ".com" signifies a commercial site. Other designations include, for example, ".org" for organization (such as the ABA) and ".edu" for educational sites, such as a university. Domain names are obtained through a company that registers the names and assigns them a numeric address.

[63] If these "stops" did not exist, then a transmission over the Internet from a lawyer to a client who had a password-protected e-mail "mailbox" would legally be no different than e-mail on America Online.

[64] 18 U.S.C. § 2511(2)(a)(i), quoted in note 14, *supra*.

[65] *Id.*

[66] Gidari, *supra*, note 25 (emphasis added). In a sense, a digital communication is more secure because if it is overheard by another human being (due for example, to phone company error), it will be unintelligible, and the odds of an e-mail message being "crossed" with a line carrying a computer that could happen to pick up and translate the e-mail message would seem to be astronomical.

[67] Misdirection of an e-mail by a router, or by human error, could also occur. Thus, for

entity that owns the router could lawfully be monitoring the router and so could read a confidential transmission. Does the opportunity for interception by a person monitoring a router make it unreasonable to expect confidentiality?

b. Encrypted Messages.

The approach of the *Maxwell* court would indicate that an *encrypted* e-mail sent over the Internet should be subject to a reasonable expectation of privacy. Encryption is an electronic "lock-and-key" technology.[68] The most common approach to encryption is what is called "public-key" encryption. In public-key encryption, two different electronic "keys" are used. One key is used by the sender to encrypt the message, and another is used by the recipient to de-crypt it. The decryption key is kept secret, and is the "private key." The encryption key is made public, and is known as the "public key." When a party wants to send an encrypted message to someone, they find that person's public key, use it to encrypt the message, and then send it to the recipient, who is the only person able to unencrypt it, with the private key. Even the person with the public key cannot unencrypt a message once encrypted with a person's public key.[69] The public key may be posted on the Internet, or given to potential recipients on diskettes or by e-mail. There are a number of different encryption software programs available.[70]

Thus, put at its simplest, messages are "locked" by the sender, making them unreadable except by the intended recipient, who has a "key" (in the form of an electronic password) to decode the message. Therefore, if a person who transmits an encrypted message reasonably believes that only the intended recipient will have a key to decode the message, it would seem that encrypted messages sent over the Internet would be made with a reasonable expectation of confidentiality. If an unauthorized person decoded the message, it would seem no different than, for example, had a Federal Express employee opened a sealed envelope containing a confidential document. Encrypted e-mail messages are confidential.

c. Unencrypted Messages.

The first opinions to address the issue reasoned that lawyers could not ethically transmit unencrypted e-mail over the Internet unless they first obtained the client's informed, written consent. Since then, the ethics opinions on the issue of whether lawyers may ethically use unencrypted e-mail have reached conflicting results.

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example, even though an e-mail is addressed by the sender to the proper alphanumeric address, a router could mistakenly send it to the wrong numeric address. Likewise, there could be a glitch that causes erroneous transmission of all e-mail sent through a particular router. While no doubt possible, such scenarios seem far-fetched at best.

[68] *See generally*, Peter B. Bensinger, Jr., *Can the Decrepit Encrypt*, a paper presented at the ABA 22nd National Conference on Professional Responsibility in Chicago, Illinois on May 30, 1996.

[69] Bensinger, *supra,* note 69 at p. 3-4.

[70] There are certain limitations on encryption: some practical, others legal. There is the matter of cost, and encryption requires that both the attorney and client have the same or compatible encryption program, and coordinate its use. More critically, while the concept of encryption is sound, and would result in virtually impregnable messages, in the real world the protection afforded to an encrypted message is only as good as the encrypting software. *See* Bruce Schneier, *Security Pitfalls in Cryptography,* <http://www.counterpane.com/pitfalls.html> (visited May 5, 1998); Matt Curtin, *Snake Oil Warning Signs: Encryption Software to Avoid,* <http://www.interhack.net.people/cm...q.html> (visited May 5, 1998).

As a legal matter, encryption programs are classified as weapons or munitions under 23 U.S.C. § 2778, and thus have severe restrictions on their distribution outside the United States. *See Karn v. United States Dept. of State*, 925 F. Supp. 1 (D.D.C. 1996). This provision was recently declared unconstitutional. *Bernstein v. United States Dep't of State*, 945 F. Supp. 1279 (N.D. Cal. 1996).

The first two opinions reasoned that transmission of unencrypted Internet e-mail violated the lawyer's duty to safeguard client confidences, and so could be done only with client consent.[71]

The Iowa Bar Association reconsidered an earlier opinion[72] and altered its original conclusion regarding the use of the Internet in some measure, but still found that unencrypted e-mail should not be sent over the Internet,[73] stating:

> Pure inter-exchange of information or legal communication with clients is an exception to the Division I of this opinion, *but with sensitive material to be transmitted on E-mail counsel must have written acknowledgment by client of violation of DR 4-101 which acknowledgment includes consent for communication thereof on the Internet or non-secure intranet or other forms of proprietary networks, or it must be encrypted or protected by passwords/fire wall or other generally accepted equivalent security system.*[74]

More recent bar association opinions have disagreed with the Iowa opinion. For example, the bar associations of Arizona and Illinois approved the use of unencrypted e-mail to transmit client confidences.[75] The Arizona opinion stated that "it is not unethical to communicate with a client via e-mail even if the e-mail is not encrypted; this Committee simply suggests that it is preferable to protect attorney/client communications to the extent it is practical."[76]

The Illinois opinion provided a lengthy explanation as to why it rejected the earlier conclusions of the South Carolina and Iowa bar associations that "because it is possible for Internet or other electronic mail service providers to intercept electronic mail messages, lawyers should not use electronic mail for 'sensitive' client communications unless the messages were encrypted or the client expressly consented to 'non-secure' communication."[77] With regards to Internet e-mail, the opinion reasoned:

> The third type of electronic mail, that carried on the Internet, typically travels in another fashion. Rather than moving directly from the sender's host computer to the recipient's host computer, Internet messages are usually broken into separate 'packets' of data that are transmitted individually and re-assembled into a complete message at the recipient's host computer. Along the way, the packets travel through, and may be stored temporarily in, one or more other computers (called 'routers') operated by third parties (usually called an 'internet service provider' or 'ISP') that helps distribute electronic mail over the Internet.
>
> Unlike a cordless telephone message, for example, an Internet e-mail is not

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[71] *See generally,* J.T. Westermeier & Leonard T. Nuara, *Ethical Issues for Lawyers on the Internet and World Wide Web,* 14 No. 3 Computer Lawyer 8 (March 1997) (describing Iowa and North Carolina's opinions).

[72] Iowa Bar Association Formal Opinion 95 (1996).

[73] *See generally,* J.T. Westermeier & Leonard T. Nuara, *Ethical Issues for Lawyers on the Internet and World Wide Web,* 14 No. 3 Computer Lawyer 8 (March 1997) (describing Iowa and North Carolina's opinions).

[74] *Id.* at p.2 (emphasis added).

[75] State Bar of Arizona Advisory Ethics Op. 97-04 (Apr. 7, 1997); Illinois State Bar Assoc. Advisory Op. on Prof. Conduct Op. No. 96-10 (May 16, 1997).

[76] State Bar of Arizona Advisory Ethics Op. 97-04 (Apr. 7, 1997).

[77] *Id.*

> broadcast over the open airwaves, but through ordinary telephone lines and the intermediate computers. When an Internet message is transmitted over an ordinary telephone line, it is subject to the same protections and difficulties of interception as an ordinary telephone call. To intercept an Internet communication while it is in transit over telephone lines requires an illegal wiretap.
>
> Consequently, the real distinction between an Internet electronic message and an ordinary phone call is that Internet messages may be temporarily stored in, and so can be accessed through, a router maintained by an ISP. It is possible that an employee of an ISP (as part of the maintenance of the router) could lawfully monitor the router and thereby read all or a part of a confidential message. As in the case of telephone and proprietary electronic mail providers, it is also possible for dishonest employees of an ISP to intercept messages unlawfully. The Committee does not believe that the opportunity for illegal interception by personnel of an ISP makes it unreasonable to expect privacy of the message.[78]

The Vermont Bar Association followed the Illinois opinion and likewise approved the use of unencrypted Internet e-mail, reasoning:

> [A]ll three types of electronic messages (local network, public network, or Internet) appear no less secure than the ordinary fax or telephone communication. For example, e-mail on a local or public network can be accessed only from within the group which owns the network.
>
> E-mail sent by [sic -- within] America Online, CompuServe, or MCI Mail (all of which are public networks travels from a sender's computer to a computer 'mail box' maintained by the public network over a reserved phone network. Access to the public networks is password protected. Undeniably, e-mail sent over public networks and BBS's is potentially less secure than mail sent over a private network because the employees of the public network or an outside person who 'cracks' or breaks into the system could intercept the message, but any phone call can be tapped, legally or otherwise, and the mails and faxes can be intercepted and read. Since this possibility of interception also exists for fax transmission and regular mail, no reason exists to treat e-mail differently.
>
> Internet e-mail travels to its destination differently. E-mail sent over the Internet does not go directly from the sender's computer over a land-based line to a pass-word protected 'mail box.' The message is broken into two or more 'packets' of information by the sending computer or host computer, which are the sent individually over the lines an ultimately reassembled back into the complete message, at the recipient's 'mail box'. The mail boxes may exist on the recipient's computer or may exist on the host computer the recipient uses to connect to the internet. These information packets must pass through and be temporarily stored in other computers called 'routers', operated by different firms known as 'internet service providers' which assist in distributing e-mail over the internet. To intercept an internet transmission in transit would constitute an illegal wire tap.[79]

The South Carolina Bar Association recently re-examined its earlier conclusion that a lawyer could communicate with a client by

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[78] *Id.*

[79] Vermont Bar Assoc. Op. 97-5 (1997). *See generally,* Wendy R. Leibowitz, 'Can We Talk?' E-mail Is Ethics Maze, National Law Journal A1 (Aug. 18, 1997) (explaining the Vermont, South Carolina, and Illinois opinions).

unencrypted e-mail only with "an express waiver by the client."[80] That opinion concluded that "There exists a reasonable expectation of privacy when sending confidential information through electronic mail (whether direct link, service, or Internet). Use of electronic mail will not affect the confidentiality of client communications under South Carolina Rule of Professional Conduct 1.6."[81] With respect to unencryped Internet e-mail, the opinion reasoned:

> Likewise, e-mail transmissions via commercial networks or the Internet maintain confidentiality. While there exists a potential for communications be intercepted, albeit illegally, from a commercial network mailbox or an Internet "router", the Committee does not believe such a potential makes an expectation of privacy unreasonable. The same potential exists for the illegal interception of regular mail, the interception of a facsimile, the unauthorized wiretapping of land-based telephone.
>
> The Committee concludes, therefore, that communication via e-mail is to a reasonable expectation of privacy. Because the expectation is no less reasonable that the expectation of privacy associated with regular mail, facsimile transmissions, or land-based telephone calls and because the interception of e-mail is now illegal under the Electronic Communications Privacy Act, 18 U. S. C. §§2701(a) and 2702(a), use of e-mail is proper under Rule 1.6. Accord, Illinois State Bar Assn. Advisory Opinion No. 96-10; New York State Bar Assn., CPLR 4547 (January 24, 1997).
>
> The Committee notes that a finding of confidentiality and privilege of such should not end the analysis. An attorney owes a client a duty of reasonable care in keeping information confidential. There exists that a prudent attorney would be hesitant to discuss by facsimile, telephone, or regular mail. A lawyer should discuss with a client such options as encryption in order to safeguard against even inadvertent disclosure of sensitive or privileged information when using e-mail.[82]

d. To Encrypt or Not?

Several commentators have rightly focused on Judge Learned Hand's seminal opinion in *The T.J. Hooper.*[83] Judge Hand recognized that merely because an industry had not generally adopted the precaution of having radio receivers on board tugs so that the tugs could receive weather reports, failing to do so could still constitute a breach of duty, since "a whole calling may have unduly lagged in the adoption of new and available devices."[84] The observation is no doubt true.

Determinant of that issue is the cost-benefit analysis. The issue is not *whether* encryption is sometimes required, but *when* it must be used. Some "information is so vital that the lawyer should not use any kind of telephone."[85]

Those who advocate encryption, however, make no apparent exception, and mention no rule of reason. Is it necessary, for example, for a lawyer transmitting privileged information which, even if

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[80] S.C. Ethics Advisory Op. 97-08 (June 1997), quoting S.C. Ethics Advisory Opinion 94-27.

[81] *Id.*

[82] S.C. Ethics Advisory Op. 97-08 (June 1997).

[83] 60 F.2d 737 (2d Cir. 1932). *E.g.,* Joan C. Rogers, *Ethics, Malpractice Concerns Cloud E-mail, On-Line Advice*, ABA/BNA Manual On Professional Conduct 59, 63 (citing comments of Charles Merrill of McCarter & English).

[84] 60 F.2d at 740.

[85] William Freivogel, *Cellular and Cordless Telephones: Privilege, Confidentiality and Liability*, ALAS Loss Prevention J. 7, 10 (May 1997).

intercepted, would be at best unlikely to cause harm to the client, to encrypt that information? Must he do so, or violate the disciplinary rules?

The argument that encryption is always required due to the "risks" associated with the Internet would also mean that it would be improper to send an unencrypted letter by overnight delivery, and that doing so can waive the privilege or be grounds for disciplinary action against the lawyer.[86] Those who conclude that encryption should be required for Internet e-mail might ask why paper documents should be mailed, why Federal Express is allowed, and why unencrypted land-line phone calls are proper.

However, two objective aspects of Internet confidentiality that warrant discussion. First, as with faxes, mail, or Federal Express, misdirection of e-mail can occur over the Internet. Federal statutes do not appear to address unintentional receipt caused by misdirection of e-mail.[87] Again, however, the potential for misdirection of a fax does not destroy any possibility of privilege over every fax. Nonetheless, because misdirection of a privileged fax can waive privilege, so, too, can misdirection of e-mail. Further, misdirection could harm a client even if privilege is not waived. Having said that, however, the potential for misdirecting an e-mail appears no greater than that of misdirecting a fax: with reasonable care, misdirection can be avoided.[88] Fortunately, Texas lawyers who receive a misdirected e-mail from opposing counsel who do not return it unread run the risk of disqualification. *See In re Meador* , ___ S.W.2d ___ (Tex. Apr. 14 1998) (not yet reported).

Second, there are unknowns about the scope of "hacking" on the Internet. There are "hacker" problems relating to e-mail confidentiality.[89]

Principally, there are what are known as "sniffers."[90] The Internet operates as one big inter-connected web of computers, such that the information intended for any computer on the Internet may pass through any number of other computers while in transit. This means that an intermediate computer often receives information that is intended for another computer further down the line on the Internet. Capturing this information as it is going through these intermediate computers over the Internet is called sniffing.[91] Sniffers use software to search for unencrypted e-mail destined to or from certain hosts and copy the message as it goes through the router.[92]

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[86] *See* David Beckman and David Hirsch, *Making Encryption the Norm*, ABA Journal 82, 82 (Sept. 1997).

[87] The ABA recently mentioned inadvertent transmission of e-mail when analyzing waiver of privilege over a misdirected fax: "the availability of xerography and proliferation of facsimile machines and e-mail make it technologically ever more likely that through inadvertence, privileged or confidential materials will be produced to opposing counsel by no more than the pushing of the wrong speed dial number on a facsimile machine." ABA Formal Op. 92-368, p. 1. *Accord*, Florida State Bar Assoc. Comm. on Prof. Ethics 93-3 (Feb. 1, 1994) ("such an inadvertent disclosure might occur as part of a document production, a misdirected facsimile, or e-mail transmission, a 'switched envelope' mailing, or misunderstood distribution list instructions").

[88] Some firms use "disclaimers" on their e-mail, such as are common on faxes, that state that the information in the e-mail is intended to be confidential and should be returned if received by an unintended recipient. Including such disclaimers is certainly an option which should be considered for confidential Internet e-mail. *See generally*, Ilene Knable Gotts, *Liability On-Line: Electronic Traps For The Unwary*, 42 No. 1 *The Practical Lawyer* 15 (Jan. 1996).

[89] Robert L. Jones, *Client Confidentiality*, *supra*, note 58.

[90] *Id.*

[91] *Id.*

[92] *Id.* There is also the legitimate "sniffing," done by network administrators, who are permitted to monitor traffic load on certain parts of the

The existence of sniffing is a real, but difficult to assess, threat to confidentiality. It is also a felony. It is illegal to intercept an e-mail at any point while in transit or when passing through or stored on an intermediary router or other computer except as necessary for business purposes.[93] For this reason, it seems likely that "interception of communications over the Internet or over the phone should not result in waiver of the attorney-client privilege," because "there is no waiver of privilege when a thief steals a document out of a file cabinet, and likewise no waiver when the file is in digital form and the break-in occurs through the phone line."[94] The same argument could be made to justify that it is not a breach of the duty of confidentiality to use the Internet to transmit client confidences.

G. Conclusion.

Even if privilege is not waived by Internet transmission, there are "real business risks associated with use of digital communications today, just as there are risks associated with use of fax machines, voice mail, and ordinary 'snail' mail (physical mail) . . . ."[95] A client with an extremely sensitive issue could be harmed if the unintended receipt of Internet communications causes third parties to become aware of certain information, even if privilege is not lost.

Consequently, lawyers who communicate over the Internet with or about their clients on such sensitive matters should, before engaging in such communications, disclose to their clients not only the extremely slight potential risk of waiver of privilege, but also the potential practical consequences of disclosure as well. A lawyer should consider whether to advise clients of the potential risks, and remind them how the Internet works, so that they do not transmit sensitive identifiable confidential information the disclosure

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network to ensure proper functioning. While it is a crime for monitors to disclose any information, or to conduct more monitoring than is necessary, these persons probably do not have a legal duty of confidentiality to someone transmitting information over the Internet. *See McKamey v. Roach*, 55 F.3d 1236 (6th Cir. 1995) (no private right of action for intercepting cordless phone broadcasts).

[93] Computer-to-computer communications over telephone lines are "electronic communications" within 18 U.S.C. § 2510(12). The intermediate computers (routers and hosts) are included in 18 U.S.C. § 2510, which provides:

> (14) *'electronic communications system'* means any wire, radio, electromagnetic, photo optical or photoelectronic facilities for the transmission of electronic communications, and *any computer facilities or related electronic equipment for the electronic storage of such communications;*
>
> (15) 'electronic communication service' means any service which provides to users thereof the ability to send or receive wire or electronic communications.

(Emphasis added). Routers, hosts and other intermediate computers are covered by 18 U.S.C. § 2510(17), which defines "electronic storage" as:

> (A) any temporary, *intermediate* storage of a wire or electronic communication *incidental to the electronic transmission thereof; . . .*

(Emphasis added). Anyone who intentionally *obtains* an "electronic communication" while it is stored in an "electronic storage system" or an "electronic communication service" commits a crime pursuant to 18 U.S.C. § 2701(a). Likewise, any person who provides an "electronic communication service" who discloses the content of an "electronic communication" stored in or carried on that service commits a crime. 18 U.S.C. § 2702(a).

[94] Gidari, *supra*, note 25.

[95] Gidari, *supra*, note 25.

of which will likely be detrimental to the client over the Internet without informed consent to the possible risks.[96]

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[96] *See also*, Peter R. Jarvis & Bradley F. Tellam, *The Internet: New Dangers of Ethics Traps*, 56-Dec. Or. St. B. Bull. 17 (Dec. 1995) (discussing e-mail and concluding that client should be warned about the uncertainty regarding the Internet and "agree upon a proposed course of action").

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EXPERT TESTIMONY/ ROBINSON-HAVNER ISSUES

POST *DAUBERT, ROBINSON & HAVNER* FROM GATEKEEPER TO BEEKEEPER

MARY WILSON

Post *Daubert, Robinson & Havner*

From Gatekeeper to Beekeeper

Environmental Superconference
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Post *Daubert, Robinson & Havner*
From Gatekeeper to Beekeeper

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Post *Daubert, Robinson & Havner*
From Gatekeeper to Beekeeper

I. Introduction

Since the suggested criteria for admissibility of scientific expert testimony were first proposed by the U.S. Supreme Court in the case of *Daubert v Merrell Dow Pharmaceuticals, Inc,* 113 S.Ct. 2786 (1993) and later by the Texas Supreme Court in *E.I. duPont de Nemours and Company, Inc, v Robinson,* 923 S.W.2d 549 (Tex. 1995), many courts have struggled with the criteria and it's applicability to cases involving "hard" science versus "soft" science including technical, but not necessarily scientific, matters. This struggle has resulted in a divergence of opinion in both Federal and State courts as to whether the *Daubert* and *Robinson* standards are hard and fast rules that must be applied to every case in which an expert provides an opinion, whether it is for purely "hard" sciences or even whether it is only intended for new and novel techniques or methods. The Texas Supreme Court has recently provided it's opinion on how this problem should be resolved in the case of *Gammill v Jack Williams Chevrolet, Inc.*, 1998 WL 352951(Tex.1998). In essence, the Texas Supreme Court recognizes that there may be cases in which the strict application of the *Daubert* and *Robinson* criteria (which were always intended to be non-exclusive) might be inappropriate.

In addition, this paper also addresses other issues relating to *Daubert* and *Robinson* which have surfaced since the issuance of these opinions including the standard for review on appeal, the standard by which district court opinions will be reviewed, the criteria for qualifications of experts, application of *Daubert* and *Kelly v State,* 824 S.W.2d 568 (Tex. Crim. App. 1992) to criminal cases and the application of *Daubert* to decisions reached by federal agencies as to the proper "science" to be used in promulgating regulations.

II. *Daubert* and *Robinson*

A. The criteria

Virtually every seminar presented in the State of Texas in the last two years has included a topic on the *Daubert* and *Robinson* criteria and their application to expert testimony in every field of expertise. Nonetheless, it is always helpful to review the standards and clearly analyze what the cases require. Since it is presumed that every reader of this paper will have read the *Daubert* and *Robinson* cases, no analysis of the cases will be presented here. Instead, I will provide the following chart which outlines the basic criteria and incorporates language from both *Daubert* and *Robinson* as to what must be proven before expert testimony can be admitted. I will also provide a source for each of the standards where appropriate.

Relevance

1) Will it assist the trier of fact to understand the evidence or determine a fact in issue. (Rule 702 of both the Texas and Federal Rules of Evidence).
2) Will it make the existence of any fact more probable or less probable than it would be without the evidence. (Rule 401 and 402 of the Texas and Federal Rules of Evidence).
3) The testimony must be sufficiently tied to the facts that it will aid the jury in resolving factual disputes.
4) Is the probative value of the testimony substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury. (Rule 403 of the Texas and the Federal Rules of Evidence).

Reliability

1) Does the testimony relate to scientific, technical or other specialized knowledge. (Rule 702 of both the Texas and Federal Rules of Evidence).
2) Is the testimony grounded in the methods and procedures of science.
3) Is the inference or assertion derived from the scientific method.
4) Is the testimony more than a subjective belief or unsupported speculation.
5) The principles of sound scientific methodology are the pivotal factor, not the conclusions that those principles and method generate.

Reliability = Validity - can it be tested

Daubert and *Robinson*

1) The extent to which the theory has been or can be tested.
2) Whether the theory has been subjected to peer review and/or publication.
3) The technique's potential rate of error.
4) Whether the underlying theory or technique has been generally accepted as valid by the relevant scientific community.

Robinson

5) The extent to which the technique relies upon the subjective interpretation of the expert.
6) The non-judicial uses which have been made of the theory or technique.

B. The *Daubert* and *Robinson* progeny

The *Daubert* Court made it clear that it's intent was to overrule the "General Acceptance" test that, for many years, had been the standard from the case of *Frye v United States,* 293 F. 1013 (D.C. Cir. 1923). The Court, in doing so, indicated that the "rigid, exclusive test" imposed by *Frye* would no longer be the strict requirement that had been in effect for many years. According to the *Daubert* court, the Federal Rules of Evidence provides a "liberal...general approach of relaxing traditional barriers to opinion testimony". The Supreme Court intended, by the new criteria, to give the trial court authority to determine whether the evidence is trustworthy before refusing admissibility of evidence simply because it does not have general scientific acclaim.

But are the standards relaxed? A review of the post-*Daubert* cases from each of the Circuit Courts and from at least 12 state supreme courts would seem to indicate that the introduction of scientific evidence has become more difficult. Rather than only having the evidence accepted generally in the scientific community, the proponent of the evidence must now fulfill additional standards over and above the standard of "general acceptance". Part of the problem may come from the lower courts adhering strictly to all of the factors set forth in *Daubert*, rather than viewing them as independent, nonexclusive indicators of reliability. The result has been that a large majority of the cases deal with evidence that has not been admitted through a failure to meet each of the *Daubert* criteria.[1]

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[1] A review of a sampling of the cases which have applied *Daubert* or *Robinson* and have determined that the factors were not met, thus excluding evidence from experts include the following: *Barrett* v *Atlantic Richfield Co.,* 95 F.3d 375 (5th Cir. 1996)(study of the effect of exposure to contaminates on cotton rats located on a superfund site not admissible to show possible health effects due to exposure to humans); *Burroughs Wellcome Company v Crye*, 907 S.W. 2d 497 (Tex. 1995), the Court held evidence of studies relating to tests conducted on pigs feet do not constitute sufficient evidence to establish causation relating to frost bite resulting from polysporin spray; *Deimer v Cincinnati Sub-Zero Products, Inc.,* 58 Fed.3d 341 (7th Cir. 1995) the Court denied testimony relating to product design of a hyperthermia machine which fell and caused injuries to a nurse who was moving the machine. *Bennett v PRC Public Sector, Inc.*, 931 F.Supp. 484 (S.D.Tex.1996) testimony relating to defective design of a computer aided dispatch system used by the Houston Police Department failed to establish that the design caused any injuries to Plaintiffs' dispatchers who utilized the system. *Mascarenas v Miles, Inc.*, 986 F.Supp. 582 (W.D.Mo. 1997) court refused to admit expert testimony that Plaintiff's exposure to pesticides caused Plaintiff's cancer. *Goewey v Velsicol Chemical Corp.*, 106 F.3d 390 (4th Cir.1997) Court disallowed expert testimony of three experts relating to Plaintiff's exposure to triorthocresylphosphates ("TOCP") on the grounds that the witnesses could not establish that TOCP was present in roof sealant to which Plaintiff was exposed or that if present the TOCP could have caused Plaintiff's juries. *Navarro v Fuji Heavy Industries, Ltd.*, 117 F.3d was 1027 (7th Cir. 1997) Court disallowed evidence by expert witnesses that an automobile was defectively designed when a suspension system corroded and broke which caused the car to flip over and kill Plaintiff. The Court ruled that Plaintiff's expert's testimony in an affidavit that the manufacturer knew of the special corrosion problems in Chicago, Illinois and failed to take steps to prevent such corrosion, was mere speculation on the part of the expert.

A reading of the *Robinson* case would certainly lead one to believe that the Texas Supreme Court viewed the admission of scientific evidence under *Daubert* to be a more restrictive standard. The Court fully intended the new factors to bar the admission of evidence which was previously admitted under only the criteria of general acceptability.[2] In explaining the basis for the adoption of the *Daubert* factors, the Texas Supreme Court expressed it's intent to limit scientific evidence and to restrict evidence from "hired gun" experts.

> Professional expert witnesses are available to render an opinion on almost any theory, regardless of its merit....Expert witnesses can have an extremely prejudicial impact on the jury, in part because of the way in which the jury perceives a witness labeled as an expert...A witness who has been admitted by the trial court as an expert often appears inherently more credible to the jury than does a lay witness. Subsequently, a jury more readily accepts the opinion of an expert witness as true simply because of his or her designation as an expert...Added to the potentially prejudicial influence of the term expert is the difficulty inherent in evaluating scientific evidence. Jurors are often expected to understand complex testimony regarding arcane scientific concepts and are even asked to resolve issues on which the experts cannot agree...Because expert evidence can be hard to evaluate, it can be both powerful and misleading. *Robinson.* at 553.

Since Robinson, Texas courts have reviewed expert testimony with a more critical eye and have applied the factors strictly to expert witnesses whose testimony appears to be scientific or technical.

III. The Scope of *Daubert* and *Robinson*

A. Novel techniques; "Hard science" v "Soft science"

Although the application of the factors from *Daubert* and *Robinson* have resulted, in many instances, in the rejection of expert testimony that does not strictly meet each of the factors, the greater concern has been defining the scope of the applicability of *Daubert*. Since the decisions were first entered, courts have wrestled with whether the factors apply only to "hard" scientific evidence or that which theoretically can be tested or if it should also apply to "soft" science (i.e. psychological analysis) which cannot be tested but which rely on principles and methodology of the discipline. When the factors are applied to this "soft" science oftentimes the testimony must be excluded because there is no way to quantify the opinions. Simply put, what is "scientific" knowledge and how far should the factors be applied? As recognized by the Seventh Circuit, "the drafters of Rule

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[2] See for example *Purina Mills, Inc. v Odell,* 948 S.W.2d 927, 932 (Tex. App. -Texarkana 1997), *pet. denied* (Recognizing that the admissibility standards for expert evidence have become more strict).

702 seem to have acknowledged that the line between "scientific" and "technical" is not a bright one." *Cummins v Lyle Industries*, 93 F.3d 362, 368 (7th Cir. 1996).

Also, some courts have questioned whether *Daubert* applies only to new and novel theories that should be subject to rigorous testing in a discipline or if it also applies to well established methodologies on which there is not much differing of opinions by experts (i.e. basic laws of physics that apply to mechanical engineering). The *Daubert* Court indicated that the requirements of Rule 702 do not "apply specially or exclusively to unconventional evidence. Of course, well-established propositions are less likely to be challenged than those that are novel, and they are more handily defended." *Daubert* at footnote 11. Nonetheless, the struggle to define parameters for applying the *Daubert* and *Robinson* standards have resulted in inconsistent opinions and the denial of evidence that might otherwise have been considered noncontroversial.

Although a great many courts have strictly adhered to the application of each of the factors set forth by *Daubert* and *Robinson*,[3] many courts have found difficulty applying *Daubert* to every situation in which an expert provides an opinion. By way of example, the following cases reflect fact situations in which the courts have refused to follow the *Daubert* criteria because it did not fit the fact situation in question. In *Iacobelli Construction Inc v County of Monroe*, 32 F.3d 19 (2nd Cir. 1994, the Second Circuit held that foundation engineering was not within the scope of *Daubert* and did not apply the factors. In *Compton v Subaru of America Inc.*, 82 F.3d 1513 (10th Cir. 1996), the Tenth Circuit did not apply the *Daubert* factors to an engineering expert's testimony relating to the design of an automobile that rolled over, because his experience in the area was sufficient. In *McKendall v Crown Control Corp.*, 122 F.3d 803 (9th Cir. 1997) the Ninth Circuit held that the

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[3] Many courts have adhered to a strict application of the *Daubert* factors even in cases where the evidence was merely technical. For instance, in *Fowler v State of Texas*, 958 S.W.2d 853 (Tex. App. - Waco, 1997) *pet. granted* the Appellate Courts psychological evidence regarding domestic violence was disallowed. The Court found that there is "no reason why evidence regarding the "soft sciences" is not susceptible to *Kelly*..." What the trial court's screening for reliability accomplishes is the elimination of an unsubstantiated, unsupported opinion. *Fowler* at 863. In *$18,000 in U.S. Currency v State of Texas*, 961 S.W.2d 257 (Tex. App.- Hous. (1st Dist.) 1997) *no pet.* the testimony of a Houston police officer relating to the training of a drug dog was not allowed as it did not comport with each of the elements of *Kelly* and *Daubert*. In *America West Airlines, Inc v Tope*, 935 S.W.2d 908 (Tex. App. - El Paso, 1996) *no writ,* the testimony of a psychologist who had treated a former employee of the airline who was suing for wrongful termination, was disallowed under *Kelly* and *Daubert* because the psychologist did not follow generally recognized techniques, had not taken notes of her sessions, had not administered traditional psychological tests, did mot have a medical degree or a Ph.D. degree in psychology, and could not point to any publications supporting her method of treatment. *America West* at 918. Even in the *Cummins* case reference above, the Court did not feel that the line between science and technology could be accurately defined and thus applied *Daubert* to expert testimony relating to designs of trim press machine, stating that the expert's conclusions and opinions clearly lend themselves to testing and substantiation by the scientific method.

Daubert factors did not apply to a mechanical engineer who had investigated hundreds of forklift accidents and that his experience was sufficient. In *Freeman v Case Corp.*, 118 F.3d 1011 (4th Cir. 1997) the Fourth Circuit did not apply *Daubert* to the testimony of a mechanical engineer who designed tractors and mowers since he was relying on his years of experience and training.

Even in Texas, Appellate Courts have refused to apply the *Daubert* and *Robinson* factors in cases that only involved "specialized" knowledge. In *Dico Tire, Inc. v Cisneros*, 953 S.W. 2d 776 (Tex. App. - Corpus Christi 1997) *writ denied,* the Court admitted the testimony of a tire engineer as to the cause of a tire blowout based on his specialized knowledge and technical expertise. The Court stated that not every testifying expert is providing scientific evidence. *Id.* at 786. In *Wal-Mart Stores, Inc. v Garcia,* 1998 WL 76200 (Tex. App. - San Antonio, 1998) *no pet.*, the testimony of a licensed engineer as to the degree of force caused by a sign that fell on the Plaintiff was allowed without meeting the criteria of *Daubert* and *Robinson*, because it involved "little, if any, subjective interpretation by the expert, the theories are not novel, the techniques have little if any potential rate of error..." *Id.* at 2.

Perhaps the best description of the concerns of many of the Federal and State courts with the applicability of *Daubert* in instances where expert testimony is offered in "soft" science cases was expressed by the Austin Court of Appeals in the opinion in *Nations v State,* 944 S.W.2d 795 (Tex. App. - Austin 1997) *pet. ref'd*. The testimony of an eyewitness identification expert was allowed and the Court refused to apply the criteria set forth by the Court of Criminal Appeals in *Kelly v State*, 824 S.W.2d 568 (Tex. Crim. App. 1992) (which criteria tracks the requirements of *Daubert* and *Robinson).* The Court opined:

> We think... that a rigid application of the *Kelly* criteria might exclude relevant and reliable expert testimony. That anomaly explains our reluctance to measure the reliability of testimony regarding eyewitness identification or other psychological testimony without further guidance from the higher courts of this state. If specialized knowledge will be admissible when helpful to the trier of fact under Rule 702, whether or not it can be scientifically validated, we must also develop guidelines for distinguishing such specialized knowledge from scientific knowledge that must be validated...While not scientific, this specialized knowledge offers subjective observations and comparisons based on the expert's training, skill, or experience that may be helpful to the jury in understanding or determining the facts. To distinguish between science and other specialized knowledge, the trial court might look to the purpose for which the evidence is introduced. *Nations* at 800-801.

B. *Gammill v Jack Williams Chevrolet, Inc.*

Just last month, in *Gammill v Jack Williams Chevrolet, Inc.*, 1998 WL 352951 (Tex. 1998), the Texas Supreme Court, in a unanimous opinion, recognized the concerns of many of the courts in steadfastly applying the *Daubert* and *Robinson* criteria in every expert witness situation and attempted to clarify the confusion in several respects. The facts of *Gammill* are as follows: Mrs.

Gammill was driving her Isuzu Trooper with her 3 year old son in the front seat and her 10 year old daughter in the back seat. The vehicle swerved off the road and hit a utility box and some trees. Mrs. Gammill was severely injured, her daughter was killed and her son sustained minor injuries. Plaintiffs allege that the vehicle was defectively designed because the accelerator pedal became caught in a wiring harness beneath the dashboard and would not release and that her daughter died because her seatbelt did not restrain her as it should have. The district court granted summary judgment for defendants on the grounds that the testimony of the expert witnesses who testified on behalf of the Plaintiffs did not meet the *Daubert* and *Robinson* criteria. The Court of Appeals affirmed the summary judgment.

One of the experts who testified for the plaintiffs was a mechanical engineer. The Plaintiffs argued that his testimony should have been allowed and should not have been disqualified under *Robinson* because *Daubert* and *Robinson* only apply to 1) opinions based on novel science, as opposed to established science and 2) the opinions based on an expert's individual skill, experience, or training are not subject to the *Robinson* reliability test.

The Supreme Court first restated that the *Robinson* factors are non-exclusive and that the trial court may consider other factors which it finds helpful. The factors that should be used depend on the facts of each particular case. The Court pointed out that in both *Daubert* (in footnote 11) and in *Kelly* the respective Courts each specifically stated that the *Daubert* and *Robinson* factors were not limited to novel scientific evidence. The Court explained that the same considerations found in the *Robinson* opinion, relating to the concerns of professional "hired gun" experts having the ability to mislead juries, was the reason not to limit the application of *Robinson* criteria to only novel or unconventional evidence.

> "...we believe the rules governing admission of scientific evidence should not differ depending on whether the evidence is considered novel or unconventional...The concerns we articulated in *Robinson* exist regardless of whether the scientific evidence presented is novel or conventional. We therefore hold that the standard adopted in *Robinson* applies to all scientific expert testimony." *Gammill* at 8.

This result is entirely in keeping with the previous *Robinson* decision and each decision from the Supreme Court relating to these issues since the *Robinson* case was decided. However, more surprising was the ruling of the Court as it relates to the application of the *Robinson* factors to expert evidence supported only by the skill, experience and training of the expert. The Court begins the analysis recognizing that there is a conflict with allowing expert testimony based only on the skill, experience or training of the expert because Rule 702 already requires that the requisite skill, experience and training is the basis for the initial qualification of the expert.

> On the one hand, an exception for evidence based on a witness's skill and experience would easily swallow the rule. Any witness qualified to testify as an expert would almost necessarily possess the requisite skill and experience to support such testimony. If that were all Rule 702 required, merely establishing the witness's

qualifications would show the relevance and reliability of the testimony every time. On the other hand, there are many instances when the relevance and reliability of an expert witness's testimony *are* shown by the witness's skill and experience" *Gammill* at 8.

The Court uses two examples of circumstances when allowing expert testimony might be appropriate without the imposition of the *Robinson* factors. The first is the testimony of an experienced car mechanic as to the problems with a car's performance, which is acceptable based on his skill and experience and does not require resorting to engineering principles. The second example, used by both the Texas Supreme Court and by several U. S. Circuit Courts in similar opinions, is from the Sixth Circuit case of *Berry v City of Detroit*, 25 F.3d 1342 (6th Cir. 1994). In that case, the Court explained the difference between the experience needed to explain how a bee flies and the experience needed to testify whether a bee always takes off into the wind. In the first case, an aeronautical engineer might be a helpful witness. If the witness is familiar with the component parts of a bee, he would be qualified to provide an opinion even if he had never even seen a bee fly. However, if it was necessary to prove that bees always take off into the wind, a beekeeper with no scientific training might be the appropriate witness if his experience and qualifications were proved up.

The Court then canvassed the conflicting decisions rendered by the various Circuit Courts and the other jurisdictions. The Court recognized that the Fifth Circuit is one of the jurisdictions which has <u>not</u> accepted the premise that the *Daubert* factors can be disregarded in certain circumstances where only the experience and skill of the expert is necessary.[4] The Fifth Circuit in the case of *Watkins v Telsmith, Inc.*, 121 F.3d 984 (5th Cir. 1997) affirmed the ruling of the district court in refusing to admit the testimony of a civil engineer who claimed that there were alternative designs for a conveyor that was supported by only one wire rope. He testified that the design of the conveyor was defective and was the cause of the accident which resulted in the death of the Plaintiff's husband. The Fifth Circuit believed that alternative designs include elements of science, technology and methodology which require the imposition of the *Daubert* factors. The concern expressed by the Court in allowing expert testimony without the scrutiny that the *Daubert* factors provide is that less factual support for expert's opinions would become acceptable.

"...it seems exactly backwards that experts who purport to rely on general engineering principles and practical experience might escape screening by the district court

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[4] Even though the *Watkins* case is currently the latest recognized opinion by the 5th Circuit in this area, the Court may be coming to another opinion. In *Moore v Ashland Chemical Inc.*, No. 95-20492 (5th Cir. Oct. 20, 1997, and amended Nov. 24, 1997) the Fifth Circuit issued an opinion and an amended opinion consistent with the *Gammill* opinion, stating that there is a difference in "hardc" or "Newtonian" science as opposed to mere specialized knowledge. In the former case *Daubert* would apply in the later case, it would not. However, despite the issuance of 2 opinions, the Court, on it's own motion, granted a rehearing en banc which was held on January 21, 1998. No further word has been heard since. Perhaps the 5th Circuit seeks further guidance from the U.S. Supreme Court in the *Carmichael* case.

> simply by stating that their conclusions were not reached by any particular method or technique. The moral of this approach would be, the less factual support for am expert's opinion, the better...We conclude that whether an expert's testimony is based on "scientific, technical or other specialized knowledge," *Daubert* and Rule 702 demand that the district court evaluate the methods, analysis, and principles relied upon in reaching the opinion. *Watkins* at 991.

The Texas Supreme Court was very careful to emphasize that even though there may be circumstances in which an expert's testimony may not be subject to the requirements of the *Robinson* factors, the testimony still must meet the fundamental requirements of Rule 702 of relevance and reliability, whether it is scientific, specialized or technical. Thus, even if the *Daubert* and *Robinson* factors are not always appropriate for every situation in which an expert may be called upon to provide testimony, there must always be a showing of relevance and reliability.

> "...there must be some basis for the opinion offered to show its reliability. Experience alone may provide a sufficient basis for an expert's testimony in some cases, but it cannot do so in every case...The reliability and relevance prerequisites for expert opinion to be admissible are part of Rule 702 and apply to all such evidence. In that sense, *Daubert* applies to all expert testimony. *Daubert* does not apply in the sense that the considerations it set out for determining whether the prerequisites are satisfied cannot be applied to all types of evidence. *Gammill* at 12.

The Court appeared to recognize the difficulty that this opinion might cause in it's application. The Court suggested that further clarification on the issue might come from the U.S. Supreme Court when it makes it's ruling in the case of *Carmichael v Samyang Tire Inc.*, 131 F.3d 1433 (11th Cir. 1997), *cert. granted sub nom. Kumho Tire Co .v Carmichael,* 66 U.S.L.W. 3793 (U.S. June 22, 1998)(No. 97-1709). In this case the district court granted a summary judgment in favor of Samyang stating that the testimony of an expert on tire failure was not admissible because it did not meet the *Daubert* criteria. The Plaintiffs argued that the testimony should be admissible because the expert was not offering a "scientific" opinion and that his opinion was based on years of experience in examining tire blowouts. The 11th Circuit reversed holding that even though the requirements of relevance and reliability apply under Rule 702, there was a distinction between scientific and non-scientific testimony. Scientific experts are those who rely on the application of scientific principles, rather than on skill or experience based observation. Like the Texas Supreme Court, the 11th Circuit sought to provide an example of the distinction between scientific evidence which would mandate the imposition of the *Daubert* factors and non-scientific evidence, which rely solely on experience and skill. An auto mechanic with years of experience might be able to identify whether the plug burned out because of years of normal wear or because of some defect, even though he has no knowledge of the general principles of chemistry or physics or be able to explain how a spark plug works. The U.S. Supreme Court granted *cert.* on the case on June 22, 1998 and no opinion was issued as of the date of the presentation of this article. It may be that the U.S. Supreme Court has not had the final word on the line of demarcation between "hard science" and "technical" matters.

IV. Qualifications of Expert Witnesses

One area not frequently discussed in the wake of decisions like *Daubert* and *Robinson* is the initial qualification of the expert witness. This is, however, an area that should not be forgotten in the push to have the witness's testimony meet each of the *Daubert* and *Robinson* factors. In fact, if anything, the *Daubert* and *Robinson* cases have made it even more important that the expert retained to provide significant testimony be specifically tailored to the needs of the case. The seminal case relating to the qualifications of experts was *Broders v Heise,* 924 S.W.2d 148 (Tex. 1996), the Texas Supreme Court disallowed the testimony of an emergency room physician because he did not have the specific qualifications to testify relating to the specific cause of death. The Court made it clear that because of the specialization of medicine, a testifying expert must have specific knowledge of the type of injury/disease in question before he can be qualified. Also, in the *Gammill* case, the Supreme Court agreed with the district court's decision that one of the witnesses was not qualified to testify on the grounds that he did not have the specific qualifications to testify as an automobile design expert. Thus, it is abundantly clear that objections relating to the qualifications of an expert is a primary tool to eliminate the testimony of an expert even before the Court has to consider whether that expert's testimony meets the qualifications of *Daubert* and *Robinson.*

The requirements for the acceptance of any expert's testimony fall under the parameters of Rule 702 of the Texas and Federal Rules of Evidence: "...a witness qualified as an expert by knowledge, skill, experience, training or education, may testify thereto in the form of an opinion or otherwise." But every case since the inception of *Daubert* and *Robinson* has required, due to the nature of the criteria for the admissibility of the testimony, that the expert have exactly the qualifications needed to testify regarding the specific issue before the court or the testimony of the expert will not be accepted. A primary examples of this found in another Texas Supreme Court case. In *United Blood Services v Longoria*, 938 S.W. 2d 29 (Tex. 1997) the testimony of a witness relating to the standard of care of blood banks in failing to screen for the HIV virus was excluded because the expert was not an expert in medicine or osteopathy, was not an expert in blood banking, hematology or immunology, never worked for a blood bank, never took any courses on blood banking, etc. Thus, every proponent of evidence must be careful that the expert has exact experience in the science or technology on which he is to testify. This may actually be an easier way of disqualifying a witness than attacking the methodology, criteria, and testing used in formulating the expert's testimony.

V. Appellate Issues

A. Imposing *Robinson* criteria on appeal

In July 1997, the Texas Supreme Court in *Merrell Dow Pharmaceuticals. Inc v Havner.,* 953 S.W.2d 706 (Tex. 1997) reviewed a case relating to the testimony of an expert on birth defects due to the mother having taken Bendectin during pregnancy. The defendant raised the issue of the failure of the experts to meet the *Robinson* criteria at several junctions during the development of the case. The evidence was allowed by the trial court. On appeal, the defendant urged that there was no

evidence to support the verdict that Bendectin caused the defects in the infant child. The Court provided an extensive analysis of the criteria for review of a no evidence point on appeal. Based on that analysis, the Court determined that the appellate courts must review the reliability of the experts testimony to see if it meets the no evidence standards. In doing so, the appellate courts must rely upon the standards of *Robinson* to make such a no evidence analysis. The court indicated that: "If the expert's scientific evidence is not reliable, it is not evidence. The threshold determination of reliability does not run afoul of our no evidence standard of review." *Havner* at 713. The Court attempted to provide guidance for the appellate courts in determining what factors the courts should look to in making a no evidence review under the *Robinson* criteria.

> If the foundational data underlying opinion testimony are unreliable, an expert will not be permitted to base an opinion on that data because any opinion drawn from that data is likewise unreliable. Further, an expert's testimony is unreliable even when the underlying data are sound if the expert draws conclusions from that data based on flawed methodology. A flaw in the expert's reasoning from the data may render reliance on a study unreasonable and render the inferences drawn therefrom dubious. Under that circumstance, the expert's scientific testimony is unreliable and, legally, no evidence. *Havner* at 714.

The Court then undertook a thorough review of all of the studies, particularly the epidemiological studies to see if there was any scientifically reliable evidence to support the jury's verdict and determined that there was not. Finally, the Court noted that the evidence presented on causation must do more than establish that an illness may be caused by exposure to a particular chemical. The expert must also provide evidence which would rule out other, possible causes in order for the causation evidence to be considered reliable.

Texas appellate courts have begun to analyze no evidence cases by utilizing the *Robinson* criteria when reviewing expert testimony. One such case which was environmental in nature was *Mitchell Energy Corp. v Bartlett,* 958 S.W.2d 430 (Tex.App. - Fort Worth 1997) *no pet.* Plaintiffs alleged that their ground water was contaminated by hydrocarbons due to oil and gas exploration conducted by Mitchell Energy Corp over the course of many years. The Plaintiffs presented numerous experts who each had theories relating to how the hydrogen sulfide got into the ground water. Using the *Havner* no evidence standard for appellate review, the Court determined that each of the expert's testimony lacked sufficient credibility to establish causation. Relying on *Havner,* the Court found that there was no evidence of the contamination and reversed and rendered in favor of the defendant. Another case to adopt the *Havner* approach of utilizing *Robinson* criteria when reviewing a no evidence point on appeal, was *General Motors Corp. v Saenz*, 966 S.W.2d 545 (Tex.App. - San Antonio 1997)*pet. filed.* Plaintiffs allege that Mr. Sanchez was killed when his 1990 Chevrolet pick-up slipped its gear shift and backed over him. Both sides provided expert testimony relating to the design of the gear lever and box. The trial court allowed each of the expert's testimony. The Appellate Court affirmed the trial court's decision and found that there was some evidence to support the finding of a design defect and that the case simply involved two engineers' views on which modification of an existing design was safer.

The most recent case from the Texas Supreme Court to address the issue of applying the *Robinson* standard on appeal was *Maritime Overseas Corp. v Ellis*, 1998 WL 175692 (Tex. 1998). The trial court allowed the testimony of Plaintiff's five experts that extended exposure to the pesticide Diazinon aboard a ship owned by Maritime caused Ellis irreversible delayed neurotoxicity. The defendant did not raise, at any point either prior to or during trial, any objection to the admissibility of the evidence based on the *Robinson* criteria. Instead, the defendant argued for the first time on appeal that the Court of Appeals should apply *Robinson* to determine if plaintiffs experts applied a proper scientific methodology under a legal sufficiency appeals point. In an 8-6 decision the Court ruled that the focus of *Robinson* was the trial court's discretion in admitting or excluding scientific evidence after a party lodges an objection to the reliability of the opponent's scientific expert either before trial or when the evidence is offered at trial. However, the Court determined that if the party opposing the introduction of the evidence does not lodge such an objection during or before the trial, he waives the objection.

> *Daubert* does not support the proposition that a reviewing court can in effect exclude expert testimony that was not objected to based on its scientific reliability before trial or when it was offered at trial and then render judgment against the offering party...To preserve a complaint that scientific evidence is unreliable and thus, no evidence, a party must object to the evidence before trial or when the evidence is offered. *Ellis* at 5.

The Court went on to suggest that to hold otherwise would unfairly prevent the offering party from having an opportunity to cure any defect in the evidence that may exist and he would be subject to a trial by ambush. Another result would be to usurp the trial court's function as "gatekeeper", leaving such decisions in the hands of the Appellate Courts. The decision on appeal of whether the scientific evidence is reliable would base an appellate review of a record that was not made.

An interesting note from Judge Abbott in his concurring opinion was to address at what point in time a *Daubert/Robinson* challenge should be made. He felt that to wait until trial to make such an objection to the evidence was too late. He indicated that this issue had never been decided by the Supreme Court and provided several procedural methods that he felt was appropriate. First, the parties could be required to notify the court and opposing parties in advance of trial if they intended to offer scientific evidence or if they have a challenge to the opponent's evidence. Second, the court could conduct a preliminary hearing on admissibility in advance of plans to offer the evidence. Third, in complex litigation, the court could appoint a panel of specially trained scientists or a special master to hear evidence and report on complicated scientific and statistical matters. Fourth, the court could render any expert testimony inadmissable or rule objections waived if the parties do not fully comply with the notice requirements listed in number 1 above. *Ellis* at 10.

The Texas Supreme Court is in good company in holding that a *Robinson* objection must be made at trial or waived. Similar rulings have come from the First and the Ninth Circuits. In *Marbled Murrelet v Babbit,* 83 F.3d 1060 (9th Cir.1996) involving a citizen suit to prevent logging on private property under the Endangered Species Act (which allegedly affected a marbled murrelet

nesting habitat), the Court indicated that failure to raise *Daubert* objections at trial resulted in waiver of the right to raise the argument on appeal. Likewise, in *Cortes-Irizarry v Corporacion Insular de Seguros*, 111 F.3d 184 (1st Cir. 1997) the court refused to apply the *Daubert* criteria for the first time on appeal when no objection was made at trial.

> If trial courts should be slow to employ *Daubert* at the summary judgment stage, appellate courts should be even more hesitant to head in that direction where there has been no development of the issue below. After all, the bifurcated inquiry into reliability and relevance which *Daubert* requires is best performed by trial judges who, unlike appellate judges, have a broad array of tools which can be brought to bear on the evaluation of expert testimony. Hence, we can envision few, if any, cases in which an appellate court would venture to superimpose a *Daubert* ruling on a cold, poorly developed record when neither of the parties nor the nisi prius court has had a meaningful opportunity to mull the question. *Cortes* at 189.

B. Standard of review

Finally, in the appellate arena, the U.S. Supreme Court in *General Electric Co. v Joiner,* 118 S.Ct. 512 (1997) clarified that the decision of the trial court to allow or disallow scientific evidence under *Daubert* is reviewed on an "abuse of discretion" standard. This, of course, was of no consequence to the Texas courts who had always reviewed the admissibility of such evidence on an abuse of discretion standard.

VI. Applicability of *Daubert* to Federal Agency decisions

It will come as no surprise to practitioner in the environmental area that courts have declined to extend the *Daubert* standards beyond the admissibility of testimony in a litigation context. In *Sierra Club v Marita,* 46 F.3d 606 (7th Cir. 1995) the Sierra Club requested that the Court utilize the *Daubert* standards in determining whether the United States Forest Service had utilized solid scientific principles in certain conservation biology studies which served as a basis for the approval of timber harvesting. The Court indicated that while such an approach might assure better documentation of an agency's scientific decisions, forcing an agency to make such a showing as a general rule is intrusive, undeferential and not required. An environmental impact study required by the regulations under NEPA is designed to ensure open and honest debate of the environmental consequences of an agencies actions, not to prove admissibility of testimony in a court of law.

VII. Conclusion

Although there are many very good reasons to limit the strict application of *Daubert* and *Robinson* to situations in which an expert is called upon to provide opinions in every scientific or technical context, one can easily see how the Supreme Court has left the door opened to some confusion on the part of trial courts. The examples of car mechanics and beekeepers are excellent examples of why *Robinson* might not fit every fact situation, but they are oversimplified. Trial

courts need more guidance in the way of instructions on what to look for in determining that the *Daubert* and *Robinson* factors are not applicable in a given situation. Without this guidance, there will no doubt be a significant number of cases which will now go up on appeal looking for a decision as to whether the factors were inappropriately applied or inappropriately disregarded. The cases of *Daubert* and *Robinson* have provided the trial courts with good indicators of reliability in scientific areas. Now the courts need equally good indicators of when *Daubert & Robinson* do not apply and what to consider if the *Daubert* criteria is not appropriate.

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Miscellaneous

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"She Got the Gold Mine and I Got the Shaft"

TENTH ANNUAL TEXAS ENVIRONMENTAL SUPERCONFERENCE
August 7, 1998

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I. INTRODUCTION

A. GENERAL

There are certain conflicts inherent in the mixture of the policies underlying environmental laws, i.e., protecting public health and the environment, and the policies underlying the Bankruptcy Code[1], i.e., settling a debtor's liabilities equitably and providing a debtor with a "fresh start." Some of the more noticeable areas where these conflicts collide are those affecting (i) the right of contribution; (ii) the priority of environmental claims against a bankruptcy estate; (iii) the dischargeability of environmental liabilities as debts in bankruptcy; (iv) trustee's ability to abandon contaminated property; and (v) the effect of the automatic stay on government enforcement actions.

Environmental problems may be a primary cause of a bankruptcy -- such as a corporation whose real property needs major remediation or who is facing numerous lawsuits alleging liability for environmental contamination, clean up, and toxic torts; or environmental problems may be a minor issue in a bankruptcy case -- such as minor real property contamination, past unauthorized discharges at a manufacturing plant, or numerous other environmental issues.

II. BANKRUPTCY OVERVIEW*

Jurisdiction and Venue -- The jurisdictional provisions regarding Bankruptcy Courts have now been codified in 28 U.S.C. § 1334 and 28 U.S.C. § 157 which vests the initial jurisdiction regarding bankruptcy cases in the United States District Court, but refers most matters to the Bankruptcy Court, which is a unit of the District Court. Most bankruptcy proceedings are conducted by the Bankruptcy Court. Rulings of the Bankruptcy Court may be appealed to the District Court and then to higher appellate courts.

Venue of bankruptcy cases is governed by 28 U.S.C. §§ 1408-10 and 1412. In order to establish venue, the debtor must have been domiciled or had a residence, principal place of business or principal assets in the district for the 180 days immediately preceding the date of the petition, or for a longer part of such 180 days than in any other district. This simply means that venue is proper in a district if the debtor has been in that district more than 91 of the preceding 180 days. Section 1412 provides for change of venue for the convenience of the parties or in the interest of justice. Because many United States corporations are incorporated in the State of Delaware, many Chapter 11 cases have been filed in Delaware.

* A glossary of bankruptcy terms is attached as Exhibit A to this paper.

Liquidation -- A liquidation under the Bankruptcy Code is conducted by a trustee pursuant to section 704 of the Bankruptcy Code. A trustee is appointed upon the filing of the bankruptcy petition, and although the creditors may elect another trustee at the initial creditors' meeting, this is rare. The creditors may also form a committee to consult with the trustee in connection with the administration of the debtor's estate, make recommendations to the trustee regarding the performance of the trustee's duties and submit to the bankruptcy court or the trustee any question affecting the administration of the debtor's estate. Creditors' committees are rarely formed in Chapter 7 liquidation cases. Businesses may also be liquidated through other state and federal proceedings such as receiverships.

Reorganization -- Most bankruptcy reorganizations are commenced by the debtor, although the creditors may file an involuntary case against a debtor if they meet certain criteria. In most Chapter 11 (reorganization) cases under the Bankruptcy Code, the debtor remains in control and possession of its assets as a debtor-in-possession. In some instances, for example, where the debtor engages in some form of misconduct, a trustee may be appointed to take possession of the debtor's assets and operate the debtor's business. The trustee acts as a fiduciary for the creditors of the debtor's estate.

A. LIQUIDATION

Chapter 7 is the liquidation chapter of the Bankruptcy Code, and is available to individuals, corporations and partnerships. In a Chapter 7 bankruptcy case, the debtor ceases to have any legal authority with respect to the property of the bankruptcy estate, the manner of its disposition, or the distribution of the proceeds. Chapter 7 is structured to provide for the appointment of a Chapter 7 trustee to supervise the expeditious conversion of the estate's assets to cash, and distribute the proceeds of those assets to creditors in accordance with the schedule of distribution contained in the Bankruptcy Code. The liquidation of the estate is conducted according to the Bankruptcy Code and Rules and the Chapter 7 trustee does not have discretion or flexibility with respect to the manner in which the proceeds of a liquidation will be distributed to creditors.

1. Principal Laws Governing Liquidation.

Chapters 1, 3 and 5 of the Bankruptcy Code apply in all bankruptcy cases. Chapter 1 contains definitions and rules of construction, specifies who may be a debtor in different forms of cases, governs waiver of sovereign immunity and includes a provision (section 105) which gives broad authority to the bankruptcy court to enter orders. Chapter 3 covers how a case is commenced, governs officers and their compensation, provides for an automatic stay and borrowing by a debtor and provides the provisions on protection to creditors. Chapter 3 also regulates the use, sale or lease of property, obtaining credit by the debtor in possession or the trustee and the assumption and rejection of executory contracts. Chapter 5

determines what constitutes property of the estate, the rights of creditors, priorities among creditors and contains a provision which authorizes the Bankruptcy Court to determines the tax obligations of debtors. Chapter 5 also contains the avoiding powers of the trustee or debtor in possession which authorize the trustee or debtor in possession to avoid certain transfers, including preferential and fraudulent transfers and unauthorized post petition transfers.

The liquidation of business entities, other than banking or insurance institutions, is normally governed by the Bankruptcy Code and various sections of Title 28 of the United States Code. Chapter 7 of the Bankruptcy Code applies to individuals or businesses; Chapters 1, 3 and 5 of the Bankruptcy Code apply in all bankruptcy cases.

2. Commencement of a Liquidation.

A case under the Bankruptcy Code is commenced by the filing of a petition with the bankruptcy court. The petition may be filed by the debtor (a "voluntary" petition) or by the petitioning creditors against the debtor (an "involuntary" petition). A voluntary petition under Chapter 7 may be filed by any debtor who meets the eligibility standards of section 109 of the Bankruptcy Code which authorizes the filing of a Chapter 7 case by most entities.

Section 109 excludes certain persons from eligibility under Chapter 7 including railroads, domestic insurance companies, banks, savings banks, cooperative banks, savings and loan associations, building and loan associations, homestead associations and credit unions as well as foreign insurance companies, banks, savings banks, cooperative banks, savings and loan associations, building and loan associations, homestead associations, or credit unions engaged in such business in the United States. Legislative history indicates that such entities are excluded under section 109 since they are subject to regulations by other supervisory authorities.

If the debtor is a corporation, the petition must contain a declaration of the president, other officer of the corporation or authorized agent verifying that the filing of the petition on behalf of the debtor has been authorized. A voluntary petition filed on behalf of a partnership may be filed by one or more of the general partners, if all general partners consent to the petition.

Under certain limited conditions, creditors may commence involuntary proceedings under the Bankruptcy Code to force a debtor to liquidate its nonexempt assets. An involuntary case may be commenced against any entity eligible for relief under Chapter 7 except farmers and non-profit corporations. An involuntary case against a partnership may be filed by less than all of the general partners since a voluntary petition requires that all general partners consent. Finally, an involuntary petition may be filed against a partnership when relief has been ordered for all of the general partners.

The filing of a bankruptcy petition, whether voluntary or involuntary, invokes an automatic stay pursuant to section 362 of the Code, preventing essentially all actions against the debtor or property of the estate. The concept behind the automatic stay is the right of the debtor to have a "breathing spell" - an opportunity to rehabilitate and formulate a plan of reorganization or liquidate in an orderly fashion. Section 362(a) enumerates the actions which are subject to the automatic stay. The language is very broad and all inclusive and applies to all entities as defined in section 101(15) of the Bankruptcy Code. Among other things, the automatic stay applies to the commencement or continuation of legal or administrative proceedings, the enforcement of judgments, the creation, perfection and enforcement of liens, set off of claims and any act to exercise control over property of the estate. The stay in commercial insolvencies normally does not extend to third parties, such as guarantors, but has been interpreted to apply to situations where actions against third parties would necessarily result in liability to the debtor. In addition, section 105 of the Bankruptcy Code has been used to enjoin actions against third parties when such action would be detrimental to a reorganization effort. Several actions are excluded from the scope of the automatic stay including criminal proceedings, the collection of alimony, maintenance or support, certain post petition lien perfection action, the enforcement of police or regulatory powers, and commodities setoffs. Before taking any actions against a debtor, a creditor should closely review the provisions of section 362 to avoid any violations of the automatic stay. Section 362 contains provisions for relief from the automatic stay for certain specified reasons and for cause.

3. Parties to a Bankruptcy Case.

Debtor--The debtor is the person or entity who seeks voluntary relief under the Bankruptcy Code, or who has been forced involuntarily into bankruptcy by petitioning creditors.

Debtor-in-Possession--In a Chapter 11 bankruptcy case, the debtor becomes a debtor in possession (unless or until a trustee is appointed) which operates its own business, and remains in possession of its assets and property pursuant to section 1101. The Chapter 11 debtor in possession has the rights, powers and duties of a trustee and must manage the estate's assets in accordance with the requirements of the Bankruptcy Code.

Bankruptcy Judge--The bankruptcy judge presides over the administration of a bankruptcy case and decides contested aspects of that case. A bankruptcy judge does not become actively involved in the daily administration of the bankruptcy case, as that task has been delegated to the debtor, the United States Trustee and any appointed trustee.

Bankruptcy Court Clerk--The clerk of the bankruptcy court receives all documents which are placed in the court record in a bankruptcy case. In addition, the clerk's office schedules hearings to be heard by the bankruptcy judge, usually upon written request by an attorney.

United States Trustee--In almost every jurisdiction, a United States Trustee has been appointed by the United States Attorney General to supervise all bankruptcy cases filed in that particular district. In Chapter 7 cases the United States Trustee is responsible for appointing individual trustees. The United States Trustee is responsible for appointing trustees when a trustee is ordered appointed by the bankruptcy judge in a Chapter 11 case.

Trustee--Trustees represent the creditors' interests in a bankruptcy case. A trustee may be any individual who, by experience or training, is qualified to liquidate property of the debtor, or who can operate the debtor's business. The United States Trustee in each district maintains a list of such qualified individuals who may be appointed to serve as the trustee in a particular bankruptcy case. The role of a Chapter 7 trustee is to collect all of the assets of a debtor, liquidate the assets for the benefit of the debtor's creditors, and make a distribution to the debtor's creditors. In addition, the Chapter 7 trustee may investigate a debtor's affairs to determine what assets, if any, the debtor possesses. Sections 701 through 704 of the Bankruptcy Code govern the Chapter 7 trustee's duties. Generally, a trustee is not appointed in a Chapter 11 bankruptcy case unless the debtor-in-possession engages in some type of misconduct. If a trustee is appointed by the court in the Chapter 11 case, the trustee will take possession of the debtor's estate, and operate the debtor's business. In addition, a Chapter 11 trustee may file a schedule of assets and liabilities of a debtor, investigate any of the debtor's actions, and file a plan of reorganization.

Creditors--The principal intended beneficiaries of a bankruptcy case are the creditors, who have a specific right to be heard in bankruptcy cases. Section 101(10) of the Bankruptcy Code defines a "creditor" as an entity that has a claim against the debtor which arose prior to the commencement of a bankruptcy case. The interests of unsecured creditors in Chapter 7 cases are usually protected by the appointed Chapter 7 trustee. Secured creditors also often play major roles in Chapter 7 cases. The interests of unsecured creditors in Chapter 11 cases are usually protected by the creditors' committee and, if appointed, the Chapter 11 trustee. The debtor in possession also owes a fiduciary duty to the creditors. Secured creditors also often play major roles in Chapter 11 cases.

Professionals--Upon order of the bankruptcy court, the various parties in interest may retain attorneys, accountants, appraisers, real estate brokers, auctioneers or other professionals to perform specialized functions within a bankruptcy case. Individual creditors or parties in interest do not have to obtain

court approval for the retention of such professionals. The decision to retain such professionals depends upon numerous factors, including the complexity of the case and the amount and type of assets involved in the bankruptcy case. The compensation of such professionals is strictly scrutinized by the United States Trustee and the bankruptcy court.

Examiner--Only the bankruptcy court may appoint an examiner in a Chapter 11 case. Unlike the appointment of a trustee, the appointment of an examiner does not change the status of a debtor as debtor in possession. The duties of an examiner are limited to conducting an investigation of the acts and business affairs of a debtor in possession, but may be expanded by order of the court.

Creditors' Committee--In Chapter 11 bankruptcy cases, committees are appointed by the United States Trustee. Generally, an unsecured creditors' committee represents the interests of all unsecured creditors. If there are no unsecured creditors in a bankruptcy case, or if fewer than three unsecured creditors are willing to serve on a committee, an unsecured creditors' committee might not be appointed unless specifically requested. Additional committees may be appointed at the discretion of the bankruptcy court to represent equity security holders or other significant interests in a bankruptcy case in order to assure adequate representation of that creditor group within the bankruptcy case.

4. <u>The Liquidation Estate</u>.

Although all of the debtor's assets are part of the bankruptcy estate, section 522 of the Bankruptcy Code allows an individual (as opposed to a corporation or a partnership) debtor to exempt certain property from his or her bankruptcy estate. The debtor's exemption claim removes these assets from the bankruptcy estate, and allows the debtor to retain them free from the claims of his or her unsecured creditors.

The Bankruptcy Code provides for a set of standard federal exemptions that a debtor may elect to claim unless the debtor's state provides that the federal exemptions may not be claimed. Although most states have "opted out" of the federal exemptions, some states allow a debtor to elect either the federal exemptions found in the Bankruptcy Code or the state exemptions for the particular state of the debtor.

Section 722 of the Bankruptcy Code provides that an individual debtor may redeem personal property intended primarily for personal, family or household use from a lien securing a dischargeable consumer debt, if the property is exempted under Section 522 of the Bankruptcy Code or has been abandoned under Section 554, by paying the lienholder the amount of their allowed secured claim. The right to redeem amounts to a right of first refusal for the debtor to purchase consumer goods that might otherwise be repossessed.

If an individual debtor cannot redeem property, the creditor may permit the debtor to reaffirm the debt secured by the property under section 524(c) of the Code. Reaffirmation agreements generally contemplate reaffirmation of the entire debt and accrued interest. Such agreements must be reviewed by the bankruptcy court at a hearing at which the debtor must assure the court that reaffirmation is both in the debtor's best interest, and that the agreement will not work a hardship. These agreements may be rescinded "at any time prior to discharge or within sixty (60) days after such agreement is filed with the court, whichever occurs later, by giving notice of rescission to the holder of ... [the] claim." 11 U.S.C. § 524(c)(4).

The Chapter 7 trustee is charged with the responsibility of liquidating all property of the estate and distributing the proceeds of those assets to creditors in accordance with the schedule of distribution contained in the Bankruptcy Code.

A trustee may sell its property free and clear of all liens, claims and interests pursuant to section 363 if certain conditions are met, including if the sale exceeds the price of all liens secured by the property, if the third party could be required to accept a money satisfaction for its interest or if the interest of third parties in the property is in dispute. Property may be sold free of the interests of co-owners if partition in kind is impracticable, the sale of an undivided interest will not maximize value, the benefit to the estate outweighs the detriment to the co-owner and the property is not used in the production of certain kinds of energy.

Underscoring this objective of maximum liquidation value is the notion of practicality. Not every asset in the debtor's estate must be held by the trustee for ultimate liquidation on the open market. The trustee is responsible for concentrating his or her efforts on preserving and liquidating only those assets which will maximize the benefit to the debtor's estate, which in turn will satisfy creditors. In this respect, abandonment aides the trustee in achieving the goal of maximizing creditor recoveries.

Abandonment is a means by which the trustee relinquishes the estate's interest in property of the estate. Certain property of the estate is abandoned when in the opinion of the Trustee retention and subsequent liquidation of the assets would result in a superfluous or negligible gain or possibly even a net loss to the estate. The trustee may abandon any property of the estate after notice and opportunity for a hearing pursuant to § 554(c) of the Bankruptcy Code.

Rule 9019 of the Bankruptcy Rules authorizes the trustee to compromise claims and other disputes pursuant to court order. Notice of the proposed compromise must be given to creditors and other parties in interest who are entitled to oppose the compromise.

5. Trustee's Avoidance Powers.

The Bankruptcy Code empowers a trustee (or Chapter 11 debtor-in-possession) to recover or avoid certain transfers made or obligations incurred by a debtor within specified time periods prior to the filing of the bankruptcy petition. The abilities granted trustees are generally referred to as "avoidance powers" and are governed by sections 544 through 550 of the Bankruptcy Code. The most commonly used avoiding powers are those contained in section 547 (preferential transfers) and section 548 (fraudulent conveyances). Using these avoidance powers, the trustee can retroactively analyze the pre-bankruptcy activity of the debtor; if the debtor made transfers, incurred obligations or otherwise took actions inconsistent with the principal of equality of distribution, then the trustee may be able to unwind the transfer or obtain compensation from the person who received the transfer or benefited from it.

Certain time limitations apply to the trustee's avoidance actions. With respect to preferences, there is a 90 day period prior to filing the petition during which certain payments to creditors may be avoided as preferential (i.e., as violating the equality of distribution rule). There is also a one year insider preference period which permits the avoidance of transfers to persons defined as "insiders" pursuant to section 101 (30) of the Bankruptcy Code. With respect to fraudulent conveyances, the trustee's section 548 rights extend to those transfers which occurred within one year before the filing of the bankruptcy petition. This one year requirement relates to when the transfer actually occurred.

Section 547(b) sets out the elements which must be established by the trustee in order to prove a preference and thus avoid the transfer. For a transfer to be avoided, it must meet all of the following criteria:

- ✔ There must be a transfer;
- ✔ Of the debtor's property or an interest in the debtor's property;
- ✔ Which is to or for the benefit of a creditor;
- ✔ The transfer must be an account of an antecedent debt;
- ✔ And made at a time when the debtor is insolvent;
- ✔ The transfer must have occurred within 90 days (or one year if the creditor is an insider) before the filing of the bankruptcy petition; and
- ✔ The transfer must result in the creditor receiving more payment than that creditor would receive:
  - ✓ Under Chapter 7 liquidation of the debtor's assets;
  - ✓ If such payment had not been made; and
  - ✓ If the creditor received payment as other similarly situated creditors in the bankruptcy case.

There are several statutory defenses to an allegation that a creditor received an avoidable preferential transfer such as transfers in the ordinary course of the debtor's business and contemporaneous exchanges for new value.

There are two general categories of transfers which may be attacked as fraudulent under the Bankruptcy Code and thus avoidable if made within one year of the filing of the bankruptcy petition. Provision is made for avoidance of transfers:

- ✔ Undertaken with actual intent to defraud (section 548(a)(1) of the Bankruptcy Code); and

- ✔ Where the debtor receives less than reasonably equivalent value as consideration of the transfer at a time when the debtor is insolvent, has unreasonably small capital or believes it will be unable to pay its debt as those debts become due (section 548(a)(2)).

Certain state fraudulent transfer laws may also apply which may permit recovery of fraudulent transfers older than one year.

6. Creditors and Claims.

Shortly after a bankruptcy case is filed, all creditors who were scheduled by the debtor receive notice of the commencement of the case, the date and time of the first meeting of creditors and the fixing of certain dates and deadlines in the case. One of the most important deadlines in a bankruptcy case is the bar date for filing proofs of claim. In Chapter 7 cases, the claims bar date is 90 days after the initial date scheduled for the first meeting of creditors (which meeting typically is held approximately 30 days after the petition is filed). Section 101(5) of the Bankruptcy Code defines 'claim' and includes contingent, disputed and unliquidated obligations.

A proof of claim should be prepared in the form of a written statement setting forth the creditor's claim and attaching any writings or documentation upon which the claim is based. The claim is then filed with the bankruptcy court. The trustee has the duty to examine all proofs of claim and object to any improper claims.

B. PRIORITIES

1. Priority in Specific Collateral.

Secured and general unsecured claims against the debtor may be filed. In addition to secured claims, certain claims are entitled to priority pursuant to section 507 of the Bankruptcy Code. These priority claims include, but are not

limited to, expenses incurred in the administration of the bankruptcy estate, claims for wages or salaries (up to $4,000 and incurred within 90 days of the petition date), limited employee benefits and certain types of unsecured tax claims. Claims for the breach of leases of real property are limited and certain claims are subordinated to other claims. Foreign creditors are entitled to participate in the distribution equally with local creditors, as long as they have followed the appropriate steps for asserting their claims. Often creditors misunderstand where they rank in the priority scheme since only part of the priority system is set forth in the "priority" section of the Bankruptcy Code. The actual priorities are as follows:

a. Surcharging Secured Creditor Collateral.

The highest priority available with respect to specific collateral is the ability to charge a secured creditor's collateral with the costs and expenses of preserving or disposing of the property under section 506(c) of the Code. Courts have been reluctant, however, to permit trustees or debtors-in-possession to "surcharge" a secured party's collateral for payment of administrative expenses unless the expenditure was primarily for the benefit of the secured creditor.

b. Priming Liens.

The next highest priority with respect to specific collateral is a priming lien which is granted for new money provided by section 364(d) of the Code. These priming liens are available to the debtor to permit borrowing in circumstances in which it can be virtually certain that the priming lien will not impair the recovery which the primed lienholder would enjoy in the absence of a priming lien. Section 364(d) of the Code permits the court to give an entity a lien on already encumbered property of the estate, senior or equal to all other existing liens.

c. Pre-Petition Security Interests.

The next priority are the normal pre-bankruptcy secured claims pursuant to section 506(a) of the Code. Normal pre-bankruptcy properly perfected secured claims are to be paid, at a minimum, to the full extent of the value of the creditor's collateral. *See* 11 U.S.C. § 506. Further, certain set-off rights are also treated as secured claims by section 506(a) of the Code.

Note that in Chapter 7 cases, tax liens are treated as section 507(a)(8) priority claims to the extent that claims of higher priority than section 507(a)(8) claims do not exceed the value of the collateral subject to the lien. *See* 11 U.S.C. § 724(b).

d. Junior Secured Creditors.

Beneath senior lienholders are pre-petition subordinate or junior liens pursuant to section 506(a) of the Code. Such subordinate liens may also consist of court-ordered subordinate liens for new money loaned to the debtor after the commencement of the case. *See* 11 U.S.C. § 364(c)(2).

2. Priority Among Unsecured Claims.

a. Unsecured Super-Super Priority Creditors.

The highest priority among unsecured claims are court-ordered unsecured priority claims for new money made available to the debtor pursuant to section 364(c)(1) of the Code. Such "super-super priority" claims are authorized by the court to a creditor who extends post-petition credit to the debtor. Such a "super-super priority" claim has priority over all administrative expenses set forth in sections 503(b) or 507(b) of the Code.

b. Inadequate "Adequate Protection"Super Priority Creditors.

Section 507(b) of the Code grants the inadequately protected secured creditor a priority superior to the administrative and other priority claims in the case (the so-called "super-priority" claim).

c. Administrative Expense Priority.

Claims entitled to priority under section 507(a) are next in line. Section 507(a) ranks the various claims entitled to priority under that subsection. The highest ranking claims under section 507(a) are administrative expenses allowed under section 503(b), and any fees and charges assessed against the estate under Chapter 123 of Title 28. *See* 11 U.S.C. § 507(a)(1). Section 503(b) covers costs and expenses of preserving the estate. Such costs and expenses include certain postpetition taxes, fines and penalties, and compensation to certain creditors. Such costs also include the professionals necessary to navigate the case through the bankruptcy process including trustees, examiners, indenture trustees, attorneys and accountants. The Section 503 "administrative priority" also includes any

administrative priority granted to a reclaiming seller under section 546(c), and any priority for postpetition credit extended under sections 364(a) or 364(b) of the Code. Claims for environmental cleanup costs are frequently treated as administrative expense claims. Obligations incurred pursuant to an executory contract entered into or assumed by the trustee or debtor-in-possession under section 365 of the Code constitute administrative expenses. Likewise, postpetition rent for the reasonable value of the use and occupancy of real estate or the utilization of personal property by the estate are also administrative expenses

Section 726(b) provides that if a case is converted from chapter 11 to a chapter 7 case, the costs of administration incurred in connection with the chapter 7 case have priority over the costs of administration incurred in connection with the preceding chapter 11 case.

d. Involuntary Case "Gap" Claims.

Unsecured claims arising in the ordinary course of business or financial affairs of the debtor between the time an involuntary petition is filed against a debtor and the earlier of the appointment of a trustee or the entry of an order for relief. 11 U.S.C. § 507(a)(2). The priority afforded these involuntary "gap" claims protects those creditors who deal with the debtor during this gap period because such creditors typically may not have any knowledge of the filing of the involuntary petition.

e. Wage and Salary Claims.

Allowed unsecured claims for wages, salaries or commissions, including vacation, severance and sick leave pay earned by an individual within 90 days before the date of the filing of the petition or the date of the termination of the debtor's business, whichever occurs first. These types of priority claims are limited to $4,000 for each individual. 11 U.S.C. § 507(a)(3).

f. Contributions to an Employee Benefit Plan.

Unsecured claims for contributions to an employee benefit plan arising from services rendered within 180 days before the earlier of the date of the filing of the petition or the date of the cessation of the operation of the debtor's business. 11 U.S.C. § 507(a)(4). This priority is limited to the number of employees covered by each plan multiplied by $4,000, less the aggregate amount paid by the debtor to such employees for priority wage claims pursuant to section 507(a)(3),

plus the aggregate amount paid by the debtor on behalf of such employees to any other employee benefit plan.

g. Claims Against Grain Storage and Fish Storage/Processing Facilities .

The fifth priority under section 507(a) claim status concerns persons engaged in the production or raising of grain, who are doing business with a debtor who owns or operates a grain storage facility and to United States' fishermen who are doing business with a debtor who owns or operates a fish storage or processing facility. 11 U.S.C. § 507(a)(5)(A) & (B). This priority is limited to $4,000 for each "such individual", and was created to resolve the problem of commingling of perishable goods.

h. Deposits by Consumers.

Unsecured claims of individuals, to the extent of $1,800 for each such individual, arising from the prepetition deposit of money with the debtor, in connection with the purchase, lease or rental of property, or the purchase of services for the personal, family or household use of the creditor, if the goods or services were not delivered or provided. 11 U.S.C. § 507(a)(6).

i. Alimony and Child Support.

Certain claims of a spouse, former spouse, or child of the debtor. Such claims include alimony, maintenance or support of such spouse or child in connection with a separation agreement, divorce decree or other order of a court. 11 U.S.C. § 507(a)(7).

j. Priority Tax Claims.

Certain unsecured tax claims of governmental units that are not more than three years old. 11 U.S.C. § 507(a)(8). This priority status applies to taxes measured by income or gross receipts, property taxes, taxes required to be collected or withheld for which the debtor is liable in any capacity, employment taxes, excise taxes, customs duties, and certain penalties assessed for non-payment of the aforementioned taxes.

Tax penalties which do not constitute compensation for actual pecuniary loss are not entitled to priority status under section 507(a)(8).

k. Obligations to Agencies Regulating Federally Insured Depository Institutions.

Allowed unsecured claims based upon any commitment by the debtor to a Federal depository institutions regulatory agency to maintain the capital of an insured depository institution. 11 U.S.C. § 507(a)(9).

Note that pursuant to section 507(d) of the Code, an entity that is subrogated to the rights of a holder priority claim under section 507(a)(3) through section 507(a)(9) is not subrogated to the right of the holder of such claim to priority in payment.

l. Non-priority Unsecured Claims.

If there are any funds left in the estate after all of the claims listed above have been paid in full, holders of allowed unsecured non-priority claims—*i.e.*, claims that are not encompassed by any of the Code's priority provisions—are next in line for distributions from the estate.

m. Late-Filed Claims in Chapter 7 Cases.

Pursuant to section 726(a)(3), claims, other than claims entitled to priority under section 507, filed by persons with notice or actual knowledge of the claims bar date, that are tardily filed are subordinated to general unsecured claims in a Chapter 7 case. Note that in cases filed under other chapters of the Code, late-filed claims are disallowed entirely. *See* 11 U.S.C. § 502(b)(9).

n. Penalty Claims in Chapter 7 Cases.

In Chapter 7 cases, claims (whether secured or unsecured) for pre-petition (or pre-trustee appointment) fines, penalties or forfeitures, or for multiple, exemplary, or punitive damages are subordinated below late-filed claims. 11 U.S.C. § 726(a)(4).

o. Claims for Interest in Chapter 7 Cases.

In Chapter 7 cases, in the event that all of the preceding classes of claims have been paid in full, holders of all unsecured claims shall be entitled to interest which shall accrue at the legal rate from the petition date. 11 U.S.C. § 726(a)(5).

3. Mechanisms for Reordering Bankruptcy Priorities.

a. Subordination Agreements.

Subordination agreements–commonly taking the form of an agreement whereby one (junior) creditor agrees to forgo repayment of the amount owed to it by the debtor until another (senior) creditor of the debtor is paid in full, whether or not the debtor is in bankruptcy–are enforceable in bankruptcy to the same extent that such agreements are enforceable under applicable non-bankruptcy law. 11 U.S.C. § 510(a). A subordination agreement only effects the rights of creditors who are parties to the agreement.

b. Equitable Subordination.

Section 510(c) gives bankruptcy courts authority to equitably subordinate secured and unsecured claims and order that any lien securing a subordinated claim be transferred to the estate. This section codifies the principle, enunciated in the oft-cited case of *Pepper v. Litton*, 308 U.S. 295, 307-09 (1939), that bankruptcy courts, as courts of equity, are empowered "to sift the circumstances surrounding any claim to see that injustice or unfairness is not done in administration of the bankrupt estate," and to disallow or subordinate claims where necessary to prevent unfairness.

c. Substantive Consolidation.

Substantive consolidation is an equitable doctrine whereby the assets of, and claims against, two or more entities are merged, creating a common fund of assets and a single body of creditors. In addition, claims between the entities are eliminated upon consolidation. The purpose for substantive consolidation is to preserve the assets of the debtor by avoiding the expense and difficulty of sorting out the separate assets and liabilities of the debtor and its affiliate entities, who may or may not also be bankruptcy debtors. Because the entities to be consolidated invariably have different debt-to-asset ratios, substantive consolidation results in the redistribution of wealth among the creditors of the various entities. Creditors of the less solvent entities stand to gain by substantive consolidation because now their claims will be satisfied out of the pooled assets of the relatively more solvent consolidated debtor, whereas creditors of the more solvent entities stand to lose by substantive consolidation because the consolidated debtor is relatively less solvent than the individual entity against which they originally held their claims. Because substantive consolidation alters the

substantive rights of parties to the bankruptcy, it is to be used sparingly.

d. Disallowance of Claims Otherwise Valid Under Non-bankruptcy Law.

Code provisions such as section 502(b)(6) & (7), which limit the allowable amount of claims arising from termination of leases of real property and employment contracts respectively, are also methods by which the Code prioritizes the rights of creditors. To the extent that a claim subject to one of these provisions exceeds the limitation set forth in the applicable provision, that portion of the claim is given the lowest possible priority–it is simply disallowed. Note that the claims partially disallowed under these provisions would presumptively otherwise be valid in their full amount under applicable non-bankruptcy law.

C. PROPERTY OF THE ESTATE - TRUST FUND DOCTRINE

Property in which the debtor only holds legal title, and not an equitable interest as of the petition date–in other words, property held by the debtor solely in the capacity of a trustee for the benefit of others–is excluded from the bankruptcy estate and is not distributed in satisfaction of creditors' claims. 11 U.S.C. § 541(d). Technically speaking, property held in trust by the debtor does become property of the estate, but does so "only to the extent of the debtor's legal title to such property." *Id.* Rather, property held in trust by the debtor will be distributed solely and directly to the beneficiaries of the trust(s), to the complete exclusion of the claims of creditors of the debtor. In this sense, trust beneficiaries are said to enjoy a priority over creditors to the extent that the amount of trust property in the debtor's possession as of the petition date is sufficient to satisfy the amount to which the beneficiary is entitled to receive under the trust.

A growing array of state and federal statutes create trust status for funds transferred pursuant to activities regulated by those statutes, and, in the event of bankruptcy, persons protected by such statutes assume the preferred status of trust beneficiaries (assuming that the trust funds can be traced) rather than creditors. Assets which are deemed by statute to be trust funds include: federal income taxes withheld from an employee's wages; sales tax collected by the seller (in certain states); employee contributions to pension or benefit plans maintained by employers and regulated under ERISA; funds paid to general contractors for the purpose of paying subcontractors, laborers and materialmen engaged on a particular project (in certain states); perishable agricultural commodities received by a merchant, dealer or broker subject to PACA and all receivable and proceeds from the sale of such commodities; and passenger facility charges (PFCs) collected by airlines.

D. DISCHARGE OF CLAIMS AND DEBTOR

Section 727 governs discharge in Chapter 7 cases. Only an individual person (a human being, not a partnership or corporation) is entitled to receive a discharge in a Chapter 7 case. A Chapter 7 discharge only discharges debts that arose before the filing of the bankruptcy case or, in an involuntary case, before the date on which an order for relief was entered, and operates to prevent creditors with pre-petition claims from pursuing such claims against the individual debtor after the discharge. If the trustee or a creditor can prove that the debtor engaged in certain misconduct, then the debtor will remain personally liable on all of his or her debts. Section 727(a) provides for the denial of a debtor's bankruptcy discharge if the debtor did any of the following:

- ✔ Conveyed, destroyed or concealed property of the debtor within one year prior to the filing of the case, or property of the estate after the filing of the case, if such action was done with intent to hinder, delay or defraud creditors;

- ✔ Unjustifiably concealed, destroyed, falsified or failed to keep or preserve recorded information from which the debtor's financial condition could be ascertained;

- ✔ Knowingly and fraudulently made a false oath or claim in connection with the bankruptcy case;

- ✔ Failed to satisfactorily explain any loss of assets;

- ✔ Refused to obey a court order (other than an order to testify);

- ✔ Committed any of the above acts within one year prior to the filing of a bankruptcy case of an insider;

- ✔ Received a discharge under Chapter 7 or Chapter 11 within the past six years;

- ✔ Received a Chapter 12 or Chapter 13 discharge within the past six years, unless payments under the Chapter 12 or Chapter 13 plan totaled at least 1 00 percent of allowed unsecured or 70 percent of such claims and the plan was proposed in good faith and was the debtor's best effort; or

- ✔ Executed, and the court approved, a written waiver of discharge after the filing of the bankruptcy case.

If the debtor is denied a discharge, then all of his or her debts survive the bankruptcy case, except that any payments received by creditors during the pendency of the case are credited against the surviving debts.

Section 523 provides that certain debts are not discharged. If a creditor establishes that its debt falls within one of the exceptions to dischargeability of a debt, then that creditor has certain rights to seek a court order that its claim not be discharged in bankruptcy.

Section 523(a) excepts from discharge the following debts:

- ✔ Most income and excise taxes for the three years immediately preceding the bankruptcy case and debts incurred to pay such taxes;
- ✔ Debts for money, property or services obtained by fraud or false representations, including the use of false financial statements;
- ✔ Certain consumer debts for luxury goods, or services or cash advances made shortly before the filing, if the debtor obtained the goods or services under false pretenses or through fraud;
- ✔ Debts not scheduled by a debtor, unless the creditor had actual knowledge of the bankruptcy case so that it could have filed a timely proof of claim;
- ✔ Debts incurred by a debtor's fraud or defalcation while acting in a fiduciary capacity;
- ✔ Debts for child support and alimony and certain debts incurred in connection with and divorce or separation;
- ✔ Debts for willful and malicious injury by the debtor to another entity or such entity's property;
- ✔ Most fines, penalties or forfeitures that a debtor owes to a governmental entity;
- ✔ Debts for an educational loan made, insured or guaranteed by a governmental unit or nonprofit institution, with certain restrictions;
- ✔ A judgment which arose from liability incurred by the debtor as a result of operating a motor vehicle while legally intoxicated;

- ✔ Debts that were or could have been listed in a prior bankruptcy case concerning the debtor, in which the debtor waived or was denied a discharge;

- ✔ Debts relating to fraud contributing to a loss at a federally insured financial institution or capital commitments to such institutions;

- ✔ Obligations for criminal restitution;

- ✔ Certain real estate membership fees; and

- ✔ Certain filing fees.

E. OFFICERS, DIRECTORS AND AFFILIATES

In Chapter 7 proceedings officers, directors and/or affiliates of the Chapter 7 debtor are generally not personally liable for claims against the debtor. This includes such claims as wages or employee benefits owed by the debtor, as well as general unsecured claims. However, personal liability can extend to an officer or director of a Chapter 7 debtor in the event of non-payment of certain types of taxes, for certain environmental claims, for breach of fiduciary duty and for fraudulent or illegal acts committed by the officer or director. The liability of officers and directors under common law may be enforced by a bankruptcy trustee, and such causes of action are normally included as property of the bankruptcy estate.

Officers and directors normally owe a fiduciary duty to creditors, as well as shareholders, when the debtor approaches the zone of insolvency, the time when the directors know, or should know, that the debtor has encountered serious financial difficulty. This duty to maximize the value of the business enterprise is accompanied by a duty of care regarding its assets and operations and a duty of loyalty to the enterprise itself. Affiliates can be liable for controlling the debtor enterprise to the extent that the debtor becomes the mere agent or instrumentality of the affiliate (usually the parent corporation or shareholder) or otherwise misuses the debtor to the detriment of the creditors or to perpetrate a fraud upon the creditors. Officers, directors and affiliates are not automatically liable for trading while the debtor is insolvent unless such parties engage in misrepresentation or other forms of actionable activity.

Claims of officers, directors and affiliates can also be "equitably subordinated" to the claims of other creditors. The most frequent basis for equitable subordination is the breach of a fiduciary duty. Normally, this arises when a controlling shareholder, officer or director acts in a way that is unfair to the corporate debtor or preferential to the fiduciary as against the position of

other creditors. Evidence of undercapitalization is a significant factor which is considered by the courts.

Shareholders and other affiliates can be held liable for the debts of a corporation. If the debtor is determined to be the "alter ego" of the shareholder affiliate. The alter ego doctrine is normally utilized where the stockholders utilize the corporate entity as a sham to perpetuate a fraud, to shun personal liability, or to encompass other truly unique situations. The doctrine is evoked in situations where the legal boundaries of separate entities are ignored by the parties. If multiple entities are operated, in fact, as a single entity, the court may deem them to be alter egos. Commingling of funds is a factor which is often present in alter ego cases. Substantive consolidation is a related doctrine that is used by bankruptcy courts when it is equitable to combine the debtor with a related business entity. Many of the same factors considered in connection with the application of the alter ego doctrine are also considered in connection with a determination of substantive consolidation.

Section 152 of Title 18, United States Code, sets out numerous insolvency - related crimes which are punishable by fines and/or imprisonment. These crimes include concealing property of the estate, making false oaths or declarations and presenting false claims against the estate.

B. REORGANIZATION

1. Principal Laws Governing Reorganization.

Generally speaking, the same laws which govern bankruptcy liquidations apply to business reorganizations. Chapter 11 is the principal reorganization chapter of the Bankruptcy Code, and may be used by most entities, including partnerships, corporations and individuals. The purpose of Chapter 11 is to preserve and protect the integrity of assets from the claims of creditors, so as to permit the debtor an opportunity to reorganize and restructure its assets and liabilities and once again become economically viable.

Chapter 12 is designed to give special relief to a family farmer with regular annual income. Individuals, partnerships and corporations are potentially eligible for Chapter 12 relief. Chapter 13 is a rehabilitation vehicle for an individual with regular income, unsecured debts of less than $269,250 and secured debts of less than $807,750. Chapters 12 and 13 contain provisions for an automatic stay of proceedings against co-debtors and enhanced discharge provisions. Chapter 9 deals with the reorganization of municipalities.

2. Commencement of Reorganization.

The commencement of a Chapter 11 reorganization proceeding is basically the same as a Chapter 7 liquidation proceeding and may be either voluntary or

involuntary. Although there is no statutory requirement that a voluntary Chapter 11 petition be filed in good faith, the bankruptcy courts have held that there is an implicit good faith requirement. In particular, the bankruptcy courts have been more likely to dismiss a Chapter 11 bankruptcy case for lack of good faith where property was transferred to the debtor just prior to the filing in order to obtain the benefits of the automatic stay, or where the sole purpose of the filing was to stay a foreclosure action without any intention of reorganizing through refinancing, sale or other arrangement. Cases filed under Chapters 9, 12 and 13 may only be commenced by the filing of a voluntary petition.

Upon the entry of the order for relief, the debtor's estate is created as of the original date of the petition. Until entry of the order for relief, however, the debtor remains in control of its assets and may continue to operate its business. After the entry of the order for relief, the debtor may remain in possession of its assets as a debtor in possession.

3. Reorganization Estate.

The filing of a petition for relief under the Bankruptcy Code creates an estate. Section 541 of the Code specifies what becomes property of the debtor's estate. The concept of property of the estate is broad in scope, encompassing all kinds of property, including tangible and intangible property, causes of action, real and personal property, property held by the debtor in trust for others and property of the debtor held by others.

The creation of a bankruptcy estate has the effect of divesting the debtor of all legal and equitable interests it possessed in property at the time of the bankruptcy filing. In a Chapter 11 case, the debtor becomes the debtor-in-possession, and as such can only transfer estate property in the ordinary course of its business without an order of the court.

Although section 541 specifies the property of the estate, it only contains limited tests for determining what is or is not "property" for purposes of the debtor's estate. The courts normally must look to non-bankruptcy law, usually state law, to determine which interests of the debtor are included as property of the estate. Therefore, what becomes property of the estate often varies depending on the applicable state law. As in Chapter 7, a Chapter 11 individual debtor is entitled to exempt certain property from its bankruptcy estate.

The Trustee's avoidance powers, previously discussed, also apply to the Chapter 11 debtor-in-possession or trustee.

4. Administrative Powers.

The Section 362 automatic stay discussed on Page 13 also applies to Chapter 11 reorganization cases. The filing of a bankruptcy petition, whether

voluntary or involuntary, invokes an automatic stay pursuant to section 362 of the Code, preventing essentially all actions against the debtor or property of the estate. Section 362 contains provisions for relief from the automatic stay for certain specified reasons and for cause.

The debtor in possession (or trustee, if one is appointed) continues to operate the debtor's business during the pendency of the case. Section 1107 enumerates the rights, powers and duties of the debtor in possession, while section 1106 sets forth the duties of the trustee and/or examiner. While the debtor may continue to operate its business in the ordinary course, it must obtain court approval for any transactions which are not in the ordinary course of its business. Cash collateral includes cash, negotiable instruments, documents of title, securities, deposit accounts and other cash equivalents as well as the proceeds, products, offspring, rents and profits if both the estate and a third party (usually a secured creditor) has an interest in such items. Section 363 of the Bankruptcy Code provides that the debtor cannot use, sell or lease cash collateral unless the secured creditor consents or the court authorizes such use, sale or lease. If collateral is used, the secured creditor is entitled to adequate protection.

A debtor may sell its property free and clear of all liens, claims and interests pursuant to section 363 if certain conditions are met, including if the sale exceeds the price of all liens secured by the property, if the third party could be required to accept a money satisfaction for its interest or if the interest of third parties in the property is in dispute. Property may be sold free of the interests of co-owners if partition in kind is impracticable, the sale of an undivided interest will not maximize value, the benefit to the estate outweighs the detriment to the co-owner and the property is not used in the production of certain kinds of energy.

For a debtor-in-possession, obtaining financing to support its ongoing operations can be a vital part of the reorganization process. The Bankruptcy Code provides certain incentives and protections for lenders that provide financing to debtors-in-possession.

Section 364 of the Code is the principal section governing financing of a debtor-in possession and authorizes the obtaining of credit by the trustee or debtor-in-possession. It governs the debtor's efforts to obtain financing on a secured or unsecured basis. A debtor in possession may obtain unsecured credit in the ordinary course of business without court involvement. The incurrence of other debt on a secured or unsecured basis requires a court order. Subsection (d) of section 364 even allows the debtor or trustee, after notice and hearing, to obtain credit secured by a lien senior or equal to an existing lien on the debtor's property, if the interests of the holder of the existing lien are adequately protected. The Bankruptcy Code speaks in terms of priority only, and does not state the terms of the loan or the nature of the lien documents. The lender and debtor-in-possession must negotiate the terms and obtain court approval of those terms.

5. Creditors and Claims.

As in a Chapter 7, all Chapter 11 creditors receive notice of the filing of the petition, the date and time for first meeting of creditors, and the deadline for filing proofs of claim. Section 101(5) of the Bankruptcy Code defines "claim" and includes contingent, disputed and unliquidated obligations. The deadline for filing proofs of claim in a Chapter 11 case is fixed by the bankruptcy court. Special rules apply to the filing of claims in Chapter 11 cases. Although any creditor may file a proof of claim in a Chapter 11 bankruptcy only those creditors whose claims have been omitted from the debtor's schedules, and those creditors whose claims have been scheduled as disputed, contingent or unliquidated must file a claim. Thus, if a creditor is scheduled as undisputed, liquidated and non-contingent, and the creditor agrees with the amount scheduled and the characterization of the claim (secured, unsecured or priority), the creditor need take no further action. The debtor-in-possession, or any other entity as may be directed by the court or pursuant to the debtor's plan of reorganization, has the duty to examine all proofs of claim and object to any improper claims, but any creditor may object to the claim of another creditor.

Section 365 of the Bankruptcy Code authorizes the debtor to assume or reject executory contracts and leases. Special provisions govern the time periods for assumption or rejection of real property leases. Executory contracts and leases can be assumed by the debtor if the non-debtor party is provided with adequate assurance of future performance and the debtor cures defaults under the executory contract or lease. The debtor may assign the assumed lease or executory contract to a third party if the debtor can establish that the assignee can perform with regard to the lease or contract in the future. Certain contracts cannot be assumed including contracts for financial accommodation and others, for example, personal services contracts, cannot be assigned. Damages from the rejection of real property leases are limited by section 502.

Section 553 of the Bankruptcy Code preserves the right of setoff but subjects the exercise of the right of setoff to the automatic stay. Section 506 gives to the holder of a right of setoff the rights of a secured creditor, including the right of adequate protection. Certain transfers and manipulations creating rights of setoff are not recognized.

Although the Bankruptcy Code does not exclude environmental claims from the scope of the discharge in Chapter 11, cases have struggled with the distinction between environmental claims that are discharged in the Chapter 11 case and continuing environmental obligations that do not constitute dischargeable claims. Generally, if the environmental obligation arose prepetition and was recognizable at the time of the confirmation it will be discharged unless it relates to property which remains property of the debtor. Injunctive obligations are also often determined to be non dischargeable.

The Chapter 11 debtor's discharge is all encompassing and discharges the reorganized debtor from all pre-confirmation claims. However, individuals (but not corporations or partnerships) receiving a Chapter 11 discharge will be limited by all of the exceptions to discharge listed in Section 523 of the Code. A Chapter 11 debtor receives a discharge when its plan of reorganization is confirmed.

6. Officers, Directors, Affiliates.

The personal liability of corporate officers, directors and affiliates is the same under Chapter 11 as under Chapter 7.

The provisions of section 152 of Title 18, United States Code, regarding insolvency-related crimes also apply to corporate officers and directors of Chapter 11 debtors.

If the debtor remains in possession, it normally continues to be managed by its officers and directors during the Chapter 11 reorganization, subject to the approval by the Bankruptcy Court of transactions outside of the ordinary course of business. Normally, the management of the debtor devises and prepares the plan of reorganization and presents it to the Bankruptcy Court for approval. This is usually done after intensive negotiations with the representatives of the creditors. Post reorganization management of the debtor is determined by the plan of reorganization, and must be disclosed in the statutory disclosure statement required by section 1125 of the Bankruptcy Code.

7. Reorganization Plan and Process.

The ultimate objective of a Chapter 11 debtor is to obtain court approval of a plan of reorganization which restructures and perhaps, forgives certain pre-petition debt. The relevant sections of the Bankruptcy Code governing the plan itself are sections 1121 through 1129. Section 1121 gives the debtor the exclusive right to file a plan during the first 120 days of a Chapter 11 bankruptcy case. The bankruptcy court may, however, extend or reduce that 120 day period upon timely request. Once the debtor's exclusivity period expires, any creditor or other party in interest may file a plan. Normally, the debtor negotiates the terms of the plan of reorganization with representatives of its creditors before it files the plan. A plan may provide for the full payment of a creditors, partial payment of creditors, the conversion of all or part of the debt of the debtor into stock or other equity of the debtor or a third party, or any other type of arrangement which is acceptable to the creditors of the debtor. A plan may also provide for the orderly liquidation of the debtor.

Section 1123(a) sets forth the provisions which every plan must contain. Included in these provisions are the requirements that a debtor must designate classes of claims or interests, indicate whether each class is impaired or unimpaired, and if such class is impaired the treatment it will receive under the

plan, provide the same treatment for all members of a class of claims or interests, except to the extent that the holder of a particular claim or interest agrees to accept less favorable treatment, and provide adequate means for the plan's implementation. Section 1123(b) includes optional provisions a plan may contain such as the assumption, rejection or assignment of any executory contract or unexpired lease or the sale of all or substantially all of the property of the estate. Section 1129 of the Bankruptcy Code contains the requirements for confirmation of the plan of reorganization, including the requirement that priority unsecured tax claims be paid with deferred cash payments no later than six years after the date of assessment.

Once a plan has been filed, and before votes of creditors can be solicited, a disclosure statement, which has been approved by the bankruptcy court, must be provided to all holders of claims or interests in the debtor's estate. A disclosure statement must set forth the terms of the plan, as well as sufficient information to allow the holders of claims and interests to make an informed decision whether to vote for or against the plan. Once the disclosure statement is approved by the Bankruptcy Court, the disclosure statement, the plan and a ballot will be sent to the creditors and other parties in interest. Section 1125 of the Bankruptcy Code governs the post-petition disclosure and solicitation of a plan.

Section 1123 specifically contemplates classifying each creditor and/or interest holder into a class in accordance with the provisions of section 1122. Only similar claims may be placed in the same class. Normally, secured creditors are classified separately unless they all hold the same collateral, such as secured bondholders. Each claimant of a particular class must be treated the same. Often, for reasons of convenience, small unsecured claims may be placed in one class, to be paid in full upon confirmation of the plan. With such treatment, those unsecured creditors will not impaired, and thus, will not be eligible to vote on the proposed plan.

The plan must also state whether the class of claims or interests will be impaired or unimpaired. The claim is not impaired if the plan leaves the legal, equitable and contractual rights of the claimant unaltered. In the event that a claim is impaired, the plan must set forth the treatment of that claim. Examples of treatment methods include:

- ✔ Partial payment of the claim;
- ✔ Payment in full or in part over time with or without interest; or
- ✔ Conversion of the claim to an equity interest in the debtor or some third party.

Once a plan has been proposed, there are two methods by which it can be confirmed. The first is the "acceptance" method, in which all impaired classes of claims or interests have voted in the requisite number and amount to accept the plan. In determining acceptance or rejection, only creditors or interest holders who actually vote are counted. In order for a class of claims to accept the plan, votes representing at least two-thirds in amount of claims voted, and more than one-half in number of the creditors actually voting in that class must be cast for acceptance of the plan. Acceptance by a class of interests requires an affirmative vote by two-thirds in amount of the allowed interests actually voting in connection with the plan. Even if the plan is accepted by all classes of impaired claims and interests, it must still meet the requirements of section 1129(a). Section 1129(a) requires that the debtor have complied with all Code requirements, that the plan was proposed in good faith, feasibility, that each creditor must be paid at least as much as it would have received in a Chapter 7 case, and full payment of priority claims.

The second method of plan confirmation is the "non-acceptance" or "cramdown" method, in which at least one class of impaired claims (but not interests) has voted in the requisite number and amount to accept the plan, and certain other requirements are met with respect to all non-consenting impaired classes of claims or interests. Cramdown may become necessary if a class of claims or interests rejects the plan. Section 1129(b) provides for the "cramdown" confirmation of a plan if the proponent of the plan requests confirmation, the plan does not discriminate unfairly, and the plan is fair and equitable. Generally, a plan will be fair in equitable if the claims held by each senior class of creditors are paid or provided for in full before any junior class of creditors receives anything under the plan or if no junior class of claims or interests receives anything pursuant to the plan. This concept is generally referred to as the "absolute priority rule".

Section 506 of the Bankruptcy Code provides that a secured claim is recognized as secured to the extent of the value of the collateral of the secured creditor. The remaining deficiency, if any, is treated as unsecured. Section 1111(b) of the Bankruptcy Code provides a special procedure whereby a secured creditor can elect to have its entire claim treated as secured, but it is rarely used because the treatment of those claimants electing treatment under section 1111(b) is often less favorable than the treatment provided those creditors who do not elect to be treated pursuant to section 1111(b).

For a plan to be confirmed, if it has not been accepted by a class of secured creditors, the plan must provide that the secured creditor retains its lien on its collateral and receives deferred cash payments with a present value of the value of the collateral. Alternatively, the collateral may be sold with the liens attaching to the proceeds of the sale. In that event, the secured creditor has the right to bid the full amount of its claim (both the secured portion of the claim and the unsecured deficiency) for the collateral. A plan may also be confirmed if it

provides the secured creditor with the "indubitable equivalent" of its claim. Often, the debtor and the secured creditor will disagree about the rate of return or discount rate to apply to the stream of payments to be received by the secured creditor and the other terms and conditions of repayment.

In order to comply with the absolute priority rule with respect to a dissenting class of unsecured creditors the plan must provide that the dissenting class receives property with a present value equal to the allowed amount of its claims or that no junior class of creditors or interests receives anything under the plan. The term "property" is used in its broadest sense, and may consist of stock or other securities, notes, tangible personal property, real estate and other items.

Holders of equity interests must receive or retain property of a value of any fixed liquidation preference or redemption price or the holders of any interests junior to such dissenting class of holders must receive nothing pursuant to the plan. Of course, the absolute priority rule can also be violated if a class of creditors or interest holders receives more than the allowed amount of its claims or interests.

Typically, a plan of reorganization will provide for the continued jurisdiction of the bankruptcy court over such matters as objections to claims, any litigation which may be pending in the bankruptcy case, and other routine matters concerning implementation and enforcement of the terms of the plan. Section 1141 of the Code sets forth the effect of confirmation of the plan. The Chapter 11 debtor's discharge is effective upon confirmation of the plan, unless the plan provides for the liquidation of all or substantially all of the property of the estate, the debtor does not engage in business after consummation of the plan and the debtor would be denied a discharge under Section 727 of the Code if the case were a case under Chapter 7, or, in the case of an individual debtor, if a debt is excepted from discharge under section 523 of the Code. Chapters 9, 12 and 13 contain specific discharge provisions which are applicable to those chapters.

III. ENVIRONMENTAL ISSUES IN A BANKRUPTCY CASE

A. GENERAL

There are certain conflicts inherent in the mixture of the policies underlying environmental laws, i.e., protecting public health and the environment, and the policies underlying bankruptcy laws, i.e., settling a debtor's liabilities equitably and providing a debtor with a "fresh start," Some of the more noticeable areas where these conflicts collide are those affecting (i) the right of contribution; (ii) the priority of environmental claims against a bankruptcy estate; (iii) the dischargeability of environmental liabilities as debts in bankruptcy; (iv) trustee's ability to abandon contaminated property; and (v) the jurisdiction and effect of the automatic stay on government enforcement actions.

B. CONTRIBUTION CLAIMS

The Comprehensive Environmental Response., Compensation, And Liability Act of 1980,[2] § 9613(f)(1) provides that a claim for contribution may be brought during or after any civil action under CERCLA §§ 9606 or 9607(a) against any person who is liable or potentially liable under CERCLA § 9607(a). A person may also retain the right to bring a private action for contribution in the absence of either a CERCLA §§ 9606 or 9607 action. However, CERCLA § 9613(f)(2) provides that a party who has settled with the United States or a state in an administrative or judicially approved settlement is not liable for contribution claims regarding matters addressed in the settlement. This "contribution protection" provides an incentive for settlement by allowing the settling parties to sue other parties who have not settled their liability with the Environmental Protection Agency ("EPA") for contribution in the amount of the difference between the settlement and the actual cost of the response action.

1. The Importance of Timing.

It is very problematic for an entity with a claim for contribution or indemnification under CERCLA if the party against whom the entity is seeking recovery files for relief under the Bankruptcy Code. The degree of severity of this situation escalates if the claim is contingent or unliquidated. In most situations, and the area of environmental claims is no exception, timing is everything.

The timing involved in the Bankruptcy Code[3] (the "Code") and CERCLA differ greatly. In an attempt to promote rapid cleanup of environmental waste sites, Congress adopted a policy of delaying litigation regarding cleanup costs until after the cleanup. Therefore, liability under CERCLA may not be assessed until after the EPA has conducted an investigation of the site in question, decided what remedial measures need to be taken and determined which Potentially Responsible Parties ("PRPs") will bear the costs. In contrast to CERCLA's policy of delaying litigation and ultimate liability of various entities, the Code accelerates matters to further its policy of granting a debtor a "fresh start" and lend some finality to the bankruptcy process.

The date of the filing of a petition for bankruptcy relief is also an important time reference with respect to discharge and priority issues. The debtor will generally be discharged of all unsecured claims arising before that date or "pre-petition." If distributions are made on a debtor's pre-petition claims, the claimant may receive only a portion of its claim. If the claim, however, arises post-petition, the debtor may be liable for the entire amount as an administrative cost. Therefore, the time at which an environmental claim arises is a relevant issue whether a contribution claim will be recognized in the bankruptcy case, what priority will be given to a claim and whether the claim will be discharged by the bankruptcy.

2. Section 502(e).

Section 502 of the Code governs the allowance of claims in bankruptcy cases. 11 U.S.C. § 502. Section 502(a) accords claims *prima facie* allowability and they are "deemed allowed unless a party-in-interest objects. Section 502(e) generally governs the treatment of claims filed by entities liable with the debtor, such as sureties and guarantors, for contribution or reimbursement. Section 502(e) provides:

> (e)(1) Notwithstanding subsections (a), (b) and (c) of this section and paragraph (2) of this subsection, the court shall disallow any claim for reimbursement or contribution of an entity that is liable with the debtor on or has secured the claim of a creditor, to the extent that -
>
> (A) such creditor's claim against the estate is disallowed;
>
> (B) such claim for reimbursement or contribution is contingent as of the time of allowance or disallowance of such claim for reimbursement or contribution; or
>
> (C) such entity asserts a right of subrogation to the right of such creditor under section 509 of this title [title 11].[4]

Section 502(e) is a unique provision of the Code and may cause harsh results since some contingent claims for contribution will be disallowed without further consideration by the bankruptcy court if certain criteria are met.[5] Note, however, that § 502(e) is not applicable to unliquidated claims for contribution, but only to contingent claims for contribution.

3. Section 502(e)(1)(B)'s Three Prong Test.

Section 502(e)(1)(B) indicates that the following three elements must be established in order for a contribution claim to be disallowed:

> (1) the claim must be one for reimbursement or contribution;
>
> (2) the entity asserting the claim for reimbursement or contribution must be "liable with the debtor" on the claim; and
>
> (3) the claim must be contingent at the time of its allowance or disallowance.[6]

(a) The claim must be for reimbursement or contribution.

With regard to the first requirement, namely that the claim be for reimbursement or contribution, it has been held that a right to indemnification is included in the first requirement of § 502(e)(1)(B).[7]

(b) The claimant must be liable with the debtor or have secured a claim of a creditor.

The second requirement for the disallowance of a contingent claim pursuant to § 502(e)(1)(B) has been construed by one court to include all claims upon which the contribution claimant is liable "jointly" with the debtor regardless of whether such joint liability has been judicially determined.[8]

It is a gray area under the case law whether 502(e)(1)(B) applies to claims for a private right of action to recover CERCLA response costs directly against a debtor. Several courts have refused to apply 502(e)(1)(B) to disallow direct contingent claims based on CERCLA. In *In re Allegheny Intern'l, Inc.*,[9] the claimant initiated voluntary clean up activities at a landfill and brought an action against the debtor under CERCLA §107(a)(4)(B) for its recovery of response costs; no federal or state agency had brought or threatened an enforcement action. The court found that while an action for recovery of response costs incurred by a government entity falls within the scope of §502(e)(1)(B), a claimant's direct claim for response costs is not excluded.[10] The co-liability prong of the three prong test was not satisfied because the claimant did not "seek to recover response costs owed to, or incurred by, the EPA, the DEC, or any other third party, but instead seeks to recover response costs it has directly incurred and will directly incur in the future."[11] The *Allegheny* court then created an escrow fund to partially cover potential environmental costs.

The court in *In re Harvard Indus., Inc.*[12], allowed a direct contingent claim based on CERCLA because the co-liability element of § 502(e)(1)(B) was not present. In *Harvard Indus.* the claimant voluntarily undertook cleanup efforts at a landfill site and sued the debtor for recovery of past and future costs. The court allowed the claims and reasoned that the claimant's claim for future costs, while contingent, was a direct claim and therefore was not subject to being disallowed under § 502(e)(1)(B).[13]

In other cases, the courts appear to apply § 502(e)(1)(B) to all CERCLA claims although it is not always clear whether the "direct" claim argument was actually made. In *Charter*,[14] the court, without elaboration, applied § 502(e)(1)(B) to a claim under CERCLA § 107(a)(4)(B) (providing for a private right of action to recover response costs). The court recognized that the purpose behind CERCLA's right of contribution was to encourage private parties to move forward and assume financial responsibility for cleanup without worrying about reimbursement. They could seek recovery, or a portion thereof, in contribution litigation. The court

found that disallowing contribution claims in bankruptcy was not inconsistent with CERCLA policy. The court reasoned that disallowing the contingent contribution claims in bankruptcy promoted the goal by encouraging other PRPs to incur the expense associated with a cleanup before being able to file an allowed claim in the bankruptcy. That rule, according to the court, expedites the clean up.[15]

It has been held that joint tortfeasors are co-liable with a debtor for purposes of § 502(e)(1)(B).[16]

(c) The claim must be contingent at the time of its allowance or disallowance.

Blacks Law Dictionary, (5th ed. 1979) defines "contingent" as follows:

> *Contingent*. Possible, but not assured; doubtful or uncertain; conditioned upon the occurrence of some future event which is itself uncertain or questionable. Synonymous with provisional.

One court has defined a contingent claim as a claim that "has not yet accrued and which is dependent on some future event that may never happen."[17]

Some courts appear to hold that the future event that must occur for a contingent claim of reimbursement to convert into a certain claim for purposes of § 502(e) is when the co-debtor pays the claim.[18]

In *In re Hemingway Transport, Inc.*,[19] pre-petition, the debtor sold real property to a developer, Juniper. Post-petition, the EPA sent a notice to Juniper identifying it as a PRP under CERCLA and as a result liable for the cost of cleanup. The lower court disallowed Juniper's claim for contribution against the debtor for estimated CERCLA costs citing § 502(e)(1)(B). The First Circuit vacated the part of the lower court's opinion disallowing the claim for contribution for future response costs since the EPA had elected not to assert a claim against the debtor's estate. The First Circuit ruled that § 502(e)(1)(B) did not require that a creditor claim be evidenced by a formal proof of claim, but that it was "incumbent on the trustee to produce substantial evidence of the existence of a right to payment on the part of a creditor."[20] The First Circuit further ruled that the Chapter 7 trustee had the initial burden of filing a surrogate claim on behalf of the EPA (under § 501(c)) as a precondition to obtaining simultaneous disallowance of Juniper's contingent claim under § 502(e)(1)(B). The court also stated that Juniper should have the same right to file a claim on behalf of the EPA (under § 501(b)). The First Circuit remanded the case with instructions to the bankruptcy court to set a bar date in which the Chapter 7 trustee may file an EPA claim, without prejudice to Juniper's right to file a surrogate claim as well. If no claim is filed, the court ruled, the § 502(e)(1)(B) claim would be dismissed.[21] The Supreme Court declined to grant certiorari.[22]

In *In re Eagle-Picher Indus.*,[23] the claimants argued that their claims were not contingent because they had entered into a consent order, pursuant to which the claimants assumed the responsibility of remediating certain hazardous waste sites. The consent order, the claimants argued, absolved the debtor of any liability to the EPA. The court found that response costs claims were nevertheless "contingent" and disallowed under Code § 502(e)(1)(B) based on the finding that the consent order did not absolve the debtor of liability to the EPA. The court reasoned that the debtor was not a signatory and the EPA retained its right to sue the debtor for unpaid clean up costs in connection with the sites. Therefore, the debtor and the claimants were co-liable to the EPA for future clean up costs with respect to the sites, The court based its decision on "well settled" law that the claim of a co-liable party under § 502(e)(1)(B) is contingent until the claimant has made payment on its underlying claim to the principal creditor and "thereby fixes his right to payment from the debtor."

4. Disallowance of Contingent Claims.

Section 502(e)(2) of the Code provides in pertinent part:

> A claim for reimbursement or contribution of such an entity that becomes fixed after the commencement of the case shall be determined, and shall be allowed under subsection (a), (b), or (c) of this section, or disallowed under subsection (d) of this section, the same as if such claim had become fixed before the date of the filing of the petition.[24]

If a claim is disallowed pursuant to § 502(e)(1)(B), the disallowance is without prejudice to the refiling of the claim pursuant to § 502(e)(2). Once a claim is no longer contingent, § 502(e)(2) allows a co-debtor a claim for reimbursement or contribution as a pre-petition claim even if payment is made post-petition.[25]

It appears, therefore, that a PRP should proceed most expeditiously to achieve a determination of its response cost liability and expend the required funds to fix its claim in a co-liable party's bankruptcy case.

5. Estimation Pursuant to Section 502(c).

The mere fact that a claim is contingent or unmatured does not render it unenforceable pursuant to § 502(b)(1). Section 502(c) specifically deals with those types of claims, requiring the court to estimate any claim when the "fixing or liquidation" of such claim would "unduly delay the administration of the case.,"[26] Section 502(c) provides in pertinent part:

> (c) There shall be estimated for purposes of allowance under this section [section 502] -

> (1) any contingent or unliquidated claim, the fixing or liquidation or which, as the case may be, would unduly delay the administration of the case; or
>
> (2) any right to payment arising from a right to an equitable remedy for breach of performance.[27]

As stated in the legislative history of § 502, the section "requires that all claims against the debtor be converted into dollar amounts."[28] Therefore, as stated in Collier on Bankruptcy, § 502(c) requires the court to estimate the dollar value of any claim if liquidation of the claim in the ordinary course would unduly delay the administration of the estate.[29] The purpose of the estimation of contingent or unliquidated claims is to afford a claimant the opportunity to share in any distribution that may be made while the debtor is assured a fresh start via discharge of its pre-petition debts.[30]

The Bankruptcy Code and Rules are silent, however, as to the manner in which contingent or unliquidated claims are to be estimated pursuant to § 502(c).[31] It has been held that when estimating claims in a bankruptcy case, "the court should use whatever method is best suited to the circumstances."[32] As stated by the court in *Bittner v. Borne Chem. Co.*:

> Despite the lack of express direction on the matter, we are persuaded that Congress intended the procedure to be undertaken by the bankruptcy judges, using whatever method is best suited to the particular contingencies at issue. The principal consideration must be an accommodation to the underlying purposes of the Code. It is conceivable that in rare and unusual cases arbitration or even a jury trial on all or some of the issues may be necessary to obtain a reasonably accurate evaluation of the claims. Such methods, however, usually will run counter to the efficient administration of the bankrupt's estate and where there is sufficient evidence on which to base a reasonable estimate of the claim the bankruptcy judge should determine the value. In so doing the court is bound by the legal rules which may govern the ultimate value of the claim.[33]

Since the Bankruptcy Code and Rules are silent as to the manner in which claims are to be estimated, courts have devised several different schemes pursuant to which claims amounts are to be estimated. In one case, the debtor sought to enjoin the Department of Energy ("DOE") from continuing administrative proceedings pursuant to Proposed Remedial Orders ("PROs") and Remedial Orders ("ROs") issued by the DOE under the Emergency Petroleum Allocation Act.[34] The DOE filed claims in the debtor's bankruptcy case for violations of petroleum price regulations. The debtor also requested, inter alia, that the court estimate the DOE's claims pursuant to § 502(c). The court held that it would be in the best interest of the estate and would avoid unnecessary delay, and costs, if it estimated

the DOE's claims since the administrative process, on average, took 1,340 days and therefore was too time consuming.[35]

Where claims are based on actions pending in non-bankruptcy forums, some courts have temporarily disallowed a claim or estimated the claims at zero, while effectuating a waiver of the debtor's discharge of the claim until the pending litigation is concluded.[36] In such instances where a court estimates a claim at zero, it is not clear whether this will preclude a claimant from sharing in a distribution if the claim later becomes fixed in an amount greater than the estimated amount.[37] Other courts, in estimating contingent and unmatured claims, have held evidentiary hearings and have examined the merits of the underlying claim to arrive at an estimate.[38]

Therefore, with regard to contingent claims for environmental violations, a claimant may request the bankruptcy court to estimate its claim. The court may choose to hold an evidentiary hearing and estimate the claim itself.[39] In the alternative, if an action is already pending in another forum, the court may allow the non-bankruptcy tribunal to determine the amount of liability even though distributions to pre-petition creditors will be made from the bankruptcy estate. If the claims are very contingent the court may estimate the environmental liability at zero. As stated in *Collier on Bankruptcy*, §§ 502(e)(1)(B) and 502(c) seem to "facially" be in opposite.[40] *Collier on Bankruptcy* states, however, that each section must be viewed from different standpoints.[41]

In most cases, the reference is withdrawn to allow the district court to estimate CERCLA claims. A bankruptcy court estimated the CERCLA claims filed by the United States for the purpose of allowance under § 502(c).[42] In *National Gypsum*, the court estimated claims with respect to three sites. At the first site, the court referred to a record of decision prepared pre-petition by the EPA. Finding that the EPA had not acted in an "arbitrary and capricious" manner, the court adopted the EPA's estimate as its own. With respect to the second site, the EPA had not completed a record of decision pre-petition. The court estimated the claim "by considering the evidence in a manner based on legal rules that would government (sic) the ultimate value of the claims." Finding that the debtor's expert witness more closely followed the EPA's procedure for selecting a remedy than the EPA did, the court adopted the debtor's proposed remedy and estimation thereof with modifications. At the third site, the debtor was liable for clean up costs based on a consent agreement between the EPA and a former subsidiary of the debtor. However, the consent agreement would terminated when the property was removed from the National Priorities List (NPL). The court estimated the United States' claim against the debtor at zero.

6. Section 502(c) Versus Section 502(e)(1)(B).

Section 502(c) must be viewed from the standpoint of a creditor of the debtor and 502(e)(1)(B) must be viewed from the standpoint of a co-debtor.[43]

Collier states that a co-debtor and direct creditor are vastly different.[44] Section 502(c) mandates that a claim be estimated for allowance purposes if the actual fixing or liquidating of the claim would "unduly delay" the administration of the case.[45] Therefore, the Code provides that a creditor's claim be estimated for allowance purpose so that the creditor can share in the distributions from the estate. A surety or co-debtor, however, holds a different status from a creditor in that it has no right to share in the distributions from the estate until it pays the underlying creditor in full.[46] As stated in Collier on Bankruptcy:

> In recognition of the difference in status of the surety and the debtor's creditor, section 502(e)(1)(B), apparently, but not really in derogation of section 502(c), disallows any claim made by the surety or person secondarily liable with the debtor of any claim for reimbursement or contribution to the extent that the claim is contingent as of the time of allowance or disallowance. A claim of a surety is contingent, in this context, until the surety pays the principal creditor and thereby fixes his own right to payment from the debtor.[47]

Therefore, if a claimant with a contingent liability for violations of environmental law is liable with a debtor, its claim will fall under the purview of § 502(e)(1)(B). If. however, a claimant has a claim directly against the debtor such as a state or federal environmental agency, then the claim can be estimated pursuant to § 502(c).

A debtor does retain the ability to use the contribution protections such as CERCLA § 113(f) by settling with the EPA or under similar state environmental statutes. By settling with the EPA, the debtor can use CERCLA § 113(f) to disallow co-PRPs' claims.[48]

C. PRIORITY OF CLAIMS

In bankruptcy, environmental claimants often attempt to establish their claim as a §503 administrative expense, Code § 503(b) provides that "actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case" constituted administrative expenses. 11 U.S.C. § 503(b). Pursuant to § 507 of the Code, administrative expenses allowed under § 503(b) are entitled to priority over all general unsecured claims.[49]

Since there is no specific provision in Section 503(b)(1) giving priority to environmental claims, the general rule has been to accord environmental claims general, unsecured status.[50] Nevertheless, courts will grant an administrative priority to a claim, that (i) the right to payment arose from a post-petition transaction with the debtor's estate, rather than from a pre-petition transaction with the debtor, and (ii) the consideration supporting the right to payment was beneficial to the estate.[51]

1. Claims Based on Cleanup Cost of Post-petition Contamination.

Environmental claims arising from clean up of post-petition contamination enjoy priority as administrative expenses.[52]

When granting an administrative expense priority, a court will often cite to 28 U.S.C. § 959 or the Supreme Court's Midlantic decision, depending on the severity of the environmental contamination and the imminence of the dangers associated with it. 28 U.S.C. § 959(b) requires a bankruptcy trustee or debtor in possession to manage and operate property of the estate in accordance with applicable non-bankruptcy law. Courts have held that § 959(b) gives rise to an administrative expense.[53] Courts disagree whether Section 959(b) applies to debtors who have ceased operations and are liquidating their businesses.[54] One court has held that § 959 does not necessarily apply to debtors in constructive possession of property.[55]

In *Midlantic Nat'l Bank v. New Jersey Dep't of Environmental Protection (In re Quanta Resources Corp.)*,[56] the Supreme Court interpreted § 959(b) to require trustees or debtors in possession to comply with environmental laws applicable to property of the estate. The Supreme Court suggested as well that the trustee or debtor in possession could not abandon property so long as doing so would present an imminent and identifiable harm to public health or safety.[57] Note that *Midlantic* did not address the issue of priority of clean up expenses.

By citing § 959(b) or *Midlantic* as an analogy, cases have found that if the debtor or trustee could not abandon the property of the estate in contravention of environmental law, neither should they be able to maintain or possess the property in continuous violation of the same law; therefore, the debtor or trustee has an obligation to remedy the problem.[58]

The Supreme Court expressly left open the question in *Midlantic* of the priority accorded to governmental costs if the trustee fails to respond to a cleanup order. *Midlantic Nat'l Bank v. New Jersey Dep't. of Envtl. Protection.*[59] At least one court has concluded that cleanup obligations should be treated as a claim, not as a specific performance obligation that the trustee must carry out on an administrative expense basis.[60]

The courts have also relied on public policy to invoke priority status for environmental claims holding that the power of the trustee "must yield to governmental interests in health and safety, which includes using assets of the estate for the necessary cleanup" and viewing the removal of the waste as an obligation of the estate as well as a "risk which the creditors must bear."[61]

In *In re Kent Holland Die Casting & Plating, Inc.*,[62] the court ruled that an administrative expense claim may be awarded for damages caused by the post-petition negligence of the debtor in possession or the trustee. At least one court

has ruled that cleanup costs are not allowed priority as administrative expense before such funds are expended.[63]

2. Post-petition Cleanup Costs on account of Pre-petition Contamination.

A common issue is whether a claim should be entitled to an administrative expense priority where the contamination occurred pre-petition, but continues to be a problem post-petition. In this situation, it is likely that the claim will enjoy administrative priority if there is a showing of imminent harm.[64] However, many courts are beginning to review when the claim was incurred to determine the priority of cleanup costs. If the claim was incurred pre-petition, then post-petition cleanup costs are dischargeable unsecured claims without any priority.[65]

In *In re Virginia Builders, Inc.*,[66] the debtor leased real property and allowed waste oil to contaminate the property both pre- and post-petition. The secured creditor filed a state law environmental claim seeking to recover the costs of the cleanup. The creditor asserted the entire claim as an administrative priority claim under Section 503(b)(1)(A). While recognizing that environmental claims have generally been granted only unsecured status, the court followed authority construing Section 503(b)(1)(A) broadly. The court held that the entire cleanup cost was an administrative expense, even cleanup of contamination occurring pre-petition. The court reasoned that to allow the pre-petition contamination to continue post-petition could be construed as an altogether new, harmful act sufficient to elevate the cleanup cost as an administrative expense priority.[67]

In re Conroy, 153 B.R. 686 (W.D. Penn. 1993) (the state's claim against debtor for post-petition environmental cleanup associated with pre-petition contamination was entitled to administrative expense priority; the claim included 10% surcharge representing minimum administrative and legal expenses incurred from the state's initial investigation up until the time the state recovered its cost).

3. Pre-petition Cleanup Claims.

Costs incurred pre-petition may obtain a less favored status as unsecured claims in bankruptcy.[68] The Security Gas court indicated in dicta that environmental cleanup orders in regard to pre-bankruptcy violations were general, unsecured claims, while post-petition hazards can have administrative expense priority.[69] Additionally, pre-petition fines are usually treated as dischargeable unsecured claims.

4. Private Parties have a Higher Burden for Priority.

Private parties appear to obtain a less favored status than governmental units, having to meet a higher standard in order to receive priority for their

environmental claims.[70] For example, the claimant which was a surety on bonds put up in favor of the government in *In re Pierce Coal*,[71] was denied priority status even though the claimant asserted subrogation to the government's rights (and such priority status is allowed under § 507(d) for this type of claim).[72] These holdings tend to indicate more difficulty for private parties seeking priority for environmental cleanup through subrogation than for governments which execute the cleanup and seek priority status themselves.[73]

5. Priority of Fines and Penalties.

Fines imposed under federal environmental statutes for pre-petition violations of these statutes constitute pre-petition unsecured claims.[74] One case stands for the proposition that punitive, civil penalties assessed post-petition against a Chapter 11 debtor as punishment for environmental violations qualified as administrative expenses only to the extent they were incurred as a consequence of operating the debtor's business after the bankruptcy petition was filed and the business was operating, *Alabama Surface Mining Comm. v. N.P. Mining Co., Inc. (In re N.P. Mining Co.)*.[75] In the debtor's bankruptcy, the Alabama Surface Mining Commission ("ASMC") asserted an administrative priority claim for post-petition payment of civil penalties imposed as punishment for the debtor's environmental obligations. The fines never involved any health hazard or an imminent risk to public safety.

The Eleventh Circuit held that the punitive civil penalties assessed for post-petition mining activities did qualify as administrative expenses under §503(b)(1)(A). The decision was apparently not based on Code policy such as fairness to claimholders or environmental protection policies. Rather, the Eleventh Circuit based its decision on the federal policy embodied in 28 U.S.C. § 959(b) that a trustee must operate an estate in compliance with state law. The court noted that the penalties incurred while a trustee is merely maintaining an estate for later distribution of the assets cannot be considered a cost ordinarily incident to the operation of a business. The court reasoned, however, that since a mining operator would be required by state law to pay the fines absent bankruptcy, a trustee actually mining and acting under state law must pay the fines as well.

Some commentators have disagreed with *N. P. Mining Company*'s conclusion that punitive civil damages assessed for post-petition mining activities qualifies as administrative expenses under Section 503(b)(1)(A). They write that the decision was not based on Bankruptcy Code policy, such as fairness to claim holders, or even environmental protection policy.[76]

One court has allowed all post-petition fines as an administrative priority claim, after determining the fines were not excessive.[77]

6. Priority Over Secured Claims

A few cases have hinted that environmental claims may even take priority over secured claims. Despite an acknowledgment by the court in In re Env't. Waste Control,[78] that the debtor's commencement of both state and federally mandated corrective action would likely exhaust the debtor's dwindling assets, the court held, over a secured party's objections, that . . . [the secured party's] position regarding its priority over the estate's assets must yield in light of the competing environmental harms."

The court later clarified its ruling by stating that its decision was not meant to assign priorities.[79] The court stated that its earlier decision remarked only that under Section 363(c) the debtor could expend funds otherwise available to a creditor with priority as long as there was compliance with Section 363(e), which allows conditioning of the use of the collateral upon the provision of adequate protection of the secured creditors' interest, The court concluded that its earlier decision is not a basis for deeming a secured creditors' interest to be inferior to a environmental claim.

In another case, the court in *In re Mowbray Eng'g Co., Inc.*,[80] granted the EPA priority over even secured parties as a matter of public policy by allowing the EPA to stand in the shoes of the trustee and to obtain the trustee's right to "recover cleanup costs upon sale of the property prior to satisfying any secured claims against the property." However, it appears that priority over a secured claim may only be granted to the extent necessary to cure an immediate threat.[81]

Another court has authorized a trustee to use funds in his possession, which were subject to a security interest as proceeds from sale of uncontaminated real property, to clean up the contaminated portion of the property.[82] The secured creditor was a governmental entity secured by both the uncontaminated and contaminated properties. Therefore, the trustee using the available funds benefitted the secured creditor by cleaning up part of the collateral.

7. Liens Against Estate Property.

Even if environmental cleanup costs are not granted an administrative expense priority in bankruptcy, these costs may be entitled to priority as liens on property in the estate under § 506(c). This section grants a right of recovery, in effect a "superlien" on secured property for the "reasonable, common, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such [secured] claim." However, this superlien applies only if the secured creditor receives some benefit such as cleaning up his collateral.[83] In holding that the EPA could not obtain superlien status because the secured creditor did not receive any benefit from the cleanup action, the court in *In re T.P. Long Chem., Inc.*,[84] specified that one type of collateral could not be used for general cleanup with no benefit to the secured creditor.[85]

At least five states have enacted "superlien" provisions in their state Superfund statutes, namely, Connecticut, Maine, Massachusetts, New Hampshire and New Jersey. These statutes generally provide that a lien may be imposed against the real property subject to cleanup in order to assist the state in recovering state funds expended in the cleanup. The liens are referred to as "superliens" because they take priority over all other liens, including previously existing recorded liens.[86]

D. DISCHARGEABILITY

1. Discharge Generally.

A discharge in bankruptcy will most likely, with certain exceptions, release the debtor from liabilities for environmental damages arising before the bankruptcy petition was filed.[87] Section 523 of the Code provides for certain debts to survive a debtor's bankruptcy case.[88] A majority of the cases dealing with the dischargeability of environmental claims, however, are based on whether such claims constitute "claims" for purposes of the Code and not whether § 523 is applicable. For example, monetary claims by governmental agencies for response costs which have been expended pre-petition appear to be dischargeable debts; however, the courts are divided as to when claims "arise" for purposes of CERCLA liability and, therefore, whether they are dischargeable. In addition, it is not clear whether cleanup orders in the nature of injunctive relief give rise to a "right to payment" pursuant to the definition of "claim" under the Code and thus are dischargeable in bankruptcy.

2. When Claims "Arise" for Purposes of CERCLA Liability.

There are basically three views of when a claim "arises" for purposes of dischargeability. The pro-creditor, the "response costs" view, states that a CERCLA claim must be established, including the occurrence of response costs, before a dischargeable claim arises.[89] This view is a minority view. The pro-debtor view is referred to as the "relationship" view. The "relationship" view was adopted by the Second Circuit in the case of *In re Chateaugay Corp.*, ("LTV").[90] Several courts have recently used the relationship view test, moving it more into a mainstream category.[91] The majority view is more intended to be neutral and is referred to as the "fair contemplation" view. The "fair contemplation" view was adopted in the decision of *In re Nat'l Gypsum Co.*[92]

a. The "Response Costs" View.

United States v. Union Scrap & Metal,[93] adopted the "response costs" view, In that case, the EPA did not know about the debtor's involvement with a Superfund site until after the debtor's discharge. The EPA argued its claim was not discharged because its claims arose when it incurred response costs. The court agreed. Despite the broad definition of "claim" in the Bankruptcy Code, the

court looked to nonbankruptcy law to determine whether the EPA's CERCLA demands constituted a claim for bankruptcy purposes. Under CERCLA, a legal obligation does not arise until response costs have been incurred. The "response costs", view appears to be a minority view. In fact, another Minnesota district court in an opinion subsequent to *Union Scrap* disregarded the "response cost" rule and focused instead on whether the party asserting the CERCLA claim had notice of its claim.[94]

b. The "Relationship" View.

A very important opinion on dischargeability of environmental liability was handed down by the Second Circuit in the LTV bankruptcy case in 1991.[95] In the LTV case, the United States and the State of New York brought actions seeking declaratory judgments as to the dischargeability of (i) CERCLA response costs and (ii) RCRA and other environmental injunctive obligations.

The EPA in *Chateaugay* filed bankruptcy claims for response costs it had incurred at 14 sites at which the debtor was a PRP. All but one of the sites required additional response costs, and the EPA contended that the debtor might also be a PRP at various unidentified sites. The EPA filed an adversary proceeding to determine whether future response costs for the identified and unidentified sites were "claims" under § 101(5) of the Code. The debtor maintained that because the costs stemmed from pre-petition conduct, they were claims and were therefore not dischargeable. The district court agreed with the debtor, holding that post-petition response costs for pre-petition releases or threatened releases were dischargeable even if the EPA became aware of the releases after bankruptcy.

In affirming the district court, the Second Circuit initially reviewed Code §101(5)'s definition of "claim". The court reasoned that:

Congress unquestionably expected this definition to have wide scope. By the broadest possible definition . . . the bill contemplates that all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case.[96]

Although the court recognized that this language might arguably bar victims of a bridge collapsed from asserting claims that the bridge was constructed before, but collapsed after, the construction company filed for bankruptcy, the court reasoned:

> Yet it must be obvious that enormous practical and perhaps constitutional problems would arise from recognition of such a claim. The potential victims are not only unidentified, but there is no way to identify them. Sheer fortuity will determine who will be on one

> bridge when it crashes. What notice is to be given to these potential "claimants"?[97]

The Second Circuit determined that it did not have to decide whether the definition of "claim" applies to tort victims injured by pre-petition conduct, especially in the difficult case of pre-petition conduct that is not resulted with any harmful consequences to the victim. The court stated that it was confronted only with the far more manageable problem of sums ultimately to be owed to the EPA at such time as it incurs CERCLA response costs.[98]

The Second Circuit viewed the relationship between the EPA and the debtor as analogous to a contract rather than the tort relationship. According to the Second Circuit, "unmatured" and "contingent" contract claims are defined as "obligations that will become due and payable upon the happening of a future event that was 'within the actual or presumed contemplation of the parties at the time the original relationship between the parties was created.'"[99] The Second Circuit held:

> Though there does not yet exist between the EPA and [debtor] the degree of relationship between claimant and debtor typical of an existing though unmatured contract claim, the relationship is far closer than that existing between future tort claimants totally unaware of injury and a tort feasor. The EPA is acutely aware of [the debtor] and vice versa. The relationship between environmental regulating agencies and those subject to regulation provides sufficient "contemplation" of contingencies to bring most ultimately maturing payment obligations based on pre-petition conduct within the definition of "claims". True, EPA does not yet know the full extent of the hazardous waste removal costs, and it does not yet even know the location of all sites at which such wastes may yet be found. But the location of these sites, the determination of their coverage by CERCLA, and the incurring of response costs by EPA are all steps that may fairly be viewed, in the regulatory context, as rendering EPA's claim "contingent" rather than placing it outside the Code's definition of "claim".[100]

Applying the above rationale, the Second Circuit affirmed the district court's holding that response costs are dischargeable where they result from pre-petition releases or threatened release of hazardous substances.

c. <u>The "Fair Contemplation" View</u>.

In *In re Nat'l Gypsum Co.*,[101] the debtor filed a voluntary petition under Chapter 11, and the United States filed a Proof of Claim concerning the debtor's prepetition conduct at 7 CERCLA Superfund sites (the "Listed Sites"), and reserved its right to assert that the Debtor was liable under CERCLA for its

prepetition conduct at 13 other unlisted sites (the "Unlisted Sites"). The district court withdrew the reference to the bankruptcy court because the case raised novel issues regarding the interaction of CERCLA and the Code.

The district court first considered whether future response costs and future natural resource damage costs at the Listed Sites were "claims" under the Code and therefore subject to discharge. Relying in principal on In re Chateaugay Corp.,[102] the court used the bankruptcy concept of contingent claims to bring future CERCLA response and damage costs within the ambit of the Code. The court declined, however, to follow the Chateaugay court's deference to the Code's objective of a "fresh start" at the expense of CERCLA's goal of environmental cleanup, and ruled that only future response and natural resource damages costs that can be "fairly contemplated" by the parties at the time of the bankruptcy were claims under the Code.

Second, the court considered whether costs arising from the debtor's pre-petition conduct at the Unlisted Sites were dischargeable claims under the Code. Applying the same standard developed in its analysis of the Listed Sites, the court ruled that all liability at the Unlisted Sites arising from prepetition conduct which were fairly within the contemplation of the parties constituted dischargeable claims.

The *Nat'l Gypsum* case provides example of what could be considered fair contemplation, including "knowledge by the parties of the site in which a PRP may be liable, a National Priorities List listing, notification by EPA of PRP liability, commencement of investigation and cleanup, and occurrence and response costs."[103]

Most recent cases appear to adopt the "fair contemplation" approach, or some variation thereof.[104] Courts have additionally held that claims based on statutes enacted post-petition are not discharged.[105]

3. Whether Injunction Claims may be Discharged.

a. *Ohio v. Kovacs*.

The seminal case on the dischargeability of claims based on environmental damages is *Ohio v. Kovacs*.[106] In *Kovacs*, the Supreme Court held that a debtor's obligations under a state injunction ordering cleanup of a hazardous waste disposal site was a dischargeable debt. *Id.* at 283. The Court emphasized that the state-appointed receiver who took possession of the site to initiate cleanup had cleaned up the site prior to the bankruptcy petition. *Id.* With the receiver in control of the site, the cleanup order was by necessity converted into an obligation to pay money and thus was dischargeable in bankruptcy. *Id.* The Court, however, did not address whether every cleanup injunction that requires an expenditure of money is dischargeable. *Id.*

Subsequent case law suggest that a debtor may be unable to discharge an environmental debt if the debtor is able to cleanup the site by personal performance rather than expenditure of funds. For example, in *United States v. Whizco, Inc.*,[107] the debtor owned the equipment which would allow for a personal performance clean up. The court held that the debtor was not discharged on its cleanup obligation to the extent compliance did not require the expenditure of money.[108] In contrast to the *Whizco* case, the facts in *Kovacs* established that the debtor was "disabled by the receivership from personally taking charge of and carrying out" the cleanup.[109]

One district court case has also held that, as distinguished from *Kovacs*, obligations arising from cleanup orders which do not seek monetary payments are not dischargeable obligations since they do not fit into the Code's definition of "claims".[110] In *Hubler*, the debtor operated a surface coal mine with another as a partnership. The Secretary of the Interior (the "SOI"), discovered a violation at the mine site and issued an order requiring the partnership to remediate the area. The order was not complied with and each partner filed for bankruptcy. Each was later granted a discharge of his prepetition obligations. The SOI subsequently filed an injunction action seeking an order compelling the partners to comply with their obligations to remediate the mining site.

The court held that since the SOI was not seeking a payment from the partners but was instead seeking to compel the partners to comply with a cessation order, the partners, obligations were not dischargeable. *Id.* The court held that a cleanup order does not constitute a right to a money payment merely because the enjoined parties would be forced to expend money to comply with their cleanup obligations.[111]

A Third Circuit decision has held that a state's attempt to force a debtor to comply with environmental laws and to cleanup hazardous waste was not a claim discharged under the Bankruptcy Code, even though the debtor no longer was in possession of the property. In *In re Torwico Electronics, Inc.*,[112] the New Jersey Department of Environmental Protection and Energy issued a post-petition administrative order requiring Torwico to remedy certain environmental contamination. Torwico had not been in possession of the contaminated site for several years. Torwico argued that its "affirmative duty to cleanup the site and the duty to pay money to that end" was a claim under *Kovacs* and was therefore dischargeable. New Jersey responded that it did not seek a monetary judgment to be paid to the state, but rather sought to remedy on-going pollution by forcing Torwico to clean up the site.

Relying on *In re CMC Heartland Partners*[113] and *In re Chateuagay*,[114] the Third Circuit concluded that Torwico's obligations under the administrative order did not constitute a claim. New Jersey was seeking an injunction against the debtor to remedy on-going hazards. The Third Circuit went on to hold that New Jersey's injunction was not merely a "repackaging of a forfeited claim for

damages," but rather was an injunction to prohibit a continuing problem and an on-going threat.

Torwico also argued that it was not liable because it was no longer in possession of the site. The court held that under New Jersey law, Torwico was the generator of the hazardous waste, and as such had an on-going responsibility for the waste it disposed. The court concluded that under New Jersey law, the debtor's obligations did not run with the land, but rather with the waste.[115]

In a recent case, a bankruptcy court determined that an order to close landfills and mitigate environmental damage was not a claim with a right to payment and was not dischargeable.[116]

4. CERCLA Claim not Discharged as to Current Owner.

In *CMC Heartland Partners*,[117] the Seventh Circuit found that the United States' failure to file a proof of claim under CERCLA in the debtor's reorganization extinguished the liability of the debtor's successor (purchaser of debtors assets) for violations by the debtor as operator of a hazardous waste site; nevertheless, the court ordered that the purchaser was liable under CERCLA based on its capacity as the current owner of the hazardous waste site. The court reasoned that liability of the debtor's successor under CERCLA was a claim that runs with the land and survived the debtor's bankruptcy.[118]

In a subsequent law suit, the purchaser later argued that its claim for contribution under CERCLA was not barred by the bankruptcy bar date for filing claims since it did not have notice of its possible CERCLA claim against the debtor by the bar date. The court found that there were a number of significant facts that indicated that the purchaser had sufficient knowledge of its potential CERCLA liability to require it to file a proof of claim in the debtor's case. The court reasoned that with constructive knowledge imputed to the purchaser, the purchaser became a potential CERCLA claimant that could "tie the bankruptcy debtor to a known release of hazardous substance", the standard set forth in the earlier decision of *In The Matter of Chicago Milwaukee St. Paul & Pacific Railroad Co.*[119] The purchaser's CERCLA claims were therefore barred. The court noted that, "Our national environmental policy does not permit a commercial landowner in a tainted area to put on blinders or attempt an 'ostrich defense.'"[120]

5. Discharge is Subject to Proper Notice.

According to the court in *Waterville Indus. v. First Hartford Corp.*,[121] environmental liability cannot be discharged if the affected claim holder is not given some notice of the bankruptcy proceeding and the likelihood of discharge. In *Waterville*, the debtor argued that the confirmation of the debtor's plan of reorganization in 1984 discharged all claims for environmental liability that might arise from pollution the debtor had caused on its real estate before confirmation of

its plan. At the time the debtor filed its bankruptcy petition, the debtor was aware that environmental agencies were pursuing an environmental problem at the debtor's property. However, the debtor was not aware at that time of the identity of successor titleholders to the property.

The *Waterville* court held that the debtor was aware of contingent liability to successor titleholders in general for the environmental problems that it created and therefore, should have listed that class of creditors (i.e., successor titleholders) as having contingent or unliquidated claims.[122] As a result, the court in Waterville denied the debtor's summary judgment motion to dismiss a successor titleholder's CERCLA claims.

6. Exceptions to Discharge Under § 523.

Discharge of a debtor's environmental obligations may not be granted if one of the exceptions to discharge pursuant to § 523 of the Bankruptcy Code is applicable. 11 U.S.C. § 523. Pursuant to § 523(a)(6), a debtor may be denied his discharge of a specific claim if the debtor caused "willful and malicious injury" by abandoning hazardous substances. In *Commonwealth of Kentucky, Natural Resources and Environmental Protection Cabinet v. Lyle Van Daniels (In re Lyle Van Daniels)*,[123] the debtor had surface mined for coal under a state permit, As part of an injunction, the state court ordered the debtor to complete environmental remedial measures for the land debtor mined. The bankruptcy court found that the debtor had knowingly violated the state's statute by mining one site without a valid permit and by exceeding the area limit of the permit in another site. The bankruptcy court found, however, that the state did not hold a non-dischargeable debt under § 523(a)(6), because the state was not a "entity" under the applicable state statute.

The district court reversed, holding that the state should be regarded as an "entity" that has been injured and should be allowed to object to the discharge of its debt pursuant to § 523(a)(6). The court reasoned that Kentucky state law defines Kentucky as an entity that can be damaged by one who surfaces mine coals. The court found that the injury was "willful and malicious" and, based on the bankruptcy court's finding that the debtor had knowingly violated the state's statute, the state's claim was excepted from discharge.

Additionally, environmental fines and penalties are not dischargeable when they fall within the discharge exception for "a fine, penalty or forfeiture payable to and for the benefit of the governmental unit" not in compensation for actual pecuniary loss under § 523(a)(7).[124]

E. ABANDONMENT

The trustee in bankruptcy obtains the right to "abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and

benefit to the estate pursuant to § 554. A question arises, however, as to whether the Bankruptcy Code permits abandonment of property and the liabilities associated therewith as a means of avoiding obligations under environmental laws. It appears that attempts have been made by the courts to reconcile the policies of environmental law with those underlying bankruptcy law. The degree which courts will favor application of bankruptcy law over environmental concerns appear to be based on evaluation of a debtor's financial ability to comply with environmental concerns relative to the potential of a serious public health or safety risk.

1. *Midlantic*.

The Supreme Court held in *Midlantic Nat'l Bank v. New Jersey Dept. of Envtl. Protection*.[125] that abandonment of a hazardous waste facility was prohibited because it would be inconsistent with state and environmental laws. In that case, Quanta Resources ("Quanta") owned waste oil processing facilities in New York and New Jersey where PCB contamination was found. Midlantic National Bank held a security interest in Quanta's inventory, accounts receivable and equipment, during the pendancy of negotiations between Quanta and the state concerning cleanup of the New Jersey siter Quanta filed a petition for relief under Chapter 11 of the Bankruptcy Code. The New Jersey Department of Environmental Protection issued an administrative cleanup order and Quanta converted its case to a Chapter 7.

Although there were some assets in the estate, the Chapter 7 Trustee determined that they were insufficient to fund cleanup or maintain monitoring of the facilities and requested permission to abandon the facilities. The Bankruptcy Court approved the abandonment of both facilities. The Bankruptcy Court's ruling was ultimately appealed to the Third Circuit Court of Appeals. In separate judgments, the Third Circuit held that the bankruptcy court erred in permitting abandonment because where state law or general equitable principles protected certain public interests, those interests were not overridden by "judge-made abandonment power."[126]

In reaching its holding, the Supreme Court relied on cases which limited the trustee's abandonment power where necessary to protect governmental interests.[127] The Court also relied upon 28 U.S.C. § 959 which requires a trustee to "manage and operate the property in his possession . . . according to the valid laws of the State." The Court, however, did not reach the question of whether state laws imposing conditions on abandonment may be so onerous as to interfere with the bankruptcy process.

While requiring full compliance with state environmental laws, *Midlantic* held that such compliance is subject to certain limitations. In a footnote, the Court appeared to limit its decision to emergency situations that respond to an "imminent and identifiable harm."[128] The Court's holding in *Midlantic* seems to

indicate that only in situations where an imminent and serious threat to the environment exists will environmental regulations preempt the abandonment ower conferred upon trustees under the Bankruptcy Code.[129]

2. Post-*Midlantic* Cases.

Other cases decided subsequent to *Midlantic* which have distinguished it and allowed abandonment, indicate that abandonment would probably be allowed if no assets exist in the estate or if all of the estate's assets are encumbered.[130] In the case of *In re Smith-Douglass, Inc.*, the debtor was the owner of a fertilizer plant in Streator, Illinois, at the time it filed its Chapter 11 petition. No unencumbered assets existed in the estate, and it was eventually determined that the debtor would liquidate rather than reorganize. After liquidating all of the other assets in the estate and unsuccessfully attempting to sell the fertilizer plant, the debtor moved for leave to abandon the plant. The State of Illinois opposed abandonment on the grounds that the property violated state environmental laws although the state had not sought a "no enforcement action."

The Fourth Circuit affirmed the lower court's finding that unconditional abandonment was appropriate in light of the estate's lack of unencumbered assets coupled with the absence of serious public health and safety risks. The court therefore reversed the district court's holding that the financial condition of the debtor is irrelevant to the abandonment analysis under *Midlantic* and stated that "[w]here the estate has unencumbered assets, the bankruptcy court should require stricter compliance with state environmental law before abandonment is permitted."[131]

The ambiguity surrounding footnote 9 of the *Midlantic* opinion, which appeared to limit the abandonment right only to those cases where "no imminent or identifiable harm exists", was acknowledged by the court in *Smith-Douglass*.[132] The court focused on the conflict between federal bankruptcy law and state environmental law in addition to the role preemption by the Supremacy Clause of Article VI of the United States Constitution plays.[133] The Fourth Circuit concluded that preemption of state law is a matter of intent and Congress must not have intended to permit abandonment where conditions on property pose a danger of imminent death or illness.[134] Therefore, a narrow exception to preemption applies where there is a serious health risk posed, and the bankruptcy court does not have the power to substitute its judgment for that of the state as to what constitutes a serious public health or safety risk.[135]

In one case, the United States District Court for the District of New Jersey allowed a Chapter 7 Trustee to abandon a public water supply system contaminated with bacteria on the basis that the system did not constitute a threat of "imminent and identifiable harm to the public heath or safety and since the enforcement agency waited almost eight years before seeking to enforce its

administrative orders against the debtor.[136] In *In re Anthony Ferrante & Sons, Inc.*, the debtor was the owner and operator of a public water supply system. Approximately eight years before filing for bankruptcy, the New Jersey Department of Environmental Protection ("DEP") issued an advisory to the entities served by the water system to boil the water supplied through the system before consuming it because of bacteriological contamination. The DEP subsequently issued a series of orders directing the debtor to correct problems with the water system, some of which were corrected by the debtor.

The debtor subsequently filed for bankruptcy under Chapter 7 of the Bankruptcy Code. Approximately one month later, DEP, unaware of the bankruptcy, issued an order directing the debtor to comply with all of its previous orders and informed the debtor that noncompliance would result in the DEP's transfer of the system. The Chapter 7 Trustee then sought to abandon the water system and DEP sought an order compelling the trustee to. operate the water system.

The district court affirmed the bankruptcy court's decision to allow the trustee to abandon the water system. *Id.* at 51. The court held that the language of Midlantic is clear in that a trustee may not abandon property in contravention to state environmental law unless (i) the state law is not reasonably designed to protect the public health or safety; (ii) the state law is so onerous as to interfere with the administration of a bankruptcy case; or (iii) the violation resulting from the abandonment would be speculative or indeterminate, or would not create a risk of imminent or identifiable harm.[137]

The court held, therefore, that unlike *Midlantic*, there was little threat of harm to the public since several warnings not to consume the water had been issued to the public and the system was no longer being operated. Thus, the abandonment would not threaten the health of the public.[138] The court also noted the fact that DEP waited almost eight years before it attempted to enforce its administrative order issued against the debtor.[139] The court held that, although it did not give rise to a defense of laches, this fact, nonetheless, added support to its finding that the water system did not pose an imminent threat to the public.[140] Therefore, the court allowed the abandonment and stated that it was "powerless to prevent a trustee in bankruptcy from exercising the statutory authority to abandon worthless property unless it falls within the confines of Midlantic."[141]

Abandonment may not eliminate the estate's liability under various liability theories which are not dependent on current ownership. CERCLA §9607(e)(1), for example, prohibits the transfer of liabilities through conveyance. In addition, at least one bankruptcy trustee has been found liable under Superfund as a party that operated the facility at the time of disposal, even though the trustee possessed the ability to abandon drums of hazardous substances in the bankruptcy case.[142]

Several cases have arisen post-Midlantic in which no funds exist in the various bankruptcy estates to cure environmental problems, but the courts** perceive that the property nevertheless cannot be abandoned because of Midlantic. As a solution to this problem, all but one of these bankruptcy cases were dismissed on the basis that it was impossible for the estate to bring the property into compliance with environmental regulations.[143]

In another post-*Midlantic* case, *In re Paris Indus. Corp.*,[144] the trustee formulated an alternative to abandonment in an attempt to comply with environmental laws, even though the estate was without funds sufficient to meet the regulatory requirements. *Paris Indus.* concerned an affiliate of the debtor which owned a manufacturing facility (the "Paris Property") which had been environmentally damaged. The State of New York filed an unliquidated contingent claim for the cleanup costs which was estimated at over $1 million. The Paris Property was to be sold free and clear of liens and encumbrances for only $475,000.00 although State Street Bank and Trust Co. was owed in excess of $10 million secured by all of the debtor's assets including the Paris Property. The State of New York objected to the payment of the proceeds from the sale of the Paris Property to State Street. The purchaser, the debtor, the State of New York and State Street subsequently reached a settlement agreement. The settlement essentially provided that the buyer would give a portion of the sale proceeds in cash to the debtor who in turn would give the sum to the State of New York for the cost of the cleanup. The buyer was to also execute a promissory note payable to the trustee for the balance of the purchase price and assume part of the cleanup operations. The court, in approving the settlement agreement, noted that the State of New York had acquiesced to the settlement and held that the settlement adequately protected the public interest and was in accordance with relevant environmental and bankruptcy law.[145] The solution arrived at in *Paris* is illustrative of one way courts are attempting to reconcile the aims and policies of environmental law (e.g., to protect public health and safety) with those of bankruptcy law (e.g., to give debtors a fresh start).

In *In re L.F. Jennings Oil Co.*,[146] the court concluded that the Midlantic exception to a trustee's abandonment powers is limited to abandonment that poses an immediate threat to public welfare. In *Jennings Oil*, the property at issue did not pose an immediate and identifiable harm. The property did not appear on the state's list of contaminated sites and there was not sufficient data from the state agency's own expert that the property presented a threat.

At least one court has applied the *Midatlantic* analysis to a Chapter 11 debtor's rejection of a real property lease, where there was pre-petition contamination on the real property.[147] The Court allowed the debtor to reject the lease as long as ther was no imminent harm to public health or safety.

3. Liability of Trustee for Abandonment.

Generally, however, a bankruptcy trustee will not be subjected to personal liability for environmental penalties and cleanup costs in the absence of a showing that the trustee acted with a purposeful disregard of the applicable environmental law. In *State v. Better Brite Plating, Inc.*,[148] the state appeals court reversed the finding of the lower court court and held that the State of Wisconsin had to show that a trustee half, knowingly and intentionally violated a state environmental statute before the trustee could be held personally liable, on the theory that a lesser standard of proof could have a devastating impact on the "pool of persons willing to serve as trustees in toxic waste cases . . ."). The Wisconsin Supreme Court affirmed the appeals court. The court defined the issue as "whether the trustee, by violating the state environmental law while running the debtor's business, acted outside the scope of its authority and therefore was subject to state court jurisidiction in its personal capacity. In this case, the trustee's actions were taken in its offical capacity and were within the scope of its authority; therefore, the state court lacked jurisdiction to hold the trustee personally liable for violations of the state environmental law.

Trustees and bankruptcy attorneys kept close watch on possible criminal charges in California arising out of a debtor's abandonment of property with alleged environmental problems. Authorities in Solano County in California filed a 24-count felony complaint naming officers, employees and the bankruptcy attorneys of Infergene Company as defendants with respect to the abandonment of hazardous, radioactive and medical wastes at the debtor's laboratories. The felony complaint came just after a federal bankruptcy court vacated a temporary restraining order barring local and state authorities from filing the felony charges.

Solano County investigators discovered two 55-gallon drums of radioactive waste, a 5-gallon tub containing radioactive liquid and test tubes and hundreds of petri dishes, vials and test tubes containing cultures at a laboratory formerly operated by the debtor. Some of the materials were marked "sexually transmitted diseases." The debtor allegedly made recombinant A and G protein used worldwide for AIDS testing. The debtor was forced off of the propery by the landlord the day after it filed for bankruptcy. The debtor had stopped paying rent and was evicted.

The environmental crimes prosecutor argued that although the debtor was in Chapter 11, it was still obligated to comply with all state regulatory laws, including the obligation to remove any environmental hazards, even though the waste may have been created post-petition. According to the prosecutor, the bankruptcy attorneys were charged because their advice to the debtor to abandon the property allegedly cause the crime to occur. The felony charges were later dropped.

On a related issue, one court has held a trustee is not personally liable for environmental contamination on property sold from a bankruptcy estate.[149]

F. EFFECT OF THE AUTOMATIC STAY - SECTIONS 362 and 105 OF THE BANKRUPTCY CODE

The filing of a bankruptcy petition overates as an automatic stay of all judicial, administrative, or other actions or proceedings against the debtor and the enforcement of any judgment obtained before the petition was filed.[150] Certain governmental actions are exempt from the automatic stay where commenced or continued to enforce a governmental unit's police or regulatory power (the "police power exception").[151] Initial interpretations of the police power exception have held that the police power exception only applies to non-monetary judgments, and does not allow for recovery of monetary awards. It is unclear, however, whether governmental injunctions and cleanup orders requiring private parties to cleanup contaminated sites are exempted from or subject to the statute because they are deemed equivalent to monetary judgments.

In the case of *United States v. Price*,[152] the Third Circuit held that requiring a landfill owner to conduct a diagnostic study of toxic hazards at the site was a proper use of the court's equitable powers, because it would be "preventive rather than compernsatory."[153] In a subsequent case, the Third Circuit held that a state's injunction is exempt from the automatic stay and required a Chapter 7 debtor to take cleanup actions, even though these actions required a substantial expenditure that would deplete the estate's assets.[154] The bankruptcy court and district court previously applied the automatic stay to the injunction because "the effect of the action . . . was to collect a money judgment against *Penn Terra*."[155] The Third Circuit reversed and reinstated the state's enforcement action, directing that the inquiry should focus on the "nature of the injuries . . . including whether plaintiff seeks compensation for past damages or prevention of future harm."[156] The court indicated that the automatic stay would apply to actions to cleanup past harms but not to orders to prevent future harm.[157] *Penn Terra* does not completely clarify the applicability of the automatic stay in bankruptcy and it leaves open the bankruptcy court's authority to issue a discretionary stay under section 105 if necessary or appropriate to carry out the provisions of [the Bankruptcy Code]."[158]

> The Supreme Court's decision in *Ohio v. Kovacs*[159] further muddied the issue of when the automatic stay applies to Superfund actions. There, the State of Ohio enjoined Kovacs, on behalf of Chem-Dyne Corp. and in his individual capacity as its chief executive officer, to cleanup certain industrial and hazardous waste disposal sites and to pay $75,000 to the state for injury to wildlife, among other things. When Kovacs failed to comply with the injunction, the state had a receiver appointed who took possession of all Property and other assets of Kovacs and began cleanup of the sites. Before the cleanup was completed, Kovacs filed for bankruptcy.

The Supreme Court granted certiorari to determine the dischargeability of Kovacs' obligation under the injunction and affirmed the holding of the Sixth Circuit Court of Appeals against the state.[160] The opinion of the Court was that,

(i) in general, the automatic stay applies only to the enforcement of an environmental judgment seeking money from the bankrupt and does not apply to suits to enforce the regulatory statutes of the state, but that, (ii) Ohio's environmental injunction against Kovacs was dischargeable in bankruptcy as a "debt" converted into an obligation to pay money, since the receiver was carrying out the cleanup and only wanted money from Kovacs to defray the cleanup costs.[161]

Although it is unclear as to the current applicability of the the automatic stay to governmental injunctions and cleanup orders, the trend appears to be against enforcement of automatic stay and in favor of environmental cleanup.[162] There are many cases in which the automatic stay was not imposed where the government seeks to enforce environmental compliance.[163] For example, in *In re Lox Equip. Co.*,[164] the court found that the automatic stay did not apply to stay CERCLA action brought by purchaser of property against debtor where purchase occurred two months after debtor filed bankruptcy. The court held that the CERCLA claim arose post-petition and the automatic stay did not apply, The court wrote that, "A debtor should not be allowed to circumvent CERCLA by virtue of a post-petition transfer of property, particularly where there were allegations that the debtor had knowledge of the environmental problems which it did not disclose to the purchaser."

One court has held that the automatic stay did not prevent the State of Utah from commencing an action to enforce the state's environmental provisions against the debtor,[165] In *Kaiser Steel Corp.*, the State of Utah sought a determination from the bankruptcy court that it could commence an action against the debtor to enforce compliance with its environmental laws. In its opinion, the court recognized the danger that the debtor's "fresh start" would be placed if it allowed Utah to enforce its actions.[166] The court stated, however, that the debtor might have a remedy pursuant to § 105 of the Code and relied on the legislative history of § 362 in support of its contention.[167] The court, relying on the *Penn Terra* case, held that the State of Utah's action was an exercise of police power pursuant to §§ 352(b)(4) and 362(b)(5) and therefore was not a violation of the automatic stay.[168] The court also held that the state's action did not constitute an "enforcement of" a "money judgment" since the state had not commenced its enforcement action.[169]

The minority cases invoke the automatic stay where environmental compliance is concerned.[170] Other courts state that the government can seek to recover response costs under Superfund as exempt from the automatic stay because Superfund was enacted "to protect the health, safety, and welfare of the public" and not primarily for financial reasons.[171] In general, any claims or actions by private parties are stayed under the Bankruptcy Code because they are not governmental bodies to whom the police power exception to the automatic stay applies.[172] The distinguishing factor for the court in *Wheeling-Pittsburgh* was that the "main thrust" of the lawsuit related to post-petition violations by the debtor.

The court stated that since debtor had been operating under the protection of the Bankruptcy Code for almost four years it must now "conduct its post-petition business on business terms."[173]

In a contrasting decision, the bankruptcy court in *In re Chateaugay Corp.*,[174] refused to lift the automatic stay and held that it would invoke its equitable powers under § 105 of the Bankruptcy Code to enjoin a citizens group from initiating a lawsuit to monitor post-petition cleanup activities and to abate ongoing violations of the Clean Water Act at a mining site in Minnesota.[175] The court held that such proposed litigation would be an unnecessary expense of the debtor's estate since the State of Minnesota and the debtor were cooperating in effectuating a cleanup.[176]

The legislative history of § 362(a)(1) indicates that environmental litigation falls within the exception for governmental actions (i.e., the police power exception), but only as to non-monetary judgments. This restricted application of the exception to only non-monetary judgments would avoid giving the governmental unit preferential treatment concerning money judgments to the detriment of all other creditors. Therefore, claims brought by the government for reimbursement of environmental response costs should not be exempt from the automatic stay unless the governmental unit is suing a debtor for future costs of "environmental protection."[177] However, the decision of the Second Circuit in *City of New York v. Refinement Int'l, Inc.*,[178] a case of first impression in that circuit, could severely restrict the protections afforded a debtor by the automatic stay in connection with claims brought by government entities for reimbursement of environmental response costs.

In *New York v. Refinement*, the City of New York sued Refinement for recovered under CERCLA of resconse costs incurred and to be incurred by the city for removing hazardous substances contained in hazardous wastes generated by Refinement and illegally dumped at city landfills. The defendant, Refinement, as a debtor under Chapter 11 of the Bankruptcy Code, contended that the automatic stay prevented continuation of the City of New York's recovery action. The district court ruled the automatic stay did not bar continuation of the city's action, and the Second Circuit upheld the lower court's ruling. The Second Circuit based its decision on its interpretation of the legislative history of the police power exception to the automatic stay. The Second Circuit concluded "that Congress meant to except damage actions for completed violations of environmental laws from the action of the stay."[179] The Second Circuit then noted that allowing the government entity to sue for reimbursement of response costs would act as a deterrent to violators of environmental laws, and would encourage government entities to respond quickly to environmental crises "secure in the knowledge that reimbursement will follow."[180] It is unclear what effect the *New York v. Refinement* decision will have on prior case law interpreting the interplay of the general protections afforded by the Bankruptcy Code automatic stav, and the police power exception to the automatic stay.

A case following *New York v. Exxon Corp.* is *United States v. Acme Solvents Reclaiming, Inc.*,[181] where the debtor sought to stay the government's action to recover past and future response costs incurred in cleaning up the debtor's hazardous release. The debtor argued that the stay should not apply since the action did not implicate the government's police or regulatory powers and involved merely the recovery of monetary damages, not injunctive relief. The court found that all environmental enforcement actions fall within the police and regulatory exception of Section 362(b)(4), even when the agency seeks its response costs.[182]

Another court has held that the federal government is not stayed from continuing attempts to collect a pre-petition criminal fine for environmental violations.[183] Additionally, the debtor was required to continue making its structured monthly payment of the pre-petition criminal fine.

G. JURISDICTIONAL AND ELEVENTH AMENDMENT ISSUES

1. Mandatory Withdrawal.

According to the jurisdictional framework of the bankruptcy courts, withdrawal by the district court of its reference to the bankruptcy court is mandatory only when "substantial and material considerations" of federal statutes other than the Bankruptcy Code are necessary for the resolution of the case and the proceeding. The United States District Court for the Southern District of New York addressed this issue in the case of *American Tel. and Tel. Co. v. Chateaugay Corp.*[184] AT&T moved for an order withdrawing the district court's reference to the bankruptcy court so that the district court could consider its future CERCLA contribution claim to be asserted against the debtor, LTV Corporation. LTV argued that the resolution of the issues required consideration under the Bankruptcy Code alone since AT&T was requesting rulings as to the status under the Code of claims for post-confirmation response costs. The court rejected LTV's "invitation" to resolve the claims on the merits stating that the time at which a CERCLA claim arises is an open question that would require analysis of the competing policies embodied in CERCLA and the Bankruptcy Code.[185] The court found that AT&T's right to contribution pursuant to § 113(f) of CERCLA would therefore require significant consideration of CERCLA and therefore granted AT&T's motion to withdraw the reference.[186] The district court later considered the issue revised by LTV as to when a CERCLA claim arises in *In re Chateaugay Corp.*[187] However, in a subsequent matter, the district court held that withdrawal of the reference was not necessary, because a determination if a claim had been discharged was a core proceeding.[188]

Similarly, courts have also held mandatory withdrawal to apply when the issues involve (i) material consideration of OSHA and EPA occupational and health standards relating to asbestos;[189] (ii) whether CERCLA reimbursement obligations arose prior to or after the filing of the bankruptcy petition and were enjoined by the automatic stay;[190] (iii) dischargeability of cleanup costs in a

Chapter 11 proceeding;[191] (iv) prohibitory and injunctive relief as well as money damages in a complaint by the United States against the debtor;[192] (v) a motion by the debtor to enjoin and continue the automatic stay against the FAA to prevent the FAA from enforcing noise regulation orders;[193] and (vi) a proof of claim based on claims arising under CERCLA, and related questions concerning the estimation and classification of CERCLA claims.[194] Additionally, the court in *In re Commercial Oil Serv., Inc.*,[195] held that mandatory abstention, under 28 U.S.C. § 1334(c)(2), applied to a suit by the state against the debtor to enforce the state's environmental protection laws.

2. Concurrent Jurisdiction.

At least one case has recognized that a federal district court has jurisdiction to rule on issues involving bankruptcy law, environmental law on both. In *Publicker Indus. v, United States (In re Cuyahoga Equip. Corp.)*,[196] the site in question had been used to produce whiskey, industrial alcohol and a chemical solvent. After the original distiller, Publicker Industries, went out of business, it sold its operations to Overland Corporation. Later, Overland and its parent company, Cuyahoga Wrecking Corporation, filed bankruptcy and instituted bankruptcy litigation in New York against Publicker's. Thereafter the EPA filed a CERCLA action against Publicker, Overland and Cuyahoga in the Eastern District of Pennsylvania. The court addressed the issue of the apparent "collision course" between the two litigations.

The Second Circuit determined that the New York District Court had jurisdiction to approve a settlement agreement that compromised the government's CERCLA claims against the Chapter 11 debtor, despite the fact that CERCLA litigation involving the same property was pending in the Pennsylvania District Court. The court determined that the New York District Court had jurisdiction since the matter was "related to" bankruptcy, involved Section 506(c) and was a 502 claim compromised under the settlement agreement. The court also found that the New York court had CERCLA jurisdiction as well since the court was a United States District Court with exclusive original jurisdiction over all CERCLA controversies.[197]

3. Eleventh Amendment Issues.

Debtors with environmental issues regulated by state agencies now face a new uncertainty. The status of state governmental entities in bankruptcy cases is more uncertain due to the revitalization of sovereign immunity under the Eleventh Amendment in the wake of *Seminole Tribe v. Florida.*[198] The extent to which state environmental agencies are bound by the automatic stay in prosecuting fines, penalties and clean up orders against debtors, or are bound by orders entered by bankruptcy courts is now in question.

In *Seminole Tribe v. Florida*, the United States Supreme Court struck down as unconstitutional a federal law purporting to give Indian tribes standing to sue state governments in federal court for violations of the Indian Gaming Regulatory Act. The Court decided that, in most instances, Congress does not have the authority to abrogate States' Eleventh Amendment immunity from suits brought by private citizens in federal court.

Because the Court's reasoning in *Seminole Tribe* is equally applicable to any law enacted by Congress pursuant to its Article I legislative authority, including the Bankruptcy Code, it appears that state governmental entities are no longer amenable, absent consent, to suits brought by private litigants in bankruptcy courts. Justice Stevens forecasted this result in a dissenting opinion, predicting that the federal courts will no longer available as a forum for a broad range of actions against States, including, in addition to bankruptcy law, copyright and patent law, environmental law and economic regulation.

In many respects, Justice Stevens' prediction has proven accurate. Lower courts have consistently held that the Bankruptcy Clause of Article I of the Constitution does not authorize Congress to abrogate State sovereign immunity and that section 106(a) of the Bankruptcy Code is unconstitutional with respect to state governmental entities.[199] Accordingly, a majority of courts have held that absent a waiver of immunity, a bankruptcy cause of action asserted against a state entity is beyond the jurisdiction of federal courts, regardless of the nature of the relief sought.[200]

The Eleventh Amendment does not prevent state entities from consenting to be subject to suit in bankruptcy court. Sovereign immunity can be waived. However, what constitutes a waiver of state sovereign immunity in a bankruptcy case and the scope of any waivers that are deemed to have occurred is still a somewhat unsettled area.[201]

Congress attempted to clarify this issue with its 1994 amendments to section 106. Under section 106(b), as amended, it is clear that only an actually filed proof of claim will operate to waive governmental immunity, and then only with respect to a claim that arose out of the same transaction or occurrence out of which the government's claim arose.[202]

Claims asserted between the plaintiff and the state agency are considered to arise "out of the same transaction or occurrence" for purposes of section 106(b) where the claim against the state agency would be a compulsory counterclaim in an action brought by the state agency on the transaction underlying its proof of claim.[203] Although most courts treat all agencies or departments of a given state are as a single governmental unit for the purposes of section 106(b),[204] the mere fact that the opposing claims both involve agencies of a given state is an insufficient nexus to satisfy the "same transaction or occurrence" standard of section 106(b).[205]

The "same transaction or occurrence" requirement of § 106(b) was found to be satisfied where California filed a proof of claim against the debtor for unpaid tax contributions to a cleanup fund and the trustee commenced an adversary proceeding against California claiming that it was owed reimbursements from the fund.[206] Waiver of sovereign immunity has also been successfully asserted in cases where a state agency has filed a proof of claim and the debtor and/or trustee sues a state agency for damages resulting from that agency's postpetition efforts to collect that claim in violation of the automatic stay or the discharge injunction.[207] However, some courts have held that even where "the same transaction or occurrence" requirement is satisfied, waiver will not occur unless the proof of claim was filed by a state representative with authority to waive the state's sovereign immunity.[208]

Another case recently considered whether a state could file a proof of claim for remediation, fines, and penalties and object to the Bankruptcy Court's jurisdiction to approve a plan of reorganization which altered the state's rights.[209] The bankruptcy court found not only was section 106 constitutional, but alternatively the state had also waived its sovereign immunity.

One court has held that by asserting a secured claim against the debtor's estate a state entity has consented to the bankruptcy court's jurisdiction to determine the validity of both the claim and the asserted security interest.[210]

Section 106(c) provides that where the opposing claims do not arise out of the same transaction or occurrence, governmental immunity shall not prevent a party from offsetting against a claim asserted by a governmental unit, any claim by that party against the governmental unit which is property of the estate. Thus a governmental unit that has filed a proof of claim cannot assert sovereign immunity where the debtor merely seeks to offset the governmental unit's claim with its own, albeit unrelated, claim against that governmental unit. The majority view is that all agencies or departments of a given state are treated as a single governmental unit for the purposes of § 106(c).[211]

Finally, there remains the issue of whether section 106(b) & (c) are constitutional in light of *Seminole Tribe*. The Fourth Circuit and several lower courts have concluded that, while those provisions "may correctly describe those actions that, as a matter of constitutional law, constitute a state's waiver of the Eleventh Amendment, it is nevertheless not within Congress' power to abrogate such immunity by 'deeming' a waiver."[212] These courts relied on common-law waiver principles to determine whether a state has waived its sovereign immunity by participating in the bankruptcy case.[213]

One court has determined that a state entity can waive its sovereign immunity by voluntarily submitting itself to federal regulations that require it to actively participate in proceedings before a bankruptcy court.[214] In *Innes*, Kansas State University ("KSU") asserted that it was immune from a suit commenced in

bankruptcy court by a debtor to determine the dischargeability of some student loans. The student loans had been obtained through the Federal Perkins Loan Program. As a prerequisite to participation in the loan program, KSU was required to sign an agreement with the Federal Department of Education whereby it agreed to abide by certain federal regulations. The regulations required KSU to take measures to collect outstanding indebtedness on student loans including active participation in bankruptcy proceedings. The regulations required KSU to, inter alia, file proofs of claim and, where appropriate object to a debtor's discharge of his or her student loan. The court held that because KSU agreed to abide by these regulations, and KSU was expressly authorized under state law to enter into the agreement, KSU voluntarily submitted itself to the jurisdiction of the bankruptcy court. Interestingly, the opinion does not indicate whether KSU had filed a proof of claim. Whether courts will apply this same rational to states that are authorized to monitor and enforce various federal environmental laws is yet to be seen.

Another means of circumventing state sovereign immunity is by invoking the *Ex parte Young*[215] doctrine, which provides that notwithstanding state sovereign immunity, federal courts have jurisdiction over suits against state officials to obtain prospective injunctive relief from a continuing violation of federal law. The Court acknowledged the continuing vitality of the doctrine in *Seminole Tribe*, but stated that the doctrine was not available with respect to the Indian Gaming Regulatory Act because the detailed remedial provisions in that act pre-empted application of the doctrine.[216]

Several bankruptcy courts have acknowledged that the *Ex parte Young* doctrine could be applied to provide the basis for federal jurisdiction where a direct suit against the state is precluded due to state sovereign immunity. In *Koehler v. Iowa College Student Aid Commission (In re Koehler)*,[217] the court, citing *Ex parte Young*, reported that the defendant state agency did not contest the court's subject matter jurisdiction with respect to the count of the debtor's complaint seeking a declaratory judgment that the debt owed to the state agency was discharged by confirmation of the debtor's plan of reorganization. In *Schulman v. California State Water Resources Control Board (In re Lazar)*,[218] the court determined that even if the state agency had not waived sovereign immunity, the trustee could bring his claim for reimbursement of overpayments to a cleanup fund pursuant to the *Ex parte Young* doctrine.[219] The *Lazar* opinion does not explain how a claim for reimbursement of overpayments would be converted into a claim for injunctive relief envisioned by *Ex parte Young*.

The *Ex parte Young* doctrine would appear to be most applicable to prevent continuing state collection actions in violation of the automatic stay or bankruptcy discharge. State officials would risk being held in contempt of court for violating injunctions issued directly against them as defendants. At least two bankruptcy courts have concluded that 11 U.S.C. § 542, is a "statutory command" to turn-over property of the estate, akin to an injunction, which can be enforced against state

officials via the *Ex Parte Young* doctrine.[220] However, in dicta, *In re NVR L.P.*,[221] indicates that the *Ex parte Young* doctrine does not apply in the absence of the threat of a future violation of federal law. When the damage has already been done (e.g., the state has received money which it is not entitled by law to keep), the *Ex parte Young* doctrine may be of no benefit.

Seminole Tribe deals only with Congress' authority to abrogate state sovereign immunity. *Seminole Tribe* does not address the scope of unabrogated state sovereign immunity. Consider, for instance, the authority of bankruptcy courts to authorize sales of estate property free and clear of a tax lien asserted by a state taxing authority that does not consent to bankruptcy court jurisdiction or otherwise waive its sovereign immunity. Can the bankruptcy court proceed to authorize the sale, and if so, will the state be bound thereby?

The Supreme Court addressed this issue under the Bankruptcy Act in *Van Huffel v. Harkelrode*.[222] In that case, a state taxing authority asserted that its lien on real property was unaffected by a bankruptcy court directing that the property be sold free of all encumbrances with all liens attaching to the proceeds of the sale. The Supreme Court expressly rejected the taxing authority's argument that the bankruptcy court had no authority to affect the lien of a state entity. The Supreme Court reaffirmed this result in *Gardner v. New Jersey*.[223]

Because *Seminole Tribe* dealt only with Congress' authority to abrogate state sovereign immunity, *Van Huffel* and *Gardner* are still presumably viable cases.[224] Accordingly, it appears that the power of bankruptcy courts to determine the disposition of property in which a state entity claims an interest is unaffected by *Seminole Tribe*.

In a similar vein, the Fourth Circuit has determined the Chapter 11 plan confirmation process is not a suit "against one of the United States" for the purpose of the Eleventh Amendment.[225] Sovereign immunity does not prevent states entities from being bound by the terms of a confirmed plan of reorganization and sovereign immunity does not give state entities grounds to collaterally attack confirmation orders.[226]

The fact that a state has not waived its sovereign immunity by filing a proof of claim in a bankruptcy case does not deprive the bankruptcy court of jurisdiction to discharge the state's claim against the debtor on account of such failure to file a proof of claim. In *New Jersey v. Mocco*,[227] a state entity which had not filed a proof of claim moved the bankruptcy court to lift the automatic stay to enable the state to continue prosecuting its state court action against the debtor. The bankruptcy court denied the motion, determining the state's claim had been discharged on account of its failure to file a proof of claim. The state asserted that sovereign immunity prevented the bankruptcy court from discharging the state's claim. The bankruptcy court rejected this argument stating that because the state was not a defendant in the bankruptcy court, it was not entitled to Eleventh

Amendment protection.[228] The Fifth Circuit reached a similar conclusion in *Texas v. Walker*.[229] Notwithstanding *Seminole Tribe*, if a state wishes to preserve its claims against a debtor it must file a proof of claim and thereby submit the issue of the validity of the claim to the bankruptcy court.

IV. CONCLUSION

Environmental liability under CERCLA and other federal and state environmental laws and regulations can be enormous. As bankruptcies increase, the effects of that liability in a bankruptcy situation can be enormous as well. It is important, therefore, for practitioners involved with real estate transactions, workouts and bankruptcy matters to have some familiarity with environmental laws and their interaction with, and effect on, a bankruptcy.

In most instances, federal law will be applicable to the determination of the nature and scope of liability and the general rule of the federal courts is that environmental liability is strict, and that it is joint and several as to all parties unless the facts and circumstances are such that a party can establish a reasonable basis for divisibility of liability. These factors, along with the seemingly competing goals of bankruptcy and environmental laws, add up to great difficulty in handling environmental issues in bankruptcy cases.

EXHIBIT A
GLOSSARY OF BANKRUPTCY TERMS

341 MEETING: A meeting where the trustee and creditors can question the debtor about the case; presided over by the trustee in a Chapter 7 case and the United States Trustee in a Chapter 11 (§ 341; R. 2003).

2004 EXAMINATION: Court-ordered examination of any party-in-interest in a bankruptcy case (R. 2004).

ABANDONMENT: Process by which bankruptcy trustee excludes from property of the estate burdensome assets or assets of *de minimus* value (§ 554; R. 6007).

ABSOLUTE PRIORITY RULE: Requirement of plan confirmation that no junior creditor can receive a distribution unless all senior creditors are paid in full (§ 1129(b)).

ACCEPTANCE: For a creditor, an affirmative vote on the plan; for a class of creditors, an affirmative vote of two-thirds in dollar amount and more than fifty percent in number of creditors voting (§§ 1126, 1129(a)(8); R. 3018).

ADEQUATE PROTECTION: A method to protect the economic interest in collateral of a creditor during pendency of the case; automatic stay should be modified to permit creditor to proceed if debtor cannot prove creditor is adequately protected (§§ 361, 362; R. 4001).

ADMINISTRATIVE CLAIM: The ordinary and necessary expenses and debts arising in a bankruptcy case; *see* Priority (§ 503).

ADVERSARY PROCEEDING: A civil action commenced in connection with the bankruptcy case (R. 7001 *et seq.*)

AUTOMATIC STAY: Injunction arising by operation of law upon the filing of a bankruptcy case; suspends all collection efforts against the debtor (§ 362).

BEST INTEREST TEST: Plan confirmation requirement that each non-accepting creditor receive at least as much as the creditor would receive if the estate were liquidated under Chapter 7 (§ 1129(a)(7)(A)(ii)).

CASH COLLATERAL: Any of the debtor's cash, accounts receivable or proceeds in which another person has a lien; debtor cannot use cash collateral without lienholder's consent or express court authorization (§ 363(a), (b)(2)).

CLAIM: Any right to payment even if it is contingent, unliquidated or disputed (§ 101(5)).

CLASSIFICATION: The regime of creditors and equity security holders in a plan of reorganization; similarly situated creditors are typically put into the same class; dissimilar creditors in separate classes (§§ 1122, 1129).

CONFIRMATION: Court approval of a plan of reorganization; standards such as good faith, best interest of creditors, absolute priority rule, acceptance or cramdown must be met (§ 1129).

CONSUMMATION: The beginning of distributions under a confirmed plan (§ 1101(2)).

CONTESTED MATTER: Any proceeding for relief in a bankruptcy case other than pursuant to an adversary proceeding (R. 9014).

CONVERSION: Process by which debtor voluntarily (or creditors involuntarily) changes the nature of the bankruptcy case from a reorganization (Chapter 11) to a liquidation (Chapter 7) or vice versa (§§ 348, 706, 1112; R. 1017, 1019).

CORE PROCEEDING: A proceeding in a bankruptcy case where the bankruptcy judge can render a final judgment, *e.g.* a confirmation order or an order allowing a claim (28 USC §§ 157, 1334).

CRAMDOWN: Method by which debtor can alter in plan of reorganization the contractual rights of a creditor or group of creditors over such creditor's objection; must comply with absolute priority rule (§ 1129(b)).

CREDITORS' COMMITTEE: Official representative in Chapter 11 case, usually composed of seven largest unsecured creditors (§§ 1102, 1103).

DEBTOR-IN-POSSESSION or DIP: The debtor in a Chapter 11 case, acting as a trustee with respect to the debtor's assets (§§ 1101(1), 1107).

DIP FINANCING: Financing for debtor's operations in Chapter 11 case (§ 364; R. 4001(c)).

DISCHARGE: The permanent injunction obtained by an individual debtor in a Chapter 7 liquidation or any debtor in a Chapter 11 which enjoins any attempt by creditors to collect pre-bankruptcy debts; certain liabilities, like taxes and alimony are excluded from discharge (§§ 523, 524; R. 4004 *et seq.*)

DISCLOSURE STATEMENT: Prospectus-like document describing the plan and the debtor's historical and projected finances (§ 1125; R. 3016).

EQUITABLE SUBORDINATION: Concept recognized in bankruptcy pursuant to which creditor with rights *pari passu* with other creditors is accorded inferior treatment by reason of inequitable conduct (§ 510(c)).

EXAMINER: A person appointed in a Chapter 11 case to investigate the affairs and prospects of the debtor; typically has no power to control the debtor or its assets (§§ 1104, 1106).

EXCLUSIVITY: The exclusive right of the debtor in a Chapter 11 case to file a plan of reorganization during the first 120 days of the case; frequently extended several times (§ 1121).

EXECUTORY CONTRACT: A contract between the debtor and another entity pursuant to which performance is required by both parties; leases are governed by the executory contract rules (§ 365; R.6006).

EXEMPTIONS: Property which an individual debtor can exclude from property of the estate; in Texas, it includes a one-acre homestead, $60,000 of tangible personal property (head-of-household or husband and wife debtors) and certain retirement benefits (§ 522; R. 4003; Tex. Prop. Code § 42.001 *et seq.*)

FRAUDULENT TRANSFER: A transfer by a debtor for less than fair value at a time when the debtor is in financial difficulty, or a transfer by the debtor made with intent to hinder or delay a creditor (§§ 548, 549, 544; Tex. Bus. & Comm. Code 24.01 *et seq.*)

IMPAIRMENT: Any alteration in the legal rights of a creditor; only impaired creditors get to vote on a plan (§ 1124).

INVOLUNTARY or INVOLUNTARY CASE: Process by which creditors or partners force a person or entity into bankruptcy (§ 303; R. 1010-1013).

NON-CORE PROCEEDING: Proceeding related to a bankruptcy case where the bankruptcy judge prepares findings of fact and conclusions of law which must be reviewed and approved by the District Judge who enters the final order (11 USC § 157).

ORDER FOR RELIEF: Automatically entered as a matter of law upon the filing of a voluntary petition, and by the court upon the entry of an order granting relief on an involuntary petition (§§ 301, 303; R. 1002, 1004).

ORDER OF REFERENCE: WITHDRAWAL OF REFERENCE: The automatic referral to the bankruptcy court of all bankruptcy cases from the United States District Court which has original jurisdiction over all bankruptcy cases (Local Rule of U.S. District Court).

PLAN or PLAN OF REORGANIZATION: Court-approved "contract" which establishes pre-bankruptcy creditors' and shareholders' rights against debtor at conclusion of Chapter 11 (§§ 1123, 1129, 1141).

PREFERENCE: A payment to a creditor within 90 days of bankruptcy which allows the creditor to enjoy a more favorable treatment than that creditor would receive in a Chapter 7 liquidation; defenses available to recipient include ordinary course, providing subsequent new value which was not compensated, enabling loans (§§ 547, 550).

PRIORITY: The hierarchy of payment rights in a bankruptcy case; claims arising in the ordinary course of the operation of the bankruptcy case have priority over prepetition claims; other priorities in descending order include employee-related claims, certain special interest claims and tax claims (§ 507).

PROOF OF CLAIM: Court-prescribed form pursuant to which creditors establish *prima facie* validity of amount of debtor's indebtedness (§ 501; R. 3001-3008).

PROPERTY OF THE ESTATE: All tangible and intangible assets and rights of the debtor as of the commencement of the case and certain rights acquired during the case (§ 541).

REAFFIRMATION: Process by which debtor can voluntarily agree to be obligated to pay a debt that would otherwise be discharged (§ 524(c); R. 4008).

RELIEF FROM STAY: Proceeding by which protections of automatic stay are modified to permit otherwise enjoined proceedings against the debtor to proceed (usually in another forum) or to permit secured creditor to proceed against its collateral that is property of the estate (§ 362(d), (e); R. 4001(a), (d)).

REMOVAL: Process by which a state court proceeding is brought into the bankruptcy court (28 USC § 1452; R. 9027).

SALE FREE AND CLEAR: Procedure for expedited disposition of estate assets; buyer acquires property unburdened by most claims; claims attach to consideration paid (§ 363(f)).

SOLICITATION: Process by which plan-proponent (usually the debtor) obtains creditor votes on the plan (§ 1125; R. 3017, 3018).

STRONG ARM POWERS: Powers of a trustee to avoid certain kinds of liens and other transactions; trustee is given "super-creditor status" *vis-a-vis* the debtor and the debtor's other creditors and steps into the shoes of a judgment lien creditor as of the petition date (§ 544).

SUBSTANTIVE CONSOLIDATION: Process by which multiple entities' assets and liabilities are consolidated and treated as if the assets were owned and the obligations owed by a single entity.

TRUSTEE: Typically, a lawyer or accounting professional who effectively takes title to and control of the debtor's assets; always appointed in Chapter 7; replaces DIP in Chapter 11 if court so orders for cause (§§ 321-323, 701-704, 1104-1106).

UNITED STATES TRUSTEE: Government official assigned to provide administrative oversight of all bankruptcy cases (28 USC § 586).

1. 11 U.S.C. § 101 *et seq.*

2. 42 U.S.C.A. §§ 9601-9675 (1988 & Supp. 1993) ("CERCLA").

3. 11 U.S.C. § 101 *et seq.*

4. 11 U.S.C. § 502(e)(1).

5. *See In re Kent Holland Die Casting & Plating, Inc.*, 125 B.R. 493 (Bankr. W.D. Mich. 1991) (claims of a third party against the debtor were disallowed because suits brought by the EPA and the State of Michigan against the third party for violation of federal and state environmental laws were pending at the time of the third party's claim and, therefore, contingent). *See also In re Drexel Burnham Lambert Group, Inc.*, 148 B.R. 982 (Bankr. S.D.N.Y. 1992) (a case with particularly harsh § 502(e) consequences where the court acknowledged that equity is not an exception to § 502(e)).

6. *In re Bicoastal Corp.*, 141 B.R. 231 (Bankr. M.D. Fla. 1992); *In re Provincetown Boston Airlines, Inc.*, 72 B.R. at 307, 309 (Bankr. M.D. Fla. 1987).

7. *In re Wedtech I*, 85 B.R. 285, 289 (Bankr. S.D.N.Y. 1988); *Syntex Corp. v. The Charter Co. (In re The Charter Co.)*, 81 B.R. 644, 647 (M.D. Fla. 1987), *aff'd* 862 F.2d 1500, 1502 (11th Cir. 1989). *Cf. In re Provincetown Boston Airlines, Inc.*, 72 B.R. at 309 (claimant conceded that claim was for indemnification and contribution with respect to any liability which might result from a pending class action).

8. *In re Amatex*, 29 BCD 320 (Bankr. E.D. Pa. 1990); *In re The Charter Co.*, 862 F.2d at 1503.

9. 126 B.R. 919 (W.D. Pa. 1991).

10. *Id.* at 923.

11. *Id.*

12. 138 B.R. 10 (Bankr. D. Del. 1992).

13. *Id.* at 14.

14. 862 F.2d at 1500.

15. *Id.* at 1504. *See also In re Cottonwood Canyon Land Co.*, 146 B.R. 992 (Bankr. D. Colo. 1992); *In re Eagle-Picher Indus., Inc.*, 144 B.R. 765 (Bankr. S.D. Ohio 1992).

16. *In re Drexel Burnham Lambert Group, Inc.*, 23 BCD 925 (Bankr. S.D.N.Y. 1992) (settlement of a claim by a debtor's joint-tortfeasor did not eliminate the contingent nature of the claim nor remove the claimant's co-liability until the debtor's exact liability was determined; therefore, the claim was disallowed under § 502(e)(1)(B)). *See also In re Baldwin-United Corp.*, 55 B.R. 885, 890 (Bankr. S.D. Ohio 1985) (§ 502(e)(1)(B) not limited to those entities incurring contractual obligations with the debtor); *In re Provincetown-Boston Airlines, Inc.*, 72 B.R. 307, 310 (claimant found co-liable with debtor for purposes of § 502(e)(1)(B) even though liability based on an underwriting agreement and not a voluntary contractual agreement or common law principles).

17. *In re Provincetown-Boston Airlines, Inc.*, 72 B.R. at 310 (Bankr. M.D. Fla. 1987).

18. *In re Early & Daniel Indus., Inc.*, 104 B.R. 963, 967 (Bankr. S.D. Ind. 1989)(a claim for reimbursement or contribution pursuant to § 502(e)(1)(B) is contingent and therefore not allowable except to the extent that the co-debtor has actually paid the underlying claim); *see also In re Pettibone*, 110 B.R. 837, 847 (Bankr. N.D. Ill. 1990)(a contingent claim for contribution does not become allowable until the claimant pays the liability); *In re The Charter Co.*, 81 B.R. at 648, aff'd 862 F.2d 1500 (11th Cir. 1989) ("the co-debtor gains entitlement to assert reimbursement and contribution claims only to the extent the co-debtor makes these claims certain, that is, removes the third party from the debt relationship by compensating that party.").

19. 993 F.2d 915 (1st Cir. 1993).

20. *Id.* at 926.

21. *Id.* at 928.

22. *See Kahn v. Juniper Development Corp.*, Docket No. 93-187 (1993 WL 311622).

23. 144 B.R. 765 (Bankr. S.D. Ohio 1992); *aff'd*, 164 B.R. 265 (S.D. Ohio 1994).

24. 11 U.S.C. § 502(e)(2).

25. *In re Pettibone Corp.*, 110 B.R. at 846; *see Collier on Bankruptcy* ¶ 502.05 at 502-88 (15th ed. 1989).

26. 11 U.S.C. § 502(c). *In re Nova Real Estate Inv. Trust*, 23 B.R. 62 (Bankr. E.D. Va. 1982) (the language of § 502(c) is mandatory and creates an affirmative duty upon the courts to estimate claims).

27. 11 U.S.C. § 502(c).

28. *Collier on Bankruptcy* ¶ 502.03 at 502-74.

29. H. Rep. No. 95-595, 95th Cong., 1st Sess. 354 (1977); S. Rep. No. 95-989, 95th Cong., 2d Sess. 65 (1978).

30. *See In re Baldwin-United Corp.*, 55 B.R. 885, 897 (Bankr. S.D.N.Y. 1985).

31. *Bittner v. Borne Chem. Co.*, 691 F.2d 134, 135 (3d Cir. 1982).

32. *Addison v. Langston* (*In re Brints Cotton Marketing, Inc.*), 737 F.2d 1338 (5th Cir. 1984) (*quoting Collier on Bankruptcy*, ¶ 502.03 at 502-77 (15th ed. 1983)); *Bittner v. Borne Chem. Co.*, 691 F.2d 134, 135 (3d Cir. 1982).

33. *In re Bittner v. Borne Chem., Co.*, 691 F.2d 135-36 (citations omitted)

34. *In re Apex Oil Co.*, 91 B.R. 860 Bankr. E.D. Mo. 1988).

35. *Id.* at 865.

36. *In re Bittner v. Borne Chem., Co.*, 691 F.2d 134 (3d Cir. 1982); *In re Continental Airlines Corp.*, 60 B.R. 903 (Bankr. S.D. Tex. 1986).

37. *See In re Continental Airlines Corp.*, 60 B.R. 903 (Bankr. S.D. Tex. 1986).

38. *Addison v. Langston* (*In re Brints Cotton Mktg., Inc.*), 737 F.2d 1338 (5th Cir. 1984); *In re Attlebrook Properties*, 37 B.R. 338 (Bankr. D. Mass. 1983); *In re Nova Real Estate Inv. Trust*, 23 B.R. 62 (Bankr. E.D. Va. 1982) (court heard eight days of testimony regarding contingent claim to arrive at an estimate of its value); see also *In re Baldwin-United Corp.*, 55 B.R. 885 (Bankr. S.D. Ohio 1985) (rather than hold a formal trial on the merits, the court devised a procedure comparable to those used in a summary judgment hearing and set discovery deadlines).

39. *See AL Tech Specialty Steel v. Allegheny Intern. Credit*, 104 F.3d 601 (3rd Cir. 1997). The court of appeals overturned part and sustained part of a bankruptcy court's estimation of environmental claims.

40. *Collier on Bankruptcy*, ¶ 502-05 at 502-87 (15th ed. 1989).

41. *Id.*

42. *In re Nat'l Gypsum Co.*, Case No. 390-37213-SAF-11 (Bankr. N.D. Tex. July 30, 1992).

43. *Collier on Bankruptcy*, ¶ 502-05 at 502-07.

44. *Id.*

45. *Id.*

46. *Id.* at pp. 502-87 to 502-88.

47. *Id.* at p. 502-88.

48. *In re Eagle-Picher Industries, Inc.*, 197 B.R. 260 (Bankr. S.D. Ohio 1996).

49. 11 U.S.C. § 507(a)(1).

50. *In re Microfab*, 105 B.R. 161, 167 (Bankr. D. Mass. 1989).

51. *Woburn Assoc. v. Kahn* (*In re Hemingway Transport, Inc.*), 954 F.2d 11 5 (lst Cir. 1992), citing *In re Mammoth Mart, Inc.*, 536 F.2d 950, 954 (lst Cir. 1976). *See also In re Jartran, Inc.* 732 F.2d 584, 587 (7th Cir. 1984).

52. *See In re The Circle K. Corp.*, 137 B.R. 346 (Bankr. D. Ariz. 1992) (debtors may be liable for an administrative expense for environmental misconduct which occurs post-petition, but pre-petition misconduct is a pre-petition debt); *In re Great Northern Forest Prod., Inc.*, 135 B.R. 46 (Bankr. W.D. Mich. 1991) (any actual costs incurred for environmental damage caused post-petition will be entitled to an administrative expense priority); *In re Hemingway Transp., Inc.*, 73 B.R. 494 (Bankr. D. Mass. 1987)(claimant entitled to administrative expense priority for past and future response costs incurred in cleaning up the property because the costs were incurred post-petition, not that they were environmental costs). In a related proceeding in the same case, the court held that its attorneys fees would not be granted a similar priority. *In re Hemingway Transp., Inc.*, 108 B.R. 378 (Bankr. D. Mass. 1989). aff'd 126 B.R. 650 (D. Mass. 1991), *aff'd*, 954 F.2d 1 (lst Cir. 1992).

53. *See In re Snyfax Mnfg., Inc.*, 126 B.R. 30 (Bankr. D.N.J. 1990); *In re Chateaugay Corp.*, 944 F.2d 997 (2d Cir. 1991).

54. *In re Valley Steel Prod., Inc.*, 157 B.R. 442 (Bankr. E.D. Mo. 1993); *In re Heldor Indus., Inc.*, 131 B.R. 578 (Bankr. N.J. 1991); *In re Corona Plastic, Inc.*, 99 B.R. 231 (Bankr. N.J. 1989); *In re Scott Housing Sys., Inc.*, 91 B.R. 190 (Bankr. S.D. Ga. 1988); *Walsh v. West Virginia*, 70 B.R. 786 (Bankr. N.D. Cal. 1987); *In re Bourne Chemical Co.*, 54 B.R. 126 (Bankr. N.J. 1984).

55. *In re Valley Steel Prod., Inc.*, 157 B.R. 442 (Bankruptcy E.D. Mo. 1993).

56. 474 U.S. 494 (1986).

57. *Id.* at 507 n. 9.

58. *See In re Env't. Waste Control, Inc.*, 125 B.R. 546, 550 (N.D. Ind. 1991) ("a bankruptcy trustee or debtor in bankruptcy is obligated to comply with environmental laws, particularly in regards to property in its possession . . . . The law requires the debtor to take action to fulfill that obligation, regardless of its financial situation").

59. 106 S. Ct. at 758 n.2.

60. *In re MicroFab, Inc.*, 105 B.R. 152, 167 (Bankr D. Mass. 1989).

61. *In re Pierce Coal and Constr., Inc.*, 65 B.R. 521 (Bankr. N.D. W. Va. 1986); *In re T.P. Long Chem., Inc.*, 45 B.R. 278 (Bankr. N.D. Ohio 1985).

62. 125 B.R. at 504.

63. *In re MicroFab, Inc.*, 105 B.R. 152 (Bankr. D. Mass. 1989).

64. *See In re Chateauqay Corp.*, 944 F.2d 997 (2d Cir. 1991) (all cleanup costs assessed post-petition with respect to sites currently owned by debtor where there had been pre-petition release or threatened release of hazardous wastes were entitled to administrative priority); *In re Nat'l Gypsum Co.*, 139 B.R. 397 (N.D. Tex. 1992) (all response costs incurred post-petition as the result of pre-petition conduct were entitled to administrative priority under Code §§ 507 and 503(b), subject to a determination that the costs were necessitated by conditions that posed an imminent and identifiable harm to the environment and public health). *See also In re Wall Tube and Prod. Co.*, 831 F.2d 123-24 (6th Cir. 1987); *In re Stevens*, 68 B.R. 774 (D. Me. 1987); *In re Smith-Douglass, Inc.*, 856 F.2d 12., 17 (4th Cir. 1988).

65. *In re Mahoney-Troast Constr. Co.*, 189 B.R. 57 (Bankr. D.N.J. 1995); *Texaco, Inc. v. Sanders (In re Texaco, Inc.)*, 182 B.R. 937 (Bankr. S.D.N.Y. 1995).

66. 153 B.R. 729 (Bankr. E.D. Va).

67. *Id.* at 734 citing Catherine R. Heidt, *The Automatic Stay in Environmental Bankruptcies*, 67 Am-Bankr.L.J., 69, 124 (1993); *see also Department of Envtl. Resources v. Conroy*, 24 F.3d 568 (3rd Cir. 1994) (cleanup expenses plus statutory ten percent of actual costs for the state's and administrative expenses were allowed administrative expense priority).

68. *In re Security Gas v. Oil Inc.*, 70 B.R. 786 (Bankr. N.D. Cal. 1987).

69. *Id.* at 795 n.5. *See also In re Chateaugay Corp.*, 112 B.R. 513 (S.D.N.Y. 1990), *aff'd*, 944 F.2d 997 (2d Cir. 1991) (post-petition liabilities resulting from continued ownership or operations are entitled to administrative priority while those relating to pre-petition releases or threatened releases are general unsecured claims); *In re Dant and Russell, Inc.*, 853 F.2d 700

(9th Cir. 1988) (Ninth Circuit refuses to grant the administrative priority because (i) the costs of responding to the property had occurred before bankruptcy, and (ii) neither state or federal bankruptcy laws provide for such priority to claims for cleanup costs); *In re Mahoney-Troast Constr. Co.*, 189 B.R. 57 (Bankr. D.N.J. 1995); *Texaco, Inc. v. Sanders (In re Texaco, Inc.)*, 182 B.R. 937 (Bankr. S.D.N.Y. 1995). *But see In re Wall Tube & Metal Prod. Co.*, 831 F.2d 118 (6th Cir. 1987) (pre-petition release entitled to administrative priority).

70. *In re Dant & Russell, Inc.*, 853 F.2d 700 (9th Cir. 1988); *Gull Indus. v. John Mitchell, Inc. (In re Hanna)*, 168 B.R. 386 (9th Cir BAP 1994).

71. 65 B.R. 521 (Bankr. N.D. W.Va. 1986).

72. *See also Southern Ry. Co. v. Johnson Bronze Co.*, 758 F.2d 137 (3d Cir. 1985) (claim for administrative priority expenses disallowed where brought by a private purchaser of the contaminated property).

73. *But see In re Wheeling-Pittsburgh Steel Corp.*, 29 ERC 495 (Bankr. W.D. Pa. 1989).

74. *In re Wisconsin Barge Lines*, 91 B.R. 65 (Bankr. E.D. Mo. 1988), *In re Lazar*, 207 B.R. 668 (Bankr. C.D. Cal. 1997).

75. 963 F.2d 1449 (11th Cir. 1992).

76. See Ames, Kilpatrick & Salerno, *"Operate" is the Operative Word*, 11 ABI J. 8 (October 1992).

77. *Cumberland Farms, Inc. v. Florida Dept. of Environmental Protection*, 209 B.R. 786 (D. Mass. 1996).

78. 125 B.R. 546, 559 (N.D. Ind. 1991).

79. *See Resources Unlimited v. Environmental Waste Control*, 158 B.R. 998 (N.D. Ind. 1993).

80. 67 B.R. 34 (Bankr. M.D. Ala. 1986).

81. *See Env't. Waste Control*, 125 B.R. at 546 (court noted that a secured party's assertion of priority over the debtor's environmental obligations would have been stronger in the absence of imminent danger); *In re FCX, Inc.*, 93 B.R. 49 (Bankr. E.D.N.C. 1989) (court indicated that courts may not create public policy priorities).

82. *In re Guterl Specialty Steel Corp.*, 198 B.R. 128 (Bankr. W.D. Pa. 1996).

83. *In re Pierce Coal Constr., Inc.*, 65 B.R. 521 (Bankr. N.D. W.Va. 1986); *In re Distrigas Corp.*, 66 B.R. 382 (Bankr. D. Mass. 1986).

84. 45 B.R. 278 (Bankr. N.D. Ohio 1985).

85. *See also Reardon v. United States*, 947 F.2d 1309 (1st Cir. 1991) (court finds CERCLA lien provisions invalid as a denial of due process where the lien was imposed on property without notice).

86. *See In re T.P. Long Chem., Inc.*, 45 B.R. 278 (Bankr. D. Ohio 1985); *In re Charles A. Stevens*, 53 B.R. 783 (Bankr. D. Me. 1985), rev'd on other grounds, 68 B.R. 774 (D. Me. 1987).

87. 11 U.S.C. §§ 727 and 1141.

88. 11 U.S.C. § 523.

89. *See United States v. Union Scrap & Metal*, 123 B.R. 831, 838 (D. Minn. 1990).

90. 944 F.2d 997 (2d Cir. 1991).

91. *See Gull Indus. v. John Mitchell, Inc. (In re Hanna)*, 168 B.R. 386 (9th Cir. BAP 1994) and *Texaco, Inc. v. Sanders (In re Texaco, Inc.)*, 182 B.R. 937 (Bankr. S.D.N.Y. 1995).

92. 139 B.R. 397 (N.D. Tex. 1992).

93. 123 B.R. 831 (D. Minn. 1990).

94. *See Sylvester Bros- Dev. Co. v. Burlington N.R.R.*, 133 B.R. 648, 653 (D. Minn. 1991).

95. *In re Chateaugay Corp.* ("LTV"), 944 F.2d 997 (2d Cir. 1991).

96. *Id.* at 1003 (citations omitted).

97. *Id.* (citations omitted).

98. *Id.* at 1004.

99. *Id.*, citing *In re All Media Prop., Inc.*, 5 B.R. 126, 133 (Bankr. S.D. Tex. 1980), *aff'd. mem.*, 646 F.2d 193 (5th Cir. 1981).

100. 944 F.2d at 1005.

101. 139 B.R. 397 (N.D. Tex. 1992).

102. 944 F.2d 997 (2d Cir. 1991).

103. *Id.* at 408.

104. *In re Jensen*, 114 B.R. 700 (Bankr. E.D. Cal. 1990), *rev'd*, 127 B.R. 27 (Bankr. 9th Cir. 1991), *aff'd* 995 F.2d 925 (9th Cir.) (state had sufficient knowledge of debtor's potential liability to give rise to a contingent claim before debtor's bankruptcy); *NCL Corp. v. Lone Star Bldg. Centers (Eastern), Inc.*, 144 B.R. 170 (S.D. Fla. 1992) (a claimant's prepetition knowledge of potential environmental problems is evidence that the claimant "fairly contemplated" prepetition releases and that as a result these pre-petition releases constituted prepetition claims which were discharged in bankruptcy); *In the Matter of Chicago, Milwaukee, St. Paul & Pacific Railroad Co.*, 974 F.2d 775 (7th Cir. 1992) (actual response costs are not necessary for a CERCLA claim to have accrued for bankruptcy purposes, only that the claimant know that a release of a hazardous substance has occurred and that at least some CERCLA response costs are imminent); *AM Intern'l, Inc. v. DataCard Corp.*, 146 B.R. 391 (N.D. Ill. 1992) (a claim under CERCLA arises when the release of hazardous substances occurs, and that such a claim may be discharged in bankruptcy if both parties "fairly contemplated" that such a claim may arise).

105. *CMC Heartland Partners v. Union Pac. R.R. (In re Chicago, M., St.P. & Pac. R.R.)*, 78 F.3d 285, *reh'g en banc, denied* (7th Cir. 1996)(state law claims) and *In re Duplan Corp.*, 209 B.R. 324 (Bankr. S.D.N.Y. 1997)(CERCLA claims).

106. 469 U.S. 274 (1985).

107. 841 F.2d 147 (6th Cir. 1988).

108. *Id.* at 151.

109. *Kovacs*, 469 U.S. at 283.

110. *United States v. Hubler*, 117 B.R. 160 (W.D. Pa. 1990).

111. *Id.*

112. 8 F.3d 146 (3rd Cir. 1993), *cert denied* 114 S. Ct. 1576 (1994). *See also AM International, Inc. v. Datacard Corp., DBS, Inc.*, 106 F.3d 1342, 1348 (7th Cir. 1997)(adopting *Torwico* view); and *Industrial Salvage, Inc. v. State of Illinois (In re Industrial Salvage, Inc.)*, 196 B.R. 784 (Bankr. S.D. Ill. 1996) (closure order is not dischargeable where debtor retains property).

113. 966 F.2d 1143 (7th Cir. 1992).

114. 944 F.2d 997 (2d Cir. 1991).

115. *Compare In re CMC Heartland Partners*, 966 F.2d 1143 (7th Cir. 1992) (the liability of the debtor's successor under CERCLA was a claim that runs with the land and survived the debtor's bankruptcy).

116. *Industrial Salvage, Inc. v. Illinois, (In re Industrial Salvage, Inc.)*, 196 B.R. 784 (Bankr. S.D. Ill. 1996).

117. 966 F.2d 1143 (7th Cir. 1992).

118. *Id.* at 1147, citing CERCLA § 107(a)(1) and *Nurad Inc. v. William E. Hooper & Sons, Co.*, 966 F.2d 837 (4th Cir. 1992).

119. 974 F.2d 775 (7th Cir. 1992).

120. *See CMC Heartland Partners v. Union Pacific R. R. (In re Matter of Chicago, Milwaukee, St. Paul & Pacific R. R. Co.*, 3 F.3d 200 (7th Cir. 1993).

121. 124 B.R. 411 (D. Me. 1991).

122. *Id.* at 413.

123. No. 91-44 (E.D. Ky. Aug. 2. 1991).

124. *Ohio v. Kovacs*, 469 U.S. 274f 285 (1985); *In re Tinkham*, 59 B.R. 209 (Bankr. D.N.H. 1986). *Cf. Kelly v. Robinson*, 479 U.S. 36 (1986) (Chapter 7 debtor not discharged of restitution ordered as condition of probation after conviction of criminal charges pursuant to § 523(a)(7) since restitution payments benefitted penal and rehabilitative interests of the State). *But cf. Pennsylvania Dept of Public Welfare v. Davenport*, 495 U.S. 552, 110 S. Ct. 2126, 109 L.Ed.2d 588 (1990) (Chapter 13 debtor discharged of restitution obligation since S 523(a)(7) not applicable to Chapter 13 debtors).

125. 474 U.S. 494, 106 S.Ct. 755 (1986).

126. 106 S.Ct. at 758.

127. *Id.* at 759, relying on *Ottenheimer v. Whittaker*, 198 F.2d 289 (4th Cir. 1952); *In re Chicago Rapid Transit Co.*, 129 F.2d 1 (7th Cir. 1942), *cert. denied*, 317 U.S, 683 (1942); and *In re Louis Jones, Inc.*, 1 BCD 277 (Bankr. E.D. Pa. 1974).

128. 106 S. Ct. at 762 n.9.

129. *See e.g., In re MicroFab*, 105 B.R. 161 (Bankr. D. Mass. 1989) (trustee could not be prohibited from abandoning property where the alleged state law violation resulting from the proposed abandonment was merely speculative or indeterminate).

130. *See Borden, Inc. v. Wells Fargo Business Credit (In re Smith-Douglass, Inc.)*, 856 F.2d 12 (4th Cir. 1988).

131. *Id.* at 17; *see also In re FCX, Inc.*, 96 B.R. 49 (Bankr. E.D.N.C. 1989) (refusing to allow abandonment where burial of pesticides in an uncontrolled condition was found to constitute an immediate danger to the public health and there was evidence that there may have been funds to pay to remove the threat); *In re Oklahoma Ref. Co.*, 63 B.R. 562 (Bankr. W.D. Okla. 1986) (allowing abandonment of refinery if facility was in compliance with state orders, abandonment would not present an immediate threat to public health, and all available funds were cash collateral); *In re A & T Trailer Park, Inc.*, 53 B.R. 144 (Bankr. D. Wyo. 1985) (court allowed abandonment of property in non-compliance with environmental laws because no assets existed in the estate and it was "doubtful" that abandonment itself was a violation of Wyoming environmental law); *see also In re Better-Brite Plating, Inc.*, 105 B.R. 912 (Bankr. E.D. Wis. 1989), vacated on other grounds 136 B.R. 526 (Bankr. E.D. Wisc. 1990) (allowing abandonment of contaminated real property where unencumbered assets of the estate, not including uncontaminated personal property, were insufficient to cover costs of cleanup and there was no evidence of imminent harm or danger to the public).

132. *In re Smith-Douglass*, 856 F.2d 12, 15-16 (4thCir. 1988).

133. *Id.*

134. *Id.* at 16.

135. *Id.*; *see also State of New Jersey Dep't of Environ. Protection v. North American Production Accruisition Corp.*, 137 B.R. 8 (D.N.J. 1992) (court will allow abandonment of environmentally hazardous property where abandonment will not aggravate threat of harm or health and safety to public or create some additional harm); *In re Brio Ref.*, 27 ERC 1900 (N.D. Tex. 1988) (affirmed abandonment of contaminated industrial facility where hazard not discovered until after abandonment and there was no evidence that the property presented an "imminent and identifiable risk" prior to abandonment); *In re Franklin Signal Corp.*, 65 B.R. 268 (Bankr. D. Minn. 1986) (abandonment of hazardous waste drums allowed where trustee investigated substances which burdened property and

informed appropriate agencies, and drums were not impending threat to public health); *In re Oklahoma Ref, Co.*, 63 B.R. 562 (Bankr. W.D. Okla. 1986) (court allowed abandonment of refinery since no imminent harm or danger posed).

136. *In re Anthony Ferrante & Sons, Inc.*, 119 B.R. 45 (D.N.J. 1990).

137. *Id.* at 49.

138. *Id.* at 49-50.

139. *Id.* at 50.

140. *Id.*

141. *Id.* at 50-51.

142. *In re T.P. Long Chem., Inc.*, 45 B.R. 278 (Bankr. N.D. Ohio 1985).

143. *In re Commercial Oil Serv., Inc.*, 88 B.R. 126 (N.D. Ohio 1987); *In re 82 Milbar Boulevard, Inc.*, 91 B R. 213 (Bankr. E.D.N.Y. 1988); *In re Mattiace Indus, Inc.*, 73 B.R. 816 (Bankr. E.D.N.Y. 1987); *In re Charles George Land Reclamation Trust*, 30 B.R. 918 (Bankr. D. Mass. 1983). Even though the Charles George case was decided prior to Midlantiq, the issues discussed by the court are the same as those discussed in the post-Midlantic decisions. The court in *In re 82 Milbar Boulevard*, declining to deprive the debtor of the right to avail itself of bankruptcy laws, and recognizing the possibility of liability on the part of the trustee, did not dismiss the case.

144. 106 B.R. 339, 343 (Bankr. D. Me. 1989).

145. *Id.* at 343.

146. 1993 W.L. 337844 (10th Cir. September 8, 1993).

147. *In re McCrory Corp.*, 188 B.R. 763 (Bankr. S.D.N.Y. 1995).

148. 466 N.W.2d 239 (Wis. App. 1991), *aff'd* as modified, 483 N.W.2d 574 (Wisc. 1992).

149. *Tennsco Corp. v. Estey Metal Products, Inc.*, 200 B.R. 542 (D.N.J. 1996).

150. 11 U.S.C. S 362(a)(1). *Compare Overnite Trans. Co. v. Ryder/P.I.E. Nationwide, Inc.*, 137 B.R. 766 (E.D. Mo. 1992)(automatic stay provision does not apply to stay action originally commenced by the debtor for contribution under CERCLA).

151. 11 U.S.C. § 362(b)(4).

152. 688 F.2d 204 (3d Cir. 1982).

153. *Id.* at 212.

154. *Penn Terra, Ltd. v. Dept. of Envtl. Resources*, 733 F.2d 267 (3d Cir. 1984).

155. 733 F.2d at 270 (emhasis added).

156. *Id.*

157. *Id.*

158. *Id.* at 279 n.14.

159. 469 U.S. 274 (1985).

160. *Id.* at 285.

161. *Id.*

162. *In re Mateer*, 205 B.R. 915 (C.D.Ill. 1997).

163. *Word v. Commerce Oil Co.* (*In re Commerce Oil Co.*), 847 F.2d 291 (State of Tennesee allowed to proceed in action to fix liability under Water Control Act under § 1129(a)(4)); *In re Commonwealth Oil Ref, Co.*, 805 F.2d 1175, 1184 (5th Cir. 1986), *cert. denied*, 483 U.S. 1005 (1987) (requiring hazardous waste facility to file permit application or closure plan); *United States v. Wheeling-Pittsburgh Steel Corp.*, 818 F.2d 1077, 25 ERC 2017 (3d Cir. 1987) (Chapter 11 is not a permissible basis for relaxing air emissions controls mandated by the Clean Air Act); *In re Canarico Quarries Inc.*, 466 F.Supp. 1333 (D. P.R. 1979) (order requiring Chapter 11 debtor to conform with air quality regulations even though compliance required an expenditure of $323,000 for dust control equipment); *United States v. Professional Sale Corp.*, 56 B.R. 753 (Bankr. N.D. Ill. 1985) (vacating injunction obtained under § 105, which had precluded EPA from terminating operating authority of hazardous waste management facility); *In re MicroFab. Inc.*, 105 B.R. 152 (Bankr. D. Mass. 1989) (granted state's motion for relief from automatic stay to record environmental superlien based on S 362(b)(3)); *In re Lenz Oil Serv., Inc.*, 65 B.R. 292 (Bankr. N.D. Ill. 1986) (order requiring Chapter 7 debtor to undertake remedial work and order to abate public nuisance); *United States v. ILCO, Inc.*, 48 B.R. 1016 (N.D. Ala. 1985) (mandatory injunctive relief against Chapter 11 debtor to remedy environmental harms under other federal environmental acts).

164. 142 B.R. 905 (N.D. Cal. 1992).

165. *Utah Div. of Oil, Gas and Mining v. Kaiser Steel Corp.* (*In re Kaiser Steel Corp.*), 87 B.R. 662, 666 (Bankr. D. Colo. 1988).

166. *Id.* at 665.

167. *Id.* at 665-66.

168. *Id.* at 666.

169. *Id.*

170. *Thomas Solvent Co. v. Kelley* (*In re Thomas Solvent Co.*), 44 B.R. 83 (Bankr. W.D. Mich. 1984), in which an order requiring a site owner to remediate contaminated ground water was stayed on the condition that the case convert to a Chapter 7 liquidation within ninety days. The court in *United States v. Johns-Manville Sales Corp.*, 13 Envtl. L. Rep. (Envtl. L. Inst.) 20,310, 20,311 (D. N.H. 1982), held that an order requiring "the expenditure of substantial funds" was tantamount to a money judgment and, therefore, prohibited by the automatic stay. A federal district court in Colorado took a less restrictive approach to prohibiting environmental liability claims by excepting entry of a fine payable under the Clean Water Act from the automatic stay, but requiring the United States to seek collection of the fine in bankruptcy court along with the other creditors. *United States v. Standard Metals Corp.*, 49 B.R. 623 (D. Colo. 1985). This means that if any doubt exists as to the application of the automatic stay to environmental liabilities, the EPA wins. This rule is evidenced in the fact that the EPA can prosecute to fix fines, penalties, and damages but cannot collect these items in a bankruptcy context because of their pecuniary nature. *United States v. Nicolet*, 857 F.2d 202 (3d Cir. 1988); *In re Commerce Oil Co.*, 847 F.2d 291 (6th Cir. 1988); see also *New York City v. Exxon Corp.*, 112 B.R. 540 (S.D.N.Y. 1990).

171. *United States v. Mattiace Indus., Inc.*, 73 B.R. 816, 819 (E.D.N.Y. 1987).

172. *In re Chateaugay*, 118 B.R. 19, 21-22 (Bankr. S.D.N.Y. 1990). However, in a decision on a citizen's suit under the Clean Water Act, relief from the automatic stay was granted despite the inapplicability of the police power exception. *In re Wheeling-Pittsburgh Steel Corp.*, 29 ERC 1495 (Bankr. W.D. Pa. 1989).

173. 29 ERC at 1496.

174. 118 B.R. 19 (Bankr. S.D.N.Y. 1990).

175. *Id.* at 23.

176. *Id.*

177. *Id.*, citing S. Rep. No. 989, 95th Cong., 2d Sess. 52, reprinted in 1978 U.S. Code Cong. Admin. News 5787, 5838.

178. 932 F.2d 1020 (2d Cir. 1991).

179. *Id.* at 1075.

180. *Id.*

181. 154 B.R. 72 (N.D. Ill. 1993).

182. *Id.* at 74 citing *City of New York v. Exxon Corp.*, 932 F.2d 1020 (2d Cir. 1991); *United States v, Nicolet, Inc.*, 857 F.2d 202 (3d Cir. 1988); and *In re Commonwealth Oil Refining Co.*, 805 F.2d 1175, 1183-84 (5th Cir. 1986).

183. *United States v. Palm Beach Cruises, S.A.*, 204 B.R. 634 (S.D. Fla. 1996).

184. 88 B.R. 581 (S.D.N.Y. 1988).

185. *Id.* at 587.

186. *Id.* at 587-88.

187. 112 B.R. 513 (S.D.N.Y. 1990).

188. *LTV Steel Co. v. Union Carbide Corp. (In re Chateaugay Corp.)*, 193 B.R. 669 (S.D.N.Y. 1996).

189. *Hatzel & Buehler, Inc. v. Orange & Rockland Util.*, 107 B.R. 34 (D. Del. 1989).

190. *In re Johns-Manville Corp.*, 63 B.R. 600 (S.D.N.Y. 1986).

191. *Combustion Equip. Assoc., Inc. v. EPA*, 67 B.R. 709, 711 (S.D.N.Y. 1986).

192. *United States v. ILCO, Inc.*, 48 B.R. 1016 (N.D. Ala. 1985).

193. *In re Global Int'l Airways Corp.*, 48 B.R. 849 (W.D. Mo. 1985).

194. *In re Nat'l Gypsum Co.*, Civ. A. 3-91-1653-H, 1991 WL 239344 (N.D. Tex. Sept. 12, 1991). *Contra In re Envtl. Waste Control, Inc.*, 31 ERC 1462 (N.D. Ind. 1990) (federal district court refused to withdraw reference to bankruptcy court where debtor was previously found to have violated provisions of RCRA because issues to be addressed, including review of disclosure statements regarding compliance with environmental law did not call for application of environmental law).

195. 58 B.R. 311 (Bankr. N.D. Ohio 1986), *aff'd* 88 B.R. IL26 (N.D. Ohio 1987).

196. 980 F.2d 110 (2d Cir. 1992).

197. *Id.* at 115-16, citing 42 U.S.C. S 9613(b).

198. --- U.S. ---, 116 S.Ct. 1114, --- L.Ed.2d --- (1996).

199. *See, e.g., Sacred Heart Hospital v. Department of Public Welfare (In re Sacred Heart Hospital)*, 133 F.3d. 237 (3d Cir. 1998); *Matter of Estate of Fernandez*, 123 F.3d 241 (5th Cir. 1997); *Schlossberg v. Maryland (In re Creative Goldsmiths, Inc.)*, 119 F.3d 1140 (4th Cir. 1997), *cert. denied*, 118 S. Ct. 1517 (1998); *In re Martinez*, 196 B.R. 225 (D.P.R. 1996); *In re NVR L.P.*, 206 B.R. 831 (Bankr. E.D. Va. 1997).

Note that there are a handful of cases holding section 106 of the Bankruptcy Code is constitutional because the Bankruptcy Code is enforced against the states pursuant to the Fourteenth Amendment which trumps the Eleventh Amendment. *Wyoming Department of Transportation v. Straight (In re Straight)*, 209 B.R. 540 (D. Wyo. 1997); *Burke v. Georgia (In re Burke)*, 203 B.R. 493 (Bankr. S.D. Ga. 1996); *Headrick v. Georgia (In re Headrick)*, 200 B.R. 963, 967 (Bankr. S.D. Ga. 1996) (decided by same judge as *Burke*); *Mather v. Oklahoma Employment Services Commission (In re Southern Star Foods, Inc.)*, 190 B.R. 419 (Bankr. E.D. Okla. 1995). However, three circuit courts of appeal have agreed that section 106(a) was not enacted pursuant to Congress' legislative authority under the Fourteenth Amendment. *Sacred Heart Hospital v. Department of Public Welfare (In re Sacred Heart Hospital)*, 133 F.3d. 237 (3d Cir. 1998); *Matter of Estate of Fernandez*, 123 F.3d 241 (5th Cir. 1997); *Schlossberg v. Maryland (In re Creative Goldsmiths, Inc.)*, 119 F.3d 1140 (4th Cir. 1997) ("We will not presume that Congress intended to enact a law under a general Fourteenth Amendment power to remedy an unspecified violation of rights when a specific, substantive Article I power clearly enabled the law."), *cert. denied*, 118 S. Ct. 1517 (1998).

200. *See, e.g., Sacred Heart Hospital v. Department of Public Welfare (In re Sacred Heart Hospital)*, 133 F.3d 237 (3d Cir. 1998) (bankruptcy court lacked jurisdiction to enter declaratory judgment regarding whether debtor was entitled to additional time pursuant to § 108(a) to submit Medicare reimbursement claims to appropriate state agency); *Matter of Estate of Fernandez* 123 F.3d 241 (5th Cir. 1997) (bankruptcy court lacked jurisdiction to determine adversary proceeding regarding title to property where defendant state agency was one of parties claiming ownership of

property); *Schlossberg v. Maryland (In re Creative Goldsmiths, Inc.)*, 119 F.3d 1143 (4th Cir. 1997) (bankruptcy court lacked jurisdiction to determine trustee's preference complaint against state); *In re Martinez*, 196 B.R. 225 (D.P.R. 1996) (bankruptcy court lacked jurisdiction over claim against state agency for willful violation of automatic stay); *Mueller v. Idaho (In re Mueller)* 211 B.R. 737 (Bankr. D. Mont. 1997) (action to determine debtor's liability for taxes assessed by state against limited liability corporations in which debtor held ownership interest); *In re NVR, L.P.*, 206 B.R. 831 (Bankr. E.D. Va. 1997) (bankruptcy court lacked jurisdiction to enter declaratory judgment that certain postpetition transactions of Chapter 11 debtor were exempt from transfer and recordation taxes pursuant to § 1146(c)(1); noting that declaratory judgment would have *res judicata* effect in subsequent suit against state for recovery of taxes mistakenly paid). *But see, Ranstrom v. IRS (In re Ranstrom)*, 215 B.R. 454 (Bankr. N.D. Cal. 1997) (dischargeability action commenced against California Franchise Tax Board did not implicate Eleventh Amendment since no monetary or affirmative relief was sought against state); *In re Stoecker*, 202 B.R. 429, 447 (Bankr. N.D. Ill. 1996) (determination of state tax owed did not implicate Eleventh Amendment where trustee made no demand for money judgment or similar relief against state taxing authority).

201. *See AER-Aerotron, Inc. v. Texas Department of Transportation*, 104 F.3d 677 (4th Cir. 1997) (noting lack of consensus, prior to Bankruptcy Reform Act of 1994, as to what constitutes waiver of state sovereign immunity under the Bankruptcy Code).

202. *See AER-Aerotron, Inc. v. Texas Department of Transportation*, 104 F.3d 677 (4th Cir. 1997) (state's transmission of written demand for payment of claim did not operate to waive sovereign immunity under § 106(b)); *Koehler v. Iowa College Student Aid Commission (In re Koehler)*, 204 B.R. 210 (Bankr. D. Minn. 1997) (plaintiff commenced action in bankruptcy court for declaratory judgment that debt was discharged in prior Chapter 13 case and sought damages for agency's willful violation of automatic stay; agency filed counterclaim for amount owed on debt; court held that agency did not waive its immunity by filing counterclaim because it had not filed proof of claim in Chapter 13 case).

203. *United States v. Nordic Village, Inc.*, 503 U.S. 30 (1992) (interpreting pre-amendment version of § 106); *Sacred Heart Hospital v. Department of Public Welfare (In re Sacred Heart Hospital)*, 204 B.R. 132 (E.D. Pa. 1997), *aff'd*, 133 F.2d 237 (3d Cir. 1998); *Ossen v. Department of Social Services (In re Charter Oak Associates)*, 203 B.R. 17 (Bankr. D. Conn. 1996).

204. *Wyoming Department of Transportation v. Straight (In re Straight)*, 209 B.R. 540 (D. Wyo.1997); *Ossen v. Department of Social Services (In re Charter Oak Associates)*, 203 B.R. 17 (Bankr. D. Conn. 1996). *But see, In re NVR*

L.P., 206 B.R. 831 (Bankr. E.D. Va. 1997) (noting that at least one court, in a nonbankruptcy setting, has held that waiver of immunity by one state agency does not result in waiver of immunity by other agencies of the same state which are parties in the case).

205. *Sacred Heart Hospital v. Department of Public Welfare (In re Sacred Heart Hospital)*, 204 B.R. 132 (E.D. Pa. 1997), *aff'd*, 133 F.2d 237 (3d Cir. 1998) (debtor's claim against Department of Public Welfare for payment for services provided under medical assistance program did not arise out of same transaction or occurrence as proof of claim filed by Department of Revenue for unpaid taxes or proof of claim filed by Department of Labor and Industry for unreimbursed employment compensation benefits).

206. *Schulman v. California State Water Resources Control Board (In re Lazar)*, 200 B.R. 358 (Bankr. C.D. Cal. 1996).

207. *Burke v. Georgia (In re Burke)*, 203 B.R. 493 (Bankr. S.D. Ga. 1996); *Headrick v. Georgia (In re Headrick)*, 200 B.R. 963 (Bankr. S.D. Ga. 1996); *see also Wyoming Department of Transportation v. Straight (In re Straight)*, 209 B.R. 540 (D. Wyo. 1997) (proofs of claim of agencies for unpaid taxes arose out of same transaction as state's decertification of debtor's "Disadvantaged Business Enterprise" status where such decertification occurred on account of debtor's failure to pay taxes).

208. *Schlossberg v. Maryland (In re Creative Goldsmiths, Inc.)*, 119 F.3d 1140 (4th Cir. 1997); *In re NVR L.P.*, 206 B.R. 831 (Bankr. E.D. Va. 1997).

209. *In re Barrett Refining Corp.*, 1998 Bankr. Lexis 720 (Bankr. W.D.Okla. 1998).

210. *In re Fennelly*, 212 B.R. 61 (D.N.J. 1997) (state's lien was subject to avoidance under § 522(f) where state filed a proof of claim asserting secured status).

211. *See, e.g.,Ossen v. Department of Social Services (In re Charter Oak Associates)*, 203 B.R. 17 (Bankr. D. Conn. 1996) (debtor's claim against Department of Social Services could be used to offset unrelated claim of Department of Revenue Service against debtor). *But see*, *In re NVR L.P.*, 206 B.R. 831, 852 n.43 (Bankr. E.D. Va. 1997) (noting that at least one court, in a nonbankruptcy setting, has held that waiver of immunity by one state agency does not result in waiver of immunity by other agencies of the same state which are parties in the case).

212. *Schlossberg v. Maryland (In re Creative Goldsmiths, Inc.)*, 119 F.3d 1140 (4th Cir. 1997); *see Grabscheid v. Michigan Employment Security Commission (In re C.J. Rogers, Inc.)*, 212 B.R. 265 (E.D. Mich. 1997); *In re NVR L.P.*, 206 B.R. 831 (Bankr. E.D. Va. 1997)

213. *See, e.g., Grabscheid v. Michigan Employment Security Commission (In re C.J. Rogers, Inc.)*, 212 B.R. 265 (E.D. Mich. 1997); see also *Schulman v. California State Water Resources Control Board (In re Lazar)*, (determining that the State of California had made a general appearance in the bankruptcy case, by virtue of its numerous appearances before the court to protect its secured creditor status, and accordingly generally waived any Eleventh Amendment sovereign immunity claim); *In re Koehler*, 204 B.R. 210 (Bankr. D. Minn. 1997) (permitting debtor to assert its claim against the state under the "recoupment theory" of waiver for the purpose of defeating or diminishing the state's recovery on its counterclaim against the debtor).

214. *Innes v. Kansas State University (In re Innes)*, 207 B.R. 953 (Bankr. D. Kan. 1997).

215. *Ex parte Young*, 209 U.S. 123 (1908).

216. 116 S. Ct. at 1131-32.

217. 204 B.R. 210, 213 & n.1 (Bankr. D. Minn. 1997).

218. 200 B.R. 358, 382-83 (Bankr. C.D. Cal. 1996).

219. 200 B.R. 358, 383.

220. *Guiding Light Corp. v. Louisiana (In re Guiding Light Corp.)*, 213 B.R. 489 (Bankr. E.D. La. 1997) (permitting debtor to sue Secretary of Louisiana Department of Health & Hospitals for recovery of Medicaid provider payments allegedly improperly withheld from debtor); *Horwitz v. Zywiczynski (In re Zywiczynski)*, 210 B.R. 924 (Bankr. W.D.N.Y. 1997).

221. 206 B.R. 831, 843-44 (Bankr. E.D. Va. 1997).

222. 284 U.S. 225 (1931)

223. 329 U.S. 565, 578 (1947); *see also Gardner v. Pennsylvania Department of Public Welfare*, 685 F.2d 106 (3d Cir. 1982) (noting that even if Congress could not abrogate sovereign immunity, Eleventh Amendment did not prevent bankruptcy court from avoiding state's liens pursuant to section 522(f)). *But see Sacred Heart Hospital v. Department of Public Welfare (In re Sacred Heart Hospital)*, 204 B.R. 132, 139 (E.D. Pa. 1997) ("[W]hen the Eleventh Amendment is a valid defense, the type of relief at issue is unimportant."), *aff'd*, 133 F.3d 237 (3d Cir. 1998). 284 U.S. 225 (1931).

224. *See, e.g., Texas v. Walker*, No. 97-20106 (5th Cir. May 28, 1998) (stating that *Gardner* decision was not overruled by *Seminole Tribe*).

225. *Maryland v. Antonelli Creditors' Liquidating Trust*, 123 F.3d 777, 786 (4th Cir. 1997).

226. *Id.* at 786-87.

227. 206 B.R. 691 (D.N.J. 1997).

228. 206 B.R. 691, 693.

229. No. 97-20106 (5th Cir. May 28, 1998) (sovereign immunity did not preclude debtor from raising bankruptcy discharge as affirmative defense in lawsuit brought by State against debtor in state court).

BIOGRAPHY
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Hal F. Morris joined the Office of the Texas Attorney General, Dan Morales, in May, 1994 where he now supervises the team of bankruptcy attorneys responsible for all non-tax related bankruptcy matters for the State of Texas.

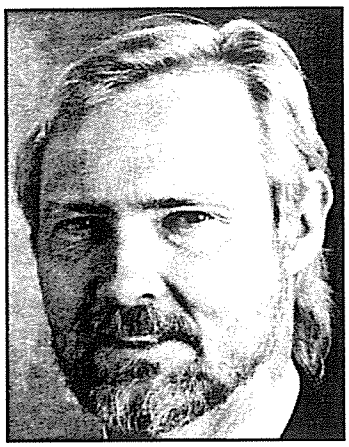
Mr. Morris specializes in environmental bankruptcy law, having begun his tenure with the Attorney General's Environmental Protection Division and later with the Natural Resources Division. His practice is devoted exclusively to bankruptcy law where he regularly represents the Texas Natural Resource Conservation Commission (Environmental), The Railroad Commission of Texas (Oil & Gas), the Public Utility Commission of Texas (Electric & Telecommunications), the Texas Department of Health, the Texas General Land Office (State Lands & Beaches), and other state agencies in matters concerning health, human safety, and the environment. Mr. Morris also represents the Consumer Protection Division, Antitrust Division, Elder Law Division, and other state agencies in non-tax related bankruptcy matters.

Mr. Morris holds five board certifications in bankruptcy law including dual certifications in both business bankruptcy law and consumer bankruptcy law firm the Texas Board of Legal Specialization in Austin, and the American Bankruptcy Board of Certification in Washington, D.C. He is also board certified by the Academy of Commercial Law Specialists in Chicago and has been a mediator since 1988. He is admitted to practice in Texas, Oklahoma, and Missouri; the United States Courts of Appeals for the 5th, 8th, 9th, and 10th Circuits, in eight United States District Courts, and the United States Supreme Court.

A graduate of Washington University, St. Louis, and the University of Missouri, he is a frequent lecturer on environmental bankruptcy law, including recent talks in San Antonio at an annual United States Trustees Seminar; at the 15th Annual University of Texas School of Law Bankruptcy Conference in Austin; and in Hamilton, Bermuda, at the Annual Conference of the National Association of Bankruptcy Trustees.

Mr. Morris's recent publications include the State Bar of Texas Environmental Law Journal article, *The Expanding Impact of Bankruptcy Law on Environmental Cases: An Introduction*, (Vol. 26, No. 3, Winter, 1996) and, *Environmental Issues for Trustees,* in the Journal of the National Association of Bankruptcy Trustees, NABTalk, Winter 1997.

Prior to his move to represent state government, Mr. Morris has been a bankruptcy partner at a 52-attorney, 111-year old law firm in west Texas.



ROBIN E. PHELAN

Robin Phelan is a partner in the Business Reorganization and Bankruptcy Section of Haynes and Boone. His practice is exclusively devoted to insolvency, reorganization and related areas, including extensive litigation in the bankruptcy court and other federal courts.

Phelan works with other Haynes and Boone attorneys to analyze the effect of bankruptcy on corporate and financial transactions. He has represented both debtors and creditors in all types of bankruptcy and insolvency proceedings ranging from sole proprietors to the Chapter 11 reorganizations of major publicly-held companies such as Zale's, LTV, Greyhound and Fruehauf. He works with clients acquiring financially troubled businesses and has acted as an operating trustee in bankruptcy cases.

Phelan is a former President and a director of the American Bankruptcy Institute, has chaired bankruptcy related committees of the American Bar Association, the State Bar of Texas, and the Dallas Bar Association and has taught Bankruptcy and Creditors' Rights at Southern Methodist University School of Law. He is a member of INSOL and the International Bar Asociation's committee on insolvency. He is a fellow of the American College of Bankruptcy and a member of the College of the State Bar of Texas. He is a frequent speaker on panels and programs throughout the United States and internationally regarding developments in bankruptcy and insolvency law and is the author of numerous publications, several relating to tax, governmental and environmental claims. He is a contributor to several major treatises on bankruptcy and has testified before both the Congressional Bankruptcy Review Commission and the Untied States Congress on insolvency matters. Phelan has recently participated in a program sponsored by the United States Department of State and the United Nations to develop model cross border insolvency provisions and participated in a White House program to improve the Unites States bankruptcy system..

Phelan earned his B.S.B.A. with a double major in accounting and finance from Ohio State University in 1967, and his law degree from Ohio State University College of Law in 1970.

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Environmental Hypothetical

It's Only Make-Believe

Jack Battle
Wade Gates
Bernice Heilbrunn
Tom Kiehnhoff

ENVIRONMENTAL HYPOTHETICAL

It's Only Make-Believe

Speakers: **Jackson Battle - Brown McCarroll & Oaks Hartline, L.L.P., Austin**
Wade Gates - BSMG Worldwide, Irving
Bernice Heilbrunn - Lyondell-Citgo Refining Company, Ltd., Houston
Tom Kiehnhoff - U.S. Attorney's Office, Beaumont

ENVIRONMENTAL HYPOTHETICAL

It's Only Make-Believe

A PROBLEM DEVELOPS

The scene: A mid-size Texas law firm.

When you arrived at your office last Monday morning, your partner, a Board member and a substantial shareholder of Little Chemical Company was waiting for you with great news: After eighteen months of intense negotiation the refining giant Slash and Burn Inc. has made an offer to acquire all of the assets of the company. Little has been teetering on the edge of insolvency for the last five years. The deal will literally save the business.

Before you can call I.M. Wright, your friend and client as well as the founder and CEO of Little, to congratulate him, the in-house attorney for Little calls you to discuss a problem that was discovered during an audit undertaken in connection with the proposed sale.

According to what in-house counsel has been told by plant managers: Non-contact cooling water at the plant normally is discharged either directly to a bayou or through an outfall regulated under both NPDES and state water quality permits or it is routed to an unlined holding pond that is designed to contain uncontaminated storm water from areas of the plant not involved in materials handling. They have the ability to pump water from the holding pond back to the non-contact water line for discharge through the bayou outfall, a system typically utilized during periods of heavy rain when the pond might otherwise overflow. However, for some time, they have had to implement other methods to cope with occasional instances in which benzene has been detected in the non-contact water lines by samples drawn from the lines or, more recently, in a few instances in which benzene odors have been detected in the vicinity of the storm water ponds. In these instances, she has been told, they have routed any such contaminated water from the non-contact water system,

including if necessary pumping from the holding pond, through the *process* wastewater system, where it is treated to permit limits prior to discharge through another state and federally-permitted outfall. Required 24-hour composite samples are collected at both the non-contact and process water outfalls.

The in-house counsel tells you that Wright was very upset when he learned that his operators had been attempting to cope with the benzene contamination problem in this manner and had instructed them to find the process leaks and fix them. However, they claim that thus far they have been unable to do so. The plant is some 70 years old, with a real spaghetti-bowl of pipes, process and non-process, that have made tracking of the problem a daunting challenge. Even more confidentially, the in-house counsel tells you that Wright is suspicious that someone inside his plant might be trying to sabotage him by diverting benzene-laden process water into the cooling water system, or directly spiking the system and/or pond with benzene.

Before she called you, the in-house counsel met with Leroy Clump, supervisor in the unit where the process contamination most likely occurred. In a brief conversation, Clump confirmed that the diversion had started over a year ago but begged-off answering any further questions because he had to deal with an upset on the unit.

In-house counsel has a courier deliver the audit file to you which includes three copies of a lab report dated six months earlier. According to the lab report, water samples collected from the holding pond at 2 p.m. on a particular day contained very high levels of benzene while samples from the same pond collected at 5 p.m. on the same day contained only trace levels. One copy of the lab report has "Dutch/FYI" written on it. "Dutch" is Wright's nickname. A second copy of the report has "wow!!!!" written in the margin next to the high benzene results. The final copy of the report

is free of any notations. In-house counsel has also reviewed the water permits for the outfalls: If waste water gathered in the composite sample at each outfall had the same level of benzene as the first sample from the holding pond, it would have to be reported as a permit violation. In-house counsel tells you that company records do not reflect that any violations of the water permits have been reported in the past year. The cost of a unit shutdown to replace all possible leaking components would likely have been a deal killer.

The timing of this problem is bad for other reasons. Residents in the community surrounding Little and the other plants in the area have blamed the plants for causing nausea, headaches, breathing problems and damage to their homes and cars. The local TNRCC office has started keeping a log of citizen complaints which has been provided to Little and the other companies in the area.

MAP ("Mad About Pollution"), a group of activists from outside the community, has scheduled a community forum to discuss the problem. Little has engaged the services of a public relations firm to assist it in presenting its interests at the forum. The consultants have reviewed the TNRCC logs and have determined that on the days residents complained most frequently about odors, the wind was blowing toward the Little plant and away from the neighborhood where the complaining residents live. In fact, using the wind data the consultants are reasonably sure that most of the odor complaints can be traced to two other plants in the area.

THE GOVERNMENT GETS INVOLVED

Unknown to Little or your firm, government investigators have been concerned about possible criminal violations at Little for some time.

John S. Nitch, a former employee at Little, has been talking to the TNRCC and the EPA for over three months. Unknown to either agency, he also contacted a local television station which agreed to videotape him while he opened the pipe carrying the contaminated waste water and released it into the holding pond. Nitch is a serious drinker with a criminal history which he concealed from Little when he was hired. Nitch's prior convictions include a five year sentence for possession of cocaine with intent to distribute. Nitch decided to embrace environmentalism after he had been disciplined for tardiness and sleeping on the job. Nitch was finally dismissed a week ago when his supervisor, Leroy Clump, smelled liquor on his breath.

Before he was fired, Nitch worked in the unit where the process contamination occurred. Nitch told government agents that process leaks in the unit were a common occurrence. Nitch has identified Clump as the person who told him how and when to divert the waste water. Nitch is poorly informed about the requirements of the company's wastewater permits, but says his suspicions were aroused when he smelled a strong odor of benzene coming off the holding pond. Nitch can't recall when the diversion began.

Nitch is willing to testify for the government, but he wants immunity.

Based on information furnished him by Nitch, the Assistant U.S. Attorney suspects that the system developed process leaks because Clump didn't maintain it. According to Nitch, the leaks had no impact on production and Clump was only concerned with keeping production at the highest possible level and at the lowest possible cost. Nitch claims that Clump bragged about the new house he was going to buy after he was promoted to plant manager. Nitch has told investigators that Clump and Wright were close friends. The Assistant has been given an article from a trade publication which discusses the history of Little and the close relationship between Clump and

Wright. The article includes comments by both Wright and Clump which are critical of the EPA and the effect environmental regulation has had on the company.

Nitch has been less cautious with his handlers at the television station. "Sweeps week" is just around the corner and the station plans to make the story about diversion of waste water at the plant, which it has tentatively titled "Crimes Against Nature," a lead on its local news broadcast for the entire week. The culmination of the report will be the video tape of Nitch opening a valve on a pipe which releases waste water into the holding pond. The station has held the tape for three months waiting for sweeps week. The lead-in to the video tape will be an interview with Nitch in which his identity and voice are disguised. During the interview, Nitch will claim that Little has also illegally buried "thousands of pounds" of hazardous waste at and near the plant.

ADDITIONAL FACTS ARE WAITING TO BE DISCOVERED

The leaks had come to the attention of the plant manager, Tom L. Ackey, a year earlier when he was told that high benzene levels had been detected in a composite sample. He ordered a resampling and called Clump into his office. Clump told him that process leaks were the likely source of benzene in the water. Tom told Clump to "solve" the problem, but didn't tell him how to solve the problem.

The storm water holding pond is visible from the parking lot used by Wright, Ackey and other employees at the plant. Benzene was detected in the holding pond when employees of the consultant hired to perform the audit collected a sample from it. The employees told their boss about the results of the analysis and he then gathered the samples analyzed in the reports found in the audit file by in-house counsel. Drafts of the audit, which included the reports found by in-house counsel, were circulated to Wright and Ackey.

A HOUSE OF CARDS IS BUILT

On the Friday before sweeps week, just four days after your meeting with Little's in-house counsel, the television station calls the local U.S. Attorney's office, the EPA and the TNRCC for comments on the story it plans to break the following Monday.

On Monday of sweeps week you get a call from in-house counsel who tells you that state and federal agents with a search warrant are at the plant. According to in-house counsel, the agents are interviewing employees and taking water samples from the holding pond. She wants to know what to do.

You call the United States Attorney's office and are directed to an AUSA who confirms that a criminal investigation is underway. At the outset of what proves to be a brief and frustrating conversation, the AUSA asks you, "Who do you represent?" You identify the company and Wright as your clients. Shortly after the conversation ends you receive a letter by fax from the AUSA which reads in part:

> "As I understand it, your firm represents the corporation, and Mr. Wright. Your firm does not claim to represent any other person in connection with this matter. As I explained, I expect that we will be sending at least two other target letters in this matter.
>
> "If you or your firm undertake to represent another target or nontarget employee in this matter I would appreciate it if you would notify me of the representation and outline the steps you have taken to secure a knowing waiver of the potential conflict of interest inherent to such multiple representation."

When your secretary brings you the fax she asks you to call Clump and Ackey. She tells you that the men called while you were on the phone with the prosecutor to say that each of them had been handed "target" letters by the agents at the search scene. The secretary described the men as

being "anxious." Clump and Ackey have testified in matters involving the company on many occasions. Your partner handled Ackey's divorce. Your secretary knows both men and tried to assure them by telling them "they didn't need to worry, we will take care of you."

The community forum is scheduled for that evening. Your public relations consultant is on the line. He wants to know about the search. He tells you he saw footage of agents entering the plant on the noon news. He chuckles and observes, "It's sweeps week, you know." He wants to know if the company still plans to feature the favorable wind data at the forum scheduled for that evening.

The agents executing the search warrant also serve a grand jury subpoena which requests, among other things: "all reports of analysis concerning water in the holding pond located at the facility." The three copies of the lab reports found by in-house counsel are in the audit file which is still sitting on your desk.

(The following advertisement was placed in the local newspaper on the Friday before sweeps week)

ILLEGAL DUMPING

The investigative team of Team 88 News has uncovered shocking information exposing a Texas Company illegally dumping cancer causing waste. A story of such magnitude Team 88 News delayed airing at the request of the Federal Government.

WATCH
"CRIME AGAINST NATURE"

MONDAY and TUESDAY
AT 6 & 10 PM

KABCK-TV
"News You Can Use"

SHOT IN THE DARK LABS, INC.

Environmental Laboratory

Dutch FYI

REPORT OF ANALYTICAL SERVICES

Sample Source: See Below
Date Collected: 2/7/98 @ 1400
2/7/98 @ 1700

P.O. Number: 4-87634
Invoice Number: 88327

Client: Little Chemical Co.
P.O. Box 1000
There, TX
Attn: Les

Collected by: Client
Report date: 2/10/98
Date received: 2/7/98
Data number: 020798-16
020798-17
Date Analyzed: See Below

Analysis Reference: *STANDARD METHODS FOR THE EXAMINATION OF WATER AND WASTEWATER*, 18TH EDITION, APHA, AWWA, WPCF, 1992

Sample Source	Benzene, mg/l
Spillover holding pond @ 1400 (020798-16)	6.972
Spillover holding pond @ 1700 (020798-17)	<0.01
Method #	602
Date:	2/8/98
Time:	2230
Analyst:	RKB

Analysis Number: 98-034-043

R. K. Bluff
Vice President

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Spillover holding pond @ 1400 (020798-16)	6.972 wow!!!!
Spillover holding pond @ 1700 (020798-17)	<0.01
Method #	602
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ENVIRONMENTAL AUDITS AND THE PROSECUTOR

Tom N. Kiehnhoff
Assistant United States Attorney
Eastern District of Texas[1]

Beginning with the investigation of a case and continuing through trial, prosecutors and law enforcement agents regularly encounter situations in which material information is protected from disclosure. The privilege against self-incrimination found in the Fifth Amendment to the United States Constitution, the Fourth Amendment's warrant requirement, and the right to legal representation guaranteed by the Sixth Amendment, one incident of which is the exchange of privileged information between attorney and client, are all examples of limits on the government's ability to compel discovery of the "truth." Environmental criminal investigations are subject to the same constitutional limits as well as other claims of privilege unique to the field.

This paper begins with a discussion of the steps taken by the EPA and Department of Justice to encourage full and voluntary disclosure of environmental violations and ends with a discussion of the self-critical analysis privilege as it may apply to information concerning environmental violations. In each discussion an effort is made to highlight issues which are unique to criminal investigations.

1. EPA AUDIT POLICY

The EPA has had an audit policy since 1986. *Environmental Auditing Policy Statement*, 51 Fed. Reg. 25004 (1986). A revised policy (Policy), which took effect on January 22, 1996, was developed to encourage "regulated entities to voluntarily discover, disclose, correct and prevent violations of federal environmental requirements." *Incentives for Self-Policing: Discovery, Disclosure, Correction and Prevention of Violations*, 60 FR 66706 (1995).[2]

On October 1, 1997, the EPA's Office of Criminal Enforcement, Forensics and Training (OCEFT) adopted a guidance document for use by the agency when a disclosure made under the Policy includes potential criminal violations (guidance document).[3] The chief purpose of the

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[1] This paper summarizes the legal research and opinions of the author and is not offered as a statement of official policy on behalf of the United States of America or any of its departments or agencies.

[2] The Policy and interpretive commentary can be found on the Web at: http://es.epa.gov/oeca/auditpol.html.

[3] The memorandum, which was written by the Director of OCEFT, is titled *Implementation of the Environmental Protection Agency's Self-Policing Policy for Disclosures Involving Potential Criminal Violations*. A copy of the memorandum, which is intended for internal guidance only, can be found on the Web at http://es.epa.gov/ocea/oceft/audpol2.html.

guidance document is to explain how the nine conditions outlined in the Policy apply to requests for relief which include potential criminal violations.

The guidance document vests authority to "receive, monitor and consider all requests for treatment under the Policy, and make recommendations to the Director of OCEFT," in matters involving potential criminal violations with the Voluntary Disclosure Board (VDB or Board). The guidance document identifies the Director of OCEFT as the Deciding Official in such cases.[4]

The Policy applies to violations discovered in connection with either an "environmental audit" or a program of "due diligence" as those terms are defined by the Policy. As discussed below, a more limited range of remedies is available for violations discovered during a self-policing activity which does not meet the definitional requirements of an "environmental audit" or a program of "due diligence."

The Policy states that the EPA will not "request or use an environmental audit report to initiate a civil or criminal investigation of the entity." 60 FR 66711. The term "environmental audit report" is defined by the Policy as "the analysis, conclusions, and recommendations resulting from an *environmental audit*." The term specifically excludes, ". . . *data obtained in, or testimonial evidence concerning, the environmental audit*." 60 FR 66711. [5] The guidance document assumes that a criminal investigation will be initiated when a disclosure involving potential criminal violations is made.[6]

If all of the requirements of the Policy are met, there is a possibility that the entity will not be referred for prosecution. 60 FR 66711.[7] There is not a similar provision in the Policy for

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[4] The VDB is located within OCEFT at EPA headquarters in Washington, D.C. The Board is chaired by the Deputy Director of OCEFT and is comprised of the Director of EPA's Criminal Investigation Division, the Director of EPA's Legal Counsel and Resource Management Division, OCEFT's Special Counsel and a representative from the Environmental Crimes Section within the Department of Justice.

[5] The following appears in the commentary which precedes the Policy: "If the Agency has independent evidence of a violation, it may seek information needed to establish the extent and nature of the problem and the degree of culpability." 60 FR 66708.

[6] The guidance document states: "Except in the rare case in which the existence and extent of criminal liability is readily apparent at the time of disclosure, the Board will instruct the SAC [Special Agent in Charge of the CID office with jurisdiction over the alleged criminal violations] to initiate a criminal investigation. During the course of the investigation, the Board will routinely monitor the progress of the investigation through the SAC, *as necessary to ensure that sufficient facts have been established to support (or oppose) a recommendation that relief under the Policy be granted.*"

[7] The following appears in the commentary which precedes the Policy: "Since the regulated entity must satisfy all of the conditions of Section D of the Policy, violations that caused serious harm or which may pose imminent and substantial endangerment to human health or the environment are not covered by this Policy." 60 FR 66707.

individuals.[8] The Policy identifies two conditions which can result in a referral for criminal prosecution for an entity which otherwise satisfies the Policy: "(i) a prevalent management philosophy or practice that concealed or condoned environmental violations; or (ii) high-level corporate officials' or managers' conscious involvement in, or willful blindness to, the violations." 60 FR 66711.

The nine conditions which must be satisfied for the benefits of the Policy to accrue are found at Section D. The guidance document offers comments on the application of the conditions to potential criminal cases.

(1) **Systematic discovery**. Under the Policy, elimination of all gravity-based penalties is limited to violations discovered as part of an environmental audit or program of due diligence as those terms are defined by the policy. A smaller reduction in gravity-based penalties (75%) is provided for violations discovered during a self-policing activity which does not meet the definitional requirements of an environmental audit or a program if the entity can satisfy the remaining specific conditions found at Section D. 60 FR 66711.

With respect to the disclosure of potential criminal conduct, the guidance document states that "any good faith disclosure *made before the official opening of a criminal investigation* may be accepted and considered by the Board."

(2) **Voluntary Discovery**. The discovery must result from the entity's own efforts to monitor its compliance. For example, the Policy would not apply to a violation "discovered" as part of a monitoring program mandated by a permit held by the entity. 60 FR 66711.

With respect monitoring data which indicates that a potential criminal violation may have occurred, the guidance document states: " . . . if an entity discovers potential criminal conduct *through a systematic review of information generated by such monitoring or sampling, and that review would not otherwise be required by law*, a disclosure may constitute a 'voluntary' discovery and be considered by the VDB."

(3) **Prompt Disclosure**. Under the Policy, the entity must fully disclose the violation in writing to the EPA within 10 days after it has discovered "that the violation has occurred, or *may have occurred*" unless a shorter time is provided by law. 60 FR 66711. [9]

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[8] "Whether or not EPA refers the regulated entity for criminal prosecution under this section, the Agency reserves the right to recommend prosecution for the criminal acts of individual managers or employees under existing policies guiding the exercise of enforcement discretion." 60 FR 66711.

[9] The following appears in the commentary which precedes the Policy: "The Agency wishes to emphasize that the integrity of federal environmental law depends upon timely and accurate reporting . . . EPA expects the Policy to encourage the kind of vigorous self-policing that will serve these objectives, and not to provide an excuse for delayed reporting . . . Where reporting within ten days is not practical because the violation is complex and

The guidance document allows for supplemental disclosures: "[W]here multi-facility or company-wide audits are being conducted and consolidated reporting is appropriate, the Board may accept supplemental disclosure as long as the initial disclosure was timely under the Policy."

(4) **Discovery and Disclosure Independent of Government or Third Party Plaintiff.** The Policy does not apply to violations reported after the entity knows or should have known that the violation has been reported by a third party, or made the subject matter of a proceeding brought by a third party or that the violation will likely be discovered or disclosed in connection with an inspection or *investigation* undertaken by a "federal, state or local agency." 60 FR 66711. [10]

The guidance document not only excludes violations reported after the "opening of a formal criminal investigation" from the scope of the Policy but also violations reported after the CID has pursued "promising investigative leads from independent sources."[11]

(5) **Correction and Remediation**. Under the Policy the entity must (1) correct the violation within 60 days, (2) certify in writing that the corrections have been made, and (3) implement any measures recommended by the EPA to remedy any "environmental or human harm due to the violation." If more time is needed the entity must notify the EPA of that fact in writing before the 60 days have elapsed. 60 FR 66711.

The guidance document states that the VDB may consult with OECA's Quick Response Team and "other EPA offices as appropriate" to determine whether this condition has been satisfied.[12] Where compliance measures are "complex," or it may take a long time to implement

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compliance cannot be determined within that period, the Agency may accept later disclosures if the circumstances do not pose a serious threat and the regulated entity meets its burden of showing that the additional time was needed to determine compliance status." 60 FR 66708.

[10] The following appears in the commentary which precedes the Policy: "This condition means that the regulated entities must have taken the initiative to find violations and promptly report them, rather than reacting to knowledge of a pending enforcement action or third-party complaint." 60 FR 66709.

[11] The guidance document states: "If a case has not been officially opened, but the SAC can demonstrate to the Board that the investigating agent was actively pursuing a promising investigative lead, the Board may determine that this condition has not been met. In making its determination, however, the Board will strictly apply CID policy that precludes more than eight hours of investigation prior to officially opening a case."

[12] The January 1997 *Audit Policy Update* (EPA 300-N-97-001) describes the function of the Quick Response Team as follows: "The QRT was formed to expeditiously, fairly, and consistently resolve nationally significant issues involving application of the Audit Policy in specific cases. Each major media enforcement program, the Department of Justice and EPA regions are represented on the QRT, which is chaired by the Office of Regulatory Enforcement within EPA's Office of Enforcement and Compliance Assistance (OECA)." The QRT has issued its own written guidance on the Policy which can be found on the Web at: http://es.inel.gov/oeca/epapolguid.html.

the remedial measures, the VDB may refer the entity to the Quick Response Team or other EPA enforcement office for entry of "an administrative consent order or judicial consent decree" to satisfy this condition.

(6) **Prevent Recurrence**. Under the Policy, the regulated entity must agree "in writing to take steps to prevent a recurrence of the violation, which may include improvements to its environmental auditing or diligence efforts." 60 FR 66711.

The guidance document states: "Disclosing entities are encouraged to provide a very detailed plan at the outset to assist the Board in the expeditious processing of disclosure requests."

(7) **No Repeat Violations**. Under the Policy, the violation (or a closely related violation) must not have occurred within the preceding three years at the same facility or within the preceding five years if the violation is part of a pattern of "federal, state or local" violations by the facility's parent organization. The term "violation" includes any violation subject to a federal or state civil judicial or administrative order, a consent agreement, or criminal conviction or plea agreement. 60 FR 66712.

The guidance document states that the VDB will not be "limited to previous criminal violations" when applying this condition.

(8) **Violations excluded**. Under both the Policy and the guidance document, certain violations are ineligible for the remedies conferred by the Policy whether or not all the other conditions of the Policy are met: "(i) [violations which] resulted in serious actual harm, or may have presented an imminent and substantial endangerment to, human health or the environment, or (ii) violate the specific terms of any judicial or administrative order, or consent agreement." 60 FR 66712.

(9). **Cooperation**. The Policy states: "Cooperation includes, at a minimum, providing all requested documents and *access to employees* and assistance in investigating the violation, any noncompliance problems related to the disclosure, and any environmental consequences related to the violations." 60 FR 66712.

The guidance document is even more specific on this point:

> "Cooperation in a criminal investigation shall include, at a minimum, access by CID Special Agents to the specific information contained in the Audit or Due Diligence Program that revealed the violation(s), access to the individuals who conducted the audit or program, access to all employees of the disclosing entity, and access to all requested documents. Such cooperation may be effected directly by the company or through counsel. Full cooperation does not require that the entity waive legitimate legal privileges available to it, but does require that any

privilege issues raised during the course of the criminal investigation be made in good faith. The Board may include in its final recommendation considerations pertaining to bad faith claims of privilege that impact the progress and result of criminal investigations."

Section H of the Policy makes it clear that the Policy was developed by the Agency "to guide settlement actions" as it relates to entities. The agency declined to make the Policy a rule. The Policy was not developed to create a privilege for information gathered during voluntary self-policing. 60 FR 66712. [13]

2. DEPARTMENT OF JUSTICE POLICY

In July, 1991, the Department of Justice publicly announced a policy to guide prosecutors when the target of an investigation has voluntarily corrected or disclosed an environmental violation, or both. *Factors in Decisions on Criminal Prosecutions For Environmental Violations in the Context of Significant Voluntary Compliance or Disclosure Efforts by the Violator.*[14]

The DOJ policy was adopted "to encourage self-auditing, self-policing and voluntary disclosure of environmental violations by the regulated community by indicating that these activities are viewed as mitigating factors in the Department's exercise of the criminal enforcement discretion."

The DOJ policy is intended to help a prosecutor decide whether or not to charge an entity or, in the case of an unincorporated business, an individual with a crime. Several factors are generally described in the DOJ policy as bearing on the prosecutor's decision: Was the disclosure voluntary? Was the disclosure timely? Was the disclosure complete? Has the defendant cooperated with the government? Was the cooperation in good faith?

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[13] Section F of the Policy includes the following: "EPA will work closely with states to encourage their adoption of policies that reflect the incentives and conditions outlined in this policy. EPA remains firmly opposed to statutory environmental audit privileges that shield evidence of environmental violations and undermine the public's right to know, *as well as to blanket immunities for violations that reflect criminal conduct*, present serious threats or actual harm to health and the environment, allow noncomplying companies to gain an economic advantage over their competitors, or reflect a repeated failure to comply with federal law." 60 FR 66712.

[14] The policy recognizes that final discretion for charging an offense rests with the prosecutor. The purpose of the policy is described as follows: "The criteria set forth above are intended only as internal guidance to Department of Justice attorneys. They are not intended to, do not, and may not be relied upon to create a right or benefit, substantive or procedural, enforceable at law by a party to litigation with the United States, nor do they in any way limit the lawful prerogatives, including civil enforcement actions, of the Department of Justice or the Environmental Protection Agency. They are provided to guide the effective use of limited enforcement resources, and do not derive from, find their basis in, nor constitute any legal requirement, whether constitutional, statutory, or otherwise, to forego or modify any enforcement action or the use of any evidentiary material."

Other factors are discussed in greater detail.

(1). **Preventative Measures and Compliance Programs.** The DOJ policy suggests that the "Attorney for the Government should consider the existence and scope of any regularized, intensive, and comprehensive environmental compliance program; such a program may include an environmental compliance or management audit." The discussion of this element emphasizes that the compliance program must be a genuine effort both designed and implemented to detect and prevent environmental violations. If a good program was in place and a violation still occurred, the DOJ policy suggests that a prosecutor should attempt to determine if the compliance policy was reviewed and corrected to eliminate any deficiencies which may have contributed to the violation.

(2). **Pervasiveness of Noncompliance.** The DOJ policy states: "In evaluating this factor, the attorney for the Department should consider, among other things, the number and level of employees participating in the unlawful activities and the obviousness, seriousness, duration, history, and frequency of noncompliance."

(3). **Internal Disciplinary Action.** The DOJ policy states: "The attorney for the Department should consider whether there was an effective system of discipline for employees who violated company environmental compliance policies."[15]

(4). **Subsequent Compliance Efforts.** The DOJ policy emphasizes the importance of timely and complete remediation. In addition the DOJ policy states: "Considerable weight should be given to prompt, good-faith efforts to reach environmental compliance agreements with federal or state authorities, or both. Full compliance with such agreements should be a factor in any decision whether to prosecute."

3. ENVIRONMENTAL AUDIT PRIVILEGE

Rule 501 of the Federal Rules of Evidence provides in part:

> "Except as otherwise required by the Constitution of the United States or provided by Act of Congress or in rules prescribed by the Supreme Court pursuant to statutory authority, the privilege of a witness, person, government, State, or political subdivision thereof shall be governed by the *principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience.*"

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[15] The issue of the discipline of individuals responsible for environmental crimes is not limited to requests for relief from monetary penalties or criminal prosecution. If an entity is charged and convicted of an environmental offense, the factors used to determine its fine will include the extent to which it has taken steps to "discipline any officer, director, employee or agent of the organization responsible for the offense." 18 U.S.C. § 3572(a)(8).

The Supreme Court has adopted a conservative approach with respect to privileges:

> "We do not create and apply an evidentiary privilege unless it promotes sufficiently important interests to outweigh the need for probative evidence. Inasmuch as testimonial exclusionary rules and privileges contravene the fundamental principle that the public has the right to every man's evidence, any such privilege must be strictly construed." *University of Pennsylvania v. EEOC*, 493 U.S. 182, 189, 110 S.Ct. 577, 582, 107 L.Ed.2d 571 (1990) (internal quotation marks and citations omitted). SEE: *In re Dinnan*, 661 F.2d 426 (5th Cir. 1981) (The Court of Appeals rejected an "academic freedom privilege" very similar to the privilege rejected by the Court in the *University of Pennsylvania* case).

The environmental audit privilege is related to what has been described as the "self-critical analysis privilege." *Bredice v. Doctor's Hospital, Inc.*, 50 F.R.D. 249 (D.D.C. 1970), aff'd 479 F.2d 920 (D.C.Cir. 1973) (qualified privilege of self-analysis for minutes of hospital meetings held to evaluate and improve clinical practices).

Proponents of the self-critical analysis privilege argue that the public has a strong interest in preserving the free flow of certain types of information and that, in the absence of a privilege, the exchange of such information will be curtailed. *Dowling v. American Hawaii Cruises, Inc.*, 971 F.2d 423, 426 (9th Cir. 1992). In the case of the environmental audit privilege this means that entities will feel free to monitor their environmental compliance and correct environmental problems without fear that the audit will be used as a road map by criminal investigators, civil inspectors or private litigants. *Louisiana Environmental Action Network, Inc. v. Evans Industries, Inc.*, 1996 WL 325588 at 2 (E.D. La.).

In can be argued that in the area of environmental enforcement the exchange of information in which the public has the greatest stake is that between a regulated entity and the government. For example, it is clear that while federal environmental law does not require an entity to engage in a specific activity which produces something called an audit, the law does, whether by permit, regulatory threshold, reporting requirement or a myriad of related obligations, require regulated entities to engage in activities the practical effect of which is to cause them monitor their environmental compliance, report violations and take steps to remedy releases or other conditions which violate a permit or other regulatory limit. The information generated as a consequence of those required activities is generally available to the government and the public.[16]

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[16] Public access to this information is not unfettered. Under both the Clean Water Act and the Clean Air Act, information otherwise available to the public can be protected if it would reveal a method or process entitled to protection as a trade secret. 33 U.S.C. § 1318(b); 42 U.S.C. § 7414(c). The fact that Congress chose to limit protection for information to trade secrets is significant when creation of a privilege is considered by the courts:

The interest of the government and the public in matters affecting the environment relates both to specific entities and to the cumulative effect of all releases. Excessive pollution has a negative impact on everything from public health to the ability of a new industry to locate in an area or for existing industry to expand.[17] Because any privilege will likely serve a narrower interest than that served by the law which gives rise to the critical self-analysis, courts may well be reluctant to recognize a self-critical analysis privilege or to use other established privileges to block the release of information when the government is requesting it.[18] *United States v. Dexter Corporation*, 132 F.R.D. 8, 10 (D. Conn. 1990); *In re Grand Jury Matter*, 147 F.R.D. 82 (E.D. Pa. 1992); *United States v. Chevron U.S.A., Inc.*, 1989 WL 121616 (E.D. Pa. 1989); *Federal Trade Commission v. T.R.W., Inc.*, 628 F.2d 207, 210 (D.C. Cir. 1980); *In re Grand Jury Proceedings*, 861 F.Supp. 386, 388-91 (D. Md. 1994).

When the request from the government is made in the course of a criminal investigation, the self-critical analysis privilege will have to be reconciled with a well-established body of case law which holds that the privilege against self incrimination guaranteed by the 5th Amendment to the United States Constitution does not apply to the records of a corporation or other "collective entity." *Braswell v. United States*, 487 U.S. 99, 104-09, 108 S.Ct. 2284, 2288-90, 101 L.Ed.2d 98 (1988); *In re Grand Jury Proceedings*, 55 F.3d 1012 (5th Cir. 1995) (The Court of Appeals adopts a multi-factor approach to determine whether a document is corporate or personal in nature). And, if an existing document is not privileged, it does not become privileged because

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"We are especially reluctant to recognize a privilege in an area when it appears Congress has considered the relevant competing concerns but has not provided the privilege itself [citation omitted]. The balancing of conflicting interests of this type is particularly a legislative function." *University of Pennsylvania*, 110 S.Ct. at 582.

[17] The following, which discusses the requirement that disclosures must be voluntary, appears in the commentary which precedes the EPA Audit Policy discussed above: "The Agency wishes to emphasize that the integrity of federal environmental law depends upon timely and accurate reporting. The public relies on timely and accurate reports from the regulated community, not only to measure compliance but to evaluate health or environmental risk and gauge progress in reducing pollutant loadings. EPA expects the policy to encourage the kind of vigorous self-policing that will serve these objectives, and not to provide an excuse for delayed reporting. Where violations of reporting requirements are voluntarily discovered, they must be promptly reported (as discussed below). Where a failure to report results in imminent and substantial endangerment or serious harm, that violation is not covered by this policy (see Condition D(8)). The policy also requires the regulated entity to prevent recurrence of the violation, to ensure that noncompliance with reporting requirements is not repeated. EPA will closely scrutinize the effect of the policy in furthering the public interest in timely and accurate reports from the regulated community. 60 FR 66708.

[18] This is not to suggest that no privileges stand between the government and corporations. For example, it is well-established that an entity can generate a body of privileged information in the course of auditing its business practices for the purpose of receiving legal advice and/or preparing for litigation. *Upjohn v. United States*, 449 U.S. 383, 389-97, 101 S.Ct. 677, 682-86, 66 L.Ed. 2d 584 (1981). Even if all the requirements of *Upjohn* are met, there are pitfalls associated with destroying the information before a judicial determination of privilege has been given, particularly when the destruction may have deviated from the corporation's document destruction policy. *McGuire v. Sigma Coatings*, 48 F.3d 902, 904 n. 4 (5th Cir. 1995).

it is transferred to an attorney for the purpose of rendering a legal opinion or giving legal advice. *Fisher v. United States*, 425 U.S. 391, 403, 96 S.Ct. 1569, 1577, 48 L.Ed.2d 39 (1976); *United States v. Robinson*, 121 F.3d 971, 974-75 (5th Cir. 1997).

The fact that the State of Texas has adopted a limited audit privilege law does not control the federal courts in federal criminal prosecutions. *United States v. Gillock*, 445 U.S. 360, 368, 100 S.Ct. 1185, 1191, 63 L.Ed.2d 454 (1980).[19]

The results are mixed when the discovery request is made by a private litigant. *Louisiana Environmental Action Network, Inc. v. Evans Industries, Inc.*, 1996 WL 325588 (E.D. La.) (Citizen suit under the Clean Water Act. The District Court held that neither the work-product privilege nor the privilege of self-critical analysis applied to memoranda which discussed an EPA inspection, the results of biomonitoring tests and the potential for litigation); *Reichhold Chemicals, Inc. v. Textron*, 157 F.R.D. 522, 527 (N.D. Fla. 1994) (The plaintiff owned land which had been contaminated by its previous owners. The court held that the self-critical analysis applied to "retrospective analyses of past conduct, practices and occurrences, and the resulting environmental consequences" which had been prepared by the plaintiff);[20] *Joiner v. Hercules, Inc.*, 169 F.R.D. 695, 699 (S.D. Ga. 1996) (Self-critical analysis privilege protects company documents used "to evaluate the company's compliance with environmental laws and regulations."); *Andritz Sprout-Bauer, Inc. v. Beazer East, Inc.*, 174 F.R.D. 609, 634-35 (M.D. Pa. 1997) (Claim of self-critical analysis privilege disregarded with respect to a request for documents prepared by environmental consultants in a case brought under CERCLA: "There is no authority before us which suggests that Pennsylvania or Virginia has adopted the self-critical analysis test. We are not persuaded that either would follow the limited number of jurisdictions which have recognized such a privilege.").

CONCLUSION

Established privileges (for example the attorney-client privilege) and agency inducements to make voluntary disclsoure will both assist and protect good faith auditing by corporations and other entities. Individuals or entities who invoke the privilege to conceal evidence of environmental harm or criminal conduct will find little solace in exisiting agency policy or the apparent trend in the courts away from expanding the self-critical analysis privilege to include environmental audits.

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[19] SEE: fn. 13. Section 5(b), Texas Environmental, Health, and Safety Audit Privilege Act.

[20] The District Judge in *Reichhold* likely would not have applied the privilege to the results of an audit of the type encouraged by the EPA Audit Policy: "This privilege in this case applies only to reports which were prepared after the fact for the purpose of candid self-evaluation and analysis of the cause and effect of past pollution, and of Riechhold's possible role, as well as other's, in contributing pollution at the site . . . this is a qualified privilege which can be overcome if one or more of the defendants can demonstrate extraordinary circumstances or special need." 157 F.R.D. at 527.

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Wade Gates, a Director in the Dallas office of BSMG Worldwide/Southwest, specializes in issues pertinent to companies in the industrial sectors. He joined the agency in 1995 to strengthen its capabilities in crisis management, risk communication, business-to-business analysis and marketing support, government and financial relations, litigation support and other areas critical to manufacturing, energy, chemical and similar industrial-based companies.

Prior to joining BSMG Worldwide/Southwest, Mr. Gates was Senior Vice President and National Director of crisis management services of a Washington, D.C.-based communication consulting firm. During his eight-year tenure with the firm, Mr. Gates served as communications counsel to numerous corporations confronted by a variety of business, environmental, marketing and legal challenges. He was also managing director of the firm's Mexico operations, encompassing counsel to multinational industrial corporations.

Mr. Gates has directed client responses to incidents and other emergencies, including:

- *Operational crises:* chemical plant explosions, facility fires, pipeline failures, and land and water transportation incidents, among others.

- *Environmental crises:* discovery of lead contamination in a school playground, PCBs in a residential neighborhood, heavy metals in a public housing development, solvents in an underground aquifer and pesticides in a community's water supply, and others.

- *Business crises:* State Attorney General and FBI investigations of wrongdoing, suicide of a chief executive during criminal inquiries, employee shootings, product recalls, large-scale layoffs and other business-related challenges.

Mr. Gates has prepared hundreds of executives for potential confrontations dealings with the news media, activist organizations and other audiences. He has conducted numerous communication training courses over the past decade, including sessions in conjunction with the University of California at Los Angeles, Instituto Tecnologico y de Estudios Superiores de Monterrey in Mexico, and the Ministries of Health and the Environment for the country of Peru.

Mr. Gates spent several years in newspaper and news wire journalism. His last position was as a Business Writer and Investigative Reporter for the *Dallas Times Herald.* He contributed to staff reports that received honors in the Pulitzer Prize and National Headliners competitions. His work has also appeared in *The New York Times*. *The Washington Post* and *Newsweek* magazine.

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Tom Kiehnhoff

Tom Kiehnhoff is an Assistant United States Attorney in the Eastern District of Texas. He prosecutes environmental crimes and other white collar offenses. He has prosecuted environmental cases involving individuals and organizations under the Clean Water Act and the Resource Conservation Recovery Act. In addition, he has prosecuted individuals under the federal wire fraud and mail fraud statutes in connection with schemes which affect the integrity of environmental enforcement programs.

In 1994, he received the Director's Award from the United States Attorney General for his work in the criminal enforcement of federal environmental laws.

Mr. Kiehnhoff has written and lectured on a variety of topics concerning environmental regulations before both governmental and private groups.

He earned his J.D., in 1975 from St. Louis University, and his B.A. in 1971 from Washington University in St. Louis, Missouri. Mr. Kiehnhoff is a member of the Colorado bar.

ENVIRONMENTAL INSURANCE COVERAGE

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ENVIRONMENTAL INSURANCE COVERAGE

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TOP 10 REASONS INSURANCE COMPANIES DON'T PAY ENVIRONMENTAL CLAIMS

By

Terrell E. Hunt
President
Risk International Services, Inc.

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10. THAT WAS A ONE-YEAR POLICY ISSUED IN 1955. IT EXPIRED 42 YEARS AGO.

- **Practice Note:** Comprehensive General Liability policies are ALWAYS IN EFFECT to cover costs of cleaning up environmental releases that occurred during policy year.
- Pollution Exclusion - 1973; "Absolute" Pollution Exclusion - 1986.
- Focus is on historical coverages, archeology.

9. THAT'S NOT AN INSURANCE POLICY; THAT'S MY FIRST GRADER'S ART PROJECT.

- **Practice Note:** If you don't have insurance documentation, find it. If you can't find it, call in an expert.
- **Practice Note:** You don't need full policy; secondary evidence is frequently enough to prove coverage and reconstruct the language of lost policies. (See Attachment 1).
- Phased approach to archeology. (See Attachment 2).
- "Trained Eye," proprietary sources, and information about underwriting practices are keys to finding sufficient policy documentation. (See Attachment 3).
- If Holocaust-era documents can be found, so can yours. (See Attachment 4).

8. **YOU'VE GOT THE WRONG CARRIER. WE'RE JUST THE AMERICAN DIVISION OF A BAHAMAS SUBSIDIARY OF A SWISS HOLDING COMPANY WHOLLY OWNED BY A BERMUDA "PARTNERSHIP" MANAGED OUT OF HONG KONG.**

- **Practice Note:** You CAN FIND the carrier.
- In periods of consolidation, the merged carrier succeeds to the liabilities of the predecessor. (Travelers now responds to Aetna's environmental claims. Zurich American is responding to Home Insurance's on-going claims; it created Risk Enterprise Management, Ltd. to run-off Home's environmental claims.)
- Even insolvent carriers may pay something: National Conferences of Insurance Guarantee Funds.

7. **DO WE KNOW YOU? WE DON'T SEE YOUR NAME ON ANY OF OUR POLICIES.**

- **Practice Note:** Real opportunity exists to recover pre-acquisition expenditures by merged subsidiaries. Start with Insurance Recovery Audit.
- Companies that have grown by acquisition succeed to the insurance rights of the predecessor company. Note stock vs. assets transactions.
- **Practice Note:** Can recover even under asset purchases, but takes some diplomacy.

6. **OUR MISSION STATEMENT STATES THAT ALL CLAIMS MUST BE DENIED FOR ONE REASON OR ANOTHER. IF THE FIRST REASON DOESN'T WORK, WE'LL FIND ANOTHER.**

- **Practice Note:** Don't be impressed by technical defenses. There is always coverage and/or a reason to settle, unless you've just lost big in litigation. (Even then!!) Insurer's defenses impact amount paid on claims, not liability itself.
- Insurance companies have defenses; they have lawyers. Be prepared to match analysis with analysis, muscle with muscle, grace with grace. (See Attachment 5).
- State-by-state law differs on pollution exclusion, owned property exclusion, number of occurrences, triggers, allocation, "as damages," "claim," etc.

5. **YOU SENT YOUR CLAIM TO THE WRONG ADDRESS. WE'RE IN NEW YORK NOW, NOT NEW JERSEY.**

- **Practice Note:** Don't settle for application of "bad" state law. Articulate ten reasons why New Jersey law applies.
- Maneuver for application of favorable law by arguing place of contracting, negotiation of contract, performance, site, and domicile, residence, place of incorporation, business of parties.
- Of these, key factors are: place of contracting, location of site, principle place of business of policyholder.

4. **IF WE DON'T OWE YOU EVERYTHING, WE DON'T OWE YOU ANYTHING.**

- **Practice Note:** Carriers have two duties: duty to defend, and duty to indemnify.
- Vastly different standards: carriers must defend as long as there is a "potential for coverage." Carriers must indemnify only where coverage is proven.
- **Practice Note:** Carriers will always shoot the volunteers. **Always involve carrier before signing up for Voluntary Cleanup Programs.**
- Change the VCP to preserves insurance rights of participants. Good public policy.

3. **MAKE ME!!**

- **Practice Note:** Do not assume that litigation is always necessary. It isn't. But be prepared to litigate to accomplish strategic objectives.
- Negotiated settlement frequently gives a better overall result than litigation: faster; less stress and less distraction; money goes to policyholder, not lawyers; long-term relationships fostered or, at least, not harmed. No risk of losing everything.
- Sometimes litigation is necessary: vest favorable jurisdiction; show toughness; thaw negotiations.

2. **POLICY LIMITS WERE IN PESOS. OUR PRINTERS DO NOT PRINT CHECKS WITH THAT MANY ZEROS AFTER A DOLLAR SIGN.**

- **Practice Note:** Most policyholders leave much money on the table by undervaluing their claim. The carriers do not point this out!!
- Your claims are larger than you think they are. Be sure to include all past costs, known future costs, and value of contingent liability assumed by policyholder upon granting release.
- Quantitative presentation, discounted to reflect bad facts or bad law.

1. **YOU DIDN'T SAY "PLEASE"**

- **Practice Note:** Speak the insurer's language. Even use their dialect, where possible.
- Present claim in manner that reflects policy language, law in the state.
- Know carrier's "run-off" philosophy, propensity to settle, decision-making structure.
- When saying "Please," be sure you are talking at the policy level.

TABLE OF ATTACHMENTS

ATTACHMENT 1: Sources of Secondary Evidence

ATTACHMENT 2: Environmental Insurance Archeology
--December 26, 1997, *Wall Street Journal*

ATTACHMENT 3: "Trained Eye" London Subscription Slip

ATTACHMENT 4: Unanticipated Applications: Insurance Archeology to Benefit Victims of Nazi Holocaust
--January 11, 1998, *New York Times*
--May 18, 1998, *New York Times*

ATTACHMENT 5: Policyholder Advocacy Memorandum

NON-PROPRIETARY SOURCES OF SECONDARY EVIDENCE OF THE EXISTENCE AND CONTENT OF LOST INSURANCE POLICIES

1. Declaration sheet of the lost policy.
2. Specimen copy of the lost policy.
3. Policy jacket for the lost policy.
4. Direct testimony of insurance agents or brokers who recall the policy.
5. Experts who will testify on the type of coverage they would have recommended the insured purchase at the time in question or on the use of standard form policy language by particular insurers during particular periods.
6. Retrospective premium reports referencing the lost policy.
7. Certificates of insurance referencing the lost policy.
8. Correspondence from the policyholder's insurance broker referencing the lost policy.
9. Invoices, cancelled checks, ledger entries, or other records indicating payment of premiums.
10. Other policies in which the lost policy might be mentioned, including umbrella and excess policies.
11. Sales and/or financing contracts or agreements where the insured might have mentioned the lost policy in its list of corporate assets.
12. Reports prepared by the insurer's claims inspector to assess the risk of providing coverage.
13. Other policies issued to the insured from the same insurer for the period immediately before or after the lost policy period.
14. The records of carriers who sold umbrella or excess coverage that was excess to the lost policy.

15. Worker's compensation files. If not in the insured's possession, a state industrial commission may have a file showing that the insurance company defended a workers' compensation claim on behalf of the policyholder.

16. London Insurance Market. Excess London insurers often maintain detailed records of underlying coverage.

17. Documentation of real estate transactions. The lost policy may have been a part of an escrow or lease agreement.

18. Line cards from the insured's broker or another entity that acquired insurance on behalf of the insured. These are records created to keep track of the policies acquired on behalf of a given insured.

19. The insurer's loss reports. Often these are kept in the carrier's automated database.

20. Premium adjustments statements. These are usually created by the accounting department of an insurance company and sent to the insured.

21. Business records and internal memoranda from the insured's files.

22. The insurer's reinsurance files, especially correspondence to the reinsurer regarding the coverage in question.

23. State insurance commissioner's files. Depending on the state and the year of the lost policy, the insurance commission might still maintain a copy of the applicable specimen policy. It also might retain copies of reports files by the insurance companies that submitted the policy to the commission for approval, or even records of premium payments.

24. Standard form policies with form numbers or policy number prefixes identical to those of the lost policy. These will need to be supported by statements from the insurer or insurance experts to the effect that the specimens accurately reflect the type of coverage provided by the lost policies.

25. Direct testimony of corporate officers, employees, agents, or auditors who recall seeing the lost policies, discussing them with the broker, asserting claims under them, etc.

Source: Thomas K. Blick, *"All Is Not Lost Even Though Your Policies Are,"* Environmental Claims Journal, Vol. 9, No. 4 at pp. 54-55 (1997).

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These Archaeologists Help Clients Solve Indemnity Crises

* * *

When Pollution-Cleanup Costs Loom, It's Time to Find That Long-Lost Policy

By LESLIE SCISM
Staff Reporter of THE WALL STREET JOURNAL

EAU CLAIRE, Wis. — Not many people besides exterminators measure their professional success by the number of basement crawl spaces they have seen.

But for an emerging number of "insurance archaeologists," success hinges on their ability to uncover old insurance policies tucked away in such dank quarters. It isn't that these documents are of interest to museums or historical societies, or even to the insurers that issued them. In fact, many insurers would rather the paper stay where it is.

But the policies are of potentially enormous value to the archaeologists' patrons: companies accused of polluting the environment. While most insurers have specifically excluded pollution damage in liability policies sold since 1986, policyholders facing cleanup litigation have figured out that one way to recoup some of their expenses is to make claims under old policies.

Long Life

Unlike the homeowner's and automobile insurance policies that most people are familiar with, liability policies sold to businesses — especially those written several decades ago — sometimes allow for claims to be filed years later, provided that the problem for which coverage is sought occurred when the policy was in force. That means, for example, that if a manufacturer dumped pollutants into a stream, the old policy might help pay for litigation and cleanup costs.

The only glitch: Because companies didn't face pollution lawsuits years ago, and didn't expect they would ever need the old policies, many were lax about preserving their insurance proof.

"All I'm ever hoping is to find a box of old records somewhere that was never thrown out," says David O'Neill, who has been spending much of his time recently searching for policies that could help Browning-Ferris Industries Inc. The giant waste-management company, facing dozens of Superfund cleanup efforts, is a big client of Mr. O'Neill's employer, Risk International Services Inc. of Houston, which has a team of 17 insurance archaeologists.

A Small Jackpot

Mr. O'Neill and two colleagues have journeyed to this Wisconsin town to meet with a dozen former trash haulers whose businesses were acquired by Houston-based Browning-Ferris. The hope is that some of these haulers possess old records that Browning-Ferris failed to obtain earlier.

Mr. O'Neill arrives in Eau Claire to find that the other two archaeologists already have uncovered a small jackpot: One trash hauler has presented them with a two-inch stack of pre-1986 policies whose limits total at least $2.5 million.

Insurance archaeologists say their sleuthing has identified tens of billions of dollars in potential coverage already — though none will say how much money, exactly, has actually been recovered from insurers as a result of their work. Terrell E. Hunt, president of Risk International, says insurers generally pay out anywhere from 35 cents to 75 cents for each $1 of a claim's value.

"They won't pay 100 cents on the dollar," he says. "If nothing else, they'll argue late notice. . . . But ultimately, the carrier will want to walk away from this problem, and the policyholder gains some significant relief."

David Pratt, a senior vice president with the American Insurance Association, an industry trade group, disputes the archaeologists' claim that old policies are a gold mine, and notes that the industry has some solid legal defenses that could beat back claims. Still, he notes that insurers are inclined to buy back old policies at less than face value "rather than go through full-blown coverage litigation about exactly what they might cover."

Possible new sources of business for archaeologists include hunting for old life-insurance policies of Holocaust victims and property and liability coverages for Cuban exiles.

The search for old policies can take archaeologists into some pretty hairy territory: Sheila Mulrennan, head of Insurance Archaeology Group in New York, says one assignment brought her staffers face-to-face with copperhead snakes; another time, her team had to wear protective gear from head to toe to view records that had been exposed to radon and were radioactive.

Full of Disappointments

But the business is full of disappointments. On this afternoon in nearby Rice Lake, Wis., Mr. O'Neill and his fellow investigators are visiting Bear Paw Co., a huge combination sporting-goods store and museum of stuffed animals collected by former trash hauler Gerald Curtis. Mr. Curtis already has hunted, unsuccessfully, for old insurance policies, fretting that he, and not just Browning-Ferris, could be named in potential litigation involving the cleanup of a local landfill.

Of particular interest are records relating to a business run by two of Mr. Curtis's uncles that was merged into Mr.Curtis's operations in 1985. But he suspects the records were destroyed years ago.

On a more promising note, Mr. Curtis is able to give the archaeologists several leads, including details of an on-the-job vehicle accident involving one of the uncles. The incident probably generated an insurance claim, which may be noted in police files or in the records of the lawyer who handled the uncle's claim. "The question is where to start," Mr. O'Neill says afterward.

The Pack Rat

Next on the day's schedule: a visit with Victor Spickler, who sold his Spickler Garbage Service to Browning-Ferris in 1991. Hopes for a big cache of documents are high because the archaeologists have heard that Mr. Spickler, whose home formerly housed his trash business, was something of a pack rat.

But Mr. Spickler has a surprise for them. "Price of scrap paper was really up a few years ago, and we did clean up everything and get rid of all we could," Mr. Spickler says, leaning back in his lounger chair in a living room cramped with shelves housing a big figurine collection.

"Oh, that was very efficient of you," Mr. O'Neill responds, maintaining his professional courtesy.

Later, Mr. O'Neill moans, "I can't believe they turned in the records to use as scrap paper."

But on reflection, he adds: "We're the absurd ones, showing up 20 years later asking if they kept old insurance policies that to them have no value."

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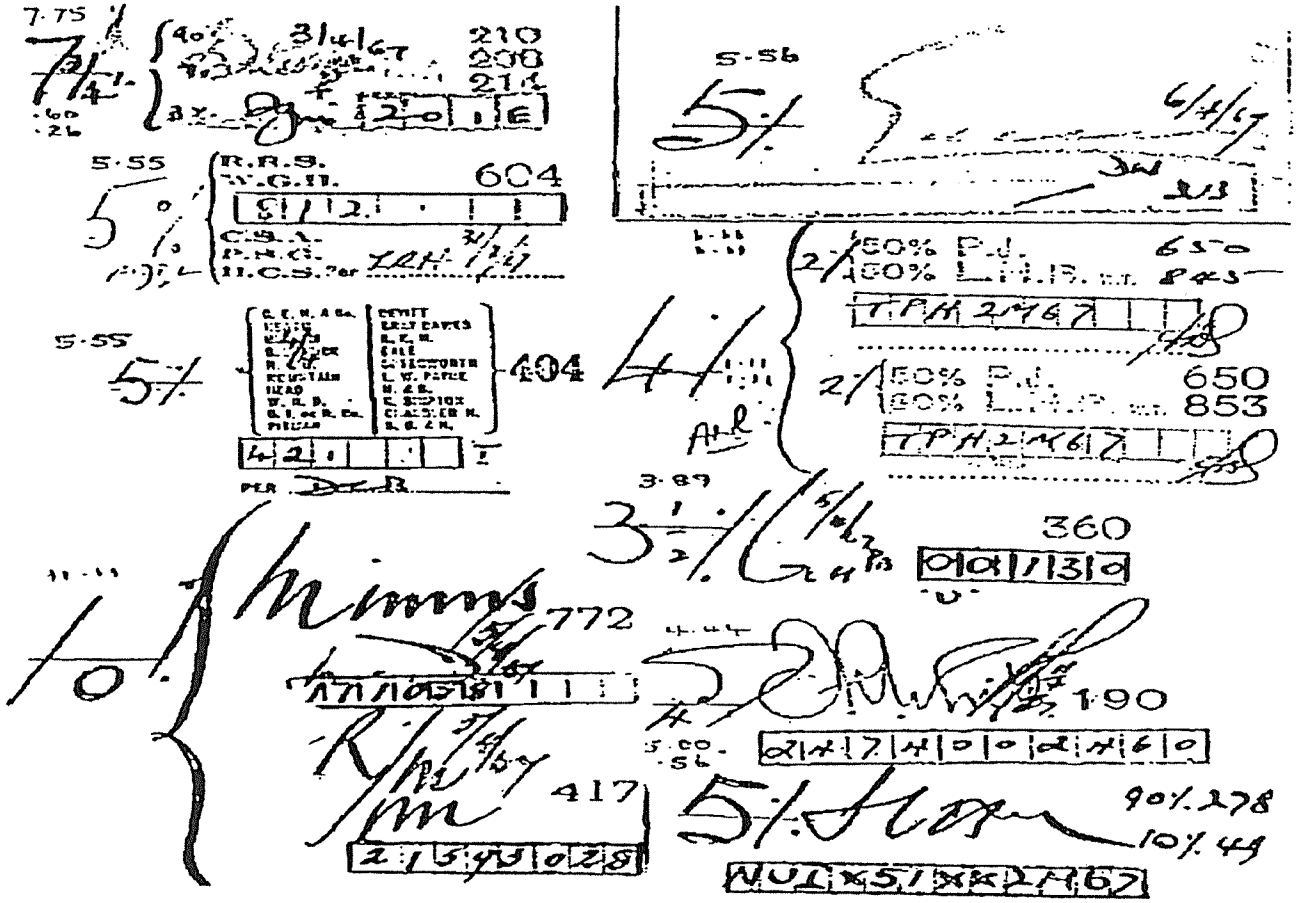
Insurance Archeology

Trained Eye



Risk International

ATTACHMENT 4

The New York Times

No. 51,034 SUNDAY, JANUARY 11, 1998

8 Y THE NEW YORK TIMES INTERNATIONAL SUNDAY, JANUARY

Archives Yield Aid for Claims On Holocaust

Insurance Is Linked To Funds for Nazis

By DAVID CAY JOHNSTON.

After World War II, Holocaust survivors and relatives of victims pressed insurance claims against German and Italian companies, which denied many of them because the claimants lacked death certificates, policy numbers or other documentation.

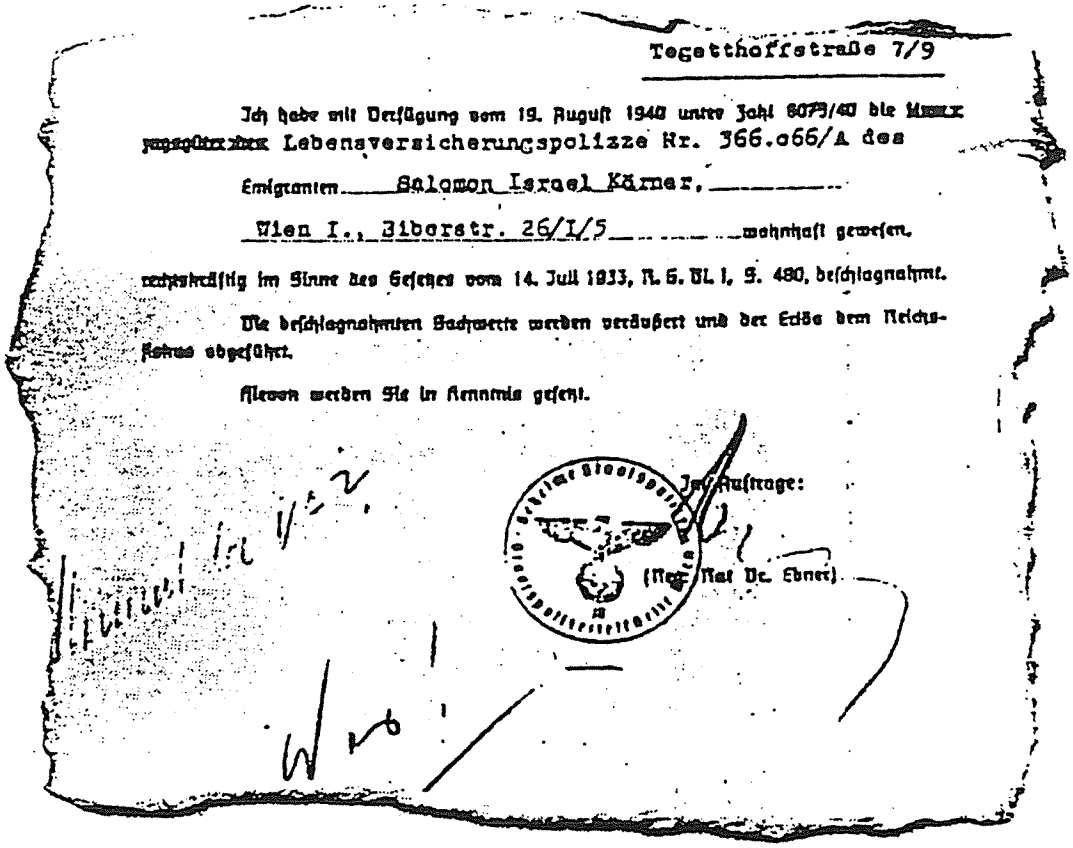
But now researchers have recovered from government and private archives documents that strengthen those claims and show how the top executives of the biggest German insurance company, Allianz AG, worked closely with the Third Reich to seize policies owned by Jews, to expand Allianz's business in conquered countries and to limit claims from riots the Nazis orchestrated to destroy Jews' property.

The most significant document found, experts say, is a single copy of an Austrian State Police report, a fill-in-the-blanks form that is so apparently banal that researchers initially did not appreciate its significance, said Terrell E. Hunt, president of Risk International, a Houston company that does insurance research.

The 1940 document directs the Italian subsidiary of Allianz to turn over to the Reich Treasury the proceeds of a life insurance policy owned by Salomon Israel Körner of Vienna.

Mr. Hunt said the numbering on the document suggests that it was one of tens of thousands of such documents in the files of the state police in Austria, which was occupied by Nazi Germany's armed forces in March 1938 and incorporated into the German Reich. He believes these seizure documents have been preserved in archives.

"This document is the key for hundreds of thousands of people to make claims," Mr. Hunt said. "Its significance is that it is a standard form on which the Nazis listed the name and address of the insured, the insurance company and the policy number, which are the details needed to make a claim."



Tegetthoffstraße 7/9

Ich habe mit Verfügung vom 19. August 1940 unter Zahl 6079/40 die [illegible] Lebensversicherungspolizze Nr. 366.066/A des

Emigranten Salomon Israel Körner,

Wien I., Biberstr. 26/I/5 wohnhaft gewesen,

rechtskräftig im Sinne des Gesetzes vom 14. Juli 1933, R. G. Bl. I, S. 480, beschlagnahmt.

Die beschlagnahmten Sachwerte werden veräußert und der Erlös dem Reichsfiskus abgeführt.

Hiervon werden Sie in Kenntnis gesetzt.

Im Auftrage:

(Reg. Rat Dr. Ebner)

A 1940 Austrian State Police report directs an insurance company to turn over funds to the Nazis.

Under a 1933 German law, the property of Jews who emigrated was confiscated. Jews who were forcibly deported to death camps were considered emigrants under that law.

The document is addressed to the "management office for the German Reich" in the Vienna office of Riunione Adriatica di Sicurta, the Italian subsidiary of Allianz, indicating that the Nazis had their own personnel in the offices of major insurers.

Linda Gerstel, a partner at Anderson Kill & Olick, a New York insurance litigation firm working on a suit by Holocaust survivors and heirs of victims against Allianz and 14 other German and Italian insurers, said the document suggests that the Allianz subsidiary acted in bad faith, violating its duty of loyalty to its policyholder.

She said that even under the 1933 German law, the insurance company had a duty to inquire into whether Mr. Körner had indeed emigrated or was entitled to payment.

Douglas L. Talley, a Risk International lawyer, said that other documents the company had gathered from war archives show that rather than simply following orders from the Third Reich, there was "a formal collusion" between financial institutions and the Nazi Government to loot assets.

Risk International has been donating its services, but Mr. Hunt said the firm needed to find a paying client to continue its work because of the volume of documents that need to be examined and catalogued to make claims. The significance of the document was disputed by the senior spokesman for Allianz, Emilio Galli-Zugaro. He confirmed that tens of thousands of similar documents exist, but he said reparations the German Government made to Holocaust survivors and victims' relatives after the war settled all claims.

"During the war it was normal — it is horrifying to say that now, but it was normal procedure then — to seize the insurance policies of Jews and give them to the Nazis," Mr. Galli-Zugaro said in a telephone interview from Rome.

"All survivors, of which there were not very many, and their heirs and those who could benefit collected their money back to then" from the German Government, he said.

"Until this lawsuit was filed in New York last year, which hit us quite unexpectedly, we had not had a claim made in 20 years."

He said 1,800 people had called a toll-free hot line Allianz set up, but that only 200 had valid claims.

The lawyer who filed the case, Edward D. Fagan of New York, said, "The suggestion that these people were paid by the German Government is just preposterous."

He said that Allianz and other insurers controlled the information needed to pay claims and relied on technicalities to deny payment or to pay less than was owed.

Mr. Fagan and Ms. Gerstel are seeking a Federal court order requiring Allianz and other insurers to open their files to them.

Allianz and most of the other 14 insurance companies named in the lawsuit have operations in the United States, which may make them subject to American courts. Allianz owns Firemen's Fund, a major property and casualty insurer, a Minnesota life insurance company that uses the Allianz name, as well as the Jefferson and Monticello insurance companies in New York.

Top Allianz executives who became senior officials in the Nazi Government were interrogated by American investigators after the war.

The New York Times

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Top Allianz executives who became senior officials in the Nazi Government were interrogated by American investigators after the war.

They described courting Nazi officials beginning in 1932 and making political contributions to the Nazis. Kurt Schmitt, who was the chief executive of Allianz in the early 1930's, became Hitler's first Minister of Economics, dined frequently with Hitler and his top aides and wore an SS uniform, the statements show.

Another Allianz executive, Eduard Hilgard, told how he worked as a top Allianz executive and as head of the 11th industrial group of the Third Reich, which oversaw insurance companies.

He also told how he helped German insurance companies settle claims for only 3 cents on the dollar from Kristallnacht, the night of Nov. 8-9, 1938, when Hitler's Government allowed gangs of Nazis to rampage across the country killing and arresting Jews, and burning synagogues and Jewish-owned businesses. The money was paid to the Reich treasury, not the shopkeepers, but by discounting the claims the insurers saved as much as $19 million, his statement showed.

When the Nazis conquered a country the assets of local insurance companies were taken over by Allianz and other German insurance companies and by Assicurazioni Generali, an Italian insurance company, a recently declassified report by American economic intelligence experts stated.

Mr. Galli-Zugaro said "there is no question" that Allianz sought to profit from the war, but he said the company never sought to profit from the Holocaust.

The New York Times

THE NEW YORK TIMES **INTERNATIONAL** MONDAY, MAY 18, 1998

Insurers Swindled Jews, Nazi Files Show

By CHRISTOPHER S. WREN

In an outburst of anti-Semitic violence that presaged the Holocaust, mobs incited by the Nazis rampaged through Berlin and other German cities on Nov. 9 and 10, 1938, smashing and torching an estimated 171 synagogues and thousands of Jewish shops and homes.

Nearly 60 years later, fresh details surrounding Kristallnacht, or "night of broken glass," have been extracted from Government archives in Moscow that have been storing Nazi documents seized by Soviet troops in 1945.

The Nazi Government was known to have confiscated insurance payments to Jews whose property was damaged in Kristallnacht. But the newly unearthed documents suggest that German insurance companies not only connived with the Nazis to avoid paying Jewish policyholders, but also sometimes exceeded Government guidelines and canceled unrelated life, health and pension policies on which Jews had been paying premiums for years.

Some of the documents are to be presented today at a hearing in Manhattan scheduled by the New York State Senate Insurance Committee. The panel, headed by Guy J. Velella, Republican of the Bronx, is considering legislation that would penalize European insurers who do business in New York if they failed to pay claims related to the Holocaust.

The documents, which abound with anti-Jewish slurs, include a confidential industry estimate that at least 19 of the 43 German fire insurance companies stood to suffer losses for the year if they fulfilled their obligations to Jewish policyholders for Kristallnacht. That contradicts an assertion of some German insurers that they did not profit from the Holocaust.

An agreement reached last month commits four European insurers, including the Allianz of Munich, the world's second-largest insurance company, to open their books to an international tribunal and help expedite the claims of people whose policies were seized or not honored.

Many insurers mentioned in the documents no longer exist. Allianz is cited in the industry estimate as one of the 19 companies that could expect to lose money, but does not appear elsewhere. Company officials did not respond to requests for comment.

The Nazi documents, found in February and April, remain stored in Moscow. Photocopies of some excerpts were made available by Risk International Services Inc. of Houston, a company that specializes in "insurance archeology" by searching repositories, from archives to attics, to retrieve lost insurance documents and determine their significance.

The vice president and counsel of Risk International, Douglas L. Talley, said although the research was preliminary, the documents indicate how the Nazis, with the German insurance industry's complicity, established the practice of confiscating the insurance assets of German Jews. Mr. Talley found some of the documents in Moscow in a Nazi folder marked "Insurance Affairs — Jewish Questions."

Some companies exceeded German guidelines in canceling policies.

According to William L. Shirer's "Rise and Fall of the Third Reich," after the Kristallnacht riots, three Nazi leaders — Hermann Göring, Josef Goebbels and Reinhard Heydrich — met with an Allianz executive who represented the German insurance industry, Eduard Hilgard. Mr. Hilgard told them that confidence in the industry would suffer if Jewish claimants were not paid, but that reimbursing them could bankrupt smaller companies.

After the war Mr. Hilgard told Allied interrogators that he had helped the companies settle Kristallnacht claims at 3 cents to the dollar.

Foreign and non-Jewish claims were paid, but Field Marshal Göring confiscated the money due Jewish policyholders. In a document dated Nov. 29, 1938, the Nova insurance company informed insurance regulators that in keeping with the confiscation order, "Jewish members of the cooperative are excluded" from receiving benefits.

In a letter dated Nov. 17, 1938, the Isar Life Insurance Stock Company said that so many Jewish clients were desperately trying to cash in their policies "that the worst fears have to be asserted for the further existence of our company." Isar asked the Government's Oversight Office for permission to deny payment or to convert policies owned by Jews to nonredeemable status.

The Economic Ministry initially balked at letting insurance companies exploit Göring's confiscation of reimbursements for Kristallnacht as a pretext for not honoring other Jewish claims. On Nov. 21, 1938, a ministry official reminded insurers that the order affected "only the insurance claims confiscated from Jews of German citizenship for the benefit of the Reich, which came due because of the events of Nov. 8, 9 and 10, 1938."

"Other insurance claims, for example, life insurance, etc., are not affected," the official wrote. "Please communicate this to the companies involved."

Other documents to be released today suggest how swiftly some companies moved to cancel life, health and pension benefits of their Jewish customers after Kristallnacht A letter from a representative of a group of health insurers dated Nov. 14, 1938, said, "To the extent insurance conditions permitted, Jewish insured were canceled already." He reminded the Government that he proposed excluding Jews in 1935 and described them as "the worst risks" who did not belong in the same risk pool as Aryans.

On Nov. 23, 1938, another German insurer selling pension annuities notified Government overseers that "we will discontinue the payment of pensions and widows' pensions beginning December of this year, insofar as the recipients are Jews."

POLICYHOLDER ADVOCACY MEMORANDUM

TO: Policyholder

FROM: Risk International Services, Inc.

SUBJECT: Environmental Insurance Coverage Law in Texas Arising Under Certain London Policies

DATE: July 1998

I. SUMMARY

Several coverage issues have surfaced during settlement discussions with London market insurers concerning the environmental claims of Policyholder. Among other items, the parties have discussed whether Texas law would apply to the claims. It is Policyholder's view that there is a high probability that Texas law would *not* apply to all the issues of all the claims. For example, it is highly unlikely that Texas law regarding groundwater property rights would govern to determine whether groundwater at an owned site in New Jersey is the property of Policyholder. As discussed below, Policyholder does not concede the position that Texas law would apply uniformly to its claims.

While it is not certain that Texas law would apply to the Policyholder claims, the parties have discussed the coverage determinations that would result from the application of Texas law. During our last settlement discussion, Policyholder became troubled with London's position on Texas law. It appeared London was unaware that the Texas Supreme Court has ruled on some critical issues and has not ruled on others. In short, it seemed that on some key points London's position was simply wrong. This memorandum is submitted to identify for London the Policyholder assessment of Texas law on certain key issues.

Under U.S. law, any contract dispute is a matter of state law ultimately subject to determination by the court of highest resort in the state. Accordingly, where the Texas Supreme Court has ruled on an issue, it is controlling. Where the Texas Supreme Court has not ruled on an issue, but lower level appellate courts in Texas have ruled, such decisions are the next most compelling indicators of how the Texas Supreme Court would rule. Finally, federal court decisions interpreting Texas law can be helpful in assessing how the Texas Supreme Court might decide an issue, but they are not as compelling indicators as are state appellate court decisions.

In summary, our assessment of the critical coverage issues is as follows:

(1) **Trigger of Coverage** - Texas law favors Policyholder's position of applying a continuous trigger (probability factor greater than 90%). Texas state appellate courts and federal courts have uniformly adopted a continuous trigger. *Cullen/Frost Bank of Dallas N.A. v. Commonwealth Lloyd's Insurance Co.*, 853 S.W.2d 252 (Tex. App. Dallas 1993), *writ denied per curiam*, 889 S.W.2d 266 (Tex. 1994); *Dayton Indep. School Dist. v. National Gypsum Co.*, 682 F. Supp. 1403 (E.D. Tex. 1988), *rev'd on other grounds sub. nom. W. R. Grace & Co. V. Continental Ins. Co.*, 896 F.2d 865 (5th Cir. 1990).

(2) **Allocation** - Texas law favors Policyholder's position of applying a vertical allocation (probability factor greater than 95%). The Texas Supreme Court has settled this issue. *American Physicians Exchange v. Garcia*, 876 S.W.2nd 842 (Tex. 1994).

(3) **Late Notice** - Liberal notice provisions in Policyholder's policies and Texas insurance regulations favor Policyholder's position that late notice does not bar coverage unless prejudice has occurred (probability factor greater than 90%). The Texas Board of Insurance has ordered that all policies issued or delivered in Texas be endorsed that failure to provide timely notice would not bar coverage unless prejudice occurred. Order No. 23080, Tex. State Board of Insurance (Mar. 3, 1973).

(4) **Pollution Exclusion** - Texas state appellate courts favor Policyholder's position that the sudden and accidental pollution exclusion does not bar coverage for gradual pollution events (probability factor greater than 65%). While some federal court decisions under Texas law have ruled to the contrary, the only two state appellate courts which have interpreted the exclusion have ruled for policyholders. *Circle "C" Ranch Co. v. St. Paul Fire & Marine Ins. Co.*, 1993 Tex. App. LEXIS 1291 (Tex. App. Austin May 5, 1993); *Union Pac. Resources Co. v. Aetna Cas.& Sur. Co.*, 894 S.W.2d 401 (Tex. App. Ft. Worth 1994).

(5) **Owned Property Exclusion** - Recent changes in Texas statutory law and court decisions, including one from the Texas Supreme Court, clearly favor Policyholder's position that groundwater is not owned property (probability factor greater than 95%). Recent amendments to the Texas Water Code and decisions by Texas state courts indicate that while landowners may have rights to groundwater, it is not property in the care, custody, control or ownership of the landowner, unless the landowner totally and physically manipulates the groundwater.

(6) **Expected/Intended Property Damage** - The standard for measuring whether a policyholder expected or intended property damage is a subjective standard favorable to the policyholder (probability factor greater than 90%). Texas state appellate courts and federal courts have decided this issue in favor of policyholders, so that actual expectation of property damage is required to bar coverage, not some lesser standard such as reasonable expectation. *Union Pac. Resources Co. v. Aetna Cas. & Sur. Co.*, 894 S.W.2d 401 (Tex. App. Ft. Worth 1994); *Bituminous Cas. Corp. V. Vacuum Tanks, Inc.*, 75 F.3d 1048 (5th Cir. 1996).

(7) **Choice of Law** - Where the site is located in New Jersey, Policyholder's extensive and almost century-old operations in New Jersey, the extensive involvement by New Jersey regulatory agencies, and the risk that contaminated soil and groundwater pose to New Jersey citizens, substantive arguments can be raised for the choice of new Jersey as opposed to Texas law (probability factor 70%). *Gilbert Spruance Co. v Pennsylvania Mfts. Ins. Co.*, 134 N.J. 96, 629 A.2d 885 (1993). Section 21.42 of the Texas Insurance Code which provides that Texas law governs policies payable to Texas citizens by insurance companies doing business in Texas suggests but does not require the application of Texas law. *Cooper Industries, Inc. v. Liberty Mutual Ins. Co.*, No. H-91-3158 (S.D. Tex. Sept. 30, 1993).

II. COVERAGE ANALYSIS

A. TRIGGER OF COVERAGE

1. Issue

The issue regarding trigger of coverage is when bodily injury or property damage must take place in order to impact an insurance policy.

2. Policy Language

In its policies, London agrees to pay "all sums" that Policyholder becomes legally obligated to pay as damages because of "personal injuries" and "property damage" caused by an "occurrence." "Occurrence" and "property damage" are defined in the policies as follows:

"Property Damage" means loss of or direct damage to or destruction of tangible property (other than property owned by the Named Assured).

"Occurrence" means an accident or a happening or event or a continuous or repeated exposure to conditions which unexpectedly and unintentionally results in personal injury, property damage or advertising liability during the policy period. All such exposure to substantially the same general conditions existing at or emanating from one premises location shall be deemed one occurrence.

Under this wording, for Policyholder's environmental claims to trigger the London policies, there must be an event or a continuous or repeated exposure to conditions which results in personal injury or property damage during the policy period.

3. Relevant Case Law

Generally, four approaches have been used to resolve the "trigger of coverage" issue:

1. **Exposure** — all policies on the risk at the time the underlying claimant or property was exposed to the injury-producing substance must cover the insured. *See, e.g., Insurance Co. of North America v. Forty-Eight Insulations,* 633 F.2d 1212 (6th Cir. 1980), *clarified and aff'd on rehearing,* 657 F.2d 814 (6th Cir.), *cert. denied,* 454 U.S. 1109 (1981), *reh'g denied,* 455 U.S. 1009 (1982).

2. **Manifestation or Discovery** — policies in effect when the resulting injury first manifests itself are responsible. *See, e.g., Eagle-Picher Industries, Inc. v. Liberty Mutual Ins. Co.,* 682 F.2d 12 (1st Cir. 1982), *cert. denied,* 460 U.S. 1028 (1983).

3. **Injury-in-Fact** — policies in effect when claimant sustains actual property damage or bodily injury regardless of when exposure or manifestation occurs are triggered. *See, e.g., American Home Products Corp. v. Liberty Mutual Ins. Co.*, 565 F. Supp. 1485 (.D.N.Y. 1983), *aff'd as modified*, 748 F.2d 760 (2nd Cir. 1984).

4. **Continuous or Triple Trigger** — all policies in effect during the entirety of an injurious process are triggered, beginning with the first exposure to a deleterious substance, continuing after direct exposure ceases but while the injury or damage progress, through at least the discovery of the damage. *See Keene Corp. v. Insurance Co. of North America*, 667 F.2d 1034 (D.C. Cir. 1981), *cert. denied*, 455 U.S. 1007, reh'g denied, 456 U.S. 951 (1982).

These four approaches are the product of extensive litigation in the late 1970s and early 1980s regarding coverage for asbestos-related bodily injury claims. Today, the "continuous or triple trigger" is the "dominant theory." Lathrop, *Insurance Coverage for Environmental Claims,* § 6.05 at 6-24, 6-25. The number of jurisdictions which adhere to the manifestation trigger continues to shrink. During the past two years, state supreme courts in California, Maryland, Minnesota, New Jersey and North Dakota have all rejected "manifestation" in favor of broader "actual injury" or "continuous trigger" models. *See Montrose Chemical Corp. v. Admiral Ins. Co.*, 897 P.2d 1 (Cal. 1995); *Chantel Assoc. v. Mt. Verrnon Fire Ins. Co.*, 656 A.2d 779 (Md. 1995) and *Kief Farmers Cooperative Elevator Co. v. Farmland Mutual Insurance Co.*, 534 N.W.2d 28 (N.D. 1995). Texas law supports application of a "continuous trigger."

Numerous Texas courts have applied the continuous trigger to bodily injury or property damage claims. *See, e.g., Dayton Indep. School Dist. v. National Gypsum Co.*, 682 F. Supp. 1403, 1410 (E.D. Tex. 1988), *rev'd on other grounds sub. nom. W.R. Grace & Co. v. Continental Ins. Co.*, 896 F.2d 865 (5th Cir. 1990)(asbestos property damage); *Stonewall Ins. Co. v. National Gypsum Co.*, No. 86 Civ. 9671 (S.D.N.Y. Dec. 22, 1992)(Tex. law); *National Standard Ins. Co. v. Continental Ins. Co.*, No. CA-3-81-1015-D (N.D. Tex. Oct. 4, 1983). In *Dayton*, a case involving asbestos-related property damage, the court held that, since the underlying plaintiffs' complaint alleged continuous and cumulative contamination, the continuous trigger should be applied in the case before it. The court stated:

> Plaintiffs' claim, by its very nature, describes property damage resulting in each and every policy period at issue in this case and, thus, requires that each policy be triggered. The Plaintiffs' complaint asserts that [the policyholders'] products were defective from the time of installation and that they released, or threatened to release, asbestos fibers into the buildings through a gradual process of deterioration, as well as through routine maintenance activities and other disturbances.

> Each alleged individual release of asbestos fibers in the Plaintiffs' buildings was part of continuing alleged contamination. . . . Because the alleged contamination was continuous and cumulative, Plaintiffs have set forth a claim of continuous exposure and property damage throughout the policy periods here at issue.

582 F. Supp. at 1409-10 (citation omitted).

The Texas Supreme Court in *American Physicians Ins. Exch. v. Garcia,* 876 S.W.2d 842 (Tex. 1994) discussed other states' laws on the trigger issue, and held that all three subject policies at issue in the case provided coverage. That is, a single occurrence triggered multiple policies. *See also Cullen/Frost Bank of Dallas, N.A. v. Commonwealth Lloyd's Insurance Co.,* 852 S.W.2d 252 (Tex. App. Dallas 1993), *writ denied per curiam*, 889 S.W.2d 266 (Tex. 1994)(rejected the notion that only one policy was triggered where continuous or repeated exposure causing continued or multiple and independent property damage over an extended period of time is alleged).

In summary, the law on trigger of coverage in Texas favors application of a continuous trigger. The recent trend as well as in the majority of courts throughout the nation is to apply the continuous trigger to environmental claims. Accordingly, there is a high probability, in all likelihood greater than 90%, that a Texas court would apply a continuous trigger to the Policyholder environmental claims and rule that every London policy on the risk from beginning of disposal to date of notification is triggered.

B. ALLOCATION

1. Issues

The subject of allocation raises three issues: (1) what is the allocation methodology that applies when multiple policies are triggered (i.e., vertical or horizontal allocation); (2) whether Policyholder possesses the right to pick and choose the policy period or periods which apply to its claims; and (3) whether multiple insurers with triggered policies may be jointly and severally liable for each claim.

2. Policy Language

Two key policy provisions provide the basis for allocating claims costs. They are:

(a) COVERAGE

Underwriters hereby agree, subject to the limitations, terms and conditions hereinafter mentioned, to indemnify the Assured for all sums which the Assured shall be obligated to pay by reason of the liability. . . .

(b) OTHER INSURANCE

If other valid and collectible insurance with any other insurer is available to the Assured covering a loss also covered by this policy, other than insurance that is specifically stated to be excess of this policy, the insurance afforded by this policy shall be in excess of and shall not contribute with such other insurance. Nothing herein shall be construed to make this policy subject to the terms, conditions and limitations of other insurance.

3. Relevant Case Law

Use of a vertical allocation was endorsed by the Texas Supreme Court in *American Physicians Insurance Exchange v. Garcia*, 876 S.W.2d 842 (Tex. 1994). In *Garcia*, Justice Cornyn said, at page 855:

> If a single occurrence triggers more than one policy, covering different policy periods, then different limits may have applied at different times. In such a case, the insurers' indemnity limits should be whatever limit applied at the single point in time during the coverage period of the triggered policy when the insurer's limits was highest [sic]. The insured is generally in the best position to identify the policy or policies that would maximize coverage. Once the applicable limit is identified, all insurers whose policies are triggered must allocate funding of the indemnity limit among themselves according to their subornation rights.

Recently, a Texas state court in a breast-implant case followed this rule in *Garcia* and rejected the use of a pro rata allocation urged by the insurance companies. *Bristol-Myers Squibb v. AIU Insurance Co.*, No. A-145, 672 (Tex. Dist. Ct. May 3, 1996). That court said of the rule in *Garcia* :

> It seems difficult to imagine a clearer or more authoritative statement of the rule of law applicable to this case as it affects insurance allocation. . . . [This] court has no alternative but to hold that the insured may select a policy, and its limit, at the single point in time when its limit was the highest.

The court in *Bristol-Myers Squibb* applied a continuous trigger and found that all policies between the date of the breast implant and the date the implant was removed were on the risk. Relying on *Garcia*, the court applied joint and several liability and permitted the policyholder to pick and choose which policy period should apply. The *Bristol-Myers* court further explained that after the policyholder's liability is paid in full, the insurance companies may seek contribution from each other.

Other Texas state courts and federal courts (applying Texas law) have ruled on the issue of allocation to determine insurance carrier liability for claims. In *CNA v. St. Paul Insurance Company*, 902 S.W.2d 657 (Tex. App. Austin 1995) the court relied on *Garcia* for the proposition that the total coverage available to the insured must be the highest liability limit available under any of the multiple policies covering the claim - a vertical allocation. The court then held that St. Paul Insurance Company could use the "other insurance" clause in the

policy to perform a pro rata allocation and seek contribution from CNA for overpayment of a settlement to the insured.[1]

The district court in *Dayton Independent School District v. National Gypsum Co.*, 682 F. Supp. 1403 (E.D. Tex., Beaumont Div., 1988), *rev'd on jurisdictional grounds sub nom. W.R. Grace & Co. v. Continental Casualty Co.*, 896 F.2d 865 (5th Cir. 1990) held in favor of the insured by applying a vertical allocation to the claims. In that case, each policy provided that Grace would be indemnified for "all sums" Grace became obligated to pay. Thus, the court held that each policy must indemnify Grace for the whole of its liabilities, without any proportional allocation of liability to Grace, subject only to policy limits. Further, Grace was entitled to select which of its policies it wished to provide coverage. Adopting a "vertical triggering" approach, the court ruled that Grace was not obligated to exhaust all underlying insurance in every policy period before it could proceed to obtain indemnification from its excess carrier. The Fifth Circuit later reversed the decision on jurisdictional grounds.

Based on the foregoing case law, there is a very high likelihood, greater than 95%, that a Texas court would permit Policyholder to vertically allocate its losses and would hold that all London insurers are jointly and severally liable with Policyholder's other insurers for the claims.

C. LATE NOTICE

1. Issues

The late notice argument raises two issues: (1) at what point in time is notice determined to be late and (2) whether late notice would serve to bar a claim for coverage.

2. Policy Language

The London policies issued to Policyholder contain several "notice" forms: One "notice" form states:

> Whenever the Assured has information from which the Assured may reasonably conclude that an occurrence covered hereunder involves injuries or damages which, in the event that the Assured should be held liable, is likely to involve this Policy, notice shall be sent as stated in Item 8 of the Declarations as soon as practicable, provided, however, that failure to give notice of any occurrence which at the time of its happening did not appear to involve this Policy, but which, at a later date, would appear to give rise to claims hereunder, shall not prejudice such claims.

[1] *See also Bethany Christian Church v. Preferred Risk Mutual Insurance Company*, 942 F. Supp. 330 (S.D. Texas 1996)(where a single occurrence triggers coverage by more than one policy, the highest policy limit in effect during the coverage period is the applicable policy limit).

Another "notice" form provides:

> Whenever it may reasonably be concluded that an occurrence covered hereunder involves injuries or damages which, in the event that the Assured should be held liable, is likely to involve this Policy, notice shall be sent as stated in Item 4 of the Declarations as soon as practicable after the Risk Manager or Risk Management Department of the Named Assured have knowledge of the occurrence.
>
> Failure on part of any interest hereunder to give such notice shall in no way prejudice the rights of any interest insured hereunder. Such notice may be in writing, by telephone, or personal conversation; provided however, that notice in writing is given as soon as practicable after such telephone or "in person" notice is given.
>
> Claims Warranty. Underwriters shall then be given immediate notice of all losses and claims (i) where the Assured has reserves totaling $100,000 or more; (ii) where a suit has been filed, for a demand or demands totaling $500,000 or more; (iii) where a suit has not been filed when the amount of claim or loss has been reasonably determined by the Assured and/or the Assured's Defense Counsel to be for an amount greater than $500,000.

Still, another "notice" form states:

> Whenever the Insurance Department of Policyholder has information from which they may reasonably conclude that an occurrence covered hereunder involves injuries or damages which, in the event that the Assured should be held liable, is likely to involve this policy, notice shall be sent as stated in Item 4 of the Declarations as soon as practicable provided, however, that failure to give notice of any occurrence which at the time of its happening did not appear to involve this policy, but which, at a later date, would appear to give rise to a claim hereunder, shall not prejudice such claims.

3. Relevant Case Law

The standards for determining whether notice was timely vary from state to state. Since 1973, Texas courts have followed the more policyholder-friendly rule that a policyholder's failure to give notice as required by its policy does not release an insurance company from its contractual liability unless the insurance company suffers substantial prejudice. Additionally, the insurer bears the burden of showing that it was substantially prejudiced as a result of the late notice.[2]

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[2] *Shelton v. Ray*, 570 S.W.2d 419, 420 (Tex. App. El Paso 1978); *Trevino v. Allstate Ins. Co.*, 651 S.W.2d 8 (Tex. App. Dallas 1983); *Hanson v. Americas Insurance Company*, 108 F.3d 627 (5th Cir.), *reh'g denied* 1997 U.S. App. LEXIS 11985 (5th Cir. 1997).

On March 3, 1973,[3] the Texas Board of Insurance issued an order that required an amendatory endorsement to all liability policies issued or delivered in the state of Texas stating that, with regard to bodily injury or property damage, the insurer must show prejudice from late notice. The endorsement provides:

> As respects bodily injury liability coverage and property damage liability coverage, unless the company is prejudiced by the insured's failure to comply with the requirement, any provision of this policy requiring the insured to give notice of action, occurrence or loss, or requiring the insured to forward demands, notices, summons or other legal process, shall not bar liability under this policy.

For policies issued after 1973, failure to notify an insurer of a claim or potential claim will not operate to bar coverage unless the insurer proves that it has been substantially prejudiced.[4] Because the London policies all postdate 1973, the relevant case law to examine is that which ruled on policies issued after 1973.

In *Hanson v. Americas Insurance Company*, 108 F.3d 627 (5th Cir.), *reh'g denied* 1997 U.S. App. LEXIS 11985 (5th Cir. 1997), the Fifth Circuit recognized that the failure to give notice of a claim poses a small risk to an insurance company. The court stated that in many instances of untimely notice of a claim, the insurer is not prejudiced at all.

There is also a difference in the notice obligation to a primary insurer and an umbrella or excess insurer. In *Cooper Industries, Inc. v. Liberty Mutual Insurance Co.*, No. H-91-3158 (S.D. Tex., Houston Div., Jan. 25, 1994), reprinted in Mealey's Litigation Reports Insurance, vol. 8, no. 14 (Feb. 8, 1994), the court held that the unexplained four or seven-year delay in providing notice to a primary insurer resulted in presumed prejudice and was late as a matter of law. However, when discussing whether there was late notice to the umbrella carrier, Stonewall Insurance Company, the court reached a different conclusion. The court denied Stonewall Insurance Company's motion for summary judgment on late notice because there were too many questions concerning Cooper Industries' notice responsibilities. The Stonewall policy (an umbrella policy) required Cooper to provide notice of an occurrence "which, in the opinion of the insured, involves or may involve liability on the part of [Stonewall]." The court denied summary judgment because there were genuine issues of material fact regarding whether Cooper had a reasonable opinion that the cleanup would not involve the Stonewall policy, and whether Cooper gave prompt notice when it realized that Stonewall's policy would be implicated.

In addition to generally favorable regulatory law and case law, the notice provisions in Policyholder's London policies are very liberal. Generally, the provisions state that failure to give notice will not prejudice Policyholder's claims where (1) the initial occurrence at the time of its happening would not appear to involve the London policy, or (2) the Risk Management Department of Policyholder did not have knowledge of the occurrence. Also, as a factual

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[3] Order No. 23080, Tex. State Board of Insurance (Mar. 3, 1973). This order became effective on or after May 1, 1973. For policies issued prior to that date, notice generally has been treated as a condition precedent to coverage. In 1987, Board Order No. 23080 was superceded by Board Order No. 50602, which maintains the same prejudice requirement.

[4] *Ratcliff v. National County Mut. Fire Ins. Co.*, 735 S.W.2d 955 (Tex. App. Dallas 1987); *Trevino v. Allstate Ins. Co.*, 651 S.W.2d 8 (Tex. App. Dallas 1983).

matter, Policyholder, has always been vigilant in addressing its environmental liabilities in order to reduce cost and exposure. Interests of all Policyholder's insurers have generally been well protected. Accordingly, not only will London insurers be unable to demonstrate substantial prejudice from late notice, but they will also be unable to demonstrate that Policyholder's Risk Management Department had actual knowledge of a claim likely to involve an umbrella or excess policy before notice was actually issued.

In all likelihood (probably greater than 90%) Policyholder's environmental claims submitted to London insurers will either be deemed not late, or if late, will not be barred by such late notice, because the London insurers have not been substantially prejudiced.

D. THE POLLUTION EXCLUSION

1. Issue

The issue to be determined is whether, under Texas law, the qualified pollution exclusion in London's policies is merely a restatement of the occurrence definition prohibiting coverage for intended or expected damage, or whether the exclusion contains a "temporal" element which precludes coverage for gradual pollution.

2. Policy Language

The London policies contain the following pollution exclusions:

(a) in respect of any operations performed by and/or on behalf of the Named Assured on and/or over water:

Seepage, Pollution and Contamination Exclusion No. 2

This Insurance does not cover any liability for:

(1) Personal Injury or Bodily Injury or loss of, damage to, or loss of use of property directly or indirectly caused by seepage, pollution or contamination.
(2) The cost of removing, nullifying or cleaning-up seeping, polluting or contaminating substances.
(3) Loss of, damage to, or loss of use of property directly or indirectly resulting from subsidence caused by sub-surface operations of the Assured.
(4) Removal of, loss of or damage to sub-surface oil, gas or any other substance, the property of others.
(5) Fines, penalties, punitive or exemplary damages.

(b) in respect of all other operations:

Industries, Seepage, Pollution and Contamination Clause No. 3

This insurance does not cover any liabilities for:

(1) Personal injury or bodily injury or loss of, damage to, or loss of use of property directly or indirectly caused by seepage, pollution or contamination, provided always that this paragraph (a) shall not apply to liability for personal injury or bodily injury or loss of or physical damage to or destruction of tangible property, or loss of use of such property damaged or destroyed, where such seepage, pollution or contamination is caused by a sudden, unintended and unexpected happening during the period of this insurance; (b) the cost of removing, nullifying or cleaning up seepage, polluting or contaminating substances unless the seepage, pollution or contamination is caused by a sudden, unintended and unexpected happening during the period of this insurance; (c) fines, penalties, punitive or exemplary damages.

This Clause shall not extend this Insurance to cover any liability which would not have been covered under this insurance had this Clause not been attached.

A couple of the London policies also contain the Waste Site Exclusion Clause which reads:

It is hereby understood and agreed that where the Named Assured has knowledge as or prior to the inception date of any annual policy period hereon with regard to any claims, situations or circumstances which have arisen and/or occurred in the past with respect to seepage, pollution and/or contamination from:

A) Any land and/or water site and/or facility owned, leased and/or operated by the Assured and used for the disposal and/or dumping of industrial waste materials.

B) Any fixed based operation provided by and/or on behalf of the Assured for the disposal, dumping and/or removal of industrial waste materials.

This Policy will not cover with respect to operations described in (A) and (B) above:

1) Personal Injury or Bodily Injury or loss of damage to or loss of use of property directly or indirectly caused by seepage, pollution or contamination;
2) The cost of removing, nullifying or cleaning-up seeping, pollution or contaminating substances;
3) Fines, penalties, punitive or exemplary damages with respect to 1) and 2) above;
4) Any cost or expenses associated with 1), 2), or 3) above.

All other terms, conditions and limitations of this policy remain unchanged.

3. Relevant Case Law

As with other insurance contract provisions, determination of the issue of the pollution exclusion is a matter of state law. The Texas Supreme Court has interpreted neither the ISO "sudden and accidental" pollution exclusion nor the London "sudden, unintended and unexpected" pollution exclusion.[5] The Texas state appellate courts which have addressed the "sudden and accidental" pollution exclusion have interpreted the exclusion favorably for insureds. Indications from these courts are that "sudden and accidental" means unexpected and unintended. Therefore, pursuant to those state court decisions, the insurance companies must provide coverage for the gradual discharge of contaminants unless they prove that the insured expected or intended the damage caused by the discharge.[6]

In *Circle "C" Ranch Co. v. St. Paul Fire & Marine Ins. Co.*, 1993 Tex. App. LEXIS 1291 (Tex. App. Austin May 5, 1993), *vacated* (May 19, 1993), the Texas court adopted the reasoning of numerous courts interpreting the term "sudden and accidental" and held that such language was equivalent to the term "expected and intended from the standpoint of the insured." The ruling was vacated only because of a settlement where the insurance company conditioned settlement on vacation of the ruling, thus avoiding future negative precedent for itself and other insurance companies.

In *Union Pac. Resources Co. v. Aetna Casualty & Sur. Co.*, 894 S.W.2d 401 (Tex. App. Ft. Worth 1994) the trial court granted summary judgment for the American and London insurance companies on the basis that the routine and deliberate discharge of waste into a landfill over a period of years was neither "sudden and accidental" nor "sudden, unintended and unexpected." The Fort Worth Court of Appeals reversed and found that the intentional routine disposal of waste at a licensed landfill does not trigger the pollution exclusion. The relevant "occurrence" was not the act of dumping into the landfill, but the migration of pollutants from the landfill. The Court of Appeals also found that the trial court abused its discretion when it refused the policyholder the right to conduct discovery on the drafting history and regulatory history of the ISO and London pollution exclusion. While this particular decision did not address the element of "suddenness," it demonstrated the application of the general principle that exclusions are to be interpreted narrowly against the insurer and in favor of coverage.

The Texas Court of Appeals in Houston has also ruled favorably for the insured on the term "sudden and accidental" in a boiler and machinery policy. *Pioneer Chlor Alkali Co., Inc. v. Royal Indem. Co.*, 879 S.W.2d 920 (Texas App. Houston 1994). In that case long term corrosion to some pipes caused a release of chlorine. The insurer argued that a covered accident had not occurred according to the policy definition of an "accident," which required the "sudden and accidental" breakdown of an object. According to the insurer, the long term corrosion of pipes could not be deemed sudden. The court rejected this argument and ruled in favor of the policyholder. The court did not consider the term "sudden and accidental" to be "a function of time." This reasoning is supported by the [dictionary] definitions of the two

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[5] A majority of courts interpret the ISO and London pollution exclusion similarly.

[6] *Circle "C" Ranch Co. v. St. Paul Fire & Marine Ins. Co.*, 1993 Tex. App. LEXIS 1291 (Tex. App. Austin 1993), *vacated* (May 19, 1993); *Union Pac. Resources Co. v. Aetna Casualty & Sur. Co.*, 894 S.W.2d 401 (Tex. App. Ft. Worth 1994).

words; neither has anything to do with time, they have to do with surprise and lack of forseeability. . . . [T]he time it actually took for the erosion/corrosion mechanism to breach the tubes is immaterial. The actual penetration of the tubes was unexpected and unforseen, complying precisely with the definitions of "sudden" and "accidental." At one point in time, the tubes were whole, an instant later they were breached."

It is reasonable to conclude that the court in *Pioneer* would reach the same decision in a landfill pollution case. The time it might take for a contaminant to escape from a landfill would be immaterial. What would be material would be the unexpectedness of such an escape. At one point in time the landfill's integrity would be intact; an instant later a breach would have occurred and the contaminant would have escaped from the landfill.

The court in *Pioneer* merely followed rules of construction laid down by the Texas Supreme Court. Because the language of an insurance policy is chosen by the insurer, if the language chosen is ambiguous or inconsistent, and susceptible to more than one reasonable interpretation, the court must resolve the uncertainty by adopting the construction that most favors the insured. The court must adopt the insured's construction, so long as it is not unreasonable, even if the construction urged by the insurer is more reasonable. *National Union Fire Ins. Co. v. Hudson Energy Co.*, 811 S.W.2d 552 (Tex. 1991). The court in *Pioneer* also found that where courts had reached differing conclusions as to the meaning of the same insurance phrase, the phrase was ambiguous as a matter of law.

Of course, the "sudden and accidental" pollution exclusion and the London "sudden, unintended, and unexpected" pollution exclusion have been interpreted differently by a number of courts across the country. Because of this fact, the court that ruled in *Pioneer* would find the London exclusion ambiguous as a matter of law and would adopt a construction in favor of coverage.

In fact, a number of other courts have found the London pollution exclusion ambiguous and have found for the policyholder. *E.g., Chemical Leaman Tank Lines, Inc. v. Aetna Cas. & Sur. Co.*, 89 f.3d 976 (3rd Cir. 1996), *cert. denied* 117 S. Ct. 485 (1996); *Time Oil Co. v. W. R. Grace & Co.*, 743 F. Supp. 1400 (W.D. Wash. 1990).

In several instances federal courts interpreting Texas law have ruled that the sudden and accidental pollution exclusion requires a temporal event.[7] As an indicator of how the Texas Supreme Court would rule on the issue, the Texas state appellate court decisions cited above are more reliable than the federal court decisions. In addition, it is clear that even if the Texas Supreme Court were to impose a temporal requirement to the qualified pollution exclusion,

[7] *Mustang Tractor v. Liberty Mutual Insurance Company*, 76 F.3d 89 (5th Cir. 1996); *National Standard Ins. Co. v. Continental Ins. Co.*, No. CA-3-81-1015-D, 1994 WL 23448 (N.D. Tex. Oct. 4, 1983)(exposure to a harmful condition over a period of years is not "sudden and accidental," but exclusion does not apply in the enclosed work environment); *Meridian Oil Production, Inc. v. Hartford Accident & Indem. Co.*, No. G-91-167 (S.D. Tex. Mar. 3, 1993), *aff'd on other grounds*, 27 F.3d 150 (5th Cir. 1994); *SnyderGeneral v. Continental Ins. Co.*, No. 3-90-CV-2396-BD (N.D. Tex. Jan 6, 1995).

a great many of the Policyholder environmental claims have arisen precisely from temporal "boom" events. A summary of these events has already been provided to London insurers with the Risk International letter of May 30, 1997 and need not be repeated here. As that summary indicates, Policyholder is capable of selecting just a half a dozen sites alone with dramatic boom events and with multimillion dollar cleanups which trigger London umbrella and excess coverage and which would not be barred by the qualified pollution exclusion.

Also, while there is no case law interpreting the Waste Site Exclusion, the Waste Site Exclusion only applies to those sites where the insured had knowledge at or prior to the inception of the policy. Thus, any contamination which came to the insured's attention after the inception date of the policy is covered. Here, the Waste Site Exclusion only applies to those sites where Policyholder had knowledge, at or prior to the inception of the policies, of contamination problems. Any contamination problems which came to Policyholder's attention after the inception date of the policies is covered. Most of the sites at issue involve contamination which came to Policyholder's attention after the London policy periods.

Three points should be obvious: (1) the Texas state courts show a willingness to adopt a narrow interpretation of the term "sudden and accidental" in favor of coverage; (2) the Texas Supreme Court has not decided the issue, but the best indicator of how that court would rule is found in state appellate decisions, not federal decisions; and (3) the Waste Site Exclusion contained in several of the London policies does not bar coverage for Policyholder's claims. It is more likely than not, probably greater than 65% likelihood, that under Texas law the qualified pollution exclusion in the London policies does not bar coverage for Policyholder's claims.

E. THE OWNED PROPERTY EXCLUSION

1. Issues

The issues to be decided are: (1) what is the scope of ownership of an insured's owned property; (2) whether groundwater and subsurface soil are owned property or property under the care, custody and control of Policyholder; and (3) to what extent is the owned property exclusion inapplicable when a remedy is performed to prevent or mitigate damage to third-party property.

2. Policy Language

The London policy definition of "property damage" appears to exclude property owned by Policyholder."[8] In addition, several policies contain the following language:

> . . . this Policy shall not apply:
>
> (a) to property in the Assured's care, custody or control, . . .

This language is referred to as either the owned property exclusion or the care, custody or control exclusion.

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[8] "Property Damage" is defined in the policies as "loss of or direct damage to or destruction of tangible property (other then property owned by the Named Assured)." It is unclear whether the definition of "property damage" is the same in every policy.

3. Relevant Case Law

Texas property law recognizes the "rule of capture" which has governed the exploitation of oil and other minerals in Texas. Under the "rule of capture," the surface owner could take or use whatever amount of oil (or groundwater) it cared to pump out of the ground. Some insurers have argued that the right to unlimited use of oil (or other minerals) implied in the rule of capture means that a surface owner has absolute ownership of the groundwater that flows beneath the surface estate. This argument, however, is incompatible with Texas law. In actuality, under the "rule of capture" the surface owner merely owns the rights to use the groundwater.[9] This conclusion is supported by both Texas statute and case law interpreting the owned property exclusion.

The Texas Water Code was significantly amended during the 1997 session of the Texas Legislature to expand the authority of Regional Groundwater Management Districts ("Districts") to regulate groundwater use and conservation, groundwater sale, drought prevention, and surface subsidence attributable to groundwater pumping.[10] As the first bill introduced in the 1997 legislative and the last bill passed, the new law broadens the District's permitting authorities to limit the rate and volume of groundwater use, and the "beneficial uses" to which extracted volumes can be put. This legislative action is the latest in a long series of measures authorized under Texas statutes and administered by the TNRCC and other state agencies to preserve groundwater and surface water quality in the State. Indeed, until the surface owner physically takes possession of the groundwater, he exercises no real "care," "custody," or "control" over the groundwater. Therefore, under Texas law, contamination of groundwater beneath a policyholder's property is best understood as damage to third-party property.

In 1996, the Texas Supreme Court established that a surface owner can have a vested right in property that is subject to the interests of others (e.g., the state) and is subject to capture by others. The court concluded "that the use of water runs with the land and, as such, [capture by others] does not constitute a taking of the landowners' property."[11] Accordingly, groundwater in the state of Texas is properly deemed to be property of the state and not exclusively property of the landowner. Under this ruling it is apparent that the landowner does not "own" the water running under his property.

The best analysis of the issues is set forth in *SnyderGeneral Corp. v. Century Indemnity Co.*, 113 F.2d 536 (5th Cir. 1997). In *SnyderGeneral*, the policyholder asserted a claim against its excess carrier for the cost (in excess of primary limits) of remediating TCA contamination of soil and groundwater resulting from a spill from an above ground storage tank. Century had moved

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[9] "The judicial doctrine of groundwater in force in Texas is referred to as the 'English' rule and sometimes as the 'absolute ownership' rule. The latter may conjure up in one's mind that notion that groundwater ownership in Texas is a super-right subject to no limitation whatever, even legislative control. The context in which the term 'absolute ownership' has been used by courts and commentators shows that it has an entirely different meaning. Its function is to distinguish the English rule from the 'American' or 'reasonable use' rule. The 'American' rule places limitations upon the right of landowner to pump and only in this respect may be said to be 'absolute'. The corollary of this rule is that the landowner is entitled to no judicial protection from the harmful pumping by others. Thus, his 'ownership' lacks one of the most significant aspects of ownership. It certainly is not 'absolute' in the sense that it is comprehensive." *See*, "The Continuing Voids in Texas Groundwater Law: Are Concepts and Terminology to Blame?", 17 *St. Mary's L.J.* 1281, 1288-1289 (1986).

[10] Senate Bill No. 1 Legislative Docket No. 4-20-244, amending various sections of the Texas Water Code.

[11] *Barshop v. Medina County Undergroundwater Conservation Dist.*, 925 S.W.2d 618 (Tex. 1996).

unsuccessfully for summary judgment arguing, among other things,[12] that the care, custody and control exclusion in its policy precluded recovery.[13] The *SnyderGeneral* court affirmed the district court's ruling:

> . . . that under Texas law, the care, custody and control exclusion only precludes insurance coverage in cases in which the insured totally and physically manipulates property. As Century failed to establish that SnyderGeneral totally and physically used or controlled the entire pool of groundwater at (its) facility, it is not entitled to summary judgment.

In an unreported case, a Texas state court categorized the insurance companies' reliance on the owned property exclusion as "just hooey."[14] The court held, instead, that the exclusion did not negate the insurance companies' duty to defend their policyholder because the underlying action alleged damages for runoff of contaminants onto third-party property and into the waters of the State. Such allegations of third-party property damage or damage to groundwater owned by the State preclude application of the owned property exclusion.[15]

Nationally, the majority view is that the owned property exclusion does not apply when the policyholder incurs costs to clean up its property for the purpose of *remedying, limiting, or preventing* further injury or damage to third parties.[16] Courts also hold that the exclusion does not apply to claims involving damage to the environment, such as groundwater or the atmosphere, which courts have found is owned by the state, by the people of the state, or is held in trust by the surface owner for the benefit of the people of the state. The reason behind these decisions is that, in most states, such ecological assets are not deemed to be the property of the surface owner and are not deemed to be within the care, custody or control of the surface owner.[17]

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[12] In addition to addressing the owned property exclusion, the *SnyderGeneral* court made important pro-policyholder rulings on the recoverability of remediation costs and on the pollution exclusion. Century had argued that "environmental cleanup costs did not constitute damages under the policy." On this point, the court held "that environmental cleanup costs, whether incurred by the federal government under CERCLA or by an individual who voluntarily undertakes the task of cleaning up hazardous waste, are damages and thus are covered by the language of Century's policy. We are persuaded that such a reading of the subject insurance policy is consistent with the conclusions of several federal courts and with decisions of Texas courts." *See, Bituminous Cas. Corp. v. Vacuum Tanks, Inc.* 75 F.3d 1048, 1053 (5th Cir. 1996)(citing decisions of federal courts); *Barnett v. Aetna Life Ins. Co.*, 723 S.W.2d 663, 666 (Tex. 1987). With respect to the pollution exclusion, the court noted that "the term 'sudden' in the pollution exclusion had a temporal component and that SnyderGeneral had created a question of fact as to the suddenness of the TCA discharge by alleging that it had occurred within a 24-hour period." This holding might stand for the proposition that a release over a 24-hour period might be sufficiently "sudden" to overcome the pollution exclusion in Texas.

[13] The relevant clause of the Century policy provided, "This policy shall not apply to: property damage to (1) property owned or occupied by or rented to the insured; (2) property used by the insured; or (3) property in the care, custody or control of the insured as to which the insured is for any purpose exercising physical control."

[14] *Capitol Metals Finishing, Inc. and Carl Booth v. Aetna Cas. & Sur. Co.*, No. 91-3286 (14th Jud. Dist. Travis County, Tex., May 26, 1993)(Bench ruling by Judge J. MCGowan) reprinted in Mealey's Litigation Reports: Insurance, Vol. 7, No. 39 (Aug. 24, 1993).

[15] *Accord In re Texas Eastern Ins. Coverage Litigation*, 870 F. Supp. 1293(E.D.Pa. 1992), aff'd on other grounds *15 F.3d 1249 (3rd Cir. 1994)(applying Texas law).*

[16] *E.g., In re Texas Ins. Coverage Litigation*, 870 F.Supp. 1293 (E.D.Pa. 1992), *aff'd on other grounds*, 15 F.3d 1249 (3rd Cir. 1994)(applying Texas law); *New Castle County v. Continental Gas. Co.*, 725 F.Supp. 800, 816-17 (D.De. 1989); *Allstate Ins. Co. v. Quinn Constr. Co.*, 713 F.Supp. 35, 40-41 (D.Mass. 1989); *Township of Gloucester*, 668 F.Supp. 394, 400 (D.N.J.); *United States v. Conservation Chemical Co.*, 653 F.Supp. 152, 200 (W.D. Mo. 1986); *South Carolina Ins. Co. v. Coody*, 813 F. Supp. 1570 (M.D.Ga. 1993); *Accord Capitol Metals Finishing, Inc., and Carl Booth v. Aetna Cas. and Sur. Co.*, No. 91-3286m tr, at 10-11 (14th Jud. Dist., Travis County, Tex., May 26, 1993)(Bench ruling by Judge J. McCowan) reprinted in Mealey's Litigation Reports: Insurance, Vol. 7, No. 39 (Aug. 24, 1993).

[17] *Intel Corp. v. Hartford Accident & Indem. Co.*, 692 F.Supp. 1171, 1182 (N.D.Cal. 1988), *aff'd*, 952 F.2d 1551 (9th Cir. 1991); *Township of Gloucester*, 668 F.Supp. at 399; *Mapco Alaska Petroleum, Inc. v. Central Nat'l Ins. Co. of Omaha*, 784 F.Supp. 1454, 1462 (D. Alaska 1991); *Conservation Chemical*, 653 F.Supp. at 200; *Northern States Power Co. v. Fidelity & Casualty Co. of N.Y.*, 504 N.W.2d 240 (Minn.

Courts nationally are split on whether all remediation costs associated with owned property contamination are recoverable, or whether only those costs directly associated with groundwater contamination or damage to property of third parties can be recovered.[18] However, the trend has been to recognize that environmental remediation costs are incurred primarily to benefit third parties. Courts have, therefore, narrowed the scope of the owned property exclusion to only those costs which are solely beneficial to the property of the policyholder.[19]

In sum, the owned property exclusion is in all likelihood inapplicable to Policyholder's claims (probability greater than 95%). It is not clear in the first place that Texas law would even apply to sites outside the state to determine whether groundwater or subsurface soil is the property of the landowner. However, even if Texas law did apply, it is clear that the state of Texas through recent legislative enactments has indicated that groundwater is actually in the care, custody and control of the state. Policyholder's claims are not barred by the owned property exclusion because it has not totally manipulated, or exercised tangible, physical control over the groundwater or subsurface soil under its sites in such a way as to be deemed the owner of such property.

F. EXPECTED/INTENDED PROPERTY DAMAGE

1. Issue

The issue to be decided is whether a policyholder's disposal of waste in a landfill is the standard utilized to determine whether a policyholder expects or intends property damage to occur.

2. Policy Language

In the London policies the expected/intended defense arises in the definition of the term "occurrence." The policies define the term as follows:

> The term "Occurrence," wherever used herein shall mean an accident or a happening or event or a continuous or repeated exposure to conditions which unexpectedly and unintentionally results in personal injury, property damage, or advertising liability during the policy period.

3. Relevant Case Law

Texas courts have applied a subjective standard in environmental insurance coverage cases when evaluating the expected/intended issue. *See e.g., Union Pac. Resources Co. v. Aetna Casualty & Sur. Co.*, 894 S.W. 2nd 401, 404 (Tex. App. Ft. Worth 1994)("[W] e hold it is the consequence rather than the event itself which must be neither expected nor intended . . . The relevant inquiry. . . is whether the policyholder expected the landfill to discharge the waste."); *American Home Assurance Co. v. Safeway Steel Prods. Co.*, 743 S.W. 2d 693, 701 (Tex. App. 1987).

App. 1993).

[18] *Cf. Unigard Mut. Ins. Co. v. McCarty's Inc.*, 756 F. Supp. 1366 (D. Idaho 1988) (EPA suit involving PCB contamination on insured's owned property is brought for the benefit of a third party--the public-- and can not be excluded from coverage as a matter of law) ; and *E.I. du Pont de Nemours v. Admiral Insurance Co.*, (Oct. 16, 1996) 1996 Del. LEXIS 379 (only costs directly associated with clean-up of third party property fall outside the owned property exclusion).

[19] *See Intel Corp. v. Hartford Accident and Indemnity Co.*, 952 F.2d 1551 (9th Cir. 1991); *Patz v. St. Paul Fire and Marine Ins. Co.*, 15 F.3d 699 (7th Cir. 1994); *Anderson Development Co. v. Travelers Indemnity Co.*, 49 F.3d 1128 (6th Cir. 1995).

In *Union Pacific*, the plaintiff brought a declaratory judgement action seeking coverage under comprehensive general liability policies for claims stemming from landfill operations. 894 S.W. 2d at 402. The appellate court reversed the trial court's grant of summary judgment in favor of the insurance companies regarding the pollution exclusion. *Id.* In its analysis of the term "occurrence," the appellate court stated that, under Texas law, the expected or intended analysis examines whether the policyholder subjectively intended the ultimate damage:

> The analysis of the term "occurrence" rests on whether the activity was expected or intended from the standpoint of the insured. The language is unequivocal in the definition of "occurrence." It is the property damage, and not the accident, which is neither expected or intended . . . [W]e hold it is the consequence rather than the event itself which must be neither expected nor intended. [The policyholder's] deposit of pollutants into a landfill cannot be the triggering event. Rather, the subsequent escape of pollutants from the disposal site is the critical inquiry for purposes of determining coverage . . . The relevant inquiry in interpreting both types of policies presented here, then, is whether the policyholder expected the landfill to discharge the waste into the surrounding environment. *Id.*, at 404 (citations omitted).

This same result occurred in a federal appellate court in the case, *Bituminous Casualty Corporation v. Vacuum Tanks, Inc.*, 75 F. 3d1048, 1054 (5th Cir. 1996). There the court stated:

We have held that under Texas law the focus is not on whether the insured's conduct or actions were intentional, but on whether the insured intended the damages or injuries which are the subject of the underlying claims. As we explained in *Meridian Oil Production Co. v. Hartford Accident and Indem. Co.*, 27 F. 3d 150 (5th Cir. 1994): "Texas courts afford coverage for fortuitous damages but deny coverage when damages are the natural and probable consequence of intentional conduct. Regardless of whether the policies involved are worded to cover 'accidents' or 'occurrences,' all offer minor variations of the same essential concept; coverage does not exist for inevitable results which predictably and necessarily emanate from deliberate actions." Id. at 152. (footnote omitted, emphasis added).

Texas law is abundantly clear (probability greater than 90%) that Policyholder will not be charged with expecting or intending property damage by mere disposal of waste in a landfill. This element of the "occurrence" definition in the London policies will not operate to bar coverage.

4. Choice of Law

At our last meeting, we discussed at some length the extent to which Texas law would govern policyholder's claims. This turns on application of the conflicts-of-law principles set forth in the RESTATEMENT (SECOND) OF LAWS 6 (1971) ("Restatement 2nd")[20] to the facts surrounding the claims. In applying the broad principles of § 6, courts often consider the following factors set

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[20] In resolving conflicts-of-law issues the Restatement 2nd looks at factors such as: the needs of the interstate and international system; the relevant policies of the forum; the relevant policies of other interested states and relative interests of those states in determination of particular issues; protection of justified expectations; basic policies underlying the particular field of law; certainty, predictability and uniformity of result; and ease in the determination and application of the law to be applied to determine which state's law governs. *See, e.g., Lumbermens Mut. Casualty Co. v. S-W Indus., Inc.*, No. C86-7339 (N.D. Ohio Aug. 1, 1989); *Aetna Casualty & Sur. Co. v. General Dynamics Corp.*, No. 88-2220C(A) (E.D. Mo. Dec. 12, 1989).

forth in § 188 of the Restatement 2nd: (1) the place of contracting; (2) the place of negotiation of the contract; (3) the place of performance; (4) the location of the subject matter of the contract; and (5) the domicile, residence, nationality, place of incorporation, and place of business of the parties. Of these factors, courts recently have placed the greatest weight on the place where the policies were contracted; the location of the waste site;[21] or the principal place of business, or headquarters of the policyholder.[22]

Application of these factors site-by-site argue alternatively for the selection of the law of Texas, New Jersey, or other state's substantive law. It is clear that for the Primary sites (1) the Plant is one of the most significant industrial facilities in the State of New Jersey; (2) the plant has been regulated by a host of New Jersey regulatory agencies (governing everything from environmental, health, safety, wage and hour, and taxation to utility rate making); (3) the contaminated ground water is ground water of the State of New Jersey; (4) the soil contaminated by the spill is soil of the State of New Jersey; and that (5) the remediation has been directed in detail and at every stage by New Jersey regulatory agencies. This array of New Jersey interests argues strongly that a court would find that New Jersey law should apply. Similar analyses of sites in other states may give rise to the application of other state laws. On the other hand, since Policyholder's principle place of business is in Texas and the contract was entered into and payments were made in Texas, a court *could* find that Texas law should govern some claims. Since the overwhelming bulk of Policyholder's claims arise from New Jersey sites we believe New Jersey law should govern all claims.

Section 21.42 of the Texas Insurance Code provides that Texas law governs policies payable to Texas citizens by insurance companies doing business in Texas, whether or not the insurance policy provides for another place of execution or payment.[23] This provision was designed by Texas interests to serve as a "hard hammer," assuring Texas litigants that Texas law would be applied by courts adjudicating their matters. In practice, however, it has been a "soft hammer" indeed. Some Texas courts have found the provision inapplicable and instead have followed the "most

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[21] *E.g., Gilbert Spruance Co. v. Pennsylvania Mfrs. Ins. Co.*, 134 N.J. 96, 629 A.2nd 885 (1993)("when the parties to the insurance contract can reasonably foresee that a New Jersey waste site will receive the insured's waste products, New Jersey should dictate the proper interpretation of the insuring agreement..."); *CPC Int'l, Inc. v. Northbrook Excess & Surpolus Ins. Co.*, 839 F. Supp. 124 (1993)(follows *Gilbert Spruance*), *writ of mandamus refused*, No. 94-1056 (1st Cir. Jan. 28, 1994), *affid*, No. 94-1276 (1st Cir. Jan. 25. 1995); *E.B. & A.C. Whiting Co. v. Hartford Fire Ins., Co.*, 741 F. Supp. 298 (D. Mass 1990), *affid*, 933 F.2nd 66 (1st Cir. 1991); *Champion Int'l Corp. v. Aetna Casualty & Sur. Co.*, No. 90-2-09616-5 (Wash. Super. Ct. Sept. 27, 1991), *reconsider. denied* (Oct. 21, 1991); *Joy Technologies, Inc. v. Liberty Mut. Ins. Co.*, 187 W. Va. 742, 421 S.E.2d 493 (1992)("*Joy Technologies*"); *American Casualty Co. of Reading, PA v. General Metals of Tacoma, Inc.*, No. C92-5192B (W.D. Wash. Feb. 8, 1994).

[22] *E.g., E.I. DuPont de Nemours & Co. v. Admiral Ins. Co.*, No. 89C-AU-99 (Del. Super. Ct. Oct. 22, 1991) (court applies Delaware law); *Monsanto Co. v. Aetna Casualty & Sur. Co.*, No. 88C-JA-118 (Del. Super. Ct. Oct. 29, 1991) (court applies Missouri law).

[23] This section reads, "Any contract of insurance payable to any citizen or inhabitant of this State by any insurance company or corporation doing business within this State shall be held to be a contract made and entered into under and by virtue of the laws of this State relating to insurance, and governed thereby, notwithstanding such policy or contract of insurance may provide that the contract was executed and the premiums and policy (in case it becomes a demand) should be payable without this State, or at the home office of the company or corporation issuing the same." Texas Insurance Code at §21.42 (Vernon 1989), adopted originally as Vernon's Ann. Civ. Stat. art. 5054 (Acts 1903, p. 94; R.S. 1911, art. 4950, unchanged).

RISK INTERNATIONAL SERVICES, INC.

Terrell E. Hunt
President

Terrell E. Hunt is president of Risk International Services, Inc. Founded in 1986, Risk International is a privately owned company that provides independent risk management services world wide, and is the country's leading provider of the specialized combination of insurance archaeology, environmental forensics, and claims recovery services relating to environmental, toxic-tort, or other "long-tail" liabilities.

Terrell joined the U.S. Environmental Protection Agency in Washington, D.C. in 1972. Terrell worked in staff and supervisory positions in EPA's toxic substances and pesticides regulatory programs from 1973 to 1983, when he joined EPA Administrator Bill Ruckelshaus' immediate staff. From 1984 to 1990 Terrell served in turn as the senior enforcement lawyer for EPA's criminal, toxic substances/pesticides, and air enforcement programs. In his last government position, Terrell served as director of EPA's Office of Enforcement Policy.

In 1990 Terrell joined the Houston law firm of Bracewell & Patterson as the partner in charge of the environmental practice at the firm's main office. His clients included a wide range of chemical and industrial manufacturers, oil/gas producers, pipeline companies, electric utilities, real estate developers and financial institutions. Terrell joined Risk International in January 1996 as executive vice president and general counsel and was named president in October, 1997.

Terrell has written and lectured extensively on such subjects as preventive counseling, civil/criminal enforcement, voluntary compliance, and environmental auditing and risk management. His articles have appeared in the *Harvard Environmental Law Review* (1992), the *George Washington Law Journal* (1995), and in numerous practitioner publications. Terrell holds a BA from Brigham Young University (Economics) and a J.D. from Georgetown University Law Center. He is a member of the District of Columbia Bar.

significant relationships" standard set forth in the Restatement.[24] In *Cooper Industries, Inc. v. Liberty Mutual Ins. Co.*, No. H-91-3158 (S.D. Tex. Sept. 30, 1993), for example, a case involving environmental clean-ups in various states (but not in Texas), the court found that New York law should apply because (a) the policies were negotiated, brokered, executed, and performed in New York; (b) the party insured at the time the policies were issued was a New York corporation with its principal place of business in New York; and (c) parties had an expectation that New York law applied. The court found that Article 21.42 of the Texas Insurance Code did not *require* the application of Texas law because the contract did not arise in the course of Liberty Mutual's Texas business. In the final analysis, despite the apparent certainty of its language, the application of Article 21.42 turns on questions of fact which may ultimately be resolved by litigation if settlement is not reached.

III. CONCLUSION

Hopefully, the explication of Texas law provided above will assist London in assessing its exposure to Policyholder's environmental claims under the policies at issue. At times it has seemed that London has been rather cursory or cavalier in its analysis of the law. At other times, the analysis has been just plain wrong. This is especially true with regard to the issue of allocation. Both the umbrella and excess policies issued by the London market have significant exposure to Policyholder's claims under Texas law, because the Texas Supreme Court has already adopted a vertical allocation allowing the policyholder to pick and choose the policies to respond to a claim. It is quite inappropriate for London to apply a horizontal allocation to the claims under Texas law in order to reduce its exposure in settlement, because such an allocation is not permissible under Texas law.

Policyholder continues to stand willing to negotiate and compromise the numerous coverage issues surrounding the claims. However, any compromise must be based upon an accurate understanding of the law at issue and the legal principles which apply. London has vastly underestimated the compromise value of the claims at issue, stemming in part from an incorrect assessment of the law. Policyholder would welcome London's written response to the legal analysis provided above and the opportunity to discuss the same.

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[24] The statute has been interpreted to have *no* extraterritorial effect and has been found by some courts to be inapplicable when the insurance company is not engaged in business in Texas. *E.g., Austin Building Co. v. National Union Fire Ins. Co*, 432 S.W.2d 697, 701 (Tex. 1968); *see also Howell v. American Life Stock Ins. Co.*, 483 F.2nd 1354, 1359-61 (5th Cir. 1973). Some courts also have found the statute inapplicable where there has been no payment by the insurance company to a Texas resident. *E.g., W.R. Grace & Co. v. Continental Casualty Co.*, 896 F.2nd 865, 883 (5th Cir. 1990)(on petition for regearing)(Art. 21.42 inapplicable where policyholder was not a Texas resident or inhabitant, even though alleged occurrence took place in Texas).

FEDERALISM REVISITED

BARRY MCBEE, CHAIRMAN
TNRCC

NOTES

Texas Natural Resource Conservation Commission

The TNRCC Commissioners



Barry R. McBee

Barry McBee has served as chairman of the Texas Natural Resource Conservation Commission (TNRCC) since August 16, 1995. He was confirmed by the Texas Senate on February 17, 1997.

Prior to his appointment to this post by Governor George W. Bush, McBee had served as Deputy Commissioner of the Texas Department of Agriculture under Rick Perry since January 1991.

McBee returned to Texas from Washington, D.C., where he served as Associate Director of Cabinet Affairs at the White House. McBee came to the White House after his selection as a 1989-1990 White House Fellow by President George Bush.

He also served the State of Texas under the administration of Governor William P. Clements, Jr. from 1987 to 1989. He served as Deputy General Counsel to the Governor and, prior to this appointment, was Chief Deputy Director of Governmental Appointments.

McBee joined Governor Clements' staff from the Dallas law firm of Thompson & Knight, where he was elected as a partner in 1986 after five years tenure.

McBee is a 1978 graduate of the University of Oklahoma (B.A. with distinction), where he was elected as a member of Phi Beta Kappa, and a 1981 graduate of the Southern Methodist University School of Law (J.D. cum laude), where he was editor-in-chief of the Journal of Air Law and Commerce.

He is married and is the proud father of two sons.

FEDERALISM REVISITED

GREGG COOKE, ADMINISTRATOR
U.S. EPA-REGION 6

NOTES

United States Environmental Protection Agency

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Texas

May 11, 1998

EPA BIOGRAPHY

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Gregg A. Cooke

Regional Administrator

Gregg A. Cooke's appointment as the Regional Administrator for Region 6 of the U.S. Environmental Protection Agency was effective on May 11, 1998. As such, he directs the Federal environmental programs affecting Arkansas, Louisiana, New Mexico, Oklahoma, and Texas.

Gregg has a long history of working with both State and Federal government environmental agencies. He was a partner in the Natural Resources, Energy and Environment Section of Haynes and Boone and a member of the Environmental Law Practice Group. His practice included environmental litigation, permitting issues, and cross-border environmental matters.

Cooke served as an Assistant Attorney General for the State of Texas for three years, first as Chief of the Environmental Protection Division and later as Chief of the Natural Resources Division. In this capacity, he supervised attorneys who represented the State of Texas in all environmental and energy-related matters. Gregg also served as the State's North American Free Trade Agreement (NAFTA) Environmental Liaison, assisting the Border Environmenta Cooperation Commission (BECC) in Ciudad Juárez, Chihuahua, Mexico, as interim general counsel. There, he helped develop the initial rules and regulations which serve as the foundation of the BECC and the North American Development Bank, institutions formed following NAFTA to address U.S.-Mexico border environmental conditions.

He is the author of numerous articles including: "Civil Environmental Enforcement in Court," Advanced Environmental Law Course, State Bar of Texas, 1995; "Border Issues Roundtable," Advanced Environmental Law Course, State Bar of Texas, 1994; "Impact of NAFTA on State Administrative Law," Advanced Administrative Law Course, State Bar of Texas, 1994; and the co-author of "The Evolving Protection of State Laws and the Environment: NAFTA from a Texas Perspective," U.S.-Mexico Policy Studies Program, University of Texas at Austin; and "The Effects of NAFTA and Its Side Agreements on Water Resources Planning and Management," American Society for Professional Engineers, 1995. Cooke is a member of the American Bar Association, the State Bar of Texas (Section on Environmental and Natural Resources, Executive Committee, 1992-1995; Public Affairs Committee, 1990-1993). He also served on the Board of Directors of the Texas Lyceum (1989-1995).

VCP/Innocent Landowner Update

James C. Morriss, III

RECENT DEVELOPMENTS UNDER THE VOLUNTARY CLEANUP PROGRAM AND INNOCENT OWNER/OPERATOR PROGRAM

By James C. Morriss III
Thompson & Knight, P.C.
Austin, Texas

I.
INTRODUCTION

During the past two sessions, the Texas Legislature has enacted two new programs for encouraging development and redevelopment of properties affected by environmental contamination. The Texas Natural Resource Conservation Commission ("**TNRCC**") has implemented the programs through both rulemaking and policy. These two programs known as the Voluntary Cleanup Program ("**VCP**") and the Innocent Owner/Operator Program ("**IOP**") provide the tools for current owners, prospective purchasers, and lenders to obtain a measure of security from the risk of significant environmental liability. This paper is designed primarily to review current issues associated with these programs. A brief overview of each program will also be presented.[1] The TNRCC has an excellent homepage on the web which provides not only the VCP and IOP regulations, but summaries of these programs. As the VCP was created two years before the IOP, the information regarding the VCP provided by the TNRCC on its homepage has been developed from a much broader base of experience and for that reason is more helpful.

II.
VCP

A. SCOPE OF THE VCP

The VCP was enacted for the expressed purpose of providing an incentive to remediate property by removing liability of lenders and future landowners. [2] The program accomplishes this goal by creating an incentive for the voluntary investigation and remediation of properties affected by environmental contamination. A property is eligible for entry into the VCP so long as it is not subject to a TNRCC order or permit or a pending agency enforcement action. The property is entered into the program by the filing of an application together with a $1,000.00 fee. In addition, the applicant must sign an agreement that generally describes the schedule of activities necessary to achieve cleanup and confirms the applicant's undertaking to pay the cost

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[1] In addition, the attached article by Scott Deatherage and Matt Knifton, also of Thompson & Knight reviews these two programs in the broader context of federal policy and developments in other states.

[2] *TEX. HEALTH & SAFETY CODE ANN.* § *361.602* (Vernon Supp. 1998).

of agency oversight for the property. The incentive or the benefit of the VCP is protection from liability to the State of Texas afforded to prospective purchasers, lenders, and future owners of the property. This is accomplished by the issuance of the certificate of completion from the TNRCC which specifically states that all lenders and future landowners who are not otherwise responsible parties for conditions on the property are released from liability to the State for cleanup of the areas described in the certificate.[3]

The VCP has been a success in many respects. From the numbers, we see that through July 17, 1998 the VCP had received 718 applications. Of these sites 204 have been issued certificates of completion. These applications relate to various types of businesses including dry cleaners, manufacturing facilities, shopping centers, warehouses, auto-related businesses and other commercial and industrial enterprises. The "market" hates uncertainty. The VCP's appeal is its ability to either eliminate or at least limit uncertainty in a time frame essential to market transactions.

One of the most helpful aspects of the VCP is the way in which the TNRCC has developed its procedures to recognize the reality of transactions. Specifically, so long as the application is filed and the prospective purchaser and lender are identified as co-applicants on the application, the transaction can go forward. The prospective purchaser does not risk losing the benefits of the release under the VCP by closing on the property. Instead, the release from liability will date back to the date of the application, if the buyer is an original applicant, or the date that the buyer is added to the application. Thus, changing status and becoming the owner of the property, while the investigation and remediation are going forward, does not affect the protection available to the new owner or to the new owner's lender. Of course, there may still be the risks associated with purchasing the property before the scope of contamination is fully defined. These risks include the possibility that cleanup is not feasible and a release of liability will not be obtained.

The VCP does not release the present owner from liability to the State. However, once the conditions on the property have been addressed to the satisfaction of the State and a certificate has been issued, the risk or exposure to the owner or present operator is substantially reduced.

The risk of facing liability under federal environmental laws for conditions addressed under the VCP have been substantially reduced by the existence of a memorandum of agreement between the TNRCC and EPA Region VI. By this agreement, the EPA and TNRCC have agreed that EPA may initiate response actions at sites under the VCP only if the VCP applicant fails or refuses to complete the necessary cleanup and the TNRCC is unable to ensure completion of response actions at the sites or in emergency situations. The only other exception is in cases in which, following the issuance of the certificate of completion by the TNRCC, conditions at the site which were previously unknown to the TNRCC and EPA indicate that the response action undertaken under the VCP is not protective of human health

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[3] For a particularly helpful analysis of the VCP, *see* the *VCP Question and Answer Booklet* at www.tnrcc.state.tx.us/waste/pcd/vcp/vcpqa.htm.

and the environment. In those cases, both the TNRCC and EPA reserve the right to take necessary response action at the site. The TNRCC believes that the memorandum negotiated with EPA Region VI represents a fair allocation of the responsibilities between the agencies and is essential to the successful implementation of the VCP.

B. WHERE DO WE GO NEXT WITH THE VCP?

The VCP has demonstrated itself to be an effective tool for resolving liabilities for respective purchasers and lenders. It has also allowed the development of properties that previously had been subject to questions about the scope of required remediation or potential for liability for conditions which might remain on the property. In summary, the VCP has made the Brownfields Program in Texas a reality. To analyze how the VCP might be more effective, one must consider present limits on its application. There are at least two areas where an expansion of the VCP could provide a useful further incentive for brownfield redevelopment. They are the use of VCP to address conditions on property classified as a "facility" by virtue of its contiguity with a RCRA hazardous waste facility and the use of VCP to address conditions in a single media without requiring comprehensive remediation for all media at a site.

1. Use of VCP to Address Solid Waste Management Units ("SWMUs") and Areas Within RCRA "Facilities"

First of all, this proposal would not involve the use of the VCP to address a hazardous waste treatment, storage, or disposal unit such as a landfill or surface impoundment. Rather, the concept would be to address properties which might be caught within the sweeping definition of "facility" by virtue of the fact that they are contiguous to the units and under common control. Many hazardous waste units are located on large tracts. Often, large portions of the tract are not devoted to hazardous waste management activities. However, by virtue of the definitions of the term "facility" existing both in state and federal law, the owner/operator of the unit must address solid waste management units ("SWMUs") on those contiguous portions of the property. Further, by virtue of present TNRCC policy, an owner of that property contemplating a sale of a portion of the property unrelated to the hazardous waste unit would not be able to use the VCP to address conditions on that property. Presently, SWMUs must be addressed in the context of the permitting process or under a compliance order with the agency. A significant benefit could be achieved by expanding the availability of the VCP to address not only conditions on any portion of the tract not involved in the management of wastes but also to address SWMUs.

Why not, at the owner or operator's option, allow those units to be investigated and addressed through the VCP? Why not allow the owner to segregate a portion of its property for sale and utilize the VCP to investigate and address any conditions on that property affording protection from liability to prospective purchasers and lenders? In other words, why not obtain the full range of brownfield benefits with the VCP for these properties as well? The answer seems to lie in a heretofore understandable reluctance to rock the boat with EPA Region VI. Now, the messages from EPA, at least from the headquarters office, seem to

suggest that the federal agency is anxious to identify innovative approaches to speed the cleanup of industrial sites and specifically how to speed actions addressing SWMUs. EPA has clearly stated that states can and should contribute innovative approaches. These positions are clearly stated in an Advance Notice of Proposed Rulemaking[4] published in 1996 and in a memorandum reiterating the policy of encouraging innovation issued by Elliott Laws and Steve Hermann in 1997[5]. EPA is presently circulating for internal review an initiative called Cleanup 2000. Hopefully, this will provide further encouragement for innovation in speeding these cleanups. Finally, states and EPA have entered into an agreement calling for development and use of innovative approaches to environmental regulatory programs.[6]

The dialogue has already begun and a meeting will soon be held between the TNRCC and EPA Region VI to explore these possibilities. The test that should be applied is whether there is any policy reason against this innovative step. The standards to address cleanup will be the same whether they are applied by the VCP staff or the RCRA permitting staff. The issue is one of expediency and the benefits that can be derived for brownfield development.

2. Availability of the VCP for Addressing Discrete Groundwater or Surface Conditions

Presently, voluntary cleanup work plans and reports must include an assessment of the full nature and extent of contamination in all media unless the person demonstrates to the satisfaction of the Executive Director that site conditions warrant a focused investigation.[7] This exception is intended to apply where the applicant demonstrates that another media has not been affected. What about the case in which it is known that groundwater is affected, but the applicant believes it possible to demonstrate that conditions on the surface did not contribute to that contamination and the applicant would like to proceed under the VCP to address surface contamination alone. This is presently not possible. From the state's perspective, the comprehensive cleanup or at least a program for eventual cleanup of all media is desirable. From the market's perspective, it may be a waste of effort. There may be specific conditions on property that can be addressed and that if addressed to the satisfaction of a prospective purchaser could allow a transaction to proceed regardless of remaining contamination in another media. Again the example of surface contamination which might interfere with an intended use of the surface and groundwater contamination which may not impede the use of the property demonstrates this point.

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4 *61 Fed. Reg. 19432* (1996).

5 *Memorandum on "Use of the Corrective Action 'Advance Notice' of Proposed Rulemaking"* from E.P. Laws and S.A. Herman, 1997.

6 *63 Fed. Reg. 24784* (1998).

7 *30 Tex. Admin. Code § 333.7* (1997).

Another reason for allowing a certification of completion for a single media becomes evident when one considers the purpose and scope of the innocent owner/operator program ("IOP"). What if the groundwater contamination emanates from an off-site source, yet conditions on the surface result from past on-site activities? Obviously, the innocent owner does not wish to address the groundwater contamination in order to obtain the protection of the VCP for a prospective purchaser. A technical argument which might be offered against separating surface and groundwater for purposes of the VCP is the difficulty which the staff of the TNRCC might encounter in determining whether conditions on the surface and conditions in the groundwater are indeed separable. This can be answered by simply requiring a clear demonstration of such a separation from the applicant in order to qualify for separate certification. This approach is being employed in the IOP context at present.

III.
INNOCENT OWNER/OPERATOR PROGRAM

A. SCOPE OF THE IOP

During the 75th legislative session, the Texas Legislature enacted House Bill 2776. The bill accomplished a number of superfund reforms, enacted lender and fiduciary liability protection, and provided liability protection to the "innocent owner and operator." The IOP had its origins in the frustration of real estate developers who found during the course of environmental investigation that their properties were affected by offsite sources. While such landowners had some success in obtaining statements from EPA that the agency would exercise its discretion not to pursue a landowner for conditions which the landowner had neither caused nor contributed to,[8] the TNRCC had no similar mechanism. In fact, the position of the TNRCC with respect to such landowners was that they were potentially liable for conditions beneath their property, notwithstanding the fact that they had not caused the contamination, and had little, if any, ability to cleanup the contamination. While the agency insisted on maintaining its position, the only cases in which such liability was asserted were those in which the agency sought access to property adjacent to a source of contamination to facilitate the investigation or remediation of the source. Thus, the agency was maintaining its position on liability as a mechanism for obtaining access. It is said that with a large enough lever one could move the world. The lever of liability was used to motivate landowners into granting access to their neighbors. The agency's position with respect to liability also seemed to be influenced by whether the owner of the property knew of the contamination at the time of purchase. Prior to the IOP the TNRCC had taken the position that developers were somehow more culpable or at least less sympathetic and therefore, more likely to be subjected to liability for cleanup of the conditions if they had knowledge of the contamination at the time of

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[8] *EPA Policy Toward Owners of Property Containing Contaminated Aquifers, 60 Fed. Reg. 34790* (1995). *See* also *EPA Guidance on Landowner Liability* under Section 107(a)(1) and *De Minimis Settlements* under Section 122(g)(1)(B) of CERCLA, and *Settlements with Prospective Purchasers of Contaminated Property, 54 Fed. Reg 34* (1989).

purchase. These agency positions had a profound effect on the ability of landowners affected by an offsite source to evaluate and quantify the risk associated with conditions on their property. This state of affairs affected the ability to secure financing, attract buyers, and ultimately develop the property. While the VCP might technically be available to such landowners, the VCP would require that the landowners commit to cleanup the contamination attributable to another.

Against this backdrop, a number of attorneys who represented clients who had experienced this problem, the legal and technical staff of the TNRCC involved in state superfund and VCP issues, and the general counsel's staff worked together to develop a legislative solution. The solution was a grant of immunity from liability for an innocent owner or operator. An innocent owner or operator is a person that is an owner or operator of property that has become contaminated as a result of release or migration of contaminates from a source or sources not located on or at the property and who did not cause or contribute to the source or sources of contamination.[9]

The innocent owner or operator is not liable under either the Texas Health & Safety Code or the Texas Water Code for investigation, monitoring, remediation, or corrective or other response action regarding the conditions attributable to a release or migration of a contaminant. There are, however, two exceptions to this broad release. First, we addressed the possibility that a party who owns property on which the source is located might attempt to subdivide the property, selling off the contaminated fringes. This would permit the seller to use the IOP to thwart the benefits intended by the VCP. A seller could cloak each buyer in the protection of the IOP without the need to address the contamination. To avoid this problem a person buying property from the person that caused the release is subject to a different burden. The person acquiring property from the person who caused the release is eligible for immunity only if that person did not know or have reason to know of contamination at the time the person acquired the property. Further, that person must have made an appropriate inquiry consistent with good commercial and customary practice.[10]

The second exception relates to reasonable access. As noted above, the TNRCC had been hanging onto liability for the innocent owner or operator in order to compel access for offsite property for investigation and remediation purposes. Thus, it was important to the TNRCC to obtain some assurance that access would be granted. Section 361.752 provides that in order to be eligible for immunity, the owner or operator must grant "reasonable access" to the property for purposes of investigation or remediation to a person designated by the Executive Director. The reasonable access may, however, be conditioned upon an agreement that the designated person may not unreasonably interfere with the use of the property, upon obtaining payment of reasonable compensation for access to the property, and upon receiving an indemnification for an intentional or negligent act of a designated person arising from the person's access to and use of the property. This provision is designed to address access by an

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[9] *TEX. HEALTH & SAFETY CODE ANN. § 361.751* (Vernon Supp. 1998).

[10] *Id. § 361.752(b).*

adjacent property owner conducting an investigation pursuant to a TNRCC directive. It does not permit the innocent owner or operator to condition access to the property by the TNRCC or its contractors. This right of access is afforded by other provisions of the Health & Safety Code[11] and the Water Code.[12]

As a primary purpose of the innocent owner/operator legislation was to facilitate transfers of property, it was important to develop a mechanism for obtaining a determination from the state that an owner was in fact an innocent owner or operator. This optional process is embodied in a certification process.[13] Under this process, a person may apply to the TNRCC for a certificate confirming that the person is an innocent owner or operator. In order to obtain a certificate, the applicant must demonstrate that it is eligible for immunity under the statute. The statute authorizes the agency to collect a fee in an amount not to exceed the cost of reviewing the application. (Unfortunately, the TNRCC was not able to obtain an appropriation during the legislative session to allow it to withdraw the monies collected to fund the program.)

B. THE IOP CERTIFICATION RULES

Following a number of informal meetings in which the authors of the legislation shared ideas with the agency staff about how the statute might work in practice, the TNRCC proposed rules concerning the certification process. The final rules were promulgated by the Commission on July 29, 1998. One of the most difficult aspects of developing the rules was the fact that the statute does not appear to contemplate that the certificate would "run with the land," as is the case with the VCP. Such an approach would make it easier to use the certificate in land transactions. This difference from the VCP is based upon the fact that the agency is directed to evaluate the status of an individual, together with the status of conditions on the property. In fact the individual's status is the key element of the analysis. This requires a separate review of the qualifications of any applicant. Further, the statute speaks in terms of "owners" and "operators" rather than prospective purchasers or lenders. Accordingly, the TNRCC concluded that it could not issue a certificate to a prospective purchaser until that individual had achieved the status of owner or operator. As a result, the regulations adopt an innovative approach allowing a prospective purchaser to apply or join the owner as a co-applicant and obtain the certificate upon filing proof of its status as owner or operator.

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[11] *TEX. HEALTH & SAFETY CODE ANN. § 361.032* (Vernon Supp. 1998).

[12] *Tex. Water Code Ann. § 12.017, 26.014* (Vernon 1988 and Vernon Supp. 1998).

[13] ___ *Tex. Reg.* _____ (1998) (to be codified at *30 TEX. ADMIN. CODE § 333.34(c)*) (promulgated July 29, 1998, with expected publication date of August 14, 1998, Tex. Natural Resource Conservation Comm.).

The rules do not require that the applicant be a current owner or operator of the site in order to apply for the certificate, but the applicant must provide proof of ownership or operation before a certificate can be issued.[14]

The rules also specify the contents of the application. The application must contain general information concerning the owner or operator, a site investigation report, a legal description of the site and the name of the site owner and/or operator as appropriate, and a statement that the owner or operator has not caused or contributed to the offsite source or sources of contamination.[15]

The Site Investigation Report must include relevant information concerning the potential for human exposure to the release or migration of contaminants at the site and information concerning site contamination which demonstrates the site has been contaminated as a result of a release or migration of contaminants from a source or sources not located on the site and that the applicant has not caused or contributed to the offsite source or sources of contamination which have released or migrated onto the site. The Site Investigation Report must also include a summary of all known historical and current site uses including a description of areas and activities where potential onsite contamination may be located.[16] If the tract has been subdivided from the property upon which the source is located, the applicant must make a further showing as required by the statute to demonstrate eligibility. Specifically, the person must have acquired the property after appropriate inquiry consistent with good and commercial and customary practice and must not have or have reason to know of the contamination at the time the property was acquired. Finally, the Site Investigation Report must include previously completed Site Investigation Reports within the possession or control of the applicant, a schedule for conducting any additional site investigation activities, and a description of any placement of institutional controls or engineering controls proposed by the applicant.[17]

The rules also allow the applicant to describe onsite contamination of contaminants that are the same or similar to those being released by the offsite source and propose investigation or remediation or other response action for review by the Executive Director. This provision is an effort on the part of the staff to tailor the IOP to deal with the present limitations of the VCP.

If a sale, transfer or change in ownership will occur during the application review process, the rules allow the prospective purchaser to join the operator in the application and provide additional information regarding the prospective purchaser to qualify the prospective

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[14] *Id.* § 333.35.

[15] *Id.* § 333.35(c).

[16] *Id.* § 333.35(c)(7).

[17] *Id.* § 333.35(d).

purchaser as an innocent owner/operator.[18] In contrast, if a certificate holder contemplates the sale or transfer of property and the prospective purchaser wishes to obtain a certificate, the certificate must first be brought current by updating information demonstrating that the existing owner/operator is still eligible and the prospective purchaser is eligible for innocent owner/operator status. This involves providing the agency with information on activities conducted on the property since the certificate was issued and possibly conducting additional site investigation activities if subsequent land use suggests that onsite contamination may occur.[19]

Section 333.36 of the rules provides for notice to adjacent land owners. The applicant is required to mail notice that the application has been submitted to property owners adjacent to the site within fourteen (14) days of submitting the application. The notice is to advise adjacent landowners of the availability of information in the agency files and request that adjacent property owners submit any additional information which may assist the Executive Director in reviewing the application within fourteen (14) days of the notice. The Executive Director notifies the applicant of any information obtained from adjacent landowners and provides the applicant with an opportunity to review that information.[20]

Section 333.38 of the rules provides that prior to the issuance of the certificate, the applicant and any co-applicant must file an affidavit affirming their eligibility prior to the issuance of the certificate.

The certificate will specify the contaminants and the media for which the Executive Director has confirmed the applicant's innocent owner/operator status. This program is quite different from the VCP which requires that the application and ultimately the certificate address all media and contaminants. As noted above, the proposed rules also provide that the certificate will only be issued to a co-applicant following receipt by the Executive Director of proof of ownership or operation. Similarly, if either institution or engineering controls for the site are required, the certificate will only be issued after the Executive Director has received proof of the filing of the restrictive covenant in favor of the agency and the state describing those restrictions.[21]

Another issue addressed by rules is revocation. The Executive Director may revoke a certificate if the certificate holder acquired the certificate by fraud, misrepresentation or knowing failure to disclose material information. The Executive Director may also revoke the certificate in instances in which the certificate holder fails to maintain institutional or engineering controls or does not pay agency costs. Finally, the Executive Director retains the

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[18] *Id.* § 333.35(e).

[19] *Id.* § 335.36.

[20] *Id.* § 335.38.

[21] *Id.* § 333.40(c).

right to revoke the certificate if new information demonstrates that the certificate holder is not an innocent owner or operator. The Executive Director will provide a certificate holder with notice in writing of the facts alleged to warrant revocation. The certificate holder will be afforded a thirty-day period in which to demonstrate to the Executive Director that it is in compliance with the requirements of the law.[22]

The issue of revocation can also arise in disputes over access. The rules as finally adopted make it clear that the commission rather than the Executive Director may revoke a certificate if a certificate holder unreasonably denies access. However, revocation must be based upon facts and/or evidence presented to the commission through an enforcement action. The certificate will remain valid until so revoked.[23] The preamble observes that this approach is consistent with internal agency procedures that have been developed to assist in access disputes should they arise.

C. ISSUES ARISING REGARDING THE INNOCENT OWNER/OPERATOR LEGISLATION

1. Access Issues

One of the most interesting debates concerning the development of rules for the innocent owner/operator program was the issue of access. Initially, there was great opposition on the part of the staff to becoming involved in the analysis of whether the position of the innocent owner/operator with respect to access was a reasonable position. This resistance was based upon the concern that the staff lacked the expertise to assess the merits of arguments over access. The statute requires an owner/operator to grant reasonable access but allows the owner/operator to condition that access on an agreement. Eventually, the staff and ultimately the commission settled on what might be characterized as an "enforcement" approach. Under this approach, the TNRCC will first confirm that access has been denied to the person designated by the TNRCC. This will be done by requesting that the designated person provide a copy of the certified letter requesting access for the purpose of investigation and/or remediation. The TNRCC will then notify the owner or operator that the agency has received documentation of that person's reluctance to provide access and that the agency has designated the person requesting access as a person entitled to reasonable access. The agency will attempt to persuade the owner or operator to give access but if the owner/operator continues to deny access, the TNRCC will refer the matter to Alternative Dispute Resolution ("ADR") and ask the ADR office to notify the disputing parties of the availability and purpose of mediation as an alternative to possible enforcement. Ultimately, if the owner/operator continues to refuse access, the matter will be referred to the enforcement division with directions to initiate an enforcement action. The enforcement action will not only seek access, but also seek revocation of any innocent owner/operator certificate held by that person. Given that most disputes involving access are, in essence, commercial disputes where the issue of money and agreement on reasonable restrictions on the use of the property are the only issues, the agency

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[22] *Id.* § 333.40(c).

[23] *Id.* § 333.40(d).

and those of us involved in developing this approach strongly believe that these matters will be resolved in the course of negotiations between the parties. Few will proceed to mediation and an even smaller number will become the subject of enforcement. However, in those cases that are referred to enforcement, the TNRCC must analyze the position of the innocent owner or operator with respect to access. Only those instances in which the agency concludes access has been unreasonably denied should proceed to the Commission.

2. Cross Media Issues

IOP cases have already been presented to the TNRCC in which groundwater contamination originates from an offsite source but surface contamination is attributable to past use of the property. As noted above, this presents a frustrating dilemma for the site owner. While the site owner is eligible for innocent owner/operator status with respect to groundwater contamination, the owner is not eligible for participation in the VCP unless it is willing to commit to cleanup the groundwater. This would, of course, defeat the benefit of the innocent owner/operator program. Some mechanism needs to be developed to dovetail the protection afforded by the IOP and the relief available under the VCP. As suggested above, this could be accomplished by allowing single media cleanups under the VCP.

IV.
INNOVATION IN THE USE OF THE VCP AND IOP: SETTLING CASES

The primary benefit to the owner/operator of the IOP is certainty with respect to liability to the state. In the past, as landowners had to be concerned about the potential for liability being imposed on their property, they could rightfully contend that the property had been damaged and that one measure of their damages was the potential remediation costs to address conditions on their property. This position had merit whether or not the condition interfered with the use of the property. The IOP eliminates that risk and focuses the damage debate on whether the conditions interfere with the use of the property, thereby affecting its value. Accordingly, the IOP, together with the VCP, have become tools in settlement discussions. A landowner whose operations have affected an adjacent property owner can offer to conduct a cleanup on the property to satisfy the risk reduction rules under the VCP and at the same time pursue on behalf of the adjacent owner/operator an innocent owner/operator certificate. This combination not only resolves any potential for liability of the innocent owner/operator to the state, but clarifies any limitations on the future use of the property. If, for example, the property can be cleaned up to risk reduction standard 2 for residential property and an innocent owner/operator certificate obtained, the affected property owner has arguably been made whole. There is no limitation on the use of the property, and the owner has no concern about future liability to the state. The opportunities for using these techniques is limited only by the imagination of the counsel for the two parties.

V.
CONCLUSION

Environmental laws have developed over time to address the shortcomings of the market. Costs that could not be otherwise brought home to industry were legislated or regulated into decision making. In some cases, we now find that these efforts have gone too far and thwart the effectiveness and benefits of the very market they were intended to repair. The VCP and IOP are corrective measures intended to balance more appropriately the effects of regulation and market. As we have seen, the market can be a powerful and positive force for environmental action. The challenge, as we rediscover the market's importance, is to continue to correct or eliminate impediments to its effectiveness.

Attachment

New State Statutes Provide Liability Relief for Owners Or Operators of Property Contaminated by Off-Site Sources

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NEW STATE STATUTES PROVIDE LIABILITY RELIEF FOR OWNERS OR OPERATORS OF PROPERTY CONTAMINATED BY OFF-SITE SOURCES

This article examines the recently enacted amendments to the Texas Solid Waste Disposal Act specifically excluding from liability owners or operators of property contaminated from an off-site source, and how other states handle such liability issues.

231.741 Introduction

In 1997, Texas enacted amendments to the Texas Solid Waste Disposal Act to specifically exclude from liability persons whc own or operate property that has become contaminated by migration of contaminants from a pollution source located on another property. The new law also provides for a process to obtain from the state's environmental agency, the Texas Natural Resource Conservation Commission, a certificate that confirms the off-site source of the contamination and that the owner or operator of the property is not liable to investigate or remediate the contamination. This legislation was designed to relieve any concern that current owners or operators or persons to whom they may sell or lease their property would be required to address such contamination. The Wisconsin Legislature recently passed a similar law, and several other states provide protections for innocent owners and operators.

These statutes are designed to address the problem of any potential liability that may attach to property to which contamination has migrated from an adjoining property. These statutes also encourage development and use of "Brownfields"—property that may be undeveloped or underdeveloped because of actual or perceived environmental contamination.

The principle underlying these statutes is that parties who did not cause the contamination should not be liable for investigating or cleaning it up. This principle derives from the age-old concepts of fundamental fairness in Western culture and centuries-old theories from English common law that only those who commit a wrong and cause harm to another should be liable for damages. In addition, from an economic perspective, if parties are concerned that they will be held liable for contamination, they may decide not to purchase the property or may seek some protection from environmental liability in the form of a price reduction, insurance, escrowed funds, indemnity, or some other form of risk shifting. There also exists the practical difficulty of remediating contamination, particularly groundwater contamination, arising on another piece of property. Technically, it may be impossible to remediate ground water if the release of contaminants from a pollution source cannot be stopped or if the treatment system only reaches a portion of the overall contaminant plume.

As a result, the Texas law was clarified to assure innocent owners and operators that they will not be held liable for another person's pollution. The resulting legislation serves as a model for Congress and other states.

(1) What is an "Innocent Owner or Operator?"

Traditionally, an "innocent landowner" was considered a person who purchased property where contamination had been released, but who could take advantage of the third party defense under the federal statute or similar state statutes because the party exercised all appropriate inquiry before acquisition of the property and did not know and had no reason to know of the environmental contamination.[1] This defense has been called the "Innocent Purchaser Defense" or the

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[1] See 42 U.S.C. §§ 9601(35)(A)(i), (B), 9607(b)(3); Tex. Health and Safety Code §§ 361.275(a)(3), (e)(2)(B), (f).

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"Innocent Landowner Defense." This is not what is meant by the term "innocent owner or operator" for purposes of this article.

In this article, an "innocent owner or operator" is a person who owns or operates property contaminated by a release from a source on a nearby property, provided the owner or operator did not cause or contribute to the release on that property.

It does not include a person who purchases, leases, or otherwise becomes an owner or operator of the "source property" from which contamination has been released. In this article, property of concern owned or operated by a particular party will be known as "on-site" property while nearby or adjacent property will be referred to as "off-site" property. The property where the source of a release arises will be known as the "source property."

(2) Why the Need for Innocent Owner or Operator Legislation?

Shortly after the passage of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, the U.S. Environmental Protection Agency and the U.S. Department of Justice began to expand the scope of liability of the act to reach any and all parties with only the most tangential, if any, responsibility for the contamination. The goal was to hold every "deep pocket" liable. Unfortunately, the statute was not very clearly drafted and the federal courts issued many opinions that broadened the scope of liability. Many state legislatures and environmental agencies adopted similar legislation and regulations. These developments created a growing concern among the business and lending communities about purchasing, leasing, or accepting as loan collateral property contaminated by hazardous wastes or hazardous substances.

Businesses and lenders directed this concern not only at properties where contaminants may have been released but also at those nearby or adjacent properties that may have become contaminated by the migration of contaminants, even though the current and any future owner had no involvement in the release of the contaminants and had never owned the source property. Actual or potential "innocent owners or operators" were concerned that, absent a solvent party who either caused the contamination or was considered an owner or operator of the source property, the government would attempt to impose liability on innocent parties.[2]

In 1995, EPA, under attack by the public, various business and industry groups, and certain members of Congress, began looking for ways to cut back on the inequitable potential liability under CERCLA and developed a variety of policies and regulations attempting to undo much of the legal concerns EPA had created. In addition to a rulemaking designed to reverse a decision by a federal court of appeals and to protect lenders,[3] EPA announced its Brownfields program. This program attempted to ease the concern in the marketplace over liability for contaminated properties.[4] "Brownfields" were defined as contaminated properties that were not being developed or adding to the economy because of the concern that buyers would not purchase the property

[2] *Dravo Corp. v. Zuber*, 804 F. Supp. 1182, 1184 (D. Neb. 1992) *aff'd on other grounds*, 13 F.3d 1222 (8th Cir. 1994) (suit by a party that caused contamination against parties that merely owned or operated property to which contamination migrated); *Reichold Chemicals v. Textron Inc.*, 888 F.Supp. 1116, 1129 (N.D. Fla. 1995) ("While it may seem inequitable, the mere migration of contaminants from adjacent land constitutes disposal for the purposes of CERCLA, and passive downstream landowners are liable for the cleanup costs resulting from their neighbors' activities"). The EPA recognized that actually CERCLA provided a defense to this liability. See note 6 and accompanying text.

[3] A case in point is *U.S. v. Fleet Factors Corp.*, 901 F.2d 1550 (11th Cir. 1990), cert. denied, 498 U.S. 1046 (1991) This case held that lenders could be liable if they had a "capacity to influence" a corporation's treatment of hazardous waste. This decision sent a shock wave through the lending community as all lenders would become their "brothers keepers" with respect to borrowers and their environmental activities. In 1992, EPA issued rules in an attempt to protect lenders. These rules were struck down in 1994, in the case of *Kelley v. EPA*, 15 F.3d 1100 (D.C. Cir. 1994), because the U.S. Court of Appeals for the D.C. Circuit concluded that EPA had exceeded its statutory authority and invaded the jurisdiction of the federal courts to determine what parties may be liable under CERCLA. Subsequently, in 1996, Congress enacted an amendment to CERCLA that added considerable protections for lenders—The Asset Conservation, Lender Liability, and Deposit Insurance Act, contained in Title II, Subtitle E, Section 2501-2505 of the 1996 Omnibus Appropriations bill [EDDG App. 501.601].

[4] EPA Progress on the Brownfields Action Agenda [EDDG App. 501.1465].

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or lenders would not lend money for such purchases because of the fear of potential environmental liabilities. Brownfields programs encourage cleanup by offering covenants-not-to-sue or releases from liability once the government approves the cleanup. States adopted similar, and in some cases, more aggressive programs to encourage voluntary cleanup of sites.[5]

These programs were not typically designed to address the downstream owner or operator whose property had been contaminated by an off-site source. However, EPA took steps to address these parties' concerns by issuing the policy described below. Unfortunately, many state environmental agencies were not willing to adopt a similar policy.

For example, the Texas Natural Resource Conservation Commission interpreted Texas environmental statutes to allow the agency to impose liability on innocent downstream landowners in certain circumstances. This lead to efforts to change Texas law to provide clear protections to innocent landowners and operators of properties that were contaminated not by their own acts but by the release and migration of contaminants from nearby properties.

The Texas legislation should serve as a model for innocent owner/operator legislation in other states and in Congress. While fault and causation may not be fully returned to the law of environmental liability, at least innocent owners and operators of property contaminated by an off-site source should be free of liability for cleaning it up. Returning this level of rationality and equity to environmental laws in this country could reduce or avoid the potential concerns over remediation liability that may plague properties contaminated by third parties. This reform of environmental law will greatly enhance both state and federal Brownfields programs and allow property to be returned to productive uses, and thereby contribute to the economy and to local, state, and federal tax revenues.[6]

[5] See, e.g., Tex. Health and Safety Code § 361.601 - .613.

[6] As of May 18, 1998, 34 sites had applied to the Texas Innocent Owner/Operator Program to obtain a certificate that the owners and operators of those properties are not liable for the contamination that has originated from off-site sources.

(a) Federal Approach to Innocent Owners and Operators

(1) EPA Policies

The federal approach to innocent owners and operators was first addressed in 1989 in an EPA guidance document entitled *EPA Guidance on Landowner Liability under Section 107(a)(1) and De Minimis Settlements under Section 122(g)(1)(B) of CERCLA, and Settlements with Prospective Purchasers of Contaminated Property.*[7] This document provided as follows:

> Even before the enactment of SARA, it was clear that the third party defense of Section 107(b)(3) was available to a landowner whose property was contaminated as the result of the act or omission of a third party who had no contractual relationship with the landowner through a deed or otherwise, as long as the landowner satisfied the other requirements of the third party defense. Examples of this situation include contamination of property by adjacent landowners and "midnight dumping." A landowner who falls within this category and demonstrates that he has exercised due care may be eligible for a *de minimis* settlement under Section 122(g)(1)(B).

EPA recognized that an innocent owner, and by extension of the argument probably an innocent operator, was not iable under the statute pursuant to the third party defense under Section 107(b)(3) of CERCLA. What was unclear was what the agency meant by "the other requirements of the third party defense." It may have been that what EPA was referring to are the due care and precautions taken against foreseeable acts or omissions of the third party that caused the contamination under Section 107(b)(3)(a) and (b). These added requirements created considerable uncertainty as to what a landowner could possibly do to avoid contaminants or hazardous substances migrating under his property. In addition, they did not answer the question of what, if anything, a purchaser is supposed to do when acquiring property contaminated by an adjacent property.

[7] U.S. Environmental Protection Agency, Office of Solid Waste and Emergency Response, No. 9835.9, 54 Fed. Reg. 34, 235 (Aug. 18, 1989) [EDDG App. 501.1001].

Six years later, in 1995, after attacks from Congress, business, local and state governments, and a variety of other sources, constituencies, and stakeholders, EPA finally announced its *EPA Progress on Brownfields Action Agenda.*[8] This was part of EPA's announced Superfund Administrative Reforms and part of EPA's Brownfields Action Agenda. One of the three main legs of the Brownfields Action Agenda was a new document entitled *EPA Policy Toward Owners of Property Containing Contaminated Aquifers.*[9] In its *Progress report on Brownfields Action Agenda,* EPA stated that the contaminated aquifer guidance "removes a major roadblock to the reuse and redevelopment of property situated above a contaminated aquifer created by a source outside their property. The guidance assures lenders, owners, and prospective purchasers of these properties that EPA does not anticipate suing them to recover cleanup costs."

The document drafted to address this issue, as mentioned above, *EPA Policy Toward Owners of Property Containing Contaminated Aquifers,* provided the details of this qualified pledge by EPA.[10] The policy states that it was designed to address two concerns of the innocent landowner. First, the policy clarified that the agency would not seek to impose liability on innocent landowners. Second, it stated that it was attempting to address the concerns that a prospective purchaser or lender might have about potential CERCLA liability. The new policy started from a general premise and then stated several conditions.

The general premise is as follows:

> [W]here hazardous substances have come to be located on or in a property solely as the result of subsurface migration in an aquifer from a source or sources outside the property, EPA will not take enforcement action against the owner of such property to require the performance of response actions or the payment of response costs.

EPA also addressed the question of due care or precautions that might be required of an innocent landowner.

> Based upon EPA's technical experience and the agency's interpretation of CERCLA, EPA has concluded that the failure by such an owner to take affirmative actions, such as conducting groundwater investigations or installing groundwater remediation systems, is not, in the absence of exceptional circumstances, a failure to exercise "due care" or "take precautions" within the meaning of Section 107(b)(3).

EPA set three conditions for not taking enforcement actions against innocent owners and operators. The first condition is as follows:

> The landowner did not cause, contribute to, or exacerbate the release or threat of release of any hazardous substances, through an act or omission.

This resurrects "causation" as a fundamental element of liability—returning to the age-old elements of common law and most statutory liability provisions. The most troubling aspect of this condition is the requirement that the landowner not "exacerbate" the release or threat of release of any hazardous substances. The concern is that "exacerbate" can take on a very broad meaning. The example given by EPA is that if a landowner operating a well might affect the migration of the contaminants in the aquifer, EPA will not apply the policy. EPA stated that it will decide on a fact-specific basis whether to enter into a *de minimis* settlement with the landowner for contamination that has migrated onto his property.

This condition is too narrow. Persons who own wells may often affect the flow of groundwater and thereby the migration of contaminants in an aqui-

[8] May 25, 1995 [EDDG App. 501.1465].

[9] U.S. Environmental Protection Agency, Office of Enforcement and Compliance Assurance, May 25, 1995, 60 Fed. Reg. 34790 (July 3, 1995) [EDDG App. 501.1425].

[10] Only a bureaucratic agency could state that it "assures" that it "does not anticipate" suing someone. How this level of "assurance" would be helpful to the market that requires certainty is perplexing, but this vague and conditional pledge is in keeping with the approach EPA and the Department of Justice have taken in Brownfields matters. The draft policy on Brownfield Agreements with states that was announced in August 1997 and then withdrawn in November 1997 [EDDG App. 501.1725] after vociferous criticism from practically all stakeholders is evidence of the difficulty these two government agencies have in providing comfort or assurance to the marketplace.

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fer without any knowledge of this result. The EPA policy suggests that a person who discovers or is informed of contamination may be unable to use the groundwater underneath the property, even if it is treated before use. The EPA policy may then transfer some part of the liability, albeit de minimis under certain circumstances to the landowner by virtue of legally operating its ground water well. EPA may have a valid basis for asking the landowner to take steps to avoid spreading groundwater contamination in certain cases, but not to transfer some or all of the liability to the innocent landowner who happens to use a well. At a minimum, EPA should have provided that any exacerbation be knowing and intentional. At that point, EPA could consider whether the party was attempting to create a cause of action for actual damages or diminution in value to his property against the party that released the contaminants.

The second condition of this policy is as follows:

> The person who caused the release was not an agent or employee of the landowner, and was not in in a direct or indirect contractual relationship with the landowner.

The first part of this condition wisely is designed to deny the landowner liability protection when he or his agent or employee caused the contamination. The second element—that the person who caused the release not be in a direct or indirect contractual relationship—addresses what may be called the "fraudulent subdivision" exception. What EPA stated it was trying to avoid is the purchase from the person who caused the contamination of a smaller tract of land that was subdivided from a larger parcel where the release occurred. In other words, the property was a subpart of the contaminant source property. The question then is whether the source of the contamination is truly off-site, or a portion of the on-site property.

Even if the buyer purchased the property from the person who caused the contamination or release, the buyer may be able to avoid liability if it establishes that it did not know or have reason to know of the contamination after exercising appropriate environmental due diligence. The purchaser would have to establish the "innocent purchaser" defense under Section 101(35)(A)(i) of CERCLA. EPA addressed this as follows:

> Thus, in the subdivision scenario described above, the current landowner might still qualify for the Section 107(b)(3) defense if he or she did not know or have reason to know that the original landowner had disposed of hazardous substances elsewhere on the larger parcel.

The concern is that a person may sell all but a small portion of the property he has contaminated—profiting from the property sold and retaining a small tract that contains the source of pollution.

The policy's third condition to avoid suit by EPA against the innocent landowner is as follows:

> There is no alternative basis for the landowner's liability for the contaminated aquifer.

Again, this appears to address the causation question. The first example given is where the landowner is a generator or transporter of the waste that caused the contamination. Liability protection should not be afforded a landowner who arranged for or transported waste to the site from which contaminants have migrated onto his property. The landowner should bear some responsibility for that waste to the extent otherwise liable under CERCLA. The second example is also causation based. EPA stated that the landowner would be liable if a source of contamination existed on its property in addition to contaminants on the property that originated from an off-site source. What is not clear and should have been stated by EPA is that the party ought to be liable in this circumstance only for that contamination released from a source on his property. The landowner should not be liable for that contamination that originated from an off-site source, even if he has contributed some contamination to his own property. In this way, responsibility for different areas, types, or sources of pollution may be apportioned in an equitable manner.

(2) Congressional Activity

In Congress, the desire to protect innocent owners and operators has been expressed as well. Senator Robert Smith (R-N.H.) authored S.B. 8 that would have reformed CERCLA in many different

ways. One of the reforms would protect owners or operators of "contiguous property" to a superfund site. The legislation provided:

> A person that owns or operates real property that is contiguous to or otherwise similarly situated with respect to real property on which there has been a release or threatened release of a hazardous substance and that is or may be contaminated by the release shall not be considered to be an owner or operator of a vessel or facility.[11]

To be excluded from the definition of "owner or operator" the person would not have been permitted to have caused, contributed, or consented to the release or threatened release; and the person could not have been liable, and not affiliated with any other person that was liable, for any response costs at the facility, through any direct or indirect familial relationship, or any contractual, corporate, or financial relationship other than that created by the instruments by which title to the facility is conveyed or financed.

The legislation provided that EPA may give assurances to such persons that it will not take action against them and will grant them protection against a cost recovery or contribution action under section 113(f). In return, for these protections, the innocent landowner would have been required to fully cooperate, assist, and allow facility access to persons responsible for response actions.

This bill was proposed in 1997 but was never passed by the Senate. Whether any Superfund reform bill will be passed in 1998 is unclear. Because it is an election year, a Superfund reform bill may not make it out of either the House or the Senate before Congressmen and Senators leave on recess to campaign for reelection.

(b) The Texas Program

(1) Legislation

a. Who Is Innocent and Not Liable for Contamination?

In order to clarify statutorily that innocent owners and operators are not liable for contaminants that migrate from nearby properties, the Texas Legislature passed amendments to the Texas Solid Waste Disposal Act. The Texas legislation defines an innocent owner or operator as a person who owns or operates property that has become contaminated because of a release or migration of contaminants from a source or sources not located on the owner or operator's property, and who did not cause or contribute to that source.[12] Certain additional requirements apply when a person acquires the property that has become contaminated by an off-site source (1) from the person that caused the release of contamination and (2) the property was formerly a portion of the tract of land on which the source of contamination is found.[13] In this situation, the person is eligible for immunity "only if, after appropriate inquiry consistent with good commercial or customary practice, the person did not know or have reason to know of the contamination at the time the person acquired the property." This limitation only applies if the owner or operator of the property acquired the property from the person that caused the release. If the property is acquired from a subsequent landowner or other person, then the limitation on liability or additional burden to meet the defense does not apply.

b. Access Issues

Under this legislation, the owner or operator must provide reasonable access to the property to persons designated by the executive director of the Texas Natural Resource Conservation Commission.[14] What constitutes "reasonable access" is often a case-by-case, site-specific issue, and the exact terms of any access agreement should be left to the party seeking access and the owner or operator of the property.

The legislation provides that an innocent owner or operator may:

- Require that the designated person not unreasonably interfere with the use of the property;
- Require that the designated person pay reasonable compensation required for access; and

[11] S.B. 8.

[12] Tex. Health and Safety Code Ann. Section 361.751(2)(A)-(B).

[13] Tex. Health and Safety Code Ann. Section 361.752(b).

[14] Tex. Health and Safety Code Ann. Section 361.752(c).

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● Require indemnification for intentional or negligent acts of the designated person arising from access.

(2) Innocent Owner/Operator Certification

The second aspect of this new legislation is a certification program for innocent owners and operators.[15] The first step in this process is the submission of an application to the TNRCC for an Innocent Owner/Operator Certificate. The applicant must submit a Site Investigation Report that demonstrates the contamination has arisen from an off-site property, and that the owner or operator has not caused or contributed to the off-site source of contamination. In addition, if the owner or operator acquired the property from the person that caused the contamination and the property is a subpart of the original source property, then the applicant must demonstrate it engaged in appropriate due diligence and did not know of have reason to know of the contamination on the property.

The legislation provides that the TNRCC may charge an application fee to cover the costs of reviewing an application. To prevent delays in agency response, the legislation provides that within 45 days of receipt of an application, the TNRCC must decide whether the application is complete. Within 90 days of receipt of an application, the TNRCC must either accept, deny, or request more information that is needed to make a decision. Within 45 days of receipt of any additional information requested, the TNRCC must issue or deny the Innocent Owner/Operator Certificate.

The TNRCC may condition the issuance of the certificate on property use restrictions that are reasonably necessary to protect the public health.[16] These restrictions may include institutional controls, such as deed restrictions or municipal zoning, that ensure the use of the property or groundwater does not pose a health risk. In addition, if the owner or operator consents, other control measures may be imposed beyond mere institutional controls. These might include fencing or other measures to restrict access. The intent was not to allow the agency to impose engineering controls that would eviscerate the liability relief for remediation, corrective action, or other response action. The TNRCC may not, for example, require the Innocent Owner/Operator to construct a French drain or slurry wall around the property or to construct a cap over contaminated soil.

(3) Draft Implementing Regulations for the Innocent Owner/Operator Program

The passage of the legislation was only the first step in creating an effective and reasonable Innocent Owner/Operator program. The next step was two-fold. It was necessary to draft implementing regulations. Even before that, persons who had applied for certificates in advance of the promulgation of regulations had to work through the TNRCC requirements and negotiate the language of the certificate. The language of the first certificate became a considerable issue of negotiation with the agency. The main issue was whether the certificate remained valid until revoked or whether it became invalid as a matter of law. The agency legal division took the position that if a certificate holder did not provide reasonable access to a party designated by the TNRCC to investigate or remediate the property, then the certificate immediately would become invalid. The agency legal staff also contended that for the certificate to remain valid, the certificate holder must allow access to the TNRCC, comply with the restrictions placed on the property in order to obtain the certificate, and not have withheld or misrepresented information to the TNRCC to obtain the certificate. In addition, the certificate would be invalid if information surfaced that the party was not qualified as an innocent owner or operator.

The difficulty with these positions was that they immediately created uncertainty over the validity of the certificate. The main purpose of the certificate was to provide certainty to the owner or operator and to the marketplace. The efforts of the agency were threatening to undermine the very value of the certificate. Fortunately, the Commissioners and their legal counsel recognized the need for certainty and due process before a certificate became invalid. The language of the certificate was changed and the implementing rules will provide that the certificate does not become invalid by operation of law but only by a revocation procedure.

[15] Tex. Health and Safety Code Ann. Section 361.753 et seq.

[16] Tex. Health and Safety Code Ann. Section 361.753(g) et seq.

The proposed rules presented a variety of other issues and challenges.[17] One was whether a new owner or operator needed to obtain a new certificate when possession, use, or control of the land was transferred. The TNRCC was not willing to interpret the statute to allow the certificate to run with the land. Although the application process for a new or prospective owner or operator was streamlined, the rules could still bear an easing of the requirements upon the parties transferring property.

As discussed above, one of the most controversial issues that arose during the issuance of the first certificate and the rulemaking process was the process by which an Innocent Owner/Operator Certificate would become invalid. The TNRCC staff wanted the certificate to become invalid by operation of law, without any due process being afforded the certificate holder. Fortunately, the legal counsel to the Commissioners and the Commissioners themselves appreciated the need for the protection of some process to revoke the certificate. Thus, the TNRCC must engage in an enforcement action to invalidate the certificate and the certificate holder will be allowed to challenge the agency's attempt to revoke the certificate.

Another issue that arose was the timing for filing deed restrictions on the use of the property. The agency took the position that the deed restrictions, if required, must be filed before the certificate is issued. This was contrary to the intent of the draft legislation that the certificate would be issued, but be conditioned on filing any required deed restriction. Hopefully, the agency will reconsider some of these issues after the public comment period on these rules is complete.

(4) Need for Future Improvements to Existing Legislation

The legislation was a significant step toward protecting innocent owners and operators. However, like any legislative/regulatory program, the specific provisions will undergo evolution in response to new issues and concerns.

A key change that needs to be addressed in the next legislative session is harmonization of the Innocent Owner/Operator Program with the Texas Voluntary Cleanup Program. The VCP program allows persons to remediate property voluntarily and, after receiving a certificate of completion from the TNRCC, to obtain a release for future owners and lenders from liability for any contamination left on the property. The issue that needs to be addressed is the TNRCC's interpretation of the relationship of the VCP and the Innocent Owner/Operator program. The agency has expressed the view that it may be difficult to use the VCP to address contamination for which the source is *on-site* and to address contamination arising from an *off-site* source through the Innocent Owner/Operator Program. Allowing a party to accomplish closure of the liability question for contaminants on his property only makes sense given the intent of the Innocent Owner/Operator legislation to hold persons liable only for the contamination they caused or that was released from the property they own or operate.

The other issues discussed above, if not accepted by the TNRCC in rulemaking, would be ripe for legislative action. The ability to obtain a certificate once and simply exclude from the protection those persons who caused or contribute to the contamination would make transfers of property easier, reduce government interference in property transactions, and result in less work for the TNRCC staff. In essence, it is a win/win situation. Another issue involves the timing of filing of deed restrictions. Landowners do not want to restrict property before they receive a certificate in the event the agency changes its mind. Under the VCP program, persons receiving VCP certificates file any deed restrictions after the certificate is issued. A similar process is even more appropriate for the Innocent Owner/Operator Program.

(c) Other State Statutes

Although Texas legislators have elected to protect innocent owners/operators from liability, lawmakers in other states have been inconsistent in their treatment of such parties. The remedial cost-recovery statutes of all states[18] may be divided into four groups based on their regulation of innocent owners/operators.[19] The first group in-

[17] 23 Tex. Reg. 4207-4213 et seq. (May 1, 1998).

[18] Three states, Nebraska, Oklahoma, and Wyoming, do not have remedial cost-recovery statutes and are therefore not included in this survey.

[19] This survey is based on state legislation passed through the 1997 legislative sessions.

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cludes the handful of states that, like Texas, have enacted express innocent owner/operator defenses into their remedial cost-recovery schemes. States in the second group have remedial cost-recovery schemes that do not hold a party liable based solely on its status as owner/operator of a contaminated site. The third group is comprised of states that impose owner/operator status liability, but provide a defense (the "third party defense") against acts or omissions of third parties modeled after CERCLA Section 107(b)(3). The liability exposure of innocent owners/operators in these states may be uncertain. The remedial cost-recovery statutes in the states that comprise the fourth group impose liability on innocent owners/operators without providing any defense for such parties.

(1) Group 1: States with the Innocent Owner/Operator Defense

Like Texas, the states of Arizona, Michigan, Montana, New Hampshire, Utah, and Wisconsin include express innocent owner/operator defenses in their remedial cost-recovery schemes. The statutory mechanisms constituting the defense vary in their conditions and scope.

Montana's legislators have essentially codified the EPA's innocent landowner policy and its three eligibility conditions.[20] The Montana remedial cost-recovery scheme provides an exclusion from liability for innocent owners or operators provided the following conditions are met: (1) the owner or operator did not cause, contribute to, or exacerbate the release through act or omission; (2) the person who caused, contributed to, or exacerbated the release must not have been an agent, or employee of the owner/operator, or have had a direct or indirect contractual relationship with the owner/operator (the "fraudulent subdivision" exception);[21] and (3) the owner/operator must not be otherwise liable under the statute. The Montana statute also contains the additional requirement that the owner/operator cooperate with the those conducting remedial activity on the property.

Simpler forms of the defense are found in Arizona, New Hampshire, Michigan, and Utah. Aside from the standard requirement that the contamination must have migrated from an off-site source, the defenses in these states contain only one or two additional conditions adopted from the EPA innocent landowner policy. For example, the Michigan statute, which applies to owners and operators, has qualified its defense with one of the EPA policy conditions, i.e., that the defendant must not have caused the release.[22] The New

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[20] The Montana innocent owner/operator defense states in part:

> A person has an exclusion and is not liable under this section if:
>
> (b) the person owns or operates real property where hazardous or deleterious substances have come to be located solely as a result of subsurface migration in an aquifer from a source or sources outside the person's property, provided that the following conditions are met:
>
> (i) the owner or operator did not cause, contribute to, or exacerbate the release or threatened release of any hazardous or deleterious substances through any act or omission. The failure to take affirmative steps to mitigate or address contamination that has migrated from a source outside the owner's or operator's property does not, in the absence of exceptional circumstances, constitute an omission by the owner or operator.
>
> (ii) the person who caused, contributed to, or exacerbated the release or threatened release of any hazardous or deleterious substance is not and was not an agent or employee of the owner or operator and is not or was not in a direct or indirect contractual relationship with the owner or operator, unless the department provides a written determination that an existing or proposed contractual relationship is an insufficient basis to establish liability under this section;
>
> (iii) there is no other basis of liability under subsection (1) for the owner or operator for the release or threatened release of a hazardous or deleterious substance; and
>
> (iv) the owner or operator cooperates with the department and all persons conducting department-approved remedial actions on the property, including granting access and complying with and implementing all required institutional controls; . . .

Mont. Code Ann. § 75-10-715(7)(b) et seq.

[21] The Montana statute includes an exception to this condition if the state provides a written determination that the contractual relationship is insufficient to establish liability. Id. at § 75-10-715(7)(b)(ii).

[22] The Michigan innocent landowner defense states in full:

Hampshire defense, which protects owners only, goes one step further and stipulates not only that the owner must not have caused the contamination but also that the owner must not have "materially contributed to the contamination."[23] On the other hand, a person triggers liability in Utah by "exacerbating" a release.[24] Finally, the Arizona defense, which shields innocent owners and occupiers, is qualified by another condition of the EPA's innocent landowner policy: the defendant must not be liable on an alternative basis.[25]

> Notwithstanding subsection (1), the following persons are not liable under this part: ...
>
> The owner or operator of property onto which contamination has migrated unless that person is responsible for an activity causing the release that is the source of the contamination.

Mich. Comp. Laws § 324.20126(4)(c).

[23] The New Hampshire innocent owner/operator defense states in part:

> Notwithstanding any other provision of law, an owner or former owner of property shall not be held strictly liable for the treatment or cleanup of hazardous waste, hazardous material, oil ..., or hazardous substance ... that are discovered on the property if:
>
> (a) The owner did not, in any way, cause or materially contribute to the contamination of the property; and
>
> (b) The contamination migrated onto the property from a source that at the time of discovery of the contamination, was located on another property.

N.H. Rev. Stat. Ann. § 147-B:10-a(III)(a), (b).

[24] The Utah innocent owner/operator defense states in full:

> A person whose property is contaminated by migration from an off-site release is not considered to have contributed to the release unless the person takes actions which exacerbate the release.

Utah Code Ann. §§ 19-6-310(2)(d), 19-6-316(2)(d), 19-6-318(1)(d).

[25] The Arizona innocent owner/operator defense states in full:

> A person is not a responsible party with respect to a hazardous substance that is located on or beneath property that is owned or occupied by that person if the hazardous substance is present solely because it migrated from property that is not owned or occupied by that person and that person is not otherwise a responsible party as prescribed by subsection A, paragraph 2 or 3.

Ariz. Rev. Stat. Ann. § 49-283(E).

Like Texas, Wisconsin has a sophisticated defense scheme for off-site migration.[26] The Wiscon-

[26] The Wisconsin innocent owner/operator statute states in full:

> (1) Exemption from Liability for Groundwater Contamination. A person, other than a state agency, is exempt from s. 292.11(3), (4) and (7)(b) and (c) with respect to the existence of a hazardous substance in the groundwater on property possessed or controlled by the person if all of the following apply:
>
> (a) The discharge of the hazardous substance originated from a source on property that is not possessed or controlled by the person.
>
> (b) The person did not possess or control the hazardous substance on the property on which the discharge originated or cause the original discharge.
>
> (c) The person conducts an investigation or submits other information, that the department determines is adequate, to substantiate that pars. (a) and (b) are satisfied.
>
> (d) The person agrees to allow the department, any authorized representatives of the department, any party that possessed or controlled the hazardous substance or caused the discharge of the hazardous substance and any consultant or contractor of such a party to enter the property to take action to respond to the discharge.
>
> (f) The person agrees to avoid any interference with action undertaken to respond to the discharge and to avoid actions that worsen the discharge.
>
> (g) The person agrees to any other condition that the department determines is reasonable and necessary to ensure that the department or other person described in par. (d) can adequately respond to the discharge.
>
> (1m) Exemption from Liability for Soil Contamination. A person, other than a state agency, is exempt from s. 292.11 (3), (4) and (7)(b) and (c) with respect to the existence of a hazardous substance in the soil on property possessed or controlled by the person if all of the following apply:
>
> (a) The discharge of the hazardous substance originated from a source on property that is not possessed or controlled by the person.
>
> (b) The person did not possess or control the hazardous substance on the property on which the

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sin remedial cost-recovery statute, which bases liability on possession or control, contains separate exemptions from liability for off-site source of groundwater contamination and soil contamination.[27] To qualify, the person who possesses or controls the property must demonstrate the following: (1) the discharge of the hazardous substance originated from a source not possessed or controlled by the person; (2) the person did not possess or control the hazardous substance at the off-site source or cause the original discharge; (3) the person allowed access to the property for response action; (4) the person did not interfere with response action and avoided actions that would have worsened the discharge; (5) the person agreed to take action necessary to prevent an imminent threat to human health, safety, or welfare or to the environment; and (6) the person agreed to any other condition that the state determined was reasonable and necessary to ensure adequate response. Texas and Wisconsin are the only states with a certification process that allows concerned parties to ask the state for a written determination on whether they qualify for the exemption. A positive determination is revocable if the state determines the requirements are no longer being met by the requesting party.

discharge originated or cause the original discharge.

(c) The person conducts an investigation or submits other information, that the department determines is adequate, to substantiate that pars. (a) and (b) are satisfied.

(d) The person agrees to allow the department, any authorized representatives of the department, any party that possessed or controlled the hazardous substance or caused the discharge of the hazardous substances and any consultant or contractor of such a party to enter the property to take action to respond to the discharge.

(f) The person agrees to avoid any interference with action undertaken to respond to the discharge and to avoid actions that worsen the discharge.

(g) The person agrees to any other condition that the department determines is reasonable and necessary to ensure that the department or other person described in par. (d) can adequately respond to the discharge.

Wisc. Stats. § 292.13(1), (1m).

[27] Wisc. Stats. § 292.13(1), (1m) et seq.

Finally, the state of West Virginia also has incorporated a form of the defense but has limited its application to the state's voluntary cleanup program. A person accused of violating an environmental law while participating in the program may plead "migration from property owned by a third party" as an affirmative defense.[28]

(2) Group 2: States without Owner/Operator Status Liability

Innocent owners/operators are protected in a second group of states whose remedial cost-recovery statutes impose liability based on a defendant's acts or omissions rather than on the defendant's status as owner or operator of a contaminated site. Obviously, in such states an express innocent owner/operator defense would be superfluous. For example, in Iowa and Missouri, liability for a hazardous substance release is predicated on the defendant's "having control over [the] hazardous substance."[29] In both states, persons "having control" are those who produce, handle, store, use, transport, refine or dispose of hazardous substances.[30] Ownership of the contaminated property does not alone confer liability. In Connecticut and South Dakota, a liable defendant must have "caused" the contamination that requires remediating,[31] while in Illinois, a defendant must have "caused" or "contributed to" the release to be liable.[32] Colorado, Kansas, Kentucky, North Dakota, and Virginia only impose liability on those "responsible" for contamination.[33] In Mississippi, cleanup responsibility falls on those "creating, or responsible for creating"

[28] W. Va. Code § 22-22-20(c).

[29] Iowa Code § 455B.392(1); Mo. Rev. Stat. § 260.530.

[30] Iowa Code § 455B.381(7); Mo. Rev. Stat. § 260.500(8).

[31] Conn. Gen. Stat. § 22a-451(a); S.D. Codified Laws Ann. § 34A-12-12.

[32] 415 ILCS 5/58.9(a)(2)(A). Although this is the general rule in Illinois, it "does not apply to any cost recovery action brought by the State...to recover costs incurred by the State prior to July 1, 1996." Id. at Section 5/58.9(f). In those actions, defendants may be liable based solely on their status as owners or operators. See id. at Section 5/22.2(f)(2).

[33] Colo. Rev. Stat. § 29-22-104(1); Kan. Stat. Ann. § 65-3455; Ky. Rev. Stat. Ann. § 224.46-580(16); N.D. Cent. Code § 23-31-01; Va. Code Ann. § 10.1-1406(19).

the need for remediation,[34] while Ohio imposes liability only on generators, transporters, and those who accept hazardous waste.[35] Finally, the threshold for liability in Idaho and North Carolina requires that the defendant must have committed one of a long list of acts, which includes discharging or disposing of the contaminant.[36]

Delaware is unique in that it imposes liability only on owners or operators of facilities where a release or threatened release occurred, and not on the owners or operators of the facilities at which the contaminants were disposed of.[37] An innocent owner/operator by definition does not own the source of the release. Therefore, Delaware's remedial cost-recovery statute does not impose liability on innocent owners/operators, and an express defense is not crucial.

(3) Group 3: States with Third Party Defense

The third, and largest, group of states includes those that (1) have enacted remedial cost-recovery statutes imposing liability based on owner/operator status defined broadly enough to include the owner/operator of a site contaminated by an off-site source, and (2) have adopted a form of the third party defense found in Section 107(b)(3) of CERCLA. As previously discussed, that section provides a defense against liability for hazardous substance releases caused by an act or omission of certain third parties[38] and provides the statutory basis for the EPA's policy against recovery of government remediation costs from innocent owners or operators. But state agencies are free to ignore the federal example when interpreting their own statutes, as Texas did before amending its statute. As a result, innocent owners or operators are vulnerable in the states with a third party defense, especially when there is no solvent party who either caused the contamination or owned or operated the source site.

States have adopted many variations of the third party defense. California,[39] Indiana,[40] and South Carolina[41] have adopted the federal remedial cost-recovery scheme, including the third party defense, by reference. Other states have adopted their own versions of the third party defense. Those states include Alabama,[42] Alaska,[43] Arkansas,[44] Florida,[45] Georgia,[46] Hawaii,[47] Louisiana,[48] Maine,[49] Massachusetts,[50] Minnesota,[51] Oregon,[52] Pennsylvania,[53] Rhode Island,[54] Vermont,[55] and Washington.[56]

Although the adoption of the third party defense by these states provides innocent owner/operators with at least some semblance of statutory protection, most of the third party defenses adopted in these states contain the ambiguous requirements that the defendant must have exercised due care with respect to the hazardous substance concerned and must have taken precautions

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[34] Miss. Code Ann. § 17-17-29(4).

[35] Ohio Rev. Code Ann. §§ 3734.15-.17.

[36] Idaho holds liable those who "treat or store hazardous waste, [or] discharge, incinerate, release, spill, place, or dispose any hazardous waste in such a manner that the waste, or any constituent may enter the environment." Idaho Code § 39-4408(1). North Carolina holds liable anyone who "(1) Discharges or deposits; or (2) Contracts or arranges for any discharge or deposit; or (3) Accepts for discharge or deposit; or (4) Transports or arranges for transport for the purpose of discharge or deposit any hazardous waste." N.C. Gen. Stat. § 130A-310.7(a)(1-4).

[37] Del. Code Ann. Tit. 7 § 9105(a)(1).

[38] 42 U.S.C. § 9607(b)(3).

[39] Cal. Health & Safety Code § 25323.5.

[40] Ind. Code § 13-25-4-8.

[41] S.C. Code Ann. § 44-56-200.

[42] Ala. Code §§ 22-30A-8, 22-30A-3(9), (10).

[43] Alaska Stat. § 46.03.822(a)(3), (b)(1)(B).

[44] Ark. Code Ann. §§ 8-7-512(a), 8-7-515(b).

[45] Fla. Stat. §§ 376.308(1)(b), (2)(d) (groundwater statute), 403.727(4)(b), (5)(d) (hazardous substance statute).

[46] Ga. Code Ann. §§ 12-8-92(9)(A), (B), 12-8-96.1(c)(3).

[47] Haw. Rev. Stat. § 128D-6(a)(2), (c)(3).

[48] La. Rev. Stat. Ann. §§ 30:2276(A)(5), 30:2277(3).

[49] Me. Rev. Stat. Ann. Tit. 38 §§ 1362(2), 1367(3).

[50] Mass. Gen. Laws Ch. 21E § 5(a)(2), (c)(3).

[51] Minn. Stat. §§ 115.03(1)(a), 115B.04(7)(d).

[52] Or. Rev. Stat. § 465.225(1), (2)(b)(C).

[53] 35 Pa. Stat. Ann. §§ 6020.701(a)(1), 6020.703(a)(3).

[54] R.I. Gen. Laws §§ 23-19.14-1, 23-19.14-7(4).

[55] Vermont Stat. Ann. Tit. 10 § 6615(a)(1), (2), (d)(3).

[56] Wash. Rev. Code § 70.105D.040(1)(b), (3)(a)(iii).

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against foreseeable acts or omissions of the third party. As discussed previously, this ambiguity may encourage state agencies to pursue innocent owners/operators. Aggressive agency action could result in expensive and lengthy lawsuits against innocent owners and operators fighting a state's imposition of liability for contamination they did not cause. Consequently, innocent owners/operators in these states may not attain the level of liability protection necessary for transactional purposes until their legislators adopt express owner/operator defenses against liability for contamination from off-site sources.

(4) Group 4: States Imposing Liability on Innocent Owners/Operators

The fourth group is composed of states with remedial cost-recovery statutes that impose owner/operator status liability but lack either an innocent owner/operator defense or a third party defense. This group includes the states of Maryland,[57] Nevada,[58] New Jersey,[59] New Mexico,[60] New York,[61] and Tennessee.[62] The need for an express innocent owner/operator defense is essential in these states where such parties may have no defense to liability.

[57] Md. Env. Code Ann. § 7-201(x)(1).

[58] Nevada holds liable anyone "who owns or controls... the area used for the disposal of the waste, material or substance." Nev. Rev. Stat. § 459.537(2).

[59] N.J. Rev. Stat. § 58:10-23.11g(b).

[60] N.M. Stat. Ann. § 74-9-34(B)(4).

[61] N.Y. Envtl. Conserv. Law § 27-1313(3).

[62] Tenn. Code Ann. § 68-212-202(3)(A).

(D) Conclusions—Proposals for Future State and Federal Legislation

Fairness and rationality need to be returned to environmental statutes. Basic principals of ethics, economics, and practicability support the imposition of liability only on those who caused contamination, not on those who have merely been affected by contamination. EPA has committed, although with some troublesome caveats, to not suing innocent owners or operators for the costs of investigating or remediating contamination that has migrated from off-site sources. Congress has considered such legislation but CERCLA reform has largely foundered. Several states have enacted innocent owner and operator legislation. Texas and Wisconsin in particular have provided a model for protecting persons who have not caused or contributed to the source of contamination. The authors of this article encourage environmental attorneys in other states to work to convince their legislatures to follow the lead of Texas and Wisconsin.

James C. Morriss III

Jim Morriss has worked in the field of environmental law for over twenty years. His practice encompasses permitting, compliance counseling, and administrative and judicial litigation in air, water, and hazardous waste matters before local and state environmental agencies, the Environmental Protection Agency, and state and federal courts. He received his law degree with honors from the University of Texas School of Law and his undergraduate degree in mechanical engineering with high honors from Southern Methodist University. He is a member of the American Bar Association's Section on Natural Resources, Energy, and Environmental Law. He is a member and has served as chairman of the Environmental and Natural Resources Law Section of the State Bar of Texas and the Environmental Section of the Dallas Bar Association. He is also a member of the Administrative Law Section of the Travis County Bar Association. He is a member of the Environmental and Energy Committee of the Iron and Steel Society. He is a shareholder of his firm, resides in Austin, and is head of the firm's Environmental Law Section. During the 75th Legislative Session he participated in the development and drafting of the lender and fiduciary liability and innocent owner/operator provisions of H.B. 2776.

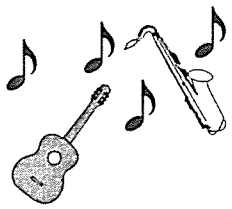
Risk Reduction Rules

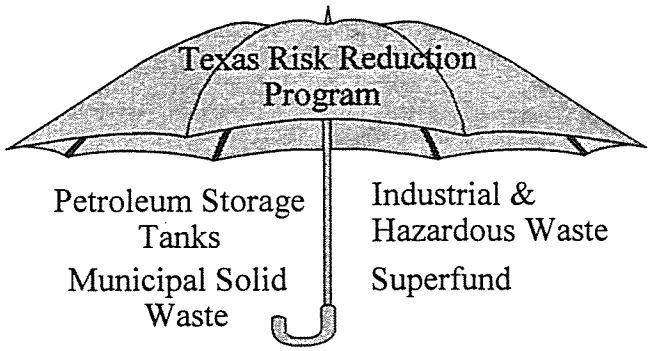
Chet Clarke

Texas Risk Reduction Program

Texas Natural Resource Conservation Commission

Chet Clarke
Technical Specialist
Remediation Division

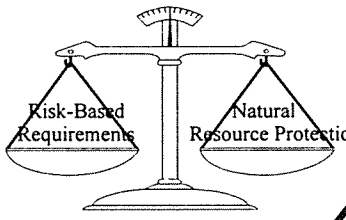


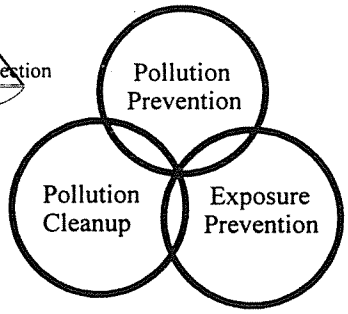


Why is a new rule needed?

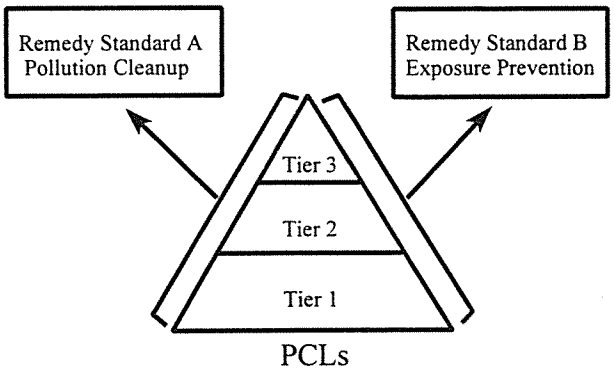
- *Single set of corrective action rules for all program areas*
- *More specificity to facilitate implementation and improve consistency*
- *Update to reflect current state of science and approaches*
- *Encourage more proactive, cost-effective corrective action*

Program Balance





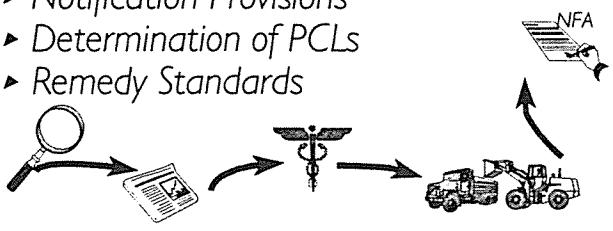
Protective Concentration Levels & Remedy Standards



FOCUS OF TRRP

General Overview

- *Assessments*
- *Notification Provisions*
- *Determination of PCLs*
- *Remedy Standards*



What was liked...

Generally liked the concepts, not the details



- *Consistent risk-based process*
- *Flexible framework*
- *Tiered process for PCL determination*
- *Performance-based remedy standards*
- *Groundwater classification*
- *Acceptance of exposure prevention remedies*
- *Plume management zones*
- *Assessment to risk-based levels*
- *Natural attenuation provisions*
- *Flexible NAPL provisions*

What was not...

Regulated community...



- *Too long & complex, overly prescriptive*
- *Too costly*
- *Assessment to below critical Tier 1 PCLs*
- *Critical Tier 1 PCLs too low, not effective screen*
- *Statistics & QA/QC*
- *Mandatory exposure pathways*
- *Limited ability to modify exposure factors*
- *Prescribed human health points of exposure*
- *Heavy reliance on deed notices*
- *Plume management zones too limited*

What was not...

Environmental Community...



- *Too long & complex, overly prescriptive*
- *Not protective*
- *Environmental Injustice*
- *Inadequate community participation*
- *Assessments not required to background*
- *Deed notices when < residential standards*
- *Groundwater classification*
- *Heavy allowance for exposure prevention*
- *Plume management zones*

Where Are We Headed?

Press Forward, Keep the Momentum

- *Restructuring rule to make shorter, simpler*
- *Identifying issues better addressed in guidance*
- *Removing unneccesary prescription*
- *Discussing the issues with stakeholders*
- *Working toward a final substantive rule*

?

Biography

Chet Clarke is the manager of the Technical Support Section of the Remediation Division. Chet is the project leader for the regulatory development and implementation of the new risk-based corrective action (RBCA) program, the *Texas Risk Reduction Program,* for across-the-agency application. Additionally, Chet provides technical support for continued implementation of the existing PST Division RBCA program. Chet currently represents Texas on the national *Partners in RBCA Implementation* work group and participated on the ASTM work group for the development of the emergency ASTM standard *Risk-Based Corrective Action for Petroleum Release Sites*. Chet was previously the Technical Specialist with the Petroleum Storage Tank (PST) Division, Section Manager for the Responsible Party Remediation (RPR)Section of the PST Division, and Team Leader with in the RPR Section. Prior responsibilities within the PST Division included development of the PST RBCA program, co-development of technical policy and guidance information as a special projects coordinator, and the oversight of corrective action at leaking storage tank sites as both a Team Leader and corrective action coordinator. Chet has a B.S. in Geology from the University of Texas at Arlington, and an M.S. in Earth Sciences (hydrogeology option) from Montana State University. He has been with the Texas Natural Resource Conservation Commission and predecessor agency since November 1988.

Open Mike

Commissioner John Baker, Moderator
Bill Ballard
Ramon Dasch
David Duncan
Ken Petersen
Scott Sherman

Texas Natural Resource Conservation Commission

The TNRCC Commissioners



John M. Baker, Jr.

John Baker, a native of Temple, was appointed by Governor George W. Bush to the Texas Natural Resource Conservation Commission (TNRCC) on September 8, 1995. He was confirmed by the Texas Senate on February 17, 1997 and his term expires on August 31, 2001.

Baker served as Agricultural Advisor to EPA Administrator William K. Reilly, from 1991 to 1993 during the Bush Presidency. He has more than 20 years experience with environmental and agricultural issues, and previously served on the Board of Directors of the Texas Corn Producers Board, the Lone Star Corn Growers Association, the Texas Beef Council and the Texas Farm Bureau. He also served on an advisory committee to the Texas Water Commission (a predecessor agency to the TNRCC) addressing the implementation of underground fuel storage tank regulations.

Baker is a former tenured professor of Soil Science and Agronomy at Oklahoma State University where he was awarded a doctoral degree in Soil Science in 1970. He also was awarded an M.S. and B.S. degrees in Agronomy from Oklahoma State University and Texas A&I University, respectively. Baker is married and the father of two daughters, with three grandchildren.

Bill Ballard is a graduate of Texas A&M University with a BS degree in Agriculture and a MBA degree in Corporate Finance. Bill received his law degree from South Texas College of Law and attended the LLM course in Agricultural law at the University of Arkansas School of Law in Fayetteville. Bill works at the Texas Natural Resource Conservation Commission in the Litigation Division, Special Investigations Section.

Ramon Dasch

Legal Division
Texas Natural Resource Conservation Commission

Ramon Dasch is the Senior Attorney for the Pollution Cleanup Division. He received his bachelor of Arts Degree from the University of Texas at Austin in 1964 and his Doctor of Jurisprudence from the University of Texas Law School in 1972. He began working for the Texas Water Commission (later to be the Texas Natural Resource Conservation Commission) in 1985. His work at the agency has included Water Quality Permitting and Enforcement, Petroleum Storage Tanks, Superfund - State and Federal, Spill Response, Voluntary Cleanup, Natural Resource Damages, and the Texas Risk Reduction Rules.

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David D. Duncan

Environmental Law Division
Texas Natural Resource Conservation Commission

David D. Duncan is the Senior Attorney for Air Quality with the TNRCC. He received a Bachelor of Arts degree from the University of Texas in 1985, and his J.D. degree from the University of Houston in 1989. He began his legal career as the Assistant Director of the Environmental Law Program at the University of Houston, then moved on to a position as a staff attorney at the Texas Air Control Board in 1991. He was appointed Senior Attorney over Petroleum Storage Tanks and Superfund when the TNRCC was created in 1993, and was subsequently named Air Senior Attorney in 1994.

Kenneth L. Petersen, Jr., Deputy Director
Office of Water Resource Management
Texas Natural Resource Conservation Commission

Kenneth L. Petersen, Jr. graduated magna cum laude from the University of Texas in Austin and received a Doctor of Jurisprudence degree there in 1978.

Career experience leading up to the present has involved administrative work before the Texas Natural Resource Conservation Commission and its predecessor agencies, the Texas Water Commission, the Texas Department of Health, and the Texas Air Control Board, as well as related litigation in various courts involving permit applications, rules development, and administrative penalty and compliance proceedings in water quality, municipal solid waste, regulation of constitutional conservation districts, industrial solid and hazardous waste, incineration activities, solution mining, petroleum storage tanks, injection well disposal, water rights, water and wastewater utilities, and Open Meetings and Open Records Act requirements.

Since November 1996, as Deputy Director, Office of Water Resource Management, Texas Natural Resource Conservation Commission, Mr. Petersen has been responsible for the administration of the State's water quality, water resource, and water and wastewater utility programs. He is currently closely involved with House and Senate Interim Committees in the implementation of Senate Bill 1, passed by the 75th Texas Legislature.

TEXAS NATURAL RESOURCE CONSERVATION COMMISSION

Scott A. Sherman
Assistant General Counsel
Texas Natural Resource Conservation Commission

Scott Sherman serves as Assistant General Counsel of the Texas Natural Resource Conservation Commission, where he provides legal advice and counsel to the Commissioners on environmental and administrative law and policy issues. Throughout his tenure at the Commission, he has concentrated on remediation and redevelopment issues, including the development of the Commission's Brownfields Initiative and the Innocent Landowner Program.

Prior to coming to the TNRCC, Scott was principal of Texas Legislative Consulting, where he focused on legislative affairs and issues of legislative intent. A cum laude graduate of Harvard Law School, Scott first practiced with Susman Godfrey in Houston, where he concentrated on business litigation.

Scott has authored a number of publications, including a series of articles on governmental affairs for the Texas Law Reporter and a four volume compilation and overview of the 1995 tort reform legislation.

Recent Articles

- "TNRCC's Brownfields Initiative: Greener Fields for The Lone Star State" (co-author with Chairman Barry R. McBee)
- "Redeveloping the Main Streets and Back Roads of Texas: Two Brownfields Case Studies", Wash. U. Envtl. L. Rep., Spring 1998, at 4.

Recent Presentations

"Superfund and Brownfields", National Association of Environmental Law Societies 1998 Annual Conference (April 3, 1998)

"Current Issues in Environmental Law", Texas Lawyer/CLE Online (May 15-29, 1998)

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