

First Federal Court Interpretation of “Affiliation” Under CERCLA’s BFPP Defense

by Polly B. Jessen and Ian K. London

In Ashley II, a federal court has interpreted for the first time the meaning of “affiliation” under CERCLA’s BFPP defense. This decision suggests that some of the standard risk management tools available in the contaminated property transaction may be construed to reveal an affiliation between a purchaser and a seller of real property, which defeats the BFPP defense and underscores the importance of encouraging purchasers of contaminated property to secure additional environmental liability protections.

Environmental counsel routinely advise clients that acquire contaminated or potentially contaminated property about the *bona fide* prospective purchaser (BFPP) defense to liability under the Comprehensive Environmental Response Compensation and Liability Act (CERCLA).¹ Although the U.S. Environmental Protection Agency (EPA) has issued guidance regarding the requirements for invoking this defense, to date there has been little case law on point. In an October 2010 decision, the U.S. District Court for the District of South Carolina handed down one of the first cases examining the requirements of the BFPP defense, *Ashley II of Charleston, L.L.C. v. PCS Nitrogen, Inc.*²

Ashley II is the first case to explicitly address the “no affiliation” element of the BFPP defense. *Ashley II* suggests that some of the standard risk management tools available in the contaminated property transaction—purchaser indemnities and close coordination of a purchaser with the EPA or other authorities with enforcement authority over a site—may be construed to reveal an affiliation between a purchaser and seller of real property that defeats the purchaser’s BFPP defense. This article discusses the *Ashley* opinion, as well as other relevant law.

Background Law: CERCLA, Brownfields Act, and BFPP

Under CERCLA § 107, a purchaser of contaminated real estate becomes jointly and severally liable for environmental response costs³ merely by acquiring ownership of a site where there has been

a release or threatened release of hazardous substances.⁴ The 2002 Brownfields Amendments to CERCLA introduced new defenses to liability for purchasers, which were intended to facilitate the redevelopment of these contaminated or “brownfields” properties. Among these defenses is the BFPP defense.⁵

Owners or tenants of owners of contaminated property can invoke the BFPP defense if the owner acquires a property after January 11, 2002, and meets all of the following statutory criteria:

- 1) the release occurred before acquisition;
- 2) the owner made “all appropriate inquiries” into the previous ownership of the facility;
- 3) the owner provided all legally required notices;
- 4) the owner exercised all appropriate care with respect to the release;
- 5) the owner cooperated with the authorities;
- 6) the owner complied with all institutional controls;
- 7) the owner complied with all requests and subpoenas; and
- 8) the owner is neither potentially liable nor affiliated with a party who is potentially liable.⁶

The criteria are conjunctive; a party must prove all eight to qualify as a BFPP.⁷ The *Ashley II* court discussed the eight criteria in deciding whether to permit the plaintiff to invoke the BFPP defense in response to defendants’ counterclaims.

Background Facts

Ashley II of Charleston, L.L.C. (*Ashley*) was formed by Cherokee Investment Partners, a large investment fund dedicated to the

Coordinating Editors

Melanie Granberg (Environmental), Denver, Gablehouse Calkins & Granberg, LLC—(303) 572-0050, mgranberg@gcgllc.com; Kevin Kinnear (Water), Boulder, Porzak Browning & Bushong LLP—(303) 443-6800, kkinneer@pbblaw.com; Joel Benson (Natural Resources and Energy), Denver, Davis Graham & Stubbs LLP—(303) 892-7470, joel.benson@dgsllaw.com



About the Authors

Polly B. Jessen is a partner with Kaplan Kirsch & Rockwell LLP, Denver—pjessen@kaplankirsch.com. Ian K. London is a law clerk with Kaplan Kirsch & Rockwell LLP, Denver, and a 2011 JD candidate, University of Denver Sturm College of Law.

Natural Resource and Environmental Law articles are sponsored by the CBA Environmental Law, Water Law, and Natural Resources and Energy Law Sections. The Sections publish articles of interest on local and international topics.

acquisition of brownfields properties, and three individuals.⁸ Ashley acquired the property at issue in the case (Site) in 2003, after performing “all appropriate inquiry” and with knowledge that the Site was contaminated with lead, arsenic, mercury, and polycyclic aromatic hydrocarbons (a known carcinogen).⁹ In two sales documents, Ashley agreed to release and indemnify the sellers of two of the parcels from liability for contamination on the Site.¹⁰ Ashley also notified the EPA that it had acquired the Site and requested the EPA to inform Ashley if it required “specific cooperation, assistance, access or the undertaking of any reasonable steps with respect to the Site,”¹¹ and responded to a request for information from the EPA regarding the Site.

Once Ashley acquired the Site, it hired an experienced environmental engineer to manage the remediation of the Site. Over the years following acquisition, activities conducted by or on behalf of Ashley included securing the property, preparing environmental site assessments, preparing a remedial action plan, and removing hazardous substances from the Site.¹² Ashley also demolished several structures on the property, which had the unintended effect of dispersing contaminated soil; shifting stormwater runoff patterns; and exposing cracked cement pads, sumps, and trenches.¹³ Additionally, during response operations, a large debris pile accumulated on the property, and the pile turned out to be contaminated.¹⁴ Ashley did not take any action with respect to the pile for more than a year.¹⁵ Ultimately, Ashley incurred response costs approximating \$200,000.¹⁶

In 2008, after further EPA involvement with the Site, Ashley sent a letter attempting to discourage the EPA from seeking to re-

cover response costs owed by the sellers. Ashley first argued that doing so would discourage Ashley’s future development efforts. Ashley also argued that its efforts to secure repayment in the instant litigation should be “adequate consideration to secure a release of Ashley’s indemnitees.”¹⁷

Ashley sued PCS Nitrogen, Inc. (PCS) under CERCLA § 107 to recover its response costs.¹⁸ PCS filed contribution claims against Ashley and a number of other parties under CERCLA § 13(f)(1), which parties also filed various counterclaims and cross claims. Ashley responded by asserting the BFPP defense to liability.

The Holding

With respect to Ashley’s claims, the court found that Ashley’s response costs were both reasonable and consistent with the national contingency plan and, therefore, were recoverable under § 107.¹⁹ The court also found that the harm on the site was indivisible, and declined to apportion the harm among the parties.²⁰ The court then turned to contribution under § 113, which allows for an equitable allocation of responsibility among liable parties.²¹

Ashley sought to avoid liability for any share of the response costs by invoking the BFPP defense.²² The court examined each statutory criterion for establishing the BFPP defense. The court declined to grant BFPP status to Ashley, finding that Ashley had not established three of the eight criteria.²³ First, Ashley had failed to establish that all disposal of hazardous substances had occurred before it acquired the Site, because the evidence indicated that there likely was some spilling or leaking that occurred as a result of Ashley’s post-purchase cleanup efforts.²⁴

Second, the court found that Ashley had failed to exercise appropriate care. In particular, the court applied common law principals of due care to conclude that, despite being aware of the existing contamination, Ashley had not ensured that existing contamination in the cracked pads, sumps, and debris pile did not spread or maintain certain capping material.²⁵ The debris pile in particular sat unattended on the site for a full year without being cleaned up.²⁶

The court finally found that Ashley had failed to demonstrate that it satisfied the requirement of no affiliation with a potentially liable party. To demonstrate no affiliation, a party must prove that:

- 1) the party is not itself potentially liable; and
- 2) the party is not affiliated with a party that is potentially liable through:
 - a) any direct or indirect familial relationship; b) any contractual corporate or financial relationship “(other than a contractual, corporate or financial relationship that is created by the instruments by which title to the facility is conveyed or financed or by a contract for the sale of goods or services);” or
 - c) “the result of a reorganization of a business entity that was potentially liable.”²⁷

The court cited EPA guidance for the proposition that, in identifying what affiliations are prohibited by CERCLA, this provision should be interpreted to effect “Congress’s intent of preventing transactions structured to avoid liability.”²⁸

In reviewing the requirements for no affiliation, the court found that “[a]s the current owner of the majority of the Site on which hazardous materials are still leaching through the soil, Ashley can be held liable for response costs.”²⁹ The court further found that the indemnification agreement between Ashley and the sellers,

plus Ashley's *ex parte* contacts with the EPA seeking to dissuade the EPA from going after the seller's share of the liability, "reveals just the sort of affiliation Congress intended to discourage."³⁰

Discussion

The court's holding with regard to no affiliation leaves purchasers of contaminated property that wish to rely on the BFPP defense in a highly uncertain position for two reasons. First, the court's conclusion that a purchaser fails to establish the defense purely because it is the current owner of a contaminated site can be read to entirely eliminate the defense. Every purchaser of contaminated property is a current owner of a site where hazardous materials are still present. There is no way to reconcile this language of the opinion with the continued existence of the BFPP defense, unless the court's language is read to mean that a purchaser must demonstrate either (1) that it can satisfy every other requirement of the BFPP defense as a condition of clearing the no affiliation hurdle or, more simply stated, (2) that the purchaser did not actually cause or contribute to the release on the property before or after purchase. In *Ashley II*, the court did find that Ashley had exacerbated conditions at the site.³¹

Second, and less easily reconciled with common practices, is the evidence of affiliation that was persuasive to the court. Specifically, the court looked at contacts with the regulatory agency and risk transfers from the seller to the buyer. The court wrote:

In indemnifying the Holcombe and Fair Parties, Ashley took the risk that the Holcombe and Fair Parties might be liable for response costs. Ashley's efforts to discourage EPA from recovering response costs covered by the indemnification reveals just the sort of affiliation Congress intended to discourage. The court finds that Ashley's affiliation with the Holcombe and Fair Parties precludes the application of the BFPP defense.³²

Close coordination with the regulatory agency and risk transfer are common elements of a successful brownfields redevelopment transaction and are steps many practitioners consider to reflect best practices in brownfields redevelopment.³³ Furthermore, it is an established tenant in CERCLA case law that environmental indemnities do not result in any transfer of statutory liability, but simply allocate contractually the financial obligations associated with that liability between private parties.³⁴ Despite receiving an indemnification from Ashley, the seller remained liable under CERCLA and retained the risk that Ashley would not be able to satisfy its indemnification obligations.

Accordingly, a fact-specific reading may be the only way to reconcile the court's holding with common business practices under CERCLA. For example, the court may have been reacting to an over-broad indemnity from the seller, coupled with failure to exercise due care with respect to known contamination, a high purchase price, and ongoing lease income. Collectively, these elements may have created the appearance that the seller was unfairly shar-

ing in the increased value of the property post-cleanup. Specifically, the record indicated that the seller contributed to the spread of contamination, failed to fully disclose the presence of contamination when deeding streets to the city, and failed to cooperate fully with the EPA and the state.³⁵ The record also indicated that the purchaser released all claims against the seller and agreed to indemnify the seller for up to \$2.7 million. In addition, although the seller's cost basis was \$491,000, the sales price was \$2.2 million and included continued lease income.³⁶ This level of benefit to the seller simply may have looked too good to be anything but a transaction structured to avoid the seller's liability.

Conclusion

At the most superficial level, for the attorney counseling clients post-*Ashley II*, this decision calls into question the continued availability of the BFPP defense to any purchaser. This concern is mitigated by a subsequent decision from the U.S. District Court for the Southern District of California that upheld the BFPP defense against a more narrow challenge, *Imperial, LLC v. Robertshaw Controls Co.*³⁷ However, the availability of the defense remains a risk for purchasers until the *Ashley II* holding is directly addressed in future decisions. Accordingly, backstopping the defense with other tools for liability risk management, such as environmental insurance, EPA enforcement deferral available for cleanup conducted under the Colorado Voluntary Cleanup and Redevelopment Act,³⁸ or even a prospective purchaser agreement with the EPA, for example, are more important protections for clients than ever.

For clients who wish to invoke the BFPP defense—and some will not—it will continue to be important to advise them to avoid transactions that establish corporate and financial relationships between the buyer and seller. Financial relationships could take the form of contracts contemplating shared sales proceeds or joint ventures, development agreements, or site ownership. After *Ashley II*, it also may be necessary to avoid indemnities that fully transfer risk from a seller to a buyer. For example, it may be necessary to exclude from a buyer's scope of indemnification any liability arising out of a release of hazardous substances during the seller's ownership of the property. Certainly, it will be appropriate to avoid (and to counsel clients to avoid) inartful communications with enforcement agencies that may suggest that the buyer and seller are somehow colluding to avoid the seller's liability.

Notes

1. Comprehensive Environmental Response, Cleanup, and Liability Act (CERCLA), 42 U.S.C. §§ 9601 to 9675.

2. *Ashley II of Charleston, L.L.C. v. PCS Nitrogen, Inc.*, No. 2:05-cv-2782-MBS, ___ F.Supp.2d ___, 2010 WL 4025885 (D.S.C. Oct. 13, 2010). Shortly after *Ashley II*, the U.S. District Court for the Southern District of California decided a second case addressing the *bona fide* prospective purchaser (BFPP) defense, *3000 E. Imperial, LLC v. Robertshaw Controls Co.*, No. cv 08-3985 PA (Ex), ___ F.Supp.2d ___, 2010 WL 5464292 (C.D.Cal. Dec. 29, 2010). The defendant contested the plaintiff's assertion of the BFPP defense to the defendant's counterclaims only on grounds that the plaintiff property owner left certain underground storage tanks in place for two years and thereby failed to take "appropriate care" with respect to the release by taking "reasonable steps to (i) stop any

continuing release; (ii) prevent any future release; and (iii) prevent or limit human, environmental, or natural resource exposure to any previously released hazardous substance." *Id.* at *11, citing 42 U.S.C. § 9601(40)(D). The court disagreed and found that the plaintiff took reasonable steps to prevent future releases and thus was entitled to the defense.

3. Liability for response costs under CERCLA extends to all removal and remedial costs incurred by the state or federal government that are not inconsistent with the National Contingency Plan (NCP), as well as any other "necessary response costs" incurred by another person that are consistent with the NCP. 42 U.S.C. § 9607(a). See also Cooke, *The Law of Hazardous Waste: Management, Cleanup, Liability, and Litigation* § 13.01[5][c][vi] (Matthew Bender, 2010).

4. Under CERCLA, parties potentially liable for cleanup include: owners/operators of a contaminated facility, owners/operators of a facility at the time of contamination, arrangers for disposal of hazardous substances, and transporters of hazardous substances. See 42 U.S.C. § 9607(a).

5. 42 U.S.C. § 9610(40).

6. *Id.*

7. See *id.* Using the conjunctive "and" in a list means that all of the listed requirements must be satisfied. *E.g.*, *Pueblo of Santa Ana v. Kelly*, 932 F.Supp. 1284, 1292 (D.N.Mex. 1996).

8. *Ashley II*, *supra* note 2 at *28.

9. See *id.*

10. *Id.* at *32-36.

11. *Id.* at *28.

12. *Id.* at *28-32.

13. *Id.*

14. *Id.* at *29.

15. *Id.* at *56.

16. *Id.* at *2.

17. *Id.* at *31.

18. *Id.* at *30.

19. *Id.* at *39-40.

20. *Id.* at *45.

21. *Id.* at *46.

22. See *id.* at *53.

23. *Id.* at *53-57.

24. *Id.* at *54.

25. *Id.* at *56-57.

26. *Id.* at *56.

27. 42 U.S.C. § 9601(40).

28. *Ashley II*, *supra* note 2 at *57.

29. See *id.*

30. *Id.*

31. *Id.* at *56.

32. *Id.* at *57.

33. See, *e.g.*, Margolis and Davis, "Doing the Brownfields Deal," in *Brownfields: A Comprehensive Guide to Redeveloping Contaminated Property* 109 (American Bar Association, 2010). See generally U.S. Conference of Mayors, "Brownfields Redevelopment: Reclaiming Land, Revitalizing Communities—A Compendium of Best Practices" (5th. ed., 2010), available at www.usmayors.org/pressreleases/uploads/november2010bestpractices.pdf.

34. 42 U.S.C. § 9607(e). See also, *e.g.*, *U.S. v. Hardage*, 985 F.2d 1427, 1433 (10th Cir. 1993).

35. *Ashley II*, *supra* note 2 at *50.

36. *Id.* at *22.

37. *3000 E. Imperial*, *supra* note 2.

38. Voluntary Clean-up and Redevelopment Act, CRS §§ 25-16-301 to -311. See "Memorandum of Agreement between the Colorado Department of Health and Environment and U.S. Environmental Protection Agency, Region III" at § III.2, available at www.cdph.state.co.us/hm/vcradoc.pdf. ■