Feature Article

HANDLING ENVIRONMENTAL REGULATORY ACTIONS: EXPAND YOUR OPTIONS

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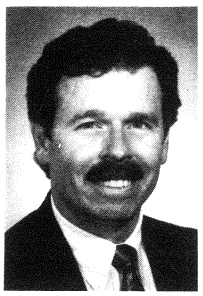

As the expense of remediating contaminated sites grows beyond the fiscal capacities of the deepest pockets,[1] and as the expense of litigating environmental coverage issues continues to escalate,[2] regulators and private interests are forced to consider fresh approaches to environmental remediation projects. Successful and efficient handling of environmental regulatory actions, while avoiding the time and cost of litigation, requires innovative strategies and comprehensive planning.

This article explores options to be considered by business management, private counsel, and insurers when a business is confronted with environmental remediation action by a regulatory agency. Dealing with these administrative matters demands a broad perspective, with a plan to utilize a variety of legal and political tactics. Using as context a recent matter considered by the California Regional Water Quality Control Board for the Central Valley, the discussion will focus on different strategies leading to administrative resolutions.

1. *See, e.g., CERCLA's Web of Liability Ensnares Secured Lenders: The Scope and Application of CERCLA's Security Interest Exception*, 25 IND. L. REV. 165, 166 (1990).

2. *See* Davis, *Insureds Versus Insurers: Litigating Comprehensive General Liability Policy Coverage in the CERCLA Arena — A Losing Battle for Both Sides*, 43 SW. L.J. 969 (1990).

Central Valley City's Contamination

One example of an imaginative, multi-faceted approach to a groundwater remediation problem was seen at a hearing in Sacramento last November before the Water Board for the Central Valley. The Board's staff recommended a remediation plan involving PCE contamination in the groundwater beneath a city in California's Central Valley. (Since this matter is pending, the city's name has not been used.) The cleanup plan would have required the potential responsible parties (PRPs), including the city itself, to remediate the groundwater contamination, the cost of which would bankrupt all of the parties. Instead, as we discuss below, the regional board opted to order further study of the situation, thus continuing the matter and affording the parties time to consider alternative remediation proposals.

The regional board's investigation found unsafe amounts of perchloroethylene (PCE), a known carcinogen, in the groundwater beneath the city. The board's staff determined that the PCE contamination was caused, at least in part, by discharges of dry cleaner solvents into the city sewer system. Leaks in the sewers then allowed PCEs into the ground and subsequently the groundwater.

The city was considered responsible for negligent maintenance of the sewer system based on cracks in sewer lines near the dry cleaners. Only three of the

several dry cleaning businesses in the city were named as PRPs despite the undisputed fact that all dry cleaners are major industrial users of PCE. The three allegedly responsible cleaners were located near sewer line cracks and above groundwater plumes found to be contaminated.

Board Hearing

The hearing took place before a standing room audience of city residents and other interested parties. Owners and operators of the dry cleaners denied any wrongdoing and argued that their handling of chemicals through the years had always been consistent with local, state, and federal law. Additionally, they pleaded their fiscal inability to meet the costs of remediation; combined business assets plus insurance proceeds would fall far short of meeting estimated remediation costs.

The city, along with representatives from other Central Valley municipalities, argued against any finding that a municipality may be responsible for VOCs disposed of through leaking city sewer lines.

Nevertheless, despite the questions raised pertaining to causation, liability, and the extent of contamination, neither the presence of groundwater contamination due to cracks in the sewers nor the prevalence of PCEs at dry cleaners was effectively disputed. As those responsible for generating or leaking contaminants are responsible for the cost of contamination cleanup per statute, the board could easily have held the city and its small businesses financially accountable for the cost of remediation. A practical problem, however, confronted the board: Who would actually provide the funds necessary for the cost of cleanup?

The small dry cleaning businesses would be driven to early and certain bankruptcy by either the cost of remediation or the cost of litigating issues of insurance coverage and liability. Likewise, the city would be incapable of meeting the cost of cleanup through any municipal financing scheme, not to mention the cost of ensuring a leak-proof sewer system. Applicable regulations did not provide for any reasonable way to fund the contamination cleanup. The state, also economically strapped, ultimately would be forced to finance the cleanup.

Industry Proposal

Following the PRPs' presentations and arguments, the California Fabric Industry (CFI) proposed that the dry cleaning industry, in conjunction with the board, the city, and other federal and state agencies, investigate other options. CFI emphasized that PCE contamination was a problem statewide for the dry cleaning industry. Counsel for CFI admitted that PCEs are prevalent in the dry cleaning industry, and though business owners adhere to regulations and take precautionary steps to ensure no PCE discharge, leaks do occur. CFI emphasized the problems throughout the state and further informed the board that state legislators already were involved in investigating the situation.

Specifically, CFI proposed that the board adopt a resolution recommending to the state legislature that a task force be established to address statewide PCE contamination. The task force would be composed of various parties involved in the city's contamination, as well as federal, state, and local government representatives and dry cleaning industry representatives.

This proposal shifted the board's focus away from the issues of liability addressed by the statutes and regulations and directed its attention to the larger issue of how to effectively manage and finance the cleanup of the contamination.

Though the recommendations of the board's staff were guided by the statutes and regulations, the end result of the staff's recommendations would lay blame without promise of a practical resolution. CFI's proposal of a task force dealt with the real problems of contamination, remediation, and financing which the statutes and regulations are intended to address. A narrow reading of the law, however, in this and many other situations, precludes an effective remediation plan.

The board adopted CFI's proposed resolution and, to give the task force a chance to resolve this problem, continued its hearing on the cease and abatement order indefinitely.

Widespread Problems Require Practical and Expansive Solutions

While counsel for the dry cleaners and the city resolutely pleaded their individual cases, counsel for CFI discussed the extensive PCE contamination related to the dry cleaning industry. In this larger context, an order by the board that would ruin three small businesses and severely damage a city would fall far short of addressing the real dilemma. The task force was proposed because *practical* resolutions of the PCE problem were far beyond the resources

available to the citizens or businesses of a small Central Valley municipality. Unless state funds are to be poured into such cleanup projects, contamination problems such as this require imaginative, large-scale funding not generally considered by regulatory agencies.

The board's decision in this case demonstrates the effectiveness of alternative approaches to handling environmental remediation claims. Though the task force may seek to tap business and insurance assets in efforts to resolve the situation, many other sources of funding will also be examined. These sources, which are certain to include various forms of use taxes or industry fees, will address more effectively the environmental remediation costs to be borne by the society. Expanded sources of funding also will enable small business to avoid the debilitating result of environmentally related administrative actions.

Practical and innovative approaches to environmental remediation claims examine alternative sources for remediation funding. As a consequence, the managing and insuring of businesses posing pollution risks will be affected greatly. Therefore, prior to embarking on the normal litigious paths of environmental disputes, business managers, insurance representatives, and counsel should consider alternative and resourceful strategies in handling environmental claims.

Consider the Options

Various options or strategies may prove beneficial to the final disposition of today's environmental disputes. A short-sighted approach to the complex problems of environmental claims may leave unexplored more efficient solutions. Strategies not normally undertaken by business people, insurers, or lawyers should be explored.

The following list of potential issues and strategies should be considered in all environmental regulation disputes.

A. Analyze Regulatory Purposes

In the early stages of an environmental administrative action it is important that counsel at least understand, if not adopt, the purposes and motivations of environmental statutes and regulations. Such understanding will provide a basis for successful communication/negotiation with regulatory agencies. Similarly, counsel is well advised to analyze the underlying motivations of regulatory agency staff personnel.

A thorough analysis of pertinent statutes and regulations must also consider constitutional challenges which may be applicable. Such constitutional issues may be raised prior to litigation and used as leverage in moving toward resourceful remedial solutions. Typical issues to be raised in considering the constitutionality of environmental regulations and statutes would include:

(1) Regulations must serve valid public objectives;

(2) Regulations must reasonably achieve valid public objectives;

(3) Classifications of uses and lands subject to regulations must be reasonably based;

(4) Regulations may constitute regulatory takings.

See Yanggen, Amrhein, *Groundwater Quality Regulation*, 14 COLUM. J. ENV. L. 60.

B. Environmental Insurance Issues

1. Coverage

Every insurance matter begins, of course, with the question of coverage. However, as the California courts impose upon insurers the broad duty of providing a defense for insureds if coverage is even possible (*Gray v. Zurich Insurance Co.*, 65 Cal.2d 263, 54 Cal.Rptr. 104, 419 P.2d 168 (1966)), it is an unusual environmental case which supports an insurer's complete denial of coverage. While coverage issues must be carefully scrutinized and evaluated, they most frequently become issues to be litigated. In seeking cost efficient resolutions to environmental regulatory matters, coverage issues will often be best reserved.

2. Defense with Reservation of Rights

In most cases a carrier will accept the defense of the insured with a reservation of rights. The reservation, however, should be carefully worded and extremely thorough to adequately preserve each of the insurer's coverage issues. The reservation of rights letter should include a clear denial or reservation of rights regarding liability, supported by the specific grounds and policy provisions upon which the reservation is based. Further, the insurer must not thereafter act in any manner which would cause

the reasonable insured to believe the insurer has waived any of the reservations. *J.C. Penney Casualty Ins. Co. v. M.K.*, 52 Cal.3d 1009, 1015-16 (Feb. 1991).

The prudent insurer will also: (1) advise the insured of any potential conflict of interest which may exist in providing the defense; (2) recommend that the insured seek the advice of independent counsel prior to accepting the proffered defense under reservation of rights; and (3) advise the insured of its options other than accepting the defense under reservation of rights. *California Insurance Law* §13.09[2] (Matthew Bender 1991); Comment, *Reservation of Rights Notices and Nonwaiver Agreements*, 12 PAC. L.J. 763, 780-81 (1981).

The great advantage to accepting a defense under reservation of rights is that having done so, the insurer is now better able to control the course of the matter. Initially, this allows the insurer to make sure all possible contributors or indemnitors are included in the controversy.

C. Identify Other Potential Responsible Parties

Nearly all environmental matters involve numerous parties and their respective insurers. Past and present property owners and/or parties in possession of the contaminated parcel(s) must be contacted, as well as the past and present carriers for each. This often involves a complicated array of PRPs and insurance companies.

Neighboring property owners should be contacted regarding their potential contribution to any contamination problems. Generally, as more facts are discovered regarding the extent of contamination, more PRPs may be identified. Property owners linked by underground streams or groundwater plumes may be causally connected to the contamination.

Involving all potentially responsible parties is consistent with the statutes and regulations governing the environmental field. Courts consistently construe the environmental statutes pertaining to PRP liability as broadly as possible. *See United States v. Fleet Factors Corp.*, 901 F.2d 1550 (11th Cir. 1990); Smith, *The Expansive Scope of Liable Parties Under CERCLA*, 63 ST. JOHN'S L. REV. 821-88 (1989).

Counsel must be aware that the opportunities for adequately resolving the matter expand with the number of parties involved.

D. Sponsor/Encourage Early Settlement Discussions

Following any confirmation of contamination and the identification of all PRPs, early settlement discussions will serve several purposes. First, they should promote meaningful exchanges between all the parties. Positions may be clarified, issues resolved or highlighted, and courses delineated — all under the protective mantel of settlement discussions.

Further, in the process of such settlement discussions/negotiations, the regulatory agency may first be advised of the realistic results of pending or proposed regulatory actions. This reality may provide impetus toward attaining practical solutions to extremely difficult contamination problems.

The initial approaches toward reasonable settlement may also cause advantageous delays in the process leading to regulatory orders or litigation. Delays are not always beneficial, as the list of contaminants increase and tests become more sensitive, but a cooperative approach to settlement may displace the advocacy which often leads to unnecessary litigation expense.

E. Monitor Remediation Discussions/Potential Solutions

Too often business people shut their eyes to real environmental problems while governmental agencies take actions which significantly impact the operations of a viable business. The active participation in regulatory decisions is in the best interests of both business and its insurers. Regulatory agency personnel, working under the guidelines imposed by law, must be led to recognize the value of practical solutions which may vary from strict interpretations of statutes or regulations.

After all, environmental statutes and regulations, and thus agency motivations, are directed at contaminant reduction and remediation for the overall benefit of the public. The social and economic realities of any business, concomitant with its value to the surrounding communities, cannot be ignored by regulatory agency personnel.

This was most evident in the regional board action discussed above. Though the agency staff performed its function by identifying contaminants and PRPs, the board was compelled to recognize the larger social context. This broad scope provoked the innovative resolution adopted by the board.

Economic and social factors involved in contamination remediation projects are explored most effectively by informative exchanges between business

representatives and regulators. These issues must be pressed resolutely by business interests even when agency personnel seem disinterested.

F. Define the Broad Parameters of Contamination and Potential Responsible Parties

As the list of PRPs grows, so the controversy expands, and the issues pertinent to the underlying contamination problem are enlarged. As in the Central Valley city's case, if the CFI had not admitted that PCEs are a problem for dry cleaners throughout the state, the board would likely have viewed the problem as local in nature. As such, the remediation problem is without effective resolution.

Given a larger framework, however, the options for effective contamination control and resolution become more recognizable.

G. When Regulations Fail to Address Remediation Adequately, Emphasize Practical Considerations

Throughout this discussion we emphasize the practical and realistic handling of contamination problems. This goal, short of complete denial of liability, must be the premise behind any negotiations with regulatory agencies. As shown in the Central Valley example, regulations should be seen as the steps taken toward effective resolutions. To the extent that regulations do not accomplish this goal, regulators may be convinced that other paths may better serve society's interests. Therefore, practical solutions should be proposed which will accomplish what the relations seek to attain.

H. Gather Community, State and/or Industry-Wide Economic Support

Be aware of and consider the opportunities for community-, state-, or industry-wide economic support. Many of today's contaminants may be traced to products or activities on which our society relies. If the society benefits from the activities causing the contamination, it may eventually accept responsibility for cleansing the environment.

As CFI successfully argued, industries serving people throughout the state may be the best source of funds for controlling future contamination. To this end, the involvement of industry boards and councils is necessary.

The state legislature has addressed the potential use of community assets to fund remediation projects. The Mello-Roos Community Facility Act, Government Code §53311 *et seq.*, provides that community facilities may be established for "removal or remedial action for the cleanup of any hazardous substance released or threatened to be release into the environment." [For a detailed discussion, see *Using Mello-Roos Financing to Clean Up Hazardous Materials*, 2 Cal. Env. Law & Reg. Rptr. 89 (June 1992).] All sources of economic support — public and private — must be examined.

I. Gather Community and State Political Support

Perhaps those forums most supportive of realistic and practical solutions to environmental problems are our local and state legislative bodies. Though it is often difficult to elicit direct action by elected officials, indirect support may be very valuable and used to great advantage. Small community groups may also be extremely useful in marshaling support in favor of practical solutions to community-wide contamination problems.

At the hearing discussed above, the board members questioned what involvement the state and local governments had in the controversy. The fact that state and local legislators were already informed and involved in the PCE contamination problem lent support to the proposal for a broader examination of potential remedial solutions.

For a discussion of how politics and the different governmental branches have affected the enforcement of environmental regulations, see Mintz, *Agencies, Congress and Regulatory Enforcement: A Review of EPA's Hazardous Waste Enforcement Effort, 1970-1987*, 18 ENVIRONMENTAL L. at 683-777.

Conclusion

As the law of environmental remediation evolves, the complex problems facing lawmakers, regulators and private counsel demand innovative strategies and resolutions. A range of public motivations and interests — social and economic — must be considered to effectively handle today's environmental regulatory actions. Rather than relying exclusively on arguments pertaining to the legal issues of causation, liability, damage assessment, and coverage, environmental lawyers should seek practical resolutions to contamination problems.

Insurance counsel, after reserving rights pertaining to the insurer, will best serve both insurer and insured by seeking a resolution short of litigation. Such resolutions are reached most effectively through active participation in the regulatory process, with counsel involved in initial discussions with all PRPs

and early settlement negotiations with regulatory agencies. This must be undertaken with a full understanding of legal, social, and political factors which may impact the remediation.

The strategies discussed here are intended to broaden counsel's approach to difficult environmental situations. They are by no means a complete list, but serve only as examples of ways in which today's environmental counsel may address practical and innovative resolutions to the complex issues of contaminant remediation.