

November 2003  
Bulletin 03-77

## New Jersey's Natural Resource Damage Crusade: A Quest for Environmental Justice, Or a Misguided Attempt to Reap a Financial Windfall?

*If you have questions or would like additional information on the material covered in this Bulletin, please contact the author:*

*James A. Kosch  
(Newark)  
973.621.3195  
jkosch@reedsmith.com*

*...or the Reed Smith attorney with whom you regularly work, or...*

*Thomas J. Burns  
(Princeton)  
609.514.5945  
tburns@reedsmith.com*

New Jersey's over-aggressive and flawed approach to collecting monies for alleged injuries to the state's natural resources, particularly groundwater, means regulatory uncertainty and potential financial hardship for its business community.

Remember that site your company owns in New Jersey? The site on which a hazardous substance release occurred that resulted in soil and groundwater contamination. The contamination you paid hundreds of thousands (perhaps millions?) of dollars to clean up. A clean-up that the New Jersey Department of Environmental Protection ("NJDEP") deemed complete, which was verified by the NJDEP's issuance of a No-Further-Action letter. That letter meant that your company has no further liability for that site, right? Or did that contamination damage the natural resources of the state, particularly the groundwater itself? Damages that the current administration will now seek to collect from your company, possibly five or 10 years after your site was remediated. "Is that possible?" you wonder. It's not only possible, but a natural resource damages ("NRD") recovery is the focus of a large-scale initiative that will be aggressively pursued by Governor James McGreevey's administration.

You see, NJDEP could have asserted an NRD claim against your company at the time you were remediating your site. But prior administrations, on the whole, chose not to do so. Those administrations focused on the remediation of the discharged substances. In fact, in the 20 years prior to 2002, NJDEP only pursued NRD claims in about 100 cases, most typically where there was an obvious and acute impact to the environment, such as in the case of a major oil spill.<sup>1</sup>

But Governor McGreevey's administration has a different perspective on NRD. Governor McGreevey has stated early and often that the enforcement of environmental laws and regulations is a high priority of his administration. And he has tapped NJDEP Commissioner Bradley Campbell to lead the charge toward accomplishing that goal. As part of his efforts to meet that responsibility, Commissioner Campbell's second-highest priority is to strengthen protection of water resources. According to the Commissioner, that will require, in part, "recovery on thousands of claims for natural resource injury to groundwater resources."<sup>2</sup> Of course, the potential recovery of millions of dollars for the cash-strapped State Treasury has to be a condition.

Commissioner Campbell is less than impressed with his predecessor's efforts to collect on NRD claims, and vowed to change the situation: "I was astounded to find, on taking office in January 2002, that the Department had not pursued, or left unsettled, thousands of cases against polluters responsible for a wide range of

LONDON  
NEW YORK  
LOS ANGELES  
SAN FRANCISCO  
WASHINGTON, D.C.  
PHILADELPHIA  
PITTSBURGH  
OAKLAND  
PRINCETON  
NORTHERN VA  
WILMINGTON  
NEWARK  
MIDLANDS, U.K.  
CENTURY CITY  
RICHMOND  
HARRISBURG  
WESTLAKE VILLAGE

## Client Bulletin 03-77

damages to New Jersey's natural resources. We are putting this program back on track and are committed to aggressively pursuing damage settlements for the residents of this state who have lost the ability to use and enjoy some of our most precious resources, including drinking water sources and wetlands."<sup>3</sup>

NJDEP's actions in the past 20 months are a clear indication that the Commissioner has every intention of fulfilling his promise to aggressively pursue NRD. In 2002, NJDEP recovered in excess of \$8 million in NRD settlements a figure greater than that reached in the previous six years, and characterized by Governor McGreevey as "just the beginning of a new commitment to enforcing our laws and pursuing damages for polluters' harm to our natural resources."<sup>4</sup> Then, in December 2002, Commissioner Campbell announced that NJDEP retained New Orleans attorney Allen Kanner, a nationally known class action trial lawyer, to review and evaluate the state's potential NRD claims and pursue them on a contingent fee basis.<sup>5</sup> And on September 24, 2003, Commissioner Campbell formally kicked off his NRD initiative by announcing that 66 companies had been issued demands to assess and restore natural resource injuries to the Passaic River caused by 18 contaminated sites within its watershed.<sup>7</sup>

"Wait a minute!" you say. "What is the NJDEP's source of authority to pursue those claims? How many claims are out there? Why is the NJDEP pursuing these claims now? How is NRD calculated? What role, if any, will the federal government play in assessing NRD? Does my company have any defenses to assert against NRD claims? Has NJDEP developed a settlement policy for NRD claims? Will insurance cover NRD claims?"

### Source of NJDEP's Authority to Pursue NRD

Several New Jersey statutes reference NJDEP's mandate to protect the state's natural resources.<sup>8</sup> But generally, NJDEP tracks NRD claims pursuant to its authority under the "New Jersey Spill Compensation and Control Act" ("NJ Spill Act"), N.J.S.A. 58:10-23.11, *et seq.* The NJ Spill Act broadly defines "natural resources" as "all land, biota, fish, shellfish, and other wildlife, air, waters and other such resources..."<sup>9</sup> It also specifically states that the "state is the trustee, for the benefit all of its citizens, of all natural resources within its jurisdiction"<sup>10</sup> As such, the state, through NJDEP, is authorized to pursue claims against polluters and other responsible parties that damage natural resources.<sup>11</sup>

### How Many Potential NRD Claims are Out There?

By a conservative estimate, at least 12,000 sites in New Jersey could be assessed natural resource damages.<sup>12</sup> Based upon that number of sites, some have projected that NRD damages could exceed \$750 million.<sup>13</sup> Commissioner Campbell, however, has stated on several occasions that several thousand potential NRD claims will not be pursued, based upon factors such as the amount in controversy, the solvency of the responsible parties, etc.<sup>14</sup> He previously estimated that the number of NRD claims that will actually be pursued is between 6,000 and 9,000. On September 24, 2003, NJDEP issued a press release indicating that the number of NRD claims to be pursued was "more than 4,000." In sum, the number of NRD claims NJDEP will actually pursue remains uncertain.

### Why is NJDEP Pursuing These NRD Claims Now?

According to the NJDEP, it is acting now because the collection of NRD is the right thing to do, and should have been done before. As a steward of the state's natural resources, it is NJDEP's duty to seek compensation for resources that have been damaged. Regardless of your point of view, one factor clearly prompting the urgency of NJDEP's action is the statute of limitations passed by the New Jersey Legislature in July 2001.<sup>15</sup> Pursuant to that statute, many of the NRD claims NJDEP and its private counsel are evaluating will be time-barred as of January 1, 2006. Many members of the business and legal community, however, perceive NJDEP's NRD crusade as a direct result of an ongoing budget deficit and the need to reduce it.<sup>16</sup>

### How is NRD for Groundwater Damages Calculated?

Currently, NJDEP uses a "Sample Surrogate Groundwater Injury Calculation" to derive a surrogate dollar value for NRD when there is an "injury" to groundwater resources of the state.<sup>17</sup> The current formula utilizes five factors to calculate an NRD surrogate dollar value: 1) Planning Area and Projected Status (determined from the New Jersey Statewide Water Supply Plan 1996, which divides the state into groundwater "deficit areas" and groundwater "surplus" areas); 2) Annual Groundwater Recharge (also determined from the New Jersey Statewide Water Supply Plan 1996); 3) Water Rate (the current value in \$/1000 gallons for the Planning Area derived from the NJ Board of Public Utilities data; 4) Aerial Extent of Contaminant Plume; and 5) Duration of Remediation (time in years from remedial decision until New Jersey Groundwater Quality standards are met or 30-year maximum, whichever occurs first).<sup>18</sup> Those factors are used in the following three-step process:

- Step 1: the aerial extent of the plume (A) is multiplied by the annual groundwater recharge (B), to derive a volume measure (C);
- Step 2: the volume of groundwater (C), is converted by a constant (7.48 gallons/cubic feet) to derive total gallons injured in one year (D); and
- Step 3: the total gallons (D) are multiplied by the duration (E) and the water rate (F) to establish the surrogate value for determining the scope of a restoration project.<sup>19</sup>

NJDEP, however, is in the process of changing that calculation. Although the new calculation has not been released to the public, early indications are that the McGreevey/Campbell administration is altering the calculation by: (1) including on-site (owned property) groundwater contamination, which had been exempted from the calculation during the Whitman administration, in the calculation; (2) generally raising the dollar quantification for the water rate<sup>20</sup>; and (3) including the vertical extent of contamination plumes, as opposed to only the aerial extent of the plume, in the calculation. Consequently, for many sites, the NRD claims made pursuant to the new calculation are likely to be several multiples over the old matrix.<sup>21</sup>

When will the regulated community be presented with this new calculation? No one is quite sure; but it's possible that entities will not see the new calculation until they are served with an NRD claim. NJDEP has resisted subpoenas and public record requests seeking information related to the new calculation. Moreover, Commissioner Campbell has publicly stated that he does not believe the NJDEP needs to promulgate a regulation that sets forth the methodology for calculating NRD claims. Instead, he believes that the calculation is part of NJDEP's "litigation strategy." More specifically, NRD targets that are willing to settle NJDEP's claims will be the beneficiaries of a "discount" calculation, while those targets that force NJDEP to litigate its NRD claims will bear the brunt of the enhanced calculation. As will be discussed immediately below, NJDEP's failure to clearly set forth its method of calculating NRD raises one of the initial defenses to be made in an NRD action.

### What Role, if any, will the Federal Government Play in NRD Assessments?

The federal government is a co-trustee with New Jersey, in terms of protecting most natural resources. And it has statutory authority, pursuant to the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) and the Oil Pollution Act (OPA), to assess and collect natural resource damages. The federal government assesses NRD claims pursuant to guidelines set forth in regulations of the Department of the Interior. See 43 CFR 11, *et seq.* In general, those regulations provide for two types of NRD assessment: (1) Type A process—which uses a computer model to assess damages, in a standard and simplified manner, that result from chemical or oil discharges in coastal and marine environments; and (2) Type B process—which is used for situations requiring an individual approach, and requires four sequential phases in an NRD assessment: Pre-assessment screen, Assessment Plan, Assessment Implementation and Post-Assessment.<sup>22</sup>

In cases where the NJDEP is taking the lead in an NRD claim, it will coordinate its efforts with the EPA, to the extent there is an overlap in their jurisdiction. Moreover, pursuant to NJDEP's Technical Requirements for Site

## Client Bulletin 03-77

Remediation, responsible parties are required to perform baseline, and if necessary, further ecological investigations in accordance with EPA and federal guidance.<sup>23</sup>

That regulatory scheme, however, does not apply to groundwater injuries. If the natural resource at issue is groundwater, a responsible party does not have to conduct an ecological investigation. Instead, the party's remedial investigation report must include: (1) the area of contaminated groundwater plume; (2) the degradability of the individual groundwater contaminants; and (3) the period during which the groundwater is estimated to exceed the applicable groundwater quality standards.<sup>24</sup>

### Are There Defenses to an NRD Claim?

Yes. Some initial defenses will be based upon allegations that NJDEP damage calculation methods violate administrative procedure and its statutory authority. For example, the NRD calculation itself arguably constitutes improper rulemaking, in violation of the Administrative Procedures Act ("APA").<sup>25</sup> Specifically, the NRD calculation is a "rule" under the APA, because it is an agency statement of applicability that, in pertinent part, implements or interprets law or policy. Consequently, NJDEP is required to conduct the promulgation of that rule in accordance with the APA, which would include publishing the proposed rule and allowing the regulated to provide comment on it. By failing to do so, NJDEP has violated the APA, and its NRD calculation is therefore void.

In addition, it can be argued that because NJDEP's calculation is based upon the concept of "loss of use" of the resource, as opposed to the restoration or replacement of the resource, NJDEP is acting ultra vires, or beyond the scope of its statutory authority, in pursuing NRD claims. More specifically, the NJ Spill Act allows NJDEP to seek the cost of "restoration and replacement...of any natural resource."<sup>26</sup> Neither the Spill Act, nor any other relevant state statute, authorizes NJDEP to seek compensation for an alleged loss of use of that resource. Therefore, to the extent NJDEP seeks NRD compensation for an alleged loss of use of that resource, rather than the cost of restoring or replacing it, it is acting beyond the scope of its authority in pursuing those NRD claims, which should therefore be dismissed. Currently, there are no court decisions in New Jersey addressing either of these arguments.

Moreover, each NRD defendant will have fact-based defenses, that will be inextricably tied to the characteristics of their respective sites and the nature of the clean-ups performed at those sites. Two examples are provided here. In the first example, the NRD defendant had a discharge at its site that migrated off-site. Because of the volume of the discharge, the defendant was able to remediate the contamination to levels well below NJDEP's Groundwater Quality Standards ("GWQS") and receive a no-further-action letter from NJDEP. If NJDEP comes to that party with an NRD claim, the defense is that the party has already "restored" the injured resource, i.e., the groundwater. Therefore, any additional payment sought by the NJDEP for NRD, in those circumstances, constitutes an impermissible double recovery, surcharge, tax, etc.

Another example is a party whose discharge could not be cost-effectively remediated to levels below the GWQS. But because the contaminated ground water was located in a non-potable, previously contaminated aquifer, NJDEP permitted the party to remediate its contamination to a certain level, at which point NJDEP created a Classification Exception Area ("CEA") for the site, and granted the party no-further-action status, requiring only continued monitoring of the expected natural attenuation of the remainder of the contamination. In those circumstances, if the NJDEP returns to that party with an NRD claim, the defense is that the groundwater at issue, by NJDEP's own admission, is not a "resource" subject to NRD. That groundwater was previously contaminated and not being used for any potable purpose. Therefore, there was neither an "injury" to or "loss of use" of that resource.

An NRD defendant may also seek to interpose receipt of a No-Further-Action letter as a defense. NJDEP is of the mind that unless an NRD claim was expressly waived, a No-Further-Action letter is not a bar to further enforcement. The breadth of protection afforded under such letters is likely to be hotly litigated.

## Client Bulletin 03-77

Please note that the defenses and examples set forth herein are not meant to be an exhaustive list of potential NRD defenses.

### Has NJDEP Developed a Settlement Policy for NRD Claims?

Yes. On September 24 2003, Commissioner Campbell issued Natural Resource Damages Policy Directive 2003-07<sup>27</sup>, which contains NJDEP's settlement policies for NRD. Generally, NJDEP prefers the performance of restoration work in lieu of the payment of money damages; it will consider the provision of substitute resources or resource services as a more cost-effective means of compensating the public for NRD, which, for groundwater injury, would include, but is not limited to, the acquisition of aquifer recharge areas, water re-use or recycling projects, and infrastructure improvements for storm water control; it will apply the current groundwater damage calculation, which does not include on-site contamination or the vertical extent of a contamination plume, for parties that are willing to settle; it will require restoration projects to bear a nexus to the injured resources and to be performed in the same watershed as the injured resource; and it will not issue no-further-action letters for sites until an assessment of ecological injuries, and a resolution of potential natural resource injuries, if any, have occurred.

### Will Insurance Cover NRD Claims?

There are two aspects to this question, the first being relevant to all potential NRD defendants and the second being relevant to those NRD defendants who have previously remediated its site: (1) Is NRD considered "property damage" as defined and covered by your applicable policies of insurance? and (2) If my insurer has already covered all, or a portion, of my clean-up costs in the past, will it cover NRD now?

With respect to the first issue, the New Jersey courts have not expressly addressed the interpretation of "as damages" language in comprehensive general liability ("CGL") policies in relation to environmental coverage claims. Courts in other state and federal jurisdictions, however, have consistently held that natural resource damages are covered claims under CGL policies,<sup>28</sup> even when courts have found that cleanup costs are not "damages" as defined by those policies.<sup>29</sup> In sum, there is ample support in case law, nationwide, for the assertion that NRD claims are covered by CGL insurance.

The second issue will generally be an issue of contract interpretation. More specifically, when an insurer has covered the clean-up costs of its insured, and the insured has received confirmation from the state or federal agency overseeing that clean-up that the work has been completed, the insurer will ask its insured for a "site release." Generally, that release will discharge the insurer from any further liability for any other costs related to that site. The question becomes "For what costs does the release relieve the insurer of further liability?" Was it for all other costs arising from the contamination of the site? Or any future clean-up costs? Or costs related to claims for bodily injury arising out of the contamination of the site? Does the release say anything about NRD? In sum, if you have previously remediated a site that was covered by insurance, and the NJDEP is now looking to assess NRD at that site, it is imperative that you determine whether you signed a release for your insurer when the cleanup was completed, and, if so, examine the terms and conditions of that release to determine whether or not NRD coverage may have been waived or released.

### Conclusion

Unquestionably, NJDEP's NRD-initiative is a key component of the McGreevey Administration's stated commitment to putting New Jersey's "environmental cop back on the beat" and must be taken very seriously. Despite questionable motives and, in many cases, suspect legal bases for pursuing these claims, NJDEP will unrelentingly pursue thousands of them in the coming months. To effectively defend themselves against NRD claims, the target-businesses will need counsel on the various legal, environmental and insurance issues raised by NRD. To what extent NJDEP's claimed goal of improving/restoring New Jersey's physical environment, through NRD claims, ultimately damages its business environment remains to be seen.

## Client Bulletin 03-77

\* \* \* \* \*

Reed Smith, a leading global law firm with nearly 1,000 lawyers located in 16 U.S. and two U.K. cities, represents Fortune 100 as well as mid-market and emerging companies. Clients include technology companies and entrepreneurs, financial services firms, life sciences companies and health care providers and insurers, communications companies, manufacturers, universities, non-profit organizations, real estate developers, and municipalities throughout the United States and in 40 countries. For more information, please visit [reedsmith.com](http://reedsmith.com).

- 
- <sup>1</sup> "State of Environmental Law In New Jersey Under the McGreevey Administration," *The Metropolitan Corporate Counsel*, April 2003.
- <sup>2</sup> "Top Ten Reasons Why New Jersey Businesses Should be Concerned About Natural Resource Damages," *The Metropolitan Corporate Counsel*, May 2003.
- <sup>3</sup> *Id.*
- <sup>4</sup> "ACTIVISTS: GET VIOLATORS CASH; State DEP faces test of its intent to enforce laws," Asbury Park Press, April 21, 2003.
- <sup>5</sup> "Qualms about a Crackdown," *NJBIZ*, March 10, 2003.
- <sup>6</sup> "State Hires Lawyer to Collect Fines," *The Star Ledger*, August 10, 2003.
- <sup>7</sup> "DEP to Address More than 4,000 Potential Claims for Natural Resource Damages Statewide," Depnews, September 24, 2003.
- <sup>8</sup> "Un-Natural Resource Damages: NJDEP Goes Too Far Afield - Part 1," *The Metropolitan Corporate Counsel*, May 2003, p. 17, fn. 13.
- <sup>9</sup> *N.J.S.A. 58:10-23.11b.*
- <sup>10</sup> *N.J.S.A. 58:10-23.11a.*
- <sup>11</sup> "McGreevey's Administration gets tough with polluters; New Jersey," *Real Estate Weekly*, February 26, 2003
- <sup>12</sup> *Id.*
- <sup>13</sup> "Un-Natural Resource Damages: NJDEP Goes Too Far Afield- Part 1," *supra*, p. 17.
- <sup>14</sup> Commissioner's Comments at Natural Resource Damages Seminar, sponsored by New Jersey Institute of Continuing Legal Education, May 2003.
- <sup>15</sup> *N.J.S.A. 58:10B-17.1(b)(1).*
- <sup>16</sup> "Natural-Resources Damages," *New Jersey Law Journal*, May 26, 2003.
- <sup>17</sup> "Un-Natural Resource Damages: NJDEP Goes Too Far Afield-Part II," *The Metropolitan Corporate Counsel*, June 2003, p. 15
- <sup>18</sup> *Id.*
- <sup>19</sup> *Id.*
- <sup>20</sup> "Top Ten Reasons Why New Jersey Businesses Should be Concerned About Natural Resource Damages," *supra*.
- <sup>21</sup> *Id.*
- <sup>22</sup> U.S. Environmental Protection Agency website, Natural Resource Damage Assessment page, [www.epa.gov/superfund/programs/nrd/nrda2.htm](http://www.epa.gov/superfund/programs/nrd/nrda2.htm), 2003.
- <sup>23</sup> *N.J.A.C. 7:26E-3.11 and 4.7*
- <sup>24</sup> *N.J.A.C. 7:26E-4.8(c) 12.*
- <sup>25</sup> *N.J.S.A. 52:14B-1, et seq.*
- <sup>26</sup> *N.J.S.A. 58:10-23.11g.a.(2)*
- <sup>27</sup> *NJDEP Policy Directive 2003-07*, September 24, 2003.
- <sup>28</sup> *See, e.g., AIU Ins. Co. v. FMC Corporation*, 799 P.2d 1253 (Cal. 1990); *Aetna Cas. and Sur. Co., Inc. v. Pintlar Corp.*, 948 F.2d 1507 (9<sup>th</sup> Cir. 1990).
- <sup>29</sup> *Continental Ins. Co. v. Northeast Pharmaceutical Chemical Co., Inc.*, 842 F.2d 977 (8<sup>th</sup> Cir. 1987) (interpreting Missouri law).