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12
13 UNITED STATES BANKRUPTCY COURT
14 EASTERN DISTRICT OF CALIFORNIA
15

16 In re:

17 **CITY OF VALLEJO, California**

18 Debtor.

Case No. 08-26813

Chapter 9

**SUPPLEMENTAL STATEMENT
OF CALIFORNIA DEPARTMENT
OF TOXIC SUBSTANCES
CONTROL IN SUPPORT OF
PROOF OF CLAIM**

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22 **I. INTRODUCTION**

23 On September 8, 2008, the Court entered its Order for Relief under Chapter 9 of the
24 Bankruptcy Code, 11 U.S.C. section 101 et seq. (See Docket # 255.) Accordingly, pursuant to
25 11 U.S.C. section 502(b)(9), the California Department of Toxic Substances Control ("DTSC"),
26 by and through its attorney, the Office of the California Attorney General, by Edward H. Ochoa,
27 Deputy Attorney General, submits this supplemental statement in support of DTSC's Proof of
28 Claim in the bankruptcy proceeding of Debtor, City of Vallejo, California ("Debtor").

1 DTSC files this proof of claim to protect its rights to: 1) ensure that certain
2 contaminated real property located at Mare Island, in the City of Vallejo, Solano County,
3 California (hereinafter the "Mare Island Site" or "Site"), where releases or threatened releases of
4 hazardous substances have occurred and may continue, shall be remediated in accordance with
5 federal and state law, and 2) recover unpaid past, ongoing and future environmental response
6 costs, which DTSC has incurred, and will continue to incur, in connection with the
7 environmental cleanup at the Site.

8 DTSC submits a claim for environmental response costs in the estimated amount of at
9 least \$18,760,500.00 with the express reservation of rights to amend this amount.

10 Nothing in this proof of claim constitutes a waiver of any rights of the DTSC or an
11 election of remedies. Further, by filing this claim, DTSC does not waive its sovereign immunity,
12 except as otherwise provided by law. DTSC makes this claim for itself and no other agency, unit
13 or entity of the State of California. Any waiver of sovereign immunity under the law resulting
14 from the filing of this claim is by DTSC, and no other agency, unit or entity of the State of
15 California, and is strictly limited to said Claim. Further, the filing of this claim shall not be
16 deemed or construed as a waiver of any objections or defenses that DTSC or any other agency,
17 unit or entity of the State of California may have to this Court's jurisdiction over DTSC or such
18 other agency, unit or entity based upon the Eleventh Amendment or related principles of
19 sovereign immunity or otherwise, all of which are hereby preserved.

20 **II. BACKGROUND**

21 **A. The California Department of Toxic Substances Control ("DTSC")**

22 DTSC is a California state government agency. DTSC regulates all aspects of
23 hazardous waste management in California, and enforces laws related to the cleanup of
24 hazardous substances in California. DTSC is the lead state environmental agency overseeing the
25 cleanup of the Mare Island Site.

26 **B. State and Federal Environmental Laws Under the HSAA and CERCLA**

27 The laws that DTSC enforce include California's Hazardous Substances Account Act
28 ("HSAA"), Cal. Health and Safety Code section 25300 et seq. The HSAA establishes a

1 comprehensive program for the cleanup of hazardous substances that have been released, or are
2 threatened to be released, into the environment. Under the HSAA, DTSC may seek recovery of
3 response costs it incurs in connection with such cleanup activities. The HSAA directs DTSC to
4 recover any costs it incurs in connection with such clean-up activities from the liable parties.
5 Cal. Health & Safety Code § 25360.

6 Under California Health and Safety Code section 25323.5, liable parties are those
7 parties described in section 107 of the federal Comprehensive Environmental Response,
8 Compensation and Liability Act ("CERCLA"), 42 U.S.C. section 9607. CERCLA section
9 107(a), 42 U.S.C. section 9607(a), makes the following *persons* liable for all costs of removal or
10 remedial action incurred by DTSC:

- 11 (1) the owner and operator of a vessel or a facility;
- 12 (2) any person who at the time of disposal of any hazardous substances owned or
13 operated any facility at which such hazardous substances were disposed of;
- 14 (3) any person who by contract, agreement, or otherwise arranged for disposal or
15 treatment, or arranged with a transporter for transport for disposal or treatment, of hazardous
16 substances owned or possessed by such person, by any other party or entity, at any facility or
17 incineration vessel owned or operated by another party or entity and containing such hazardous
18 substances; and
- 19 (4) any person who accepts or accepted any hazardous substances for transport to
20 disposal or treatment facilities, incineration vessels or sites selected by such person, from which
21 there is a release, or a threatened release which causes the incurrence of response costs, of a
22 hazardous substance.

23 In addition to its authority under the HSAA, DTSC may also bring a cost recovery
24 action against liable parties directly under CERCLA. 42 U.S.C. § 9607(a)(4)(A). Under
25 CERCLA, DTSC may recover from liable parties all response costs, including interest, incurred
26 by DTSC in investigating, overseeing and cleaning up sites with releases or threatened releases
27 of hazardous substances. 42 U.S.C. § 9607(a)(2).

28

1 **1. The Mare Island Site**

2 The Mare Island Site is a contaminated site located at Mare Island, within the City of
3 Vallejo, California. The Site is part of a former United States Naval shipyard that operated
4 between approximately 1854 through 1996. As a result of these operations, hazardous
5 substances were released at and from the Site.

6 In approximately 2001, as part of an “early transfer” agreement between the United
7 States and the Debtor, the United States transferred fee ownership of the Site to the Debtor. The
8 area of the shipyard that was transferred to the Debtor is known as “Eastern Early Transfer
9 Parcel” (EETP). Another area of the shipyard, referred to as “Western Early Transfer Parcel”
10 (WETP), was transferred by the U. S. Navy to another party, Weston Solutions Inc. The United
11 States Navy retained ownership of other areas of the shipyard located within Mare Island.

12 In consideration of the sum of \$77.67 million that was paid by the United States to the
13 Debtor, the Debtor assumed certain environmental response activities related to the hazardous
14 waste contamination existing at the Mare Island Site. The Debtor subsequently transferred fee
15 ownership of the Site to another party, Lennar Mare Island, LLC, through an agreement that is
16 further discussed below.

17 **2. Debtor’s Liability to DTSC**

18 The Debtor was a prior owner of the Mare Island Site. Under the pertinent provisions
19 of the HSAA, California Health and Safety Code section 25323.5, and CERCLA, 42 U.S.C.
20 section 9607(a), the Debtor *may* be a responsible party for the Site as a *prior owner* of the Mare
21 Island Site. Under CERCLA and the HSAA, responsible parties are liable for, *inter alia*,
22 response costs, including direct costs, administrative costs, and oversight costs incurred by
23 DTSC in conducting and/or overseeing an environmental cleanup.

24 In addition, pursuant to an “early transfer” agreement that is further discussed below,
25 the Debtor, as a prior owner of the Site, assumed certain responsibilities regarding the
26 environmental clean-up at and from the Site, including, but not limited to, controlling
27 approximately \$77.67 million to be used solely for the payment of response costs associated with
28 the Site, including DTSC’s response costs.

1 **III. THE MARE ISLAND SITE**

2 As indicated above, Mare Island is located in Solano County, California, and is
3 approximately 3.5 miles long, 1.25 miles wide, and consists of approximately 5,600 acres. From
4 approximately 1854 through 1996, Mare Island was in continuous use as a United States Naval
5 shipyard. During that time, the following activities were conducted at that site that generated
6 hazardous wastes and hazardous substances: metal plating; lead acid battery refurbishing; oil
7 handling and reclamation; abrasive blasting; ship construction and repair, nuclear and diesel
8 submarine construction and repair; leaking transformer oil storage tanks; discharge of
9 wastewater to Mare Strait; landfill disposal of solvents; polychlorinated biphenyl (PCB)
10 contaminated fluids leakage, asbestos wastes generation; hazardous wastes handling; land
11 disposal of contraband and miscellaneous ordnance, trinitrotoluene (TNT), and fulminate of
12 mercury; and waste ordnance detonation. As a result of these operations, hazardous substances
13 were released at and from the facility/Site.

14 **A. Early Transfer of Mare Island Site to Debtor**

15 In April 2001, pursuant to an “early transfer” provision contained in Section
16 120(h)(3)(C) of CERCLA (42 U.S.C. section 9620(h)(3)(C)), the Debtor and the United States of
17 America, acting by and through the Department of the Navy (“U.S. Navy”), entered into an
18 “Environmental Services Cooperative Agreement” (“ESCA”), no. N 62474-96-2-0001, in which
19 the U.S. Navy transferred fee title to the Debtor for a portion of Mare Island known as the
20 “Eastern Early Transfer Parcel” (“EETP” or “Mare Island Site”). A true and correct copy of the
21 ESCA is attached hereto as Exhibit “A.”

22 As part of the ESCA, and in consideration of the U.S. Navy’s payment to the Debtor
23 in the amount of \$77.67 million,^{1/} the Debtor assumed, or cause to be completed, certain
24 environmental response activities (or “environmental services”) related to the hazardous waste
25 contamination existing at the Mare Island Site. (Exhibit A, “ESCA,” section 301 (“Obligations
26 of the City”).) DTSC is informed and believes that the \$77.67 million payment received by the

27
28 1. And other additional payments for replacing missing data in accordance with Section
302.B of the ESCA,

1 Debtor from the U.S. Navy was deposited into an escrow account at First American Trust
2 Company and that said escrow funds are required to be used solely to pay for response activities
3 associated with the environmental clean up of the Mare Island Site, including, but not limited to,
4 payment of DTSC's oversight costs. The Debtor's approval is required for the disbursement of
5 funds thereunder. DTSC is further informed and believes that approximately \$20 million still
6 remains in said escrow account.

7 According to section 101 of the ESCA, the environmental services that Debtor agreed
8 to perform were intended to satisfy the requirements of CERCLA by satisfying the cleanup
9 requirements under applicable State law ("Equivalent State Compliance"), as provided in the
10 Consent Agreement, discussed below, that was entered into between the Debtor, Lennar Mare
11 Island, LLC, and DTSC. (*Id.*, section 101.) The ESCA was also intended to facilitate the
12 implementation of the Debtor's "Mare Island Final Reuse Plan" (Volumes I and II) as adopted
13 by the Debtor in 1994.

14 **B. Remediation Agreement Between Debtor and Lennar Mare Island, LLC**

15 In April 2001, the Debtor and Lennar Mare Island, LLC ("LMI"), in anticipation of the
16 "early transfer" of the Mare Island Site pursuant to the ESCA, entered into an agreement entitled
17 "Mare Island Remediation Agreement" ("MIRA"). A true and correct copy of the MIRA is
18 attached hereto as Exhibit "B." Pursuant to the MIRA, section 101(A), LMI agreed to perform,
19 or cause to be performed, the Debtor's obligations to perform environmental services at the Mare
20 Island Site as required by the ESCA. LMI agreed to perform the Debtor's obligations in
21 anticipation of obtaining fee title to the Mare Island Site from the Debtor and payment from the
22 Debtor for the costs incurred by LMI in performing environmental services at the Site.

23 The MIRA, Article V, section 502(C), also acknowledges that "funds deposited by the City with
24 the Fiscal Agent [First American Trust Company] are to be held and used *solely* for the purposes
25 for which such funds were received by the City from the Navy."

26 In addition to the \$77.67 million "clean-up" fund established by the U.S. Navy and the
27 Debtor, LMI and its contractor, CH2MHill, obtained insurance in the form of a remediation
28 stop-loss policy with policy limits of approximately \$55 million and an environmental liability

1 policy with policy limits of \$150 million, naming the Debtor as a named or additional insured
2 with respect to certain coverages. (See Exhibit “B,” (“MIRA”), Recitals, section E.)

3 DTSC is informed and believes that LMI is the *current owner* of the Mare Island Site
4 and that LMI has assumed the Debtor’s environmental cleanup responsibility for the Site.
5 However, DTSC is further informed and believes that the Debtor still retains approval authority
6 regarding the disbursement of funds from the First American Trust Company escrow account
7 referenced above and that these funds are to be used solely for response costs in connection with
8 the environmental cleanup of the Mare Island Site. Such response costs include DTSC’s
9 oversight costs.

10 **C. Consent Agreement Between Debtor, Lennar Mare Island, LLC and DTSC**

11 In April 2001, in contemplation of the ESCA and MIRA agreements referenced above,
12 the Debtor, LMI, and DTSC entered into a Consent Agreement for the Site. A true and correct
13 copy of the Consent Agreement is attached hereto as Exhibit “C.” In the Consent Agreement,
14 both the Debtor and LMI are referred to as the “Owner” of the Site. (Exhibit “C,” (“Consent
15 Agreement”), section 1.1.) The purposes of the parties’ Consent Agreement are stated in section
16 1.3, which provides: “The purposes of this Agreement are to bind the Owner to enter into
17 environmental restrictions on the Site prior to selection of the remedy, as necessary to protect
18 human health and the environment, and to establish the process and timetable for the completion
19 by Owner of the response and corrective actions at the Site in a manner that is consistent with the
20 National Contingency Plan (“NCP”) (citations omitted), as amended, California Health and
21 Safety Code section 25100 et seq., as amended, and other applicable state laws and regulations.”
22 (Id., at section 1.1; See also section 3.1.) Once fee title to the Site transferred from the Debtor to
23 LMI, the Consent Agreement acknowledged that the obligations of the Debtor under the *Consent*
24 *Agreement* ceased with respect to the Debtor. However, the Debtor’s obligations arising under
25 the ESCA and MIRA, as well as Debtor’s obligations to DTSC under the HSAA and CERCLA,
26 still remain.

1 **IV. BASIS FOR DTSC’S PROOF OF CLAIM**

2 **A. CERCLA and HSSA Response Costs**

3 As discussed above, the Debtor is a potentially responsible party under CERCLA and
4 the HSAA because it is a *prior owner* where hazardous substances were released at or from the
5 Mare Island Site.

6 DTSC is asserting its claim against Debtor, arising under CERCLA and the HSAA and
7 independent of the Consent Agreement^{2/}, as a protective measure to ensure that the above-
8 referenced escrow funds controlled by the Debtor are used solely for the payment of response
9 costs, including but not limited to, response costs related to remedial investigation activities, Site
10 characterization, cleanup of soil and groundwater as warranted, and DTSC’s response costs,
11 including oversight costs.

12 The Mare Island Site is still undergoing investigation, and the full extent of the
13 contamination is not currently known. Based upon DTSC’s current knowledge of the Mare
14 Island Site and the nature of the hazardous substances released and other available information,
15 DTSC has estimated that the total response costs, excluding oversight costs, are in excess of
16 \$17,940,000.00. However, since the investigation at the Site is continuing and the full extent of
17 the contamination not yet finally determined, the estimated cleanup costs may vary and DTSC
18 therefore reserves the right to amend this claim.

19 DTSC also contends that any such costs it has incurred and will incur subsequent to
20 the filing of the petition and prior to confirmation of a plan of reorganization are recoverable as
21 priority administrative expenses. DTSC reserves its right to seek payment of these post-petition
22 response costs as administrative expenses. DTSC also reserves its right to claim these
23 post-petition costs as general, unsecured claims in the event that the Court declines to afford
24 these costs administrative expense priority.

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27 2. As noted above, Sections 4.8 and 4.13 of the Consent Agreement contain express
28 reservation of rights for DTSC to bring enforcement or cost recovery actions under federal and state
laws.

1 In order to protect its rights and interests, and pursuant to the Debtor's obligations
2 arising under the ESCA, MIRA, the Consent Agreement, and federal and state law, DTSC files
3 this claim for unpaid oversight costs it has incurred and for payment of oversight costs it may
4 continue to incur. DTSC further asserts that the oversight costs incurred after June 8, 2008 are
5 entitled to payment as an administrative expense priority, but reserves the right to seek payment
6 of such costs as an unsecured general claim, and/or as post-petition ordinary course of business
7 expenses.

8 DTSC's unreimbursed oversight costs from July 1, 2008 through September 30, 2008
9 are \$67,008.07, plus interest. Further, based upon DTSC's current knowledge of the particular
10 Site and the nature of the hazardous substances released at the Site, and as contemplated by the
11 Consent Agreement, DTSC anticipates that it will continue to incur oversight costs after
12 September 30, 2008. Although the exact amount of oversight costs are yet undetermined, DTSC
13 has used a model cost estimate to estimate future oversight costs where specific cost information
14 is not currently available. Thus, for fiscal year July 1, 2008 through June 30, 2009, DTSC has
15 estimated that it will incur \$447,500.00 in oversight costs. In addition, for fiscal year July 1,
16 2009 through June 30, 2010, DTSC has estimated that it will incur \$373,000.00 in oversight
17 costs. Accordingly, DTSC reserves the right to amend this claim to provide for the additional
18 and actual oversight costs incurred after September 30, 2008.

19 B. Supporting Documents

20 The documents that support this proof of claim are numerous. Therefore, DTSC
21 summarizes these supporting documents below. Copies of these documents can be requested by
22 contacting the undersigned.

- 23 1. DTSC's Site file for Lennar Mare Island, LLC;^{3/}
- 24 2. The "Environmental Services Cooperative Agreement" ("ESCA"), no. N
25 62474-96-2-0001, which is attached hereto as Exhibit "A" without exhibits;
- 26 3. The "Mare Island Remediation Agreement" ("MIRA"), which is attached hereto

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28 3. Information regarding the Mare Island Site is also available through DTSC's EnviroStor
website at: http://www.envirostor.dtsc.ca.gov/public/profile_report.asp?global_id=48330003

1 as Exhibit "B" without exhibits;

2 4. The "Consent Agreement," which is attached hereto as Exhibit "C" without
3 exhibits;

4 5. DTSC's daily logs for oversight work at the Site;

5 6. DTSC's Summary by Activity sheets which summarize the oversight work at the
6 Site; and

7 7. Invoices sent to Debtor prior to the filing of the bankruptcy proceeding.

8 **V. CONTINGENT, UNCERTAIN, OR UNKNOWN CLAIMS**

9 DTSC is informed and believes that the Debtor may also be a liable party at an
10 unknown number of yet to be identified sites. DTSC reserves the right to assert claims against
11 the Debtor under CERCLA or California law for response and oversight costs at other facilities
12 where the Debtor is a potential responsible party. This type of claim against the Debtor arises
13 pre-petition where the existence of such claims are "fairly contemplated" by the parties. See,
14 e.g., *In re Jensen*, 995 F.2d 925, 931 (9th Cir. 1993) and *In re Chateaugay Corp.*, 944 F.2d 997,
15 1005 (2nd Cir. 1991). A primary determinant of whether a claim has been fairly contemplated
16 by the parties is knowledge by the parties of a site where a potentially responsible party may be
17 liable. *In re Jensen*, 995 F.2d at 931. Accordingly, DTSC reserves the right to assert presently
18 unidentified claims for response costs that DTSC has incurred or will incur at sites where there
19 has been a release or threatened release of hazardous substances, and where the Debtor may be a
20 responsible party.

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1 **VI. NOTICES**

2 All notices relating this claim should be sent to the undersigned attorneys for DTSC at
3 the following address:

4 Edward H. Ochoa, Deputy Attorney General
5 Office of the Attorney General
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7 San Diego, CA 92101
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10 Dated: March 6, 2009

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