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THE BLESSED STATE OF INNOCENCE: THE INNOCENT LANDOWNER DEFENSE UNDER SUPERFUND

Richard H. Mays†

“He that maketh haste to be rich shall not be innocent”
Proverbs 28:20

King David would probably fare well today in counseling owners and prospective purchasers of real estate and corporations. Innocence has achieved a high value as a defense to the rigors of liability for cleanup of hazardous waste sites under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended¹ (CERCLA, or Superfund). That liability is strict, retroactive to time immemorial, and may be joint and several. For that reason, there are some who would consider innocence to be more valuable as a defense than a virtue.

The ability of a landowner to establish that it is an innocent purchaser of property, when that property is found to be contaminated by hazardous substances, has assumed a high degree of importance in real estate and corporate transactions. It is an issue which will be raised with increasing frequency as corporations and persons who have acquired real estate without knowledge of its contaminated condition or claims by the U.S. Environmental Protection Agency, state agencies, and private parties are asked to pay for the cleanup of that property.

This article discusses:

- * the statutory basis for liability of owners of contaminated real property;
- * the statutory defense and settlement procedure available to owners who purchased the property without knowledge of its environmental condition;

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1. The Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), as amended by the Superfund Amendments and Reauthorization Act of 1986, 42 U.S.C. § 9601 *et seq.*

- * recent cases interpreting the "innocent landowner" defense;
- * a proposed statutory amendment to clarify the innocent landowner defense;
- * EPA's recently-issued guidance document on the innocent landowner defense; and
- * recommended procedures to avoid liability and establish the innocent landowner defense.

Landowners' Liability Under CERCLA

CERCLA section 107(a)² imposes strict liability for cleanup of hazardous substances on, among others, the present owners of the property on which the substances are found, as well as former owners who owned the property at the time of disposal or release of those hazardous substances. The term "owner" is defined as simply "any person owning . . . such facility," but specifically includes persons who owned facilities immediately before transfer of those facilities to a unit of state or local government by bankruptcy, foreclosure, tax delinquency, abandonment, or similar means.³

A number of classes of persons are exempt from the definition of "owner."⁴ They include the so-called "secured creditor" exemption, under which a person who, without participating in the management of a facility, holds indicia of ownership primarily to protect his security interest in the facility, is exempt from the definition of "owner." In addition, "owner" does not include a unit of State or local government which acquired title involuntarily through bankruptcy, tax delinquency, abandonment, or other involuntary acquisition by virtue of its function as sovereign, unless the governmental unit has caused or contributed to a release or threat of release of hazardous substances from the facility.⁵

Landowner Defenses to or Limitations on Liability

There is a statutory defense to CERCLA liability available under CERCLA section 107(b)(3)⁶ to landowners who claim to have purchased contaminated property without knowledge of the contamination. If the owner can meet the requirements of this sec-

2. 42 U.S.C. § 9607(a).

3. CERCLA § 101(20)(A), 42 U.S.C. § 9601(20)(A).

4. CERCLA § 101(20)(A), 42 U.S.C. § 9601(20)(A). For an in-depth discussion of the Secured Creditor Exemption from CERCLA liability, see Mays, *Secured Creditors and Superfund: Avoiding the Liability Net*, 20 ENVIRONMENTAL REPORTER (BNA), No. 13, at 609 (July 28, 1989).

5. CERCLA § 101(20)(D), 42 U.S.C. § 9601(20)(D).

6. 42 U.S.C. § 9607(b)(3).

tion, liability may be avoided altogether. There is also a second statutory provision (CERCLA section 122(g)(1)(B))⁷ which does not rise to the level of a defense, but allows the owner to use his innocence as a mitigating circumstance to minimize liability as a “de minimis” party. Innocent purchasers who cannot meet all of the requirements to earn the cloak of the absolute defense may, as an alternative, attempt to claim the limited protection of section 122(g).

The Section 107(b)(3) Defense

The defense to liability is found in section 107(b)(3), which provides in relevant part:

(b) There shall be no liability . . . for a person otherwise liable who can establish . . . that the release or threat of release of a hazardous substance and the damages resulting therefrom were caused solely by:

. . .

(3) an act or omission of a third party other than . . . one whose act or omission occurs in connection with a *contractual relationship*, existing directly or indirectly, with the defendant [*i.e.*, the landowner], if the defendant establishes . . . that (a) he exercised due care with respect to the hazardous substance concerned . . . in light of all relevant facts and circumstances, and (b) he took precautions against foreseeable acts or omissions of any third party and the consequences that could foreseeably result from such acts or omissions. (Emphasis supplied).

There are three elements contained in this section necessary to the defense that the contamination was caused solely by a third party: (1) there must be no direct or indirect relationship, contractual or otherwise, between the landowner/defendant and the third party; (2) the landowner must have exercised due care regarding the hazardous substances upon their discovery; and (3) the landowner must show that he took precautions against the acts or omissions of the third party. Because most of the attention given to this subject has focused on the first element, it is easy to forget about the latter two. However, some cases have turned on them, as we shall see.

The threshold question is whether “contractual relationship” includes deeds, leases, and other instruments of conveyance or transfer of interest in real estate. The answer to that question is

7. 42 U.S.C. § 9622(g)(1)(B).

provided in section 101(35)(A)⁸, which states that the term "contractual relationship" includes, but is not limited to land contracts, deeds, or other instruments transferring title or possession. Thus, as the owner of property contaminated by a third party, the previous owner is liable for the cost of cleanup of the property.

However, section 101(35)(A) provides an exception to the liability created by that contractual relationship under limited circumstances. Those circumstances are where:

The real property on which the facility concerned is located was acquired by the defendant after the disposal or placement of the hazardous substances on, in, or at the facility, and one or more of the circumstances described in clause (i), (ii), or (iii) is also established by the defendant . . . :

- (i) At the time the defendant acquired the facility the defendant did not know, *and had no reason to know*, that any hazardous substance which is the subject of the release or threatened release was disposed of or on, in, or at the facility;
- (ii) The defendant is a government entity which acquired the facility by escheat, or through any other involuntary transfer or acquisition, or through the exercise of eminent domain authority by purchase or condemnation;
- (iii) The defendant acquired the facility by inheritance or bequest. (Emphasis supplied).⁹

This exception, known as the "innocent landowner" defense, will most commonly arise in the context of sales of real property between two parties. Therefore, this article will focus on the circumstances contained in clause (1), above.

The critical burden that a landowner seeking coverage of the "innocent landowner" defense will have to meet is that he "did not know, and had no reason to know" of the presence of hazardous substances on the property at the time it was acquired. The standard for meeting this burden is set forth in section 101(35)(B),¹⁰ which states:

To establish that the defendant had no reason to know, as provided in clause (i) of subparagraph (A) the defendant must have undertaken, at the time of acquisition, all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability.

8. 42 U.S.C. § 9601(35)(A).

9. *Id.*

10. 42 U.S.C. § 9601(35)(B).

As to what may constitute "all appropriate inquiry," subsection (B) sets forth the following factors to be considered:

The court shall take into account any specialized knowledge or experience on the part of the defendant, the relationship of the purchase price to the value of the property, if contaminated, commonly known or reasonably ascertainable information about the property, the obviousness of the presence or likely presence of contamination at the property, and the ability to detect such contamination by appropriate inspection.

While no specific acts are set forth that might satisfy "all appropriate inquiry," it would seem inherent in the language of subsection (B) that, at a minimum, a visual inspection of the property, and a price reflective of current market values would be required.

In addition, the statute implies and the legislative history supports the position that persons who regularly engage in real estate transactions (and who are thereby "sophisticated" purchasers of property) are to be held to a higher standard than the infrequent purchaser. The legislative history establishes a three-tier system: commercial transactions are held to the highest standard; private transactions are given more leniency; and inheritances and bequests are treated most leniently.¹¹

In summary, the statutory requirements for establishing the "innocent landowner" defense, taking those contained in section 107(b)(3) and 101(35)(A) and (B) together, are:

- (1) the hazardous substances involved in the release or threat of release from the property must have been placed on the property by a third party *other than* an employee, agent, or someone in direct or indirect contractual relationship (such as a previous owner in the chain of title, a tenant,¹² sublessee,¹³ etc.) with the landowner; or
- (2)(a) if the third party was a previous owner of the property in the chain of title with the current landowner, the landowner must also show that he acquired the property *after* the disposal of the hazardous substances, and
- (b) the landowner did not know and had no reason to know of the hazardous substances that are the subject of the release

11. 1986 *U.S. Code Congressional & Admin. News*, 3279-3280; *U.S. v. Pacific Hide & Fur*, D. Idaho, Civ. No. 83-4052 (Order of March, 1989).

12. For liability of an owner for acts of disposal of hazardous substances by a tenant, see *U.S. v. Monsanto Co.*, 858 F.2d 160 (4th Cir. 1988).

13. For liability of an owner for acts of disposal of hazardous substances by a sublessee, see *State of Washington v. Time Oil Co.*, W. D. Wash. Docket Nos. C85-478TB and C86-990TB (Consolidated), Order of March 9, 1988, 17 *CHEM. WASTE LITIG. REP.* 1261.

- by having made all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice;
- (3) the landowner exercised due care with respect to the hazardous substances upon their discovery; and
 - (4) the landowner took precautions against foreseeable acts or omissions of any third party and the consequences that could foreseeably result from them.

Judicial Interpretations of the Innocent Landowner Defense

It is likely that, in most cases, the hazardous substances will have been put on the property by a prior owner or other person with whom the present owner has a contractual relationship. Therefore, the issue most often in dispute in cases involving the "innocent landowner" defense is whether the person asserting the defense undertook "all appropriate inquiry" prior to acquiring the property. A number of cases have been decided on that issue. In keeping with Congress' intent that more sophisticated parties be held to a higher standard of diligence,¹⁴ the courts have generally been more willing to find individuals entitled to the defense than corporations. Indeed, one court has gone to great lengths to avoid imposing CERCLA liability on individual landowners.

Several recent cases are illustrative.

In *United States v. Pacific Hide & Fur Depot, Inc.*,¹⁵ a corporation (McCarty's, Inc.) was formed in 1949 by Samuel McCarty to operate a scrap metal recycling business on a parcel of land in Pocatello, Idaho. Samuel McCarty and his wife died in the 1960's, leaving the stock in the corporation to their children, two of whom (S.R. and William) continued the operations of the company, while another child (Richard) owned stock but did not participate in the business management. The stock of a fourth child was redeemed by the company.

During the 1970's, capacitors containing PCB's were disposed of in a pit on the property, many of which subsequently leaked. The business remained in existence until 1982, by which time S.R. had also died and William had given his stock to his children, none of whom had been active in the management of the company. The surviving shareholders then dissolved the corporation and distributed the assets in redemption of their stock.

14. See *supra* note 11.

15. *U.S. v. Pacific Hide & Fur Depot, Inc.*, D. Idaho, Civ. No. 83-4052 (Opinion dated Mar. 13, 1989).

The EPA expended Superfund monies to clean up the site, and then sued Richard and the remaining stockholders of the company (grandchildren of the founder of the company) for reimbursement, on the theory that they were the owners and operators of the facility. The defendants raised the "innocent landowner" defense. The court noted that according to the legislative history of the statute, commercial transactions were to be held to the strictest standard; private transactions were given a little more leniency; and inheritances and bequests were treated the most leniently of all.¹⁶ The court observed that this case was more like an inheritance than a private transaction.

The government, however, argued that there was no evidence that the defendants had conducted *any* inquiry into the environmental condition of the property, and that Congress intended that everyone, under any conceivable circumstances, must make some inquiry about the existence of hazardous wastes when obtaining an interest in property. The court rejected the government's argument, replying that Congress could have made that requirement plain, but did not do so. "Instead," the court said, "Congress used terms like 'appropriate' and 'reasonable' in describing the necessary inquiry." This indicated to the court that "Congress was not laying down the bright line rule asserted by the Government. Rather, Congress recognized that each case would be different and must be analyzed on its facts."

The court held that under the facts of this case, the conduct of the defendants was reasonable, and refused to hold them liable under section 107(a)(1) as present owners and operators of the property. The Government also claimed that they were liable under section 107(a)(2) as past owners at the time of disposal of wastes on the property, but the court ruled that it did not have sufficient evidence before it to enable it to rule on that point.

Another major, but legally questionable, victory for the defense occurred in *United States v. Serafini*,¹⁷ in which the Parmoff Corporation leased property in 1967 to the City of Scranton, Pennsylvania, for use as a landfill. At the time, Serafini was the secretary of Parmoff Corp. In 1969, Parmoff Corp. sold the property to a partnership composed of Serafini and other individuals. Over 1,000 55-gallon drums, many containing hazardous waste, were on the site and apparent to view. The evidence indicated that the partners who purchased the property did not conduct an on-site inspection,

16. See *supra* note 11.

17. *U.S. v. Serafini*, 706 F. Supp. 346 (M.D. Pa. 1988).

nor did they examine photographs of the property showing the presence of the drums.

The Government conducted removal activities at the site, and sued the partnership for recovery of its costs and to require additional remedial action to be taken at the site. The partners raised the "innocent landowner" defense, and the principal issue was whether they had conducted "all appropriate inquiry" at the time of the purchase. The partners contended that the mere showing that drums were visible was not sufficient to show that they knew or had reason to know that hazardous substances had been deposited on the property.

The Government answered that landowners cannot close their eyes to hazardous waste problems, and that the reason the partners had no knowledge of the drums was only because they failed to inspect the property or make any inquiry into past use of the site. The Government also contended that the existence of a landfill on the property should give the partners reason to know of the existence of hazardous wastes on the property.

The court, while characterizing the Government's arguments as "tempting", brushed them aside. After referring to the factors listed in section 101(35)(B) to be considered in determining whether a party has undertaken "all appropriate inquiry" (but not analyzing the evidence in light of those factors), the court simply stated: "[T]he court is unable to find that the defendants' inaction was inappropriate under the facts of this case. The Government has presented no evidence from which the court can conclude that the defendants' failure to inspect or inquire was inconsistent with good commercial or customary practice."¹⁸

The court also rejected the Government's argument that Serafini, having signed the lease to the City of Scranton on behalf of Parmoff Corp., demonstrated that the partnership had notice of the site's previous use. The court answered that Serafini claimed to be serving only as Acting Secretary, that he had no knowledge of the operations or management of the company, and that he executed the lease only as a witness to the signatures of other officers of the corporation. The court also characterized as "somewhat tenuous" the Government's assertion that knowledge of the existence of a landfill on the premises was reason to know of the existence of hazardous waste on the premises.

While the *Pacific Hide and Fur* decision may be supported by a

18. *Id.* at 347.

fair reading of the relevant provisions in the statute and the legislative history, the *Serafini* case failed to reconcile the facts of that case with the requirements of the innocent landowner defense, and seems to make a mockery of the requirement that the purchaser of property make "all appropriate inquiry" into the previous uses of the property as provided in section 101(35)(B). *Serafini* may be an extreme example of the reluctance of courts to subject individuals to the potentially devastating liability of CERCLA. Purchasers would be well advised to limit their reliance upon it in guiding their property acquisition activities.

On the other side of the ledger, several courts have denied purchasers the status of "innocent landowners", and all of the persons claiming that status have been corporations.¹⁹

In *The State of Washington v. Time Oil Co.*,²⁰ the defense was not upheld where the defendant's sub-lessee apparently caused the contamination, and the defendant failed to present specific facts to indicate that some other party having no contractual relationship with defendant was solely responsible for releasing all of the hazardous substances.

In *Wickland Oil Terminals v. Asarco, Inc.*,²¹ the defendant unsuccessfully attempted to claim the "innocent landowner" defense when the evidence showed that the source of contamination was a one million cubic foot pile of smelting slag at the site which contained heavy metals, and that the defendant was aware, prior to the purchase, that the state environmental agency was concerned about the leaching of metals from the pile.

Finally, two cases demonstrate the importance of observing the requirement to exercise "due care" with respect to the hazardous substances, and the duty to take precautions against foreseeable acts or omissions of third parties as required by section 107(b)(3)(a).

In *United States v. Sharon Steel Co.*,²² the State of Utah, which had acquired a right-of-way which included part of the property

19. For a case illustrating the court's willingness to permit a corporation to argue the innocent landowner defense, see *PVO International, Inc. v. Drew Chemical Corp.*, D.N.J., Civil Docket No. 87-3921 (Opinion dated June 27, 1988), 16 CWLR 669, in which the court refused to grant a motion for summary judgment that PVO was not an innocent purchaser of a portion of a chemical manufacturing facility merely because PVO is a chemical manufacturer, and thus, according to the defendant (seller of the facility to PVO) should have known that the facility would have hazardous substances at the site.

20. See *supra* note 13.

21. *Wickland Oil Terminals v. Asarco*, N.D. Cal. Docket No. C-83-5906-SC, (Opinion dated Feb. 23, 1988) 15 CHEM. WASTE LITIG. REP. 1225.

22. *U.S. v. Sharon Steel Co.*, D. Utah, Civ. No. 86-C-0924J (Opinion dated July 13, 1988).

from which a release or threat of release existed, was not entitled to the benefit of the "innocent landowner" defense even though the release did not show that the state exercised due care with respect to mill tailings on its right-of-way.

And in *United States v. Monsanto Co.*,²³ the owner leased the site to a chemical manufacturing company for the purpose of the latter's storing raw materials and finished chemical products. The lessee subsequently expanded its business to include recycling of waste chemicals, and used the site as a waste storage and disposal facility. The court denied the owner the "innocent landowner" defense, stating that not only did a contractual relationship exist, but the owner, knowing the business of the tenant, took no precautionary action against the foreseeable conduct of the tenant, never inspecting the property during the lease. "In our view, the statute does not sanction such willful or negligent blindness on the part of absentee owners."

It is a fair assumption that, with the notoriety that CERCLA liability has received in the real estate, financial, and corporate circles across the country, the standard of care in acquiring real property is consistently rising. The *Pacific Hide & Fur* and *Serafini* cases to the contrary notwithstanding, persons who purchase or otherwise acquire commercial or industrial property without having conducted an environmental assessment of that property will undoubtedly have a most difficult time sustaining the "innocent landowner" defense, especially if those persons frequently deal in the real estate market.

Proposed Legislative Definition of "All Appropriate Inquiry"

The potential liability which may be assumed under CERCLA by ownership of property, and the uncertainties of knowing what actions may constitute "all appropriate inquiry" to avoid that liability, have led to the introduction of H.R. 2787 in the U.S. House of Representatives by Congressman Weldon and others. The bill, entitled the "Innocent Landowner Defense Amendment of 1989", would amend section 101(35) by adding a new subsection (C). That subsection would provide a landowner with a rebuttable presumption that he has made all appropriate inquiry within the meaning of subsection (B) if a "Phase 1" environmental audit was conducted immediately prior to or at the time of acquisition of the property.

A Phase 1 audit is defined as a review of the property, con-

23. *U.S. v. Monsanto Co.*, 858 F.2d 160 (4th Cir. 1988).

ducted by "environmental professionals"²⁴ consisting of a review of each of the following sources of information:

- (1) recorded chain of title documents (all deeds, easements, leases, restrictions and covenants) for a period of fifty years;
- (2) aerial photographs reflecting prior use, and which are reasonably obtainable through state or local government agencies;
- (3) determination of the existence of environmental cleanup liens against the property which have arisen pursuant to Federal, State, and local laws;
- (4) reasonably obtainable federal, state, or local government records of sites where there has been a release of hazardous substances, and which are likely to cause or contribute to a release or threat of release on the property under examination;
- (5) a visual site inspection of the property, its improvements, and the property immediately adjacent to it, to determine the obviousness of the presence or likely presence of a release or threat of release of hazardous substances.

The rebuttable presumption created by the audit does not arise unless the owner maintains a compilation of the information developed during the audit. In addition, the presumption does not arise if the audit discloses the presence or likely presence of a release or threat thereof unless the owner has taken reasonable steps to confirm the absence of such release or threat.

This bill would seem to establish reasonable, but not overly stringent, standards which are currently incorporated into many environmental audits, and it should have the support of real estate, corporate interests, and consulting firms. Perhaps unavoidably, it also raises additional questions, such as what documents are "reasonably obtainable" from federal, state, and local agencies, what are "obvious" indications of the presence or likely presence of a release, and what are "reasonable steps" to be taken to confirm that absence of a release or threat thereof of an audit discloses the likely presence of a release?

All of these issues are likely to be raised by the government in contesting the claim of a landowner to a presumption of innocence. Nevertheless, the amendment does go a long way to solve the larger problems of clarifying what constitutes "all appropriate inquiry" necessary to sustain the innocent landowner defense.

24. Environmental professionals are defined as an individual, or an entity managed or controlled by such individual, who, through academic training, occupational experience and reputation (such as engineers, environmental consultants and attorneys), can objectively conduct one or more aspects of a Phase I Environmental Audit.

Section 122(g)(1)(B) De Minimis Landowner Liability

As noted earlier in this article, there is a second statutory provision that a landowner who acquired property without knowledge of contamination may use to minimize, if not altogether avoid, CERCLA liability. CERCLA section 122(g)²⁵ addresses the manner in which potentially responsible parties (PRPs) whose liabilities may be considered *de minimis*, or minimal, may be settled as expeditiously as possible. Two classes of *de minimis* parties are mentioned, one relating to persons who contributed small amounts of waste to the site, and the other to owners of the property.

With regard to the latter group, section 122(g) provides as follows:

- (1) EXPEDITED FINAL SETTLEMENT — Whenever practicable and in the public interest . . . the [EPA] shall as promptly as possible reach a final settlement with a potentially responsible party in an administrative or civil action . . . if such a settlement involves only a minor portion of the response costs at the facility concerned and . . . the conditions in . . . subparagraph . . . (B) are met:
 - (B) the potentially responsible party
 - (i) is the owner of the real property on or in which the facility is located;
 - (ii) did not conduct or permit the generation, transportation, storage, treatment, or disposal of any hazardous substance at the facility; and
 - (iii) did not contribute to the release or threat of release of a hazardous substance at the facility through any action or omission.

This subparagraph (B) does not apply if the [PRP] purchased the real property with actual or constructive knowledge that the property was used for the generation, transportation, storage, treatment, or disposal of any hazardous substance.

While this section is similar to the defense afforded to the innocent landowner under section 107(b)(3), it is this writer's opinion that they are not the same, and that distinctions can and should be made between them.

Section 107(b)(3) provides a defense to liability, assuming that the rather stringent requirements of that section and the "all appropriate inquiry" requirements of section 101(35)(A) and (B) can be met by the landowner. In other words, the defense is reserved for

25. 42 U.S.C. § 9622(g).

those who can demonstrate that they are “pure as new-fallen snow” (putting aside acid rain considerations).

On the other hand, section 122(g)(1)(B) recognizes that there will be those purchasers of property who, while they were unaware of the presence of hazardous substances on the property at the time of purchase, may not be able to show that they conducted “all appropriate inquiry” into the past uses and ownership of the property, such as those who are as “pure as New York snow” (with apologies to New York City), and are therefore unable to satisfy the requirements of sections 107(b)(3) and 101(35).

While the latter group of PRPs may be liable, Congress undoubtedly believed that they should not be subjected to the full brunt of strict, joint and several liability, but instead should be treated as *de minimis* PRPs, and allowed to resolve their liability for a relatively nominal payment. Thus, the distinction between the complete defense under section 107, and the *de minimis* treatment of “partially-innocent” landowners under section 122(g). The EPA, however, does not seem to recognize this distinction in a meaningful way, as we shall see in the next section.

EPA Guidance in Landowner Liability Under Sections 107 and 122

EPA headquarters has recently issued a sweeping guidance document to its regional offices in the subjects of the innocent landowner defense under section 107(b)(3), settlement with *de minimis* innocent landowners under section 122(g)(1)(B), and settlement with prospective purchaser of contaminated property²⁶ (the “Guidance”). Not surprisingly, the EPA takes a very restrictive view of the innocent landowner defense, but as a result its Guidance is misguided.

Rather than recognize that CERCLA recognizes two classes of innocent landowners, the EPA attempts to link the section 107(b)(3) defense with the *de minimis* settlement authority contained in section 122(g). The EPA apparently does not discriminate between the levels of due diligence separating one from the other. Instead, the EPA merges the two, and a bastard results in which all

26. Memorandum dated June 6, 1989, from Edward E. Reich, Acting Assistant Administrator for Enforcement and Compliance Monitoring and Jonathon Z. Cannon, Acting Assistant Administrator for Solid Waste and Emergency Response to Regional Administrators, entitled “Guidance on Landowner Liability under § 107(a)(1) of CERCLA, *De Minimis* Settlements under § 122(g)(1)(B) of CERCLA, and Settlements with Prospective Purchasers of Contaminated Property.”

“innocent landowners” are treated as if they were *de minimis* PRPs under section 122(g), which assumes liability on the part of the owner, and, according to the Guidance, enables the EPA to dictate some rather onerous provisions against the owner in a consent order or decree.

This position is evidenced in, among other portions of the Guidance document, the following passage:

[A] person who acquires already contaminated property and who can satisfy the remaining requirements of Section 101(35) as well as those of Section 107(b)(3) may be able to establish a defense to liability. Although this is an affirmative defense, for which the defendant bears the burden of proof, Congress has provided a settlement mechanism which the Agency may use in its discretion for settlement purposes to resolve the liability of certain landowners prior to or in the early stages of litigation through the application of the *de minimis* settlement provisions of Section 122(g)(1)(B) of CERCLA.²⁷

Not only does the Guidance attempt to treat innocent landowners under section 107(b)(3) and section 122(g)(1)(B) the same, but it incorporates the more stringent requirements of the section 107(b)(3) defense into the requirements that a PRP landowner must meet to qualify for *de minimis* treatment under section 122(g)(1)(B), so that, in effect, there is only one set of requirements — the most stringent — for “innocent landowner” status. For example, the Guidance states:

The requirements which must be satisfied in order for the Agency to consider a settlement with the landowners under the *de minimis* settlement provisions of section 122(g)(1)(B) are substantially the same as the elements which must be proved at trial in order for a landowner to establish a third party defense under section 107(b)(3) and section 101(35).²⁸

The foregoing statement is accompanied by a footnote which states: “Even though the language in Sections 122(g)(1)(B) and 101(35) is not identical, the scope of the two provisions is substantially the same.” This writer submits that the scope of the two sections are not the same, and the reason the language of the two sections is not identical is because Congress intended that there be a defense for landowners who conducted “all appropriate inquiry” when they purchased contaminated property, but liability (albeit a

27. *Id.* at 3.

28. *Id.* at 7.

de minimis version) for those purchasers who were unaware of the contamination, but did not exercise "all appropriate inquiry."

This distinction is important to both classes of landowners. Aside from the unjustified position of requiring 122(g)(1)(B) *de minimis* landowners to meet the more stringent requirements of a 107(b)(3) defense, the EPA proposes to require all innocent landowners to enter into a consent administrative order or consent decree. An innocent landowner with a clear 107(b)(3) defense to liability arguably should not be subjected to an administrative order or decree involving considerable time and money. They will contain provisions to which a non-labile party should not be subjected.

For example, the EPA will usually attempt to obtain a cash payment from the landowner in return for a covenant not to sue. In all cases, the landowner must agree to provide access to the site, and cooperation with the EPA and its remedial contractors in any actions they may take on the property. Furthermore, the EPA will require the innocent landowner to release any claims or causes of action he may have against the U.S. or the Superfund arising from work performed or expenses incurred at the site. Finally, the Guidance document requires that "reopeners" for liability be included in the agreement, and that in the event the EPA should assert any claims against the landowner subsequent to the settlement, the burden of proof would be on the *landowner* to show that any release or threat of release that is the subject of the claim is attributable solely to conditions existing at the time of the settlement.

To subject those two classes of persons to the same standard and to the same procedures is a misinterpretation of the statute, will work injustices to both categories of innocent landowners, and will inhibit settlements with both categories.

Establishing the Innocent Landowner Defense

The potential for CERCLA liability has brought about profound changes in the way commercial and industrial properties should be acquired. Paraphrasing the Proverb at the beginning of this article, one who rushes into a real estate acquisition without taking care to avoid potential environmental liabilities is likely to be neither innocent nor rich for very long if the property contains hazardous substances. Instead, CERCLA and other laws imposing strict liability upon property owners dictate that each commercial and industrial real estate acquisition be handled with the innocent landowner defense in mind.

As the widely divergent judicial decisions discussed above illus-

trate, there is not a uniform standard for the "all appropriate inquiry" necessary to qualify a purchaser as an innocent landowner for purposes of the CERCLA section 107(b)(3) defense. Should H.R. 2787 be enacted into law, it would provide specific acts, the fulfillment of which would qualify a purchaser for the defense, and narrow the issues considerably. Until then, purchasers of property are well advised to err on the side of caution, and take measures which will, as clearly as can be determined at this time, be recognized as "all appropriate inquiry."

Those measures should include obtaining knowledgeable environmental counsel and technical expertise in planning acquisition activities. Because all properties are all somewhat different, and have been subjected to different uses, the activities which will be required to satisfy the "all appropriate inquiry" standard will differ somewhat from site to site, requiring expert advice on the most suitable approach for each site.

Generally speaking, however, it would seem that, at a minimum, what has come to be known as a Phase I environmental audit should satisfy the requirements of CERCLA section 101(35)(B), and qualify the purchaser for the innocent landowner defense under 107(b)(3). The conduct of such an audit is generally considered to be good commercial practice, and includes:

- (1) a title search to determine the history of ownership (and, to a limited extent, use) of the property;
- (2) a review of documents of federal, state, and local agencies having jurisdiction over environmental matters in the geographic area in which the property is located;
- (3) a review of aerial photographs of the property, and adjoining property, for a reasonable period of time (e.g., 30 years) to observe previous uses of the property;
- (4) a site inspection of the property to determine whether hazardous substances or wastes, or manifestations thereof, are apparent or suspected due to present or past uses of the property. Because of the potential for migration of substances, adjoining property and its history of use should also be examined. If cause exists to suspect that the property may be contaminated, preliminary soil and groundwater tests should be conducted; and
- (5) interviews should be conducted with persons who are familiar with the history of use of the property and adjoining property. Persons interviewed should include neighbors of the property and present and former employees of any facility located on

the property and adjoining property regarding waste disposal practices.²⁹

Should contamination be found on the property (or adjoining property), the purchaser will not, as to that contamination, be "innocent," but the issue of whether the prospective purchaser wants to proceed with the acquisition, and if so, who is responsible for the costs of cleanup, can be addressed in the contract. In addition, assuming the audit is done in a professional manner, it will allow the purchaser to claim the "innocent landowner" defense as to any other hazardous substances not detected by the audit.³⁰

Such an audit would presumably satisfy at least three of the five factors set forth in CERCLA 101(35)(B) that courts must consider in assessing whether "all appropriate inquiry" has been conducted. The other two factors are less objective, but one of them — any specialized knowledge or experience on the part of the owner claiming the defense — would likely be rendered academic by the purchaser conducting a state-of-the-art audit. The fifth factor (the relationship of the purchase price to the value of the property if uncontaminated) would appear to apply to transactions where the purchase price is so far below the market value of comparable property in the vicinity that almost any purchaser would be put on notice of a defect in the property.

Conclusion

The possibility of assuming CERCLA's potentially devastating liability simply through the ownership of property has brought about profound changes in the procedures to be followed in the acquisition of commercial and industrial properties. Today's prudent purchaser will establish the groundwork for the innocent landowner defense by making all appropriate inquiry into previous uses of the property. The cost of conducting such an inquiry is one that most purchasers are not accustomed to paying, and they may chafe at the added expense, but it is the best insurance against loss that can be bought.

Until Congress enacts legislation to clarify what actions are en-

29. For a detailed discussion of environmental auditing, selecting an audit firm, and maintaining confidentiality of an audit report, see Mays, *A Practical Guide to Environmental Due Diligence In Real Estate Transactions*, 10 HAZARDOUS WASTE REPORT, No. 14, at 11 (March 13, 1989) or write to the author for a complimentary copy.

30. See CERCLA § 101(35)(A)(i), which provides that the innocent landowner defense is available if, at the time of acquisition, "the defendant did not know, and had no reason to know, that any hazardous substance *which is the subject of the release or threatened release* was disposed of on, in, or at the facility."

compassed within "all appropriate inquiry" into past uses of property, the standard will continue to be uncertain. Because of the loss potential, the prudent purchaser should go to whatever extent necessary to reasonably determine that the property is free of contaminants. If the property is found to be contaminated and, notwithstanding that, the prospective purchaser wants the property, it is equally important that the nature and extent of the contamination be determined.

Should the purchaser be unfortunate enough to purchase contaminated property, despite having made all appropriate inquiry, the EPA can be counted on not to be overly sympathetic. Charged as it is with the responsibility to clean up hazardous waste sites, and not too concerned about who, among the four classes of responsible parties should pay for it, the EPA is likely to attempt to wrest some money as well as other concessions from the owner, no matter how innocent he may be. If negotiations with the EPA prove fruitless, the landowner can take hope in recourse to the courts, who have shown mercy to the innocent landowner on occasion, especially where the owner is an individual.

Recourse to the courts, however, is an expensive and uncertain last resort. It is obviously far better to invest in a comprehensive environmental audit and title search, using a qualified technical consulting firm and experienced legal counsel, to detect any problems, and plan how to deal with them. Information gained thereby will enable the prospective purchaser to quantify the risks — insofar as that is possible in the inexact science which is waste site cleanup — and to come to an informed decision about whether to purchase the property, and if so, upon what terms and conditions. It will also enable the purchaser to claim that most blessed state of innocence as to any undiscovered contamination.