Order Code RS21167
March 6, 2002

CRS Report for Congress

Received through the CRS Web

"Innocent Landowners" and "Prospective Purchasers" in the Superfund Act

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Summary

The Superfund Act contains several devices that eliminate the liability or reduce the transaction costs normally incurred under the Act by persons that acquire contaminated land. This report focuses on three of them, two addressed in the recently enacted brownfields law (P.L. 107-118). The first device is the innocent-landowner defense, available to persons who acquire land after the hazardous substance is put there, and who (among other things) find no contamination before acquisition despite "all appropriate inquiry." The second device allows use of innocent-landowner status as a basis for early de minimis settlement with EPA. The third exempts the "bona fide prospective purchaser" from "owner" and "operator" liability despite pre-acquisition awareness of contamination on the property, if certain conditions are met.

The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA, or Superfund Act)[1] contains several devices that eliminate the liability or reduce the transaction costs normally incurred under the Act by persons that acquire contaminated land. This report covers three of them. Two devices use what is popularly called *innocent landowner* status[2] – one device using this status as a defense to liability under the Act (Part I of this report); the other, with modified requirements, as merely qualifying liable parties for de minimis settlement with EPA (Part II). The third covered device is based on the *bona fide prospective purchaser*, and is intended to encourage the purchase and subsequent redevelopment of contaminated sites (Part III).

The stimulus for this report is the January 11, 2002 enactment of the Small Business Liability Relief and Brownfields Revitalization Act (SBA).[3] The SBA amended CERCLA to clarify who is eligible for innocent landowner status as a defense to liability, and to codify the "bona fide prospective purchaser" concept.

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[1] 42 U.S.C. §§ 9601-9675.

[2] The actual phrase "innocent landowner" is not used in CERCLA.

[3] Pub. Law No. 107-118 (H.R. 2869).

I. Innocent Landowner Status as a Defense to Liability

The innocent-landowner defense evolved over three enactments. It began with the original Superfund Act in 1980.[4] There, Congress created the Act's basic liability scheme, unchanged to this day. If a hazardous substance is released, or threatened to be released, from a facility, CERCLA subjects various parties, including the present owner of the facility, to strict, joint, and several liability for cleanup and other costs.[5] One of the few defenses to this stringent liability scheme is the "third-party defense," available when the release or threat of release was caused solely by --

> 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 ....[6]

The third-party defense requires further that the defendant establish that (a) he/she exercised due care as to the hazardous substance concerned, and (b) took precautions against foreseeable acts or omissions of the third party.

To the Congress of 1980, the "contractual relationship" exception must have made perfect sense. Why should a site owner escape CERCLA liability under the third-party defense when the third party who caused the contamination was an entity with whom the owner had contractual dealings? The potential for manipulation seemed obvious. Others pointed out, however, that the contractual-relationship exception might have an untoward result. If the instruments of conveyance between a seller and buyer of land were viewed as placing them in a "contractual relationship," a buyer whose property had been contaminated solely by a predecessor in the chain of title was in a bind. Despite his/her innocence, the buyer could not invoke the third-party defense.

In the 1986 amendments,[7] Congress resolved the instruments of conveyance issue. "Contractual relationship," the Act now reads, includes such instruments, but with a big exception. The exception is for the landowner who acquired the property after the hazardous substance was disposed of or placed there, and --

> at the time [the landowner] acquired the facility ... [he/she] 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.[8]

The 1986 amendments went on to explain: to establish that a defendant "had no reason to know," he/she "must have undertaken, at the time of acquisition, *all appropriate*

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[4] Pub. Law No. 96-510, enacted Dec. 11, 1980.

[5] CERCLA § 107(a); 42 U.S.C. § 9607(a).

[6] 42 U.S.C. § 9607(b)(3).

[7] Pub. Law No. 99-499, enacted Oct. 17, 1986.

[8] CERCLA § 101(35); 42 U.S.C. § 9601(35).

inquiry into the previous ownership and uses of the property ....”[9] The 1986 amendments thus answered one question: when does “contractual relationship” include land contracts? But they created another: What does “all appropriate inquiry” involve? Congress did include a brief definition of “all appropriate inquiry” in the 1986 amendments, but just a few years later efforts began in Congress to provide more detailed guidance.

These clarifying efforts culminated in the recently enacted SBA. The SBA instructs EPA to establish by regulation “standards and practices” that satisfy the “all appropriate inquiry” requirement. The regulations, required by January 11, 2004, must include --

- inquiry by an environmental professional
- interviews with past and present owners, operators, and occupants of the facility
- reviews of historical sources, such as chain of title documents and aerial photographs, and land use records
- searches for recorded environmental cleanup liens
- review of government records, waste disposal records, and hazardous waste records
- visual inspection of the facility
- specialized knowledge or experience on the part of the land acquirer
- the relationship of the purchase price to the value of the property if uncontaminated
- reasonably ascertainable information about the property, and
- the obviousness of the property contamination, and the ability to detect the contamination by appropriate investigation.[10]

Plainly, these regulations, when issued, will be a quantum leap beyond the existing CERCLA in the degree of guidance available to land purchasers.

Not all property owners will be subject to the new “all appropriate inquiry” regulations. The SBA grandfathers property purchased before May 31, 1997; it need only comply with CERCLA’s standards for “all appropriate inquiry” prior to the SBA. These less-demanding standards are --

- specialized knowledge or experience on the part of the land acquirer
- the relationship of the purchase price to the value of the property if uncontaminated
- reasonably ascertainable information about the property
- the obviousness of the property contamination, and
- the ability to detect the contamination by appropriate inspection.[11]

Property purchased on or after May 31, 1997, but before the new regulations are promulgated, must satisfy American Society for Testing and Materials procedures –

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[9] CERCLA § 101(35)(B), 42 U.S.C. § 9601(35)(B), as that provision read before amendment by the SBA (emphasis added).

[10] SBA § 223, amending CERCLA § 101(35)(B).

[11] SBA § 223, amending CERCLA § 101(35)(B).

including its document entitled "Standard Practice for Environmental Site Assessment: Phase 1 Environmental Site Assessment Process." Finally, nongovernmental or noncommercial entities that buy property for residential or similar use need only do a "facility inspection and title search," if they reveal no basis for further investigation.

The SBA adds further prerequisites for invoking the innocent-landowner defense, relating to the defendant's conduct after land purchase. He/she must cooperate with those conducting the response action, comply with any land use restrictions linked to the response action, and not impede institutional controls. Further, he/she must take "reasonable steps" to stop any continuing release, prevent any threatened future release, and prevent or limit human, environmental, or natural resource exposure to any previously released hazardous substance.[12]

In sum, the innocent-landowner defense to CERCLA liability is available on two multi-part conditions. *First*, the release was caused solely by a third party lacking a contractual relationship, direct or indirect, with the defendant. A landowner lacks a contractual relationship with predecessors in the chain of title if disposal preceded acquisition and at time of land acquisition he/she did not know and had "no reason to know" that the hazardous substance had been disposed of there. "No reason to know," in turn, means that by acquisition, he/she made "all appropriate inquiry" (as defined above) and took steps to stop any continuing release, prevent any future release, etc. *Second*, the landowner must have exercised due care and taken precautions against foreseeable acts of the third party, cooperated with the response action, complied with pertinent land use restrictions, and not impeded institutional controls.

II. Innocent Landowner Status as Enabling De Minimis Settlement

At large contaminated sites, the number of parties swept into the CERCLA liability net can be daunting. To address this, CERCLA requires EPA, when appropriate, to enter into "de minimis settlements" with certain liable parties whose blameworthiness was deemed by Congress to be minor.[13] A de minimis settlement enables a concededly liable party to "cash out" – that is, pay EPA a modest, fixed sum to discharge its liability – and thereby avoid protracted, expensive negotiations with the agency and a myriad of other liable parties over the allocation of liability at the site. At the same time, it allows the government to focus its resources on negotiations or litigation with the major parties.

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[12] This requirement raises some issues. First, the "reasonable steps" requirement seems to overlap significantly with already existing elements of the third-party defense – namely (see page 2) the requirements that the defendant exercised due care as to the hazardous substance and took precautions against foreseeable acts or omissions of the third party.

Second, the "reasonable steps" appear, as noted in the text, to be actions taken *after* the property is acquired, since it is hard to imagine stopping a release, etc., before one acquires the property. But as the SBA states it, the reasonable steps must be taken "[t]o establish that the defendant had no reason to know of the matter described in subparagraph (A)(i)," which speaks to the defendant's knowledge "[a]t the time the defendant acquired the facility." This is a seeming contradiction.

[13] CERCLA § 122(g); 42 U.S.C. § 9622(g).

One type of liable party eligible for de minimis settlement is the innocent landowner, defined differently than in Part I. When "practicable and in the public interest," the agency is directed to settle promptly with a landowner if the settlement involves only a "minor portion" of the response costs and the landowner "in the judgment of [EPA]" --

- owns the land where the facility is located
- did not conduct or permit the generation, transportation, storage, treatment, or disposal of any hazardous substance at the facility
- did not contribute to the release or the threat of release of a hazardous substance, and
- did not buy 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.

Note the several terms (e.g., "in the judgment of EPA") that give EPA wide discretion as to whether to offer de minimis settlements. Note also the absence of "all appropriate inquiry" and certain other prerequisites for innocent-landowner status as a third-party defense. Notwithstanding, EPA guidance demands all appropriate inquiry for de minimis settlement eligibility as well.[14] The guidance document makes a two-step argument. First, it asserts, the section 122 prerequisite that the landowner lack "constructive knowledge" is similar to the "had no reason to know" language in the innocent-landowner-as-defense provision. Second, since "had no reason to know" requires the defendant to do all appropriate inquiry, the lack-of-constructive-knowledge prerequisite for settlement must be read to do the same.[15]

Other CERCLA provisions empower EPA to include covenants not to sue in de minimis settlements (as CERCLA authorizes for regular settlements), direct that such settlements be entered as consent decrees or embodied in an administrative order (presumably for more effective enforcement),[16] and immunize de minimis settlors from contribution suits brought by other liable parties (claiming that the de minimis settlors got off too easy and should have to pay more).

III. Prospective Purchasers

The prospect of CERCLA liability has long been thought to chill investment in real property that is known or feared to be contaminated. Such properties are known as "brownfields" and often consist of former industrial sites in urban areas. The purchaser of land, CERCLA makes clear, becomes potentially liable (along with others) as an "owner" of the site for any response costs that may be necessary.

Early on, EPA saw a way of addressing this problem. If a buyer could know the amount of his/her liability *in advance of purchase*, it was reasoned, an informed business

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[14] 54 Fed. Reg. 34235, 34238 (Aug. 18, 1989).

[15] Even if one accepts the EPA's argument, query whether the recent enactment of the SBA, by expanding the components of "all appropriate inquiry," undermines the agency's view.

[16] Model language for such judicial consent decrees or administrative orders on consent is provided in the aforementioned EPA guidance as Attachments I and II.

decision could be made as to whether the purchase was attractive even with liability. So EPA in 1989 established a policy[17] toward prospective purchasers of contaminated property, offering in "very limited circumstances" to enter into a "prospective purchaser agreement" (PPA) – effectively, a settlement with the would-be purchaser by which EPA covenanted not to sue. Its criteria for PPAs included that (1) EPA enforcement action was anticipated at the facility, and (2) the purchaser agreed to make substantial monetary contribution to, or conduct of, the response action, where EPA's response costs would not otherwise be recoverable.

In 1995, EPA issued superseding guidance to add flexibility to the agency's criteria for entering into PPAs. Still, only about 160 were entered into from the 1989 guidance to date. As a result, Congress in the SBA provided a statutory definition of "bona fide prospective purchaser" and granted them an outright exemption from liability. In contrast with PPAs, which require the actuality or likelihood of EPA enforcement at the site and a negotiated settlement with the buyer, the new provisions are self-executing – EPA need not do anything. The buyer takes the property in the hope that should EPA ever launch an enforcement action, EPA will agree that the prerequisites for the bona fide prospective purchaser liability exemption have been met.

More specifically, the SBA exempts "bona fide prospective purchasers" (and their tenants) from CERCLA "owner" or "operator" liability if the person does not impede the response action or natural resource restoration. A "bona fide prospective purchaser" is a person who acquires ownership after SBA enactment and who shows that --

- all hazardous substance disposal at the facility occurred pre-acquisition
- the person made all appropriate inquiry (as defined in Part I)
- the person exercises "appropriate care" as to hazardous substances found at the facility by taking "reasonable steps" to stop releases, prevent any threatened future release, etc.
- the person provides full cooperation and access to persons authorized to conduct response actions or natural resource restorations
- the person complies with pertinent land use restrictions and does not impede institutional controls, and
- the person is not potentially liable, or affiliated with anyone that is.[18]

Finally, the SBA gives the U.S. a "windfall lien" on the property (or the U.S. may, by agreement with the owner, obtain other assurance of payment) if the U.S. has unrecovered response costs and the response action increased the market value of the property.

Issues remain, however. What constitutes "reasonable steps" (third bullet above)? If a landowner guesses incorrectly, his/her liability exemption disappears. (This has prompted some in the regulated community to advocate the buyer's use of *both* a PPA *and* the new bona fide prospective purchaser exemption.) As for the amount of the windfall lien, how does one compute the portion of the property's value attributable to the response action? EPA intends to publish guidance addressing these issues.

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[17] 54 Fed. Reg. at 34241-34243.

[18] SBA § 222(a), amending CERCLA to add a new § 101(40).