

8-1-1992

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Recommended Citation

Bonnie H. Keen, *Tax Assessment of Contaminated Property: Tax Breaks for Polluters?*, 19 B.C. Envtl. Aff. L. Rev. 885 (1992), <http://lawdigitalcommons.bc.edu/ealr/vol19/iss4/12>

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TAX ASSESSMENT OF CONTAMINATED PROPERTY: TAX BREAKS FOR POLLUTERS?

*Bonnie H. Keen**

I. INTRODUCTION

A company owns and operates an industrial facility that is heavily contaminated with hazardous substances.¹ Prior to the contamination, the property was worth \$1 million. The state environmental agency, however, has ordered the company to spend \$2 million to clean up the property. Because these cleanup costs far exceed the value of the property in an environmentally clean condition, the company claims that its property has a zero or negative value for tax assessment purposes. Consequently, the company is seeking a full reduction in its property taxes.

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¹ The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) defines hazardous substances. 42 U.S.C. § 9601(14) (1988). This Comment addresses contamination only from those hazardous substances that pollute the soil, surface water, and groundwater. It excludes asbestos contamination even though asbestos is a hazardous substance under CERCLA. *See* United States v. Nicolet, Inc., 712 F. Supp. 1205, 1207 (E.D. Pa. 1989). Asbestos contamination presents valuation obstacles that are inherently different from other hazardous substances. Asbestos is self-contained and limited to improvements on property in contrast to soil and groundwater contamination that can spread over a wide area, including onto adjacent properties. In addition, the EPA is prohibited from conducting a cleanup action in response to a release or threat of release "from products which are part of the structure of, and result in exposure within, residential buildings or business or community structures." 42 U.S.C. § 9604(a)(3)(B) (1988). Finally, the EPA has authority to regulate asbestos contamination in buildings directly under the Toxic Substances Control Act. 15 U.S.C. §§ 2641-2656 (1988).

This increasingly common scenario presents two problems for local taxing authorities.² The local property tax assessor first must decide whether to recognize the effects of environmental contamination on property value. In cases where a polluter is involved, the tax assessor must resolve the conflict between environmental policy concerns and the valuation principles underlying state property tax laws.

Congress passed the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) in 1980 to address the risks that contaminated properties pose to public health and the environment.³ Recently, many state legislatures have enacted environmental legislation similar to CERCLA.⁴ The two primary goals of these federal and state environmental laws are to ensure that contaminated sites are cleaned up, and that those persons involved in, or benefiting from, the use of hazardous substances are held liable for the cleanup costs.⁵ In other words, the polluter or landowner, and not the public, should pay for the cleanup.

² The Federal Environmental Protection Agency (EPA) has identified more than 36,000 properties in the United States that may be contaminated with hazardous substances. Telephone interview with Virgil P. Whitehurst, CERCLIS Helpline (Mar. 9, 1992); *see, e.g.*, *Comerica Bank-Detroit v. Metamora Township*, Nos. 103325, 110482, 112529, slip op. at 2 (Mich. Tax Trib. Apr. 17, 1989) (taxpayer sought abatement on grounds that its property was unmarketable due to contamination); *Bielat v. Macomb Township*, Nos. 93707, 100295, slip op. at 2 (Mich. Tax Trib. Oct. 7, 1987) (taxpayers sought abatements on the grounds that their properties were worthless due to contamination); *Community Consultants, Inc. v. Bedford Township*, No. 86388, slip op. at 2 (Mich. Tax Trib. July 3, 1985) (taxpayer sought abatement by claiming that property had negative value because contamination prevented its use for any purpose); *Appeal of Great Lakes Container Corp.*, 126 N.H. 167, 168, 489 A.2d 134, 135 (1985) (taxpayer claimed property unsaleable and thus untaxable due to contamination and pending lawsuit regarding liability for contamination); *Inmar Assocs. v. Borough of Carlstadt*, 112 N.J. 593, 599, 549 A.2d 38, 40 (1988) (taxpayer argued for abatement on ground that property had no value because it was unmarketable or, in alternative, that dollar-for-dollar reduction was required for cleanup costs); *Northwest Cooperage Co. v. Ridder*, Nos. 36278-36280, slip op. at 5-6 (Wash. B.T.A. July 12, 1990) (taxpayer sought abatement by claiming that its property had zero or negative value because costs of cleanup exceeded market value of property clean); *Fjetland v. Brown*, No. 37533, slip op. at 3, 6 (Wash. B.T.A. June 5, 1990) (taxpayer sought abatement by arguing that its property was unmarketable because costs of cleanup exceeded price purchaser would pay for it in uncontaminated condition).

³ 42 U.S.C. §§ 9601-9675 (1988); *see also* Resource Conservation and Recovery Act (RCRA), 42 U.S.C. §§ 6921-6939b (1988).

⁴ *See, e.g.*, Hazardous Waste Control Act, CAL. HEALTH & SAFETY CODE §§ 25100-25245 (West 1984 & Supp. 1991); MICH. COMP. LAWS ANN. §§ 299.610-299.618 (West 1984 & Supp. 1991); New Jersey Spill Compensation and Control Act, N.J. STAT. ANN. §§ 58:10-23.11 to -23.24 (West 1986 & Supp. 1990); OR. REV. STAT. §§ 465.200-465.420 (1989); Washington Model Toxics Control Act, WASH. REV. CODE ANN. §§ 70.105D.010-70.105D.921 (West Supp. 1991).

⁵ *Fjetland v. Brown*, No. 37533, slip op. at 4 (Wash. B.T.A. June 5, 1990).

Not surprisingly, these environmental laws significantly affect the value and use of contaminated property.⁶ The costs and uncertainties associated with owning contaminated property can be substantial.⁷ For example, the average cleanup cost of a site on the United States Environmental Protection Agency's (EPA's) National Priority List (NPL) is about \$40 million.⁸ In addition to cleanup costs, an owner of contaminated property may be liable under common law both for damage to surrounding properties and for personal injuries resulting from exposure to the hazardous substances.⁹

To reflect the costs of environmental liability, potential buyers of contaminated property may pay a lower price than they would for a similar property that is "clean". They may require sellers to assume the risk of liability through either a dollar-for-dollar reduction in the sales price¹⁰ or an indemnification by the sellers for the cost of cleanup.¹¹ Many potential buyers, concerned about the possible cleanup costs and liability associated with owning contaminated property, are unwilling to purchase a contaminated property at any price.¹² Moreover, potential buyers may lower their offering price or refuse to purchase a property regardless of whether the seller is the polluter or not.

Even though state tax laws require local taxing authorities to assess all real property according to the same standard of value,¹³ some local taxing authorities have refused to reduce tax assessments of contaminated properties that polluters own.¹⁴ They argue that such a reduction is contrary to the policies underlying environmental protection legislation.¹⁵ These taxing authorities choose to ignore the

⁶ See Peter J. Patchin, *Valuation of Contaminated Properties*, 56 APPRAISAL J. 7, 7 (1988).

⁷ See *infra* notes 59-137 and accompanying text.

⁸ *Paying for the Past*, ECONOMIST, Feb. 29-Mar. 6, 1992, at 80.

⁹ See *infra* notes 68-75 and accompanying text.

¹⁰ See *infra* notes 178-81 and accompanying text.

¹¹ See, e.g., *Reliable Elec. Finishing Co. v. Board of Assessors*, No. 158325, slip op. at 7, 9 (Mass. App. Tax Bd. Aug. 9, 1990) (using the income capitalization approach, taxpayer's appraiser valued property assuming that taxpayer provided indemnity and, in the alternative, that property was worthless without indemnity), *aff'd*, 410 Mass. 381, 573 N.E.2d 959 (1991); *Northwest Cooperage Co. v. Ridder*, Nos. 36278-36280, slip op. at 5 (Wash. B.T.A. July 12, 1990) (taxpayer's appraiser stated potential purchasers would either reduce purchase price by their potential liability for cleanup costs or require indemnity from seller for costs associated with contamination).

¹² Patchin, *supra* note 6, at 9.

¹³ See *infra* notes 22-24 and accompanying text.

¹⁴ See *infra* notes 142-55 and accompanying text.

¹⁵ *Id.*; see, e.g., *Firestone Tire & Rubber Co. v. County of Monterey*, 223 Cal. App. 3d

effects of contamination on property owned by polluters rather than transfer some of the financial burdens of cleanup to the public by reducing the tax base.¹⁶

Despite compelling environmental policy concerns, state courts and administrative tax boards across the country have refused to allow assessors to depart from their states' uniformity requirement.¹⁷ Moreover, these courts and tax boards have recognized that the liabilities environmental legislation imposes reduce property value.¹⁸ One court went as far as to state that "it seems beyond dispute that designation of property as having a problem serious enough to warrant EPA and Superfund cleanup will mark that property as an unmarketable pariah for years to come."¹⁹

The second and more difficult problem for assessors is determining the extent to which contamination affects property value. Assessors, however, cannot look to case law for guidance because the case law to date has not formulated a consistent methodology for measuring the impact of contamination on property assessments.²⁰ In response to this uncertainty, an administrative body in one state, the Oregon Department of Revenue (DOR), enacted its own administrative rule establishing a methodology for the valuation of contaminated property for property tax purposes.²¹ The Oregon rule provides assessors as well as taxpayers with a comprehensive and equitable solution to the unique problem of valuing contaminated property.

This Comment examines both the substantive and procedural obstacles that contribute to the uncertainties involved in tax assessment of contaminated properties. Section II of this Comment discusses the three common approaches to property valuation that form the basis for property tax assessment. Section III examines the factors affecting the valuation of contaminated property, including the costs and uncertainties associated with owning contaminated property. In section IV, this Comment describes the approaches to valuing contaminated property that taxpayers, local taxing author-

382, 390-91, 272 Cal. Rptr. 745, 750 (Cal. Ct. App. 1990); *Inmar Assocs. v. Borough of Carlstadt*, 112 N.J. 593, 600-01, 549 A.2d 38, 41 (1988).

¹⁶ See *Firestone*, 223 Cal. App. 3d at 391, 272 Cal. Rptr. at 750; *Reliable Elec. Finishing Co. v. Board of Assessors*, No. 158325, slip op. at 14-15 (Mass. App. Tax Bd. Aug. 9, 1990), *aff'd*, 410 Mass. 381, 573 N.E.2d 959 (1991).

¹⁷ See *infra* notes 149-56 and accompanying text.

¹⁸ See, e.g., *Inmar*, 112 N.J. at 600, 549 A.2d at 41; *Northwest Cooperage Co. v. Ridder*, Nos. 36278-36280, slip op. at 12 (Wash. B.T.A. July 12, 1990).

¹⁹ *SCA Servs. v. Thomas*, 634 F. Supp. 1355, 1364 (N.D. Ind. 1986).

²⁰ See *infra* note 212 and accompanying text.

²¹ See *infra* notes 232-49 and accompanying text.

ities, courts, and the Oregon DOR currently use. Section V then explores the deficiencies in these approaches and proposes a rule that will provide for uniformity in the valuation of contaminated property.

II. PRINCIPLES OF PROPERTY TAX ASSESSMENT

Most states, in either their constitution or statutes, have some provision for uniform ad valorem property taxes.²² These uniformity provisions require that, for the purpose of property tax assessment, the value of property be measured as a specified percentage of the property's fair market value.²³ Fair market value typically is defined as the price a willing buyer would pay a willing seller in an arm's-length transaction, when neither party is under duress and both parties have knowledge of relevant facts.²⁴

The fair market value of property is based on a property's highest and best use. The highest and best use of a property is the most profitable, probable, and legal use of that property.²⁵ Traditionally, government restrictions on use change a property's highest and best use and thus affect its fair market value by decreasing the property's utility.²⁶ As a result, many state statutes require that market value reflect such governmental restrictions on property.²⁷ Both assessors and appraisers use three methods to determine the market value of property: the "sales comparison" approach, the "cost" approach, and

²² AMERICAN SOCIETY OF APPRAISERS, AD VALOREM APPRAISERS: THE NEW PROFESSIONALS 5 (1975); see Daniel C. Stockford, Comment, *Property Tax Assessment of Conservation Easements*, 17 B.C. ENVTL. AFF. L. REV. 823, 839-40 (1990).

²³ Joan M. Youngman, *Defining and Valuing the Base of the Property Tax*, 58 WASH. L. REV. 713, 715 (1983); see, e.g., CAL. CONST. art XIII, § 1(a) (fair market value); MICH. CONST. art. IX, § 3 (true cash value); ARIZ. REV. STAT. ANN. § 42-227 (1980 & Supp. 1988) (full cash value); MASS. GEN. LAWS ANN. ch. 59, § 38 (West 1978) (fair cash value); N.J. STAT. ANN. § 54:4-2.25 (West 1986 & Supp. 1990) (true value); OR. REV. STAT. § 308.232 (1987) (true cash value); WASH. REV. CODE ANN. § 84.40.030 (West 1991) (true and fair value).

²⁴ See Stockford, *supra* note 22, at 827.

²⁵ AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, THE APPRAISAL OF REAL ESTATE 42 (9th ed. 1987) [hereinafter APPRAISAL OF REAL ESTATE].

²⁶ See *id.* at 40-42. Governmental restrictions include zoning laws, building codes, rent control laws, and health codes. *Id.* at 40.

²⁷ See, e.g., CAL. REV. & TAX. CODE § 402.1 (West 1987 & Supp. 1991) (assessors must consider effect of enforceable use restrictions on property value); MICH. STAT. ANN. § 7.27(1) (Callaghan 1984 & Supp. 1990) (assessors must consider advantages and disadvantages of location, quality of soil, zoning, and existing use); WASH. REV. CODE ANN. § 84.40.030 (West 1991) (assessors must consider political restrictions such as zoning as well as physical and environmental influences).

the "income capitalization" approach.²⁸ Assessors typically use all three methods in valuation process.²⁹

The sales comparison approach³⁰ involves comparing recent sales of similar properties in the same or a similar market to a subject property.³¹ Assessors make adjustments to the sale price of each comparable property to account for differences in rights conveyed, financing terms, and physical characteristics.³² The sales comparison approach is appropriate when the subject property is of a type often sold, such as single-family residential property.³³ Courts consider this approach the most reliable for determining market value because it is based on actual market data.³⁴

Under the cost approach, assessors add an estimated value of land derived from the sales comparison approach to the current value of any improvements on the land.³⁵ To determine the current value of the improvements, an assessor reduces the cost of reproducing³⁶ or replacing³⁷ the improvements by the amount of depreciation in those improvements.³⁸ Accrued depreciation results from physical deterioration, functional obsolescence, and economic obsolescence.³⁹ The cost approach is the most reliable means of valuing "special purpose" property or other types of property that are not traded frequently in the marketplace.⁴⁰ Assessors often use the cost approach as a

²⁸ See APPRAISAL OF REAL ESTATE, *supra* note 25, at 70.

²⁹ *Id.*; Stockford, *supra* note 22, at 829.

³⁰ The "sales comparison" approach also is referred to as the "market data" approach.

³¹ See Stockford, *supra* note 22, at 828.

³² APPRAISAL OF REAL ESTATE, *supra* note 25, at 70-71.

³³ *Id.* at 313; JACQUES B. GELIN & DAVID W. MILLER, THE FEDERAL LAW OF EMINENT DOMAIN 202 (1982).

³⁴ GELIN & MILLER, *supra* note 33, at 198-99 & n.4.

³⁵ APPRAISAL OF REAL ESTATE, *supra* note 25, at 71.

³⁶ "Reproduction cost is the estimated cost to construct, at current prices, an exact duplicate or replica of the building being appraised, using the same materials, construction standards, design, layout, and quality of workmanship, and embodying all the deficiencies, super adequacies, and obsolescence of the subject building." APPRAISAL OF REAL ESTATE, *supra* note 25, at 351.

³⁷ "Replacement cost is the estimated cost to construct, at current prices, a building being with utility equivalent to the building appraised, using modern materials and current standards, design, and layout." *Id.* at 352.

³⁸ *Id.* at 71.

³⁹ "Functional obsolescence is caused by internal property characteristics such as a poor floor plan, inadequate mechanical equipment, or functional inadequacy," whereas economic or external obsolescence "is caused by conditions outside the property such as a lack of economic demand, changing property uses in the area, or national economic conditions." *Id.* at 353.

⁴⁰ GELIN & MILLER, *supra* note 33, at 202. Special purpose properties are limited-market properties such as churches, schools, and museums. APPRAISAL OF REAL ESTATE, *supra* note 25, at 21.

check against sales comparison and income capitalization values. Based on the assumption that a prudent buyer will not pay more for a property than it would cost to reproduce the improvements on a similar site,⁴¹ the cost approach generally establishes the upper limit of a property's value.⁴²

Under the income capitalization approach, property value is based on the present value of the future benefits generated from a property.⁴³ To determine a property's present value, an assessor applies a capitalization rate⁴⁴ to the property's income stream and its resale or reversion value.⁴⁵ The capitalization rate is derived from current rates of return for similar properties.⁴⁶ The income capitalization approach, most often used to value income-producing property such as offices and apartment buildings,⁴⁷ is similar to the sales comparison approach because it too requires extensive market data.⁴⁸

Once an assessor has derived value indications from each approach, the assessor reconciles these values into a single market value estimate.⁴⁹ To reconcile the values, the assessor does not average the three values but rather determines which of the approaches is the most reliable and relevant to the assessed property.⁵⁰

An assessor may find, however, that the three traditional valuation methods do not apply to contaminated property. A major obstacle to valuing contaminated property is that there is very little market data.⁵¹ The explanation for this lack of market data is based on the principle of "substitution", according to which a buyer will not purchase a contaminated property when a similar uncontaminated property is available.⁵² Assessors have difficulty using the three approaches because each relies, to some extent, on market data.⁵³ Moreover, the cost approach may not be useful in the valuation of

⁴¹ APPRAISAL OF REAL ESTATE, *supra* note 25, at 346.

⁴² See GELIN & MILLER, *supra* note 33, at 216.

⁴³ APPRAISAL OF REAL ESTATE, *supra* note 25, at 71.

⁴⁴ A capitalization rate is any rate that converts a property's income into present value. *Id.* at 413.

⁴⁵ *Id.* at 71.

⁴⁶ *Id.* at 72.

⁴⁷ See GELIN & MILLER, *supra* note 33, at 202.

⁴⁸ See APPRAISAL OF REAL ESTATE, *supra* note 25, at 72.

⁴⁹ *Id.*

⁵⁰ *Id.*; DOUGLAS E. FRANKLIN ET AL., MASSACHUSETTS PROPERTY REVALUATION 35 (1983) [hereinafter MASSACHUSETTS PROPERTY REVALUATION].

⁵¹ Joseph A. Campanella, *Valuing Partial Losses in Contamination Cases*, 52 APPRAISAL J. 301, 302 (1984); Patchin, *supra* note 6, at 9.

⁵² APPRAISAL OF REAL ESTATE, *supra* note 25, at 35-36; Patchin, *supra* note 6, at 9.

⁵³ See *supra* notes 23-50 and accompanying text.

contaminated property where contamination is located in the soil or groundwater, because this approach focuses on the valuation of buildings and other improvements on property.⁵⁴ Finally, contamination may limit the usefulness of the income approach in situations where the contamination is so severe that a property has no present use.⁵⁵

An owner of contaminated property may hire an appraiser to conduct a valuation in order to determine whether the tax assessment on the property is accurate. If a taxpayer's property is overvalued, the taxpayer will pay more than its fair share of taxes. To obtain a reduction in its assessment, the taxpayer must appeal the assessment to the appropriate taxing authority and prove that the assessor's value is erroneous; thus, the taxpayer bears the burden of proving overassessment.⁵⁶ If a taxpayer fails to meet the burden of proof, a court or tax board affirms the assessor's value.⁵⁷ Courts and administrative tax boards often find that owners of contaminated property have provided insufficient proof.⁵⁸

III. FACTORS AFFECTING THE VALUATION OF CONTAMINATED PROPERTY

A. *Costs Associated with Contamination that Affects Property Value*

The presence of hazardous substances on real property can have a significant impact on the property's value.⁵⁹ Either the contamination itself or the costs of complying with environmental laws may

⁵⁴ See *Inmar Assocs. v. Borough of Carlstadt*, 112 N.J. 593, 608, 549 A.2d 38, 45 (1988).

⁵⁵ See *Fjetland v. Brown*, No. 37533, slip op. 7-8 (Wash. B.T.A. June 5, 1990).

⁵⁶ *E.g.*, MICH. STAT. ANN. § 7.650(37) (Callaghan 1984 & Supp. 1990) (taxpayer has burden of proving true cash value of property); WASH. REV. CODE ANN. § 84.40.0301(1) (West 1991) (taxpayer must overcome presumption that determination of assessor is correct); *Reliable Elec. Finishing Co. v. Board of Assessors*, No. 158325, slip op. at 16 (Mass. App. Tax Bd. Aug. 9, 1990) (taxpayers have burden of proving their right as matter of law to tax abatement), *aff'd*, 410 Mass. 381, 573 N.E.2d 959 (1991); *Appeal of Great Lakes Container Corp.*, 126 N.H. 167, 169, 489 A.2d 134, 136 (1985) ("plaintiff must prove by a preponderance of the evidence that the assessment placed on its property was disproportionately higher in relation to its true value than as to other property in general in the taxing district") (quoting *Wise Shoe Co. v. Town of Exeter*, 119 N.H. 700, 701, 406 A.2d 720, 722 (1979)). See generally *Inmar Assocs. v. Borough of Carlstadt*, 7 N.J. Tax 482 (1985) (taxpayer must overcome presumption that judgment of County Board of Taxation was correct, and then prove true value by preponderance of evidence), *aff'd*, 214 N.J. Super. 256, 518 A.2d 1110 (N.J. Super. Ct. App. Div. 1986), *aff'd, in part, and rev'd, in part*, 112 N.J. 593, 549 A.2d 38 (1988).

⁵⁷ Roger M. Groves, *Do America's State Cases Answer the Question: How Should You Value Contaminated Properties? (Sorry)*, 2 J. PROP. TAX MGMT. 1, 5 (1991).

⁵⁸ See *infra* note 210 and accompanying text.

⁵⁹ Patchin, *supra* note 6, at 7.

cause the value of the contaminated site to decrease. Costs associated with contaminated property include the cost of cleanup and liability to third parties as well as the costs resulting from limitations upon the use and transferability of the property, increased financing or insurance expenses, and market stigma. Assessors should consider the impact of each of these costs in their assessments of contaminated property.

Liability for the cost of cleaning up property in order to comply with environmental laws may be the most substantial cost facing an owner of contaminated property.⁶⁰ Under CERCLA, the owner may be liable for all removal⁶¹ or remedial costs⁶² that a federal or state agency incurs.⁶³ The owner also may be liable for any necessary response costs that private parties incur as a result of the release or threatened release of a hazardous substance on the owner's property.⁶⁴ As an alternative to conducting a cleanup itself, the EPA may order owners to perform the necessary cleanup.⁶⁵ These owners must pay for any procedures required to abate the danger or threat to public health or the environment, such as removal, containment, or treatment of the hazardous substances at the site.⁶⁶ Moreover, they may have to absorb administrative costs, monitoring costs, legal fees, engineering fees, and the costs of environmental audits, surety bonds, and special insurance.⁶⁷

In addition to paying for cleanup costs, owners of contaminated properties may be subject to third-party suits for property damage and personal injuries.⁶⁸ An owner's exposure to this type of liability may depend on whether there is publicity regarding the contami-

⁶⁰ See *supra* note 1 and accompanying text.

⁶¹ Section 9601(23) defines removal actions as temporary measures taken to abate a release or threat of release of hazardous substances, including security fencing and provision of alternative water supplies. 42 U.S.C. § 9601(23) (1988).

⁶² Section 9601(24) defines remedial actions as any permanent measures taken, including storage, confinement, excavations, and onsite treatment. *Id.* § 9601(24). Section 9601(25) defines response costs to include costs of removal and remedial actions as well as enforcement costs. *Id.* § 9601(25).

⁶³ *Id.* § 9607(a)(1), (a)(4)(A); see Note, *Liabilities of the Innocent Current Owner of Toxic Property Under CERCLA*, 23 U. RICH. L. REV. 403, 414 (1989). Additionally, an owner of contaminated property also may be liable for damages to natural resources and for any health assessments or health effects studies. 42 U.S.C. § 9607(C)-(D) (1988).

⁶⁴ 42 U.S.C. § 9607(a)(4)(B) (1988).

⁶⁵ *Id.* § 9606(a). Of course, an owner may choose to cleanup its property voluntarily in order to avoid such a lawsuit.

⁶⁶ See, e.g., *id.* § 9601(24); OR. ADMIN. R. 150-308.205-(E)(1)(c) (1990).

⁶⁷ See, e.g., 42 U.S.C. § 9601(23) (1988); OR. ADMIN. R. 150-308.205-(E)(1)(c) (1990).

⁶⁸ Patchin, *supra* note 6, at 12; Melvyn Kopstein, *Property Devaluation & a Question of Degree*, EXPERTS-AT-LAW, Mar.-Apr. 1990, at 9-10.

nation at a site.⁶⁹ Liability for property damage occurs when hazardous substances spread to the soil and groundwater of neighboring properties.⁷⁰ Similarly, an owner of contaminated property may be liable for personal injuries in a toxic tort action because hazardous substances can adversely affect public health.⁷¹ Although CERCLA does not permit a cause of action for either property damage or personal injury claims,⁷² a private party can sue for damages under state common law theories, including trespass, nuisance, negligence, and strict liability.⁷³ Awards in property damage and toxic tort cases may exceed cleanup costs.⁷⁴ In sum, the market value of contaminated property will decrease as a result of the substantial cost and uncertainty of future liability for toxic tort and property damage claims.⁷⁵

Owners of contaminated property may incur additional costs if either the nature and extent of the contamination or governmentally imposed restrictions related to the contamination limit the use of their property.⁷⁶ The presence of contamination can alter the highest and best use of a property.⁷⁷ For example, a site that had been an industrial park may be usable only as an open storage facility after the current owners discover hazardous wastes there.⁷⁸ This type of change in use necessarily would decrease a property's market value.

If there is a sufficient threat of danger to public health or the environment, an environmental agency may limit access to a contaminated site until it is cleaned up.⁷⁹ For instance, in *City of Newark v. Block 1183*,⁸⁰ the Superior Court of New Jersey issued an order that gave the New Jersey Department of Environmental Protection

⁶⁹ Patchin, *supra* note 6, at 12.

⁷⁰ *Id.*; Kopstein, *supra* note 68, at 9-10.

⁷¹ Kopstein, *supra* note 68, at 10.

⁷² Note, *supra* note 63, at 414.

⁷³ See, e.g., *Sterling v. Velsicol Chem. Corp.*, 647 F. Supp. 303, 308 (W.D. Tenn. 1986) (class action seeking damages under all four theories for injuries arising from contaminated water supply), *aff'd, in part, and rev'd, in part*, 855 F.2d 1188 (6th Cir. 1988).

⁷⁴ For example, in the Love Canal case, plaintiffs filed over \$3 billion in claims for personal injuries in contrast to \$30 million in cleanup costs. Katherine T. Eubank, *Paying the Costs of Hazardous Waste Pollution: Why Is the Insurance Industry Raising Such a Stink?*, 1991 U. ILL. L. REV. 713 n.3; see Kopstein, *supra* note 68, at 10 (there may be multimillion-dollar toxic tort suits when public discovers that site is contaminated).

⁷⁵ Patchin, *supra* note 6, at 12.

⁷⁶ See OR. ADMIN. R. 150-308.205-(E)(3)(a)(A) (1990).

⁷⁷ Patchin, *supra* note 6, at 15.

⁷⁸ *Id.*

⁷⁹ See 42 U.S.C. § 9606(a) (1988).

⁸⁰ 223 N.J. Super. 10, 537 A.2d 1311 (N.J. Super. Ct. App. Div. 1988).

(DEP) exclusive possession and control of a warehouse for the purpose of cleaning up a toxic spill.⁸¹ The DEP prohibited the owner of the warehouse from using the warehouse for almost three years. During that time, the owner incurred substantial costs, losing rental income while still paying necessary expenses, such as property taxes.⁸²

Several states have passed laws that specifically place restrictions on the transfer and use of contaminated properties.⁸³ These laws generally prohibit any sale, closure, or new use of a contaminated site prior to cleanup of the property. For example, the New Jersey Environmental Cleanup Responsibilities Act (ECRA)⁸⁴ requires owners and operators of "industrial establishments"⁸⁵ in New Jersey to secure either a "negative declaration", which is a certification from the DEP that the facility is clean,⁸⁶ or DEP approval of a cleanup plan by the date of any change in use or ownership.⁸⁷ If an owner fails to comply with ECRA, the DEP can impose several penalties, including voiding the facility's sale or transfer.⁸⁸

Whether ECRA-like statutes diminish property values is open to dispute.⁸⁹ On one hand, an assessor may argue that a hypothetical buyer will not incur cleanup costs because the current owner cannot sell the property while it is contaminated; therefore, according to this argument, no deduction is necessary to reflect cleanup costs.⁹⁰ On the other hand, transfer restrictions are similar to other governmental restrictions that assessors take into account as factors re-

⁸¹ *Id.* at 11-12, 537 A.2d at 1312.

⁸² *Id.* at 12, 537 A.2d at 1312; *see also* Appeal of Great Lakes Container Corp., 126 N.H. 167, 168, 489 A.2d 134, 135 (1985).

⁸³ *E.g.*, Hazardous Waste Control Act, CAL. HEALTH & SAFETY CODE § 25232 (West 1984); Transfer Act, CONN. GEN. STAT. § 22a-134(a) (Supp. 1990); Environmental Cleanup Responsibility Act (ECRA), N.J. STAT. ANN. § 13:1k-6 to -14 (West Supp. 1990).

⁸⁴ N.J. STAT. ANN. § 13:1k-6 to -14 (West Supp. 1990).

⁸⁵ Section 13:1k-8(f) defines industrial establishment to include any place of business engaged in operations which involve the generation, manufacture, refining, transportation, treatment, storage, handling, or disposal of hazardous substances.

⁸⁶ *Id.* § 13:1k-8(g).

⁸⁷ *Id.* § 13:1k-9a to -9b.

⁸⁸ *Id.* § 13:1k-13a to -13b.

⁸⁹ The two cases that have addressed the impact of ECRA-like statutes have done so only in dicta. *Firestone Tire & Rubber Co. v. County of Monterey*, 223 Cal. App. 3d 382, 395, 272 Cal. Rptr. 745, 753 (1990) (Department of Health and Safety's restriction did not apply on lien date because department had not identified presence of contamination until later); *Inmar Assocs. v. Borough of Carlstadt*, 214 N.J. Super. 256, 261-62, 518 A.2d 1110, 1116 (N.J. Super Ct. App. Div. 1986) (ECRA was not operative until after lien dates in question), *aff'd, in part, and rev'd, in part*, 112 N.J. 593, 549 A.2d 38 (1988).

⁹⁰ *See, e.g., Firestone*, 223 Cal. App. 3d at 391, 272 Cal. Rptr. at 750.

ducing a property's value.⁹¹ While the courts have not decided the question of whether transfer statutes increase or decrease property values,⁹² Oregon's administrative rule treats governmental restrictions on transfer as an adjustment that assessors must consider when they utilize the sales comparison approach.⁹³

Depending on the nature and extent of the contamination, the ability of a current owner or potential buyer to obtain financing, either for the sale or the future development of a property, may be severely limited. Lenders are reluctant to advance funds to owners of contaminated properties because courts may hold these lenders liable for cleanup costs.⁹⁴ In fact, lenders may have to pay for cleanup costs even if those costs exceed the amount of their foreclosed loan.⁹⁵ Moreover, courts have not settled on a standard for determining when to extend liability to lenders that would allow lenders to minimize their risk.⁹⁶

While a limited number of lenders may be willing to make a loan on mildly contaminated property, virtually none do so on severely contaminated property.⁹⁷ Those lenders willing to loan generally charge a higher interest rate on contaminated property than on uncontaminated property to compensate for their increased risk of liability for cleanup costs.⁹⁸ A higher interest rate, of course, increases the financing cost to the potential buyer. Both the reduced availability of financing and the increased costs of financing diminish the market value of the property.⁹⁹

⁹¹ See *supra* note 27 and accompanying text.

⁹² See *infra* note 274; see *Reliable Elec. Finishing Co. v. Board of Assessors*, No. 158325, slip op. at 20 (Mass. App. Tax Bd. Aug. 9, 1990) (board suggested that owner's compliance with environmental statutes may increase property's market value), *aff'd*, 410 Mass. 381, 573 N.E.2d 959 (1991).

⁹³ OR. ADMIN. R. 150-308.205-(E) (1990).

⁹⁴ See, e.g., *United States v. Fleet Factors Corp.*, 901 F.2d 1550, 1557 (11th Cir.) (court held lender would be liable as owner if it had capacity to influence debtor's disposal of hazardous wastes), *reh'g denied*, 911 F.2d 742 (11th Cir. 1990) (en banc), *cert. denied*, 111 S. Ct. 752 (1991).

⁹⁵ See, e.g., *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573, 578 (D. Md. 1986) (court held bank liable for cleanup costs of \$551,731 where loan totalled \$335,000); see also Patchin, *supra* note 6, at 8.

⁹⁶ See Note, *Cleaning Up the Debris After Fleet Factors: Lender Liability and CERCLA's Security Interest Exemption*, 104 HARV. L. REV. 1249, 1252 (1991).

⁹⁷ See Patchin, *supra* note 6, at 11.

⁹⁸ *Northwest Cooperage Co. v. Ridder*, Nos. 36278-36280, slip op. at 14-15 (Wash. B.T.A. July 12, 1990).

⁹⁹ *Id.* at 15 (citing INTERNATIONAL ASSOCIATION OF ASSESSING OFFICERS, PROPERTY ASSESSMENT VALUATION 198-202 (1977)).

Similarly, an owner of contaminated property may not be able to obtain insurance coverage for environmental pollution.¹⁰⁰ While many insurers currently refuse to provide such insurance, some provide it at extremely high premiums.¹⁰¹ The availability of insurance has decreased because insurers cannot predict the timing or the extent of damages from contamination.¹⁰² Potential buyers know that without insurance coverage they might have to bear the full costs of contamination, and therefore accordingly reduce their offering price.¹⁰³

Beyond tangible costs, a "market stigma" may attach to a contaminated property and cause a loss in its market value.¹⁰⁴ Market stigma has several causes, including unknown cleanup costs, potential liability to the public, and financing problems.¹⁰⁵ As a result of market stigma, potential purchasers may be reluctant to buy a property that once was contaminated even if a federal or state environmental agency is satisfied with the cleanup.¹⁰⁶ Consequently, the Washington Board of Tax Assessors has recognized the negative impact that stigma can have on property value.¹⁰⁷ No other administrative tax board or court, however, has taken this position toward market stigma.

To the extent that assessors can estimate the impact of the costs of contamination, they should reduce their assessments accordingly. Unfortunately, assessors may have great difficulty accurately measuring the impact of these costs on property value.

B. Uncertainties Associated with Ownership of Contaminated Property

Assessors should adjust the value of contaminated property to account for the risks associated with owning contaminated prop-

¹⁰⁰ Eubank, *supra* note 74, at 174 n.10.

¹⁰¹ *Id.* at 174.

¹⁰² *Id.* at 197-98.

¹⁰³ Northwest Cooperage Co. v. Ridder, Nos. 36278-36280, slip op. at 14 (Wash. B.T.A. July 12, 1990).

¹⁰⁴ Patchin, *supra* note 6, at 12-13. See generally Peter J. Patchin, *Contaminated Properties—Stigma Revisited*, 59 APPRAISAL J. 167 (1990).

¹⁰⁵ Patchin, *supra* note 6, at 12-13.

¹⁰⁶ *Id.* at 12.

¹⁰⁷ See Northwest Cooperage Co. v. Ridder, Nos. 36278-36280, slip op. at 21 (Wash. B.T.A. July 12, 1990) (board increased capitalization rate to reflect effect of stigma on property's future marketability); Fjetland v. Brown, No. 37533, slip op. at 8 (Wash. B.T.A. June 5, 1990) (board increased discount rate in response to additional risk that stigma would remain with property).

erty.¹⁰⁸ Ownership of contaminated property is risky in light of the numerous uncertainties regarding the ultimate cost of cleanup and who is responsible for that cost.¹⁰⁹ Although assessors should attempt to account for these uncertainties, they may not be able to quantify the effect that contamination has on property value with any degree of precision.

Cleanup costs may be difficult to estimate at the time of assessment for tax purposes because the extent of contamination, the level of cleanup required, and the appropriate method of cleanup may not be known. The primary problem is determining whether a particular site is so contaminated that the controlling federal or state environmental statute requires its cleanup. Even when a property has been placed on a federal or state list of contaminated sites, the degree of contamination on the property may be unknown. For example, the EPA may place a site on the Comprehensive Environmental Response, Compensation, and Liability Inventory System (CERCLIS) list even though the agency only suspects that the site is contaminated by hazardous wastes.¹¹⁰ Therefore, the only way to determine if a release or threatened release of a hazardous substance threatens either public health or the environment is for a government agency or private party to conduct an environmental assessment.¹¹¹

Once the presence of contamination on a property is confirmed, the degree of cleanup necessary to prevent, minimize, or mitigate harm to public health or the environment may remain uncertain. While government agencies and property owners want the property cleaned up, the two parties address the issue of "how clean is clean?" from different perspectives.¹¹² Property owners want their property declared clean so they can use or sell it.¹¹³ On the other hand, environmental legislation requires that cleanup actions achieve a level of residual contamination that does not pose a threat to public health or the environment.¹¹⁴ In light of this legislative mandate,

¹⁰⁸ See *Northwest Cooperage*, Nos. 36278-36280, slip op. at 13, 19.

¹⁰⁹ There also may be uncertainty about the potential liability to third parties and the effect of post-cleanup stigma. See *supra* notes 68-75, 104-07 and accompanying text.

¹¹⁰ *Northwest Cooperage*, Nos. 36278-36280, slip op. at 3 n.1 (Wash. B.T.A. July 12, 1990). CERCLIS is the EPA's data base containing the official inventory of CERCLA sites that the Superfund program has addressed or needs to address. 40 C.F.R. § 300.5 (1990). Placement on such a list, nevertheless, may have a significant effect on property value.

¹¹¹ Kopstein, *supra* note 68, at 9.

¹¹² See Patchin, *supra* note 104, at 171.

¹¹³ See *id.*

¹¹⁴ *E.g.*, 42 U.S.C. § 9621(d)(1) (1988). Section 9621 sets forth cleanup standards for both governmental and private remedial actions. *Id.* § 9621(a)-(d).

environmental agencies are reluctant to declare that a site is sufficiently clean.¹¹⁵ Owners therefore usually have to perform environmental assessments that demonstrate that their cleanups have abated the danger at their sites.

A further problem is that the degree of cleanup required may be ambiguous when more than one governmental standard applies to a site.¹¹⁶ For example, if a gasoline spill threatens a drinking water supply, the EPA's drinking water standard of five parts per billion applies.¹¹⁷ If, however, skin contact is a risk, the Occupational Safety and Health Administration (OSHA) standard, which allows 1,000 parts per billion, applies.¹¹⁸ In this case, cleanup costs will be significantly greater with the EPA standard than with the OSHA standard.¹¹⁹

To add to the uncertainty, environmental agencies have the discretion to require additional cleanup actions in the future.¹²⁰ An agency may determine that further cleanup measures are necessary because the agency has issued new regulations imposing more stringent environmental standards or has discovered more contamination at a site.¹²¹ Cleanup standards may become more stringent if technology advances to a level such that environmental experts could identify risks to public health at lower concentrations of hazardous substances, or if new scientific data on the effects of hazardous substances become available.

Even when an environmental agency determines the degree of cleanup required, the appropriate method for that cleanup may be unclear. Environmental agencies often are reluctant to commit themselves to accepting any one remedial method or technology until its effectiveness has been demonstrated at a site.¹²² An agency may allow an owner to attempt a less costly cleanup method upon the condition that the owner will have to use a more expensive proven method if the initial one is inadequate.¹²³

Assuming that an agency or an owner has been able to estimate cleanup costs, the question of who is liable for those costs may remain

¹¹⁵ See Patchin, *supra* note 104, at 171.

¹¹⁶ *Id.*; see 42 U.S.C. § 9621(d)(2) (1988).

¹¹⁷ Patchin, *supra* note 104, at 171.

¹¹⁸ *Id.*

¹¹⁹ *Id.*; see also Kopstein, *supra* note 68, at 11.

¹²⁰ *E.g.*, 42 U.S.C. §§ 9621(c), 9622(f)(6) (1988).

¹²¹ See David L. Canary, Legal Developments Regarding the Valuation of Contaminated Property 9 (1990) (unpublished report, on file with author).

¹²² Patchin, *supra* note 6, at 11-12.

¹²³ *Id.*

unanswered. Under CERCLA, the EPA or a court can require a wide range of parties to pay for cleanup costs.¹²⁴ CERCLA section 107 creates four categories of potentially responsible parties (PRPs): the current owner or operator of a facility; the owner or operator of a facility at the time of disposal; any person who arranged for disposal at a facility; and any person who accepted hazardous substances for transport to a facility.¹²⁵

A court may hold any of these PRPs strictly liable for cleanup costs regardless of fault.¹²⁶ PRPs, however, can escape CERCLA liability if they can fit within one of three narrow defenses.¹²⁷ A PRP must demonstrate that an act of God, an act of war, or an act or omission by a third party with whom the PRP had no contractual relationship was the sole cause of contamination.¹²⁸ The last of these defenses is known as the "third-party" defense.

In the 1986 amendments to CERCLA, the Superfund Amendments and Reauthorization Act (SARA),¹²⁹ Congress extended the third-party defense to include innocent landowners who can establish both that they acquired their property after the disposal of hazardous substances, and that they "did not know and had no reason to know that any hazardous substance" was disposed of on their property.¹³⁰ For a landowner to establish that it had no reason to know of the contamination, it must have conducted an "appropriate inquiry" into the previous ownership and uses of the property prior to the time of acquisition.¹³¹ A court will determine whether an owner has undertaken an appropriate inquiry by considering the owner's specialized knowledge or experience, the relationship of the purchase price to the market value of the property in an uncontaminated condition, commonly known information about the property, and the owner's ability to discover contamination by "appropriate inspection".¹³²

¹²⁴ 42 U.S.C. § 9606(a) (1988).

¹²⁵ *Id.* § 9607(a)(1)-(4).

¹²⁶ *See, e.g.*, *New York v. Shore Realty Corp.*, 759 F.2d 1032, 1044 (2d Cir. 1985); *see* *Stockford*, *supra* note 22, at 411-12.

¹²⁷ 42 U.S.C. § 9607(b)(1)-(3) (1988).

¹²⁸ *Id.*; *see* *Stockford*, *supra* note 22, at 415-16.

¹²⁹ 42 U.S.C. §§ 9601-9675 (1988).

¹³⁰ *Id.* § 9601(35)(A)(i).

¹³¹ *Id.* § 9601(35)(B). The landowner also must show that it exercised due care with respect to the hazardous substance and took reasonable precautions against foreseeable acts or omissions of the third party who caused the contamination. *Id.* § 9607(b)(3)(a), (b).

¹³² *Id.* § 9601(35)(B). An owner will be precluded from asserting the third-party defense if it has "obtained actual knowledge of the release or threatened release of a hazardous substance at such a facility . . . and then subsequently transferred ownership of the property to another

Many current owners, especially those owners who purchased their property before 1986, may not be able to assert this defense if they did not conduct the required in-depth examination into their property prior to purchasing it.¹³³

If a current owner is unable to fit within any of the defenses, then a court may hold that owner jointly and severally liable for the entire amount of cleanup where the harm on the property is indivisible.¹³⁴ To avoid the imposition of joint and several liability, the owner must prove that the harm is divisible, and that there is a reasonable basis for apportioning damages.¹³⁵ If an owner fails to meet its burden of proof and consequently is found jointly and severally liable, it has a right to contribution from other PRPs under SARA.¹³⁶ This right of contribution may be useless, however, if the other PRPs have ceased to exist or have become insolvent.¹³⁷ In sum, an assessor may be unable to determine who will bear the costs of cleanup unless a court or the EPA has ordered the PRP to clean up the property, and a court has decided the issue of contribution.

In light of the uncertainties concerning cleanup costs and who is liable for those costs, an appraiser or an assessor may find it impossible to quantify accurately the impact of contamination on property value. The next section will discuss the varying approaches that assessors, taxpayers, courts, and tax boards have taken to acknowledge the costs and uncertainties of owning contaminated property.

IV. CURRENT APPROACHES TO VALUING CONTAMINATED PROPERTY

Three major approaches to the valuation of contaminated property have emerged from the case law.¹³⁸ At one extreme, local taxing authorities have argued that they should be able to ignore the effect of contamination on property value.¹³⁹ At the other extreme, taxpayers who own contaminated property have argued that tax asses-

person without disclosing such knowledge" or has caused or contributed to the contamination. *Id.* § 9601(35)(C), (D).

¹³³ See Stockford, *supra* note 22, at 424.

¹³⁴ See *United States v. Chem-Dyne Corp.*, 572 F. Supp. 802, 810 (S.D. Ohio 1983); Stockford, *supra* note 22, at 418-19.

¹³⁵ *Chem-Dyne Corp.*, 572 F. Supp. at 811; see Stockford, *supra* note 22, at 419.

¹³⁶ 42 U.S.C. § 9613(f) (1988); Elizabeth F. Mason, Comment, *Contribution, Contribution Protection, and Nonsettlor Liability Under CERCLA: Following Laskin's Lead*, 19 B.C. ENVTL. AFF. L. REV. 73, 89-91, 92 (1991).

¹³⁷ See Mason, *supra* note 136, at 96-97.

¹³⁸ See Groves, *supra* note 57, at 2-5.

¹³⁹ See *infra* notes 142-76 and accompanying text.

sors should deduct cleanup costs from the market value of the taxpayers' property.¹⁴⁰ In between these two extremes, several courts, administrative tax boards, and the Oregon DOR have recognized that contamination has some effect on property values.¹⁴¹

A. One Extreme: No Reduction in Property Value for Contamination

Several local taxing authorities have refused requests from owners of contaminated property for assessment reductions, on the grounds that granting such abatements would undermine environmental policy.¹⁴² Courts and tax boards explicitly have rejected these policy arguments.¹⁴³ For example, in *Inmar Associates v. Borough of Carlstadt*,¹⁴⁴ two local taxing authorities, South Bound Brook and Carlstadt, argued that they had to disregard the effects of environmental laws on property value.¹⁴⁵ South Bound Brook posited that when polluters request tax reductions, environmental policy requires a departure from New Jersey's constitutional mandate that all property be "assessed according to the same standard of value."¹⁴⁶ In New Jersey, that standard is true value.¹⁴⁷ Essentially, South Bound Brook argued that the Supreme Court of New Jersey should replace the constitutional mandate with a balancing test that weighs the environmental policy concerns against true value assessments.¹⁴⁸ In rejecting the taxing authority's argument, the court stated that it was unable to depart from the constitutional standard of true value even for compelling public policy reasons.¹⁴⁹ Moreover, the court found that federal and state environmental legislation has an impact

¹⁴⁰ See *infra* notes 179-207 and accompanying text.

¹⁴¹ See *infra* notes 210-49 and accompanying text.

¹⁴² *E.g.*, *Firestone Tire & Rubber Co. v. County of Monterey*, 223 Cal. App. 3d 382, 391, 272 Cal. Rptr. 745, 750 (1990); *Inmar Assocs. v. Borough of Carlstadt*, 112 N.J. 593, 600-01, 549 A.2d 38, 41 (1988). Environmental policy concerns include protecting public health and welfare as well as the environment from the risks posed by hazardous substances.

¹⁴³ *Firestone*, 223 Cal. App. 3d at 391, 272 Cal. Rptr. at 750; *Inmar*, 112 N.J. at 600-01, 549 A.2d at 41; *Northwest Cooperage Co. v. Ridder*, Nos. 36278-36280, slip op. at 13 (Wash. B.T.A. July 12, 1990). The Oregon DOR implicitly rejected environmental policy arguments by requiring that all assessments include adjustments reflecting the impact of contamination. See OR. ADMIN. R. 150-308.205-(E) (1990).

¹⁴⁴ 112 N.J. 593, 549 A.2d 38 (1988).

¹⁴⁵ *Id.* at 600, 549 A.2d at 41.

¹⁴⁶ *Id.*

¹⁴⁷ *Id.* at 600-01, 549 A.2d at 40-41.

¹⁴⁸ *Id.* at 601, 549 A.2d at 41.

¹⁴⁹ *Id.*

on the true value of real property.¹⁵⁰ In short, the *Inmar* court held that an assessor's methodology is patently defective if it does not take into account the effect of such legislation.¹⁵¹

Similarly, in *Firestone Tire and Rubber Co. v. County of Monterey*,¹⁵² the California Court of Appeals for the Sixth District rejected the Monterey County Assessment Appeal Board's finding that cleanup costs should not reduce a property's assessed value.¹⁵³ The board refused to give a reduction to the taxpayer, Firestone, because it considered cleanup costs to be costs of doing business and therefore costs that Firestone's shareholders should bear.¹⁵⁴ The board further reasoned that a tax abatement in effect would transfer some of the financial burden of Firestone's legal obligation to clean up its property to other taxpayers in the county, thereby violating the policy behind pollution control laws.¹⁵⁵ The court of appeals held that the board's finding was "erroneous as a matter of law" in light of California's constitutional requirement that property be assessed at fair market value for property tax purposes.¹⁵⁶

In *Firestone*, Monterey County offered several arguments in support of the board's finding and in favor of disregarding the effects of cleanup costs on fair market value.¹⁵⁷ The county first contended that liability for cleanup belongs to a polluter and does not run with the land; therefore, the polluter cannot transfer its liability when the property changes ownership.¹⁵⁸ The county next argued that cleanup costs could not have been transferred in a hypothetical sale of the property because the California Department of Health Services (DHS) restricted any transfer of the property until it was cleaned up.¹⁵⁹ According to the county, Firestone's appraiser should have based his valuation on a hypothetical sale of environmentally clean property and not contaminated property.¹⁶⁰ The *Firestone*

¹⁵⁰ *Id.* at 600, 549 A.2d at 41; *see also* *Reliable Elec. Finishing Co. v. Board of Assessors*, No. 158325, slip op. at 20 (Mass. App. Tax Bd. Aug. 9, 1990) (Massachusetts Appellate Tax Board held it could not depart from constitutional standard of fair cash value by disregarding effects on value of environmental regulation and contamination), *aff'd*, 410 Mass. 381, 573 N.E.2d 959 (1991).

¹⁵¹ *Inmar*, 112 N.J. at 609, 549 A.2d at 46.

¹⁵² 223 Cal. App. 3d 382, 272 Cal. Rptr. 745 (1990).

¹⁵³ *Id.* at 391, 272 Cal. Rptr. at 750.

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ *Id.* at 390, 272 Cal. Rptr. at 751.

¹⁵⁸ *Id.* at 392, 272 Cal. Rptr. at 751.

¹⁵⁹ *Id.* at 392-93, 272 Cal. Rptr. at 751.

¹⁶⁰ *Id.* at 393, 272 Cal. Rptr. at 752.

court rejected these arguments on the grounds that they did not address the issue of whether contamination affects property value.¹⁶¹ The court, however, never resolved the valuation issue because it found that the taxpayer failed to establish that the assessor should have known about the presence of contamination at the time of the assessment.¹⁶²

In *Northwest Cooperage Co. v. Ridder*,¹⁶³ an assessor made numerous arguments in support of an assessment that ignored the impact of contamination on the value of an industrial drum cleaning site.¹⁶⁴ The assessor refused to reduce the value of the property even though the Washington Department of Ecology had confirmed the presence of hazardous wastes there, and environmental experts had estimated cleanup costs at between \$600,000 and \$1.5 million.¹⁶⁵ The assessor contended that the contamination had no effect on the value of the property for several reasons: cleanup costs do not run with the land if there are other PRPs who will be liable for cleanup; pollution control, monitoring, and cleanup costs are ordinary business expenses that do not run with the land; and the amount of the cleanup costs was uncertain.¹⁶⁶ The assessor alternatively argued that any reduction to account for cleanup costs would be based on pure speculation due to the lack of a cleanup order from an environmental agency at the time of assessment.¹⁶⁷

The Washington Board of Tax Appeals rejected all of the assessor's arguments.¹⁶⁸ Although the board agreed that contributions from other PRPs for cleanup costs do relieve an owner of financial responsibility, it pointed out that the situation in this case was different.¹⁶⁹ In *Northwest Cooperage*, neither the assessor nor the taxpayer could prove who would be responsible for the cleanup costs.¹⁷⁰ Because there was a risk that a potential purchaser would have to pay for the entire costs of the cleanup, the board found that cleanup costs did affect the market value of Northwest Cooperage's prop-

¹⁶¹ *Id.* at 392-93, 272 Cal. Rptr. at 751-52. The court also rejected Monterey County's contentions that Firestone's cleanup costs were not part of the unencumbered fee simple estate that assessors value for tax purposes for the same reasons. *Id.*

¹⁶² *Id.* at 394, 272 Cal. Rptr. at 752.

¹⁶³ Nos. 36278-36280 (Wash. B.T.A. July 12, 1990).

¹⁶⁴ *Id.* at 8.

¹⁶⁵ *Id.* at 2, 12.

¹⁶⁶ *Id.* at 8.

¹⁶⁷ *Id.*

¹⁶⁸ *Id.* at 13-15.

¹⁶⁹ *Id.* at 13-14.

¹⁷⁰ *Id.* at 14.

erty.¹⁷¹ Furthermore, the board held that pollution control, monitoring, and cleanup costs are not ordinary business expenses, but rather expenses that run with the land.¹⁷² Any buyer would have to incur these expenses regardless of whether it used the property for business or personal purposes.¹⁷³

In addition, the board in *Northwest Cooperage* rejected the assessor's contention that both the cost and certainty of cleanup were unknown at the time of assessment.¹⁷⁴ The board stated that under Washington's property valuation statute,¹⁷⁵ the restrictions that CERCLA and Washington's pollution control statute impose on contaminated property constitute political restrictions, similar to zoning laws, that assessors must take into account.¹⁷⁶ Assessors therefore must consider the effects of contamination on market value even if they cannot quantify that effect precisely.¹⁷⁷

B. The Other Extreme: Full Reduction in Property Value for Contamination

In contrast to the arguments of local taxing authorities, owners of contaminated properties have argued that their properties have zero or nominal value for property tax purposes when their costs of cleanup exceed the fair market value of similar uncontaminated properties.¹⁷⁸ These owners have reached their zero or nominal value conclusions by either explicitly¹⁷⁹ or implicitly¹⁸⁰ using a "dollar-for-dollar reduction" approach—claiming that fair market value should be reduced on a dollar-for-dollar basis according to the total amount of their cleanup costs. The justification for this dollar-for-dollar reduction approach is that it reflects the behavior of potential buyers in the marketplace.¹⁸¹

¹⁷¹ *Id.*

¹⁷² *Id.* at 15.

¹⁷³ *Id.*

¹⁷⁴ *Id.* at 13.

¹⁷⁵ WASH. REV. CODE ANN. § 84.40.030 (West 1991).

¹⁷⁶ *Northwest Cooperage*, Nos. 36278–36280, slip op. at 13.

¹⁷⁷ *Id.*

¹⁷⁸ *Groves*, *supra* note 57, at 2.

¹⁷⁹ *E.g.*, *Firestone Tire & Rubber Co. v. County of Monterey*, 223 Cal. App. 3d 382, 386, 272 Cal. Rptr. 745, 747 (1990); *Inmar Assocs. v. Borough of Carlstadt*, 112 N.J. 593, 599, 549 A.2d 38, 40 (1988).

¹⁸⁰ *E.g.*, *Appeal of Great Lakes Container Corp.*, 126 N.H. 167, 168 (1985); *Fjetland v. Brown*, No. 37533, slip. op. at 3 (Wash. B.T.A. June 5, 1990).

¹⁸¹ *See, e.g.*, *Firestone Tire*, 223 Cal. App. 3d at 393, 272 Cal. Rptr. at 751 (taxpayer's expert testified that purchasers with knowledge of contamination would require deduction

For varying reasons, the majority of cases have rejected taxpayers' assertions of zero or nominal value.¹⁸² In *Inmar*, the Supreme Court of New Jersey held that a dollar-for-dollar reduction in the putative value of a property for cleanup costs was not a viable method to value contaminated property.¹⁸³ The court reasoned that while cleanup costs might reduce owners' profits, owners should not automatically receive reductions in their tax assessments, because market value is not necessarily linked to owners' expenses.¹⁸⁴

Although the *Inmar* court rejected the dollar-for-dollar reduction approach, it did not adopt its own valuation method.¹⁸⁵ Rather, the court offered numerous suggestions for the appraisal community's consideration.¹⁸⁶ The court's suggestions included, if no market existed, viewing contaminated properties as special purpose properties or considering "value in use" to the owner; and if the property is not in use, treating cleanup costs as capital improvements that an owner could depreciate over the property's beneficial life.¹⁸⁷

Applying the *Inmar* court's suggestion for treating contaminated properties as special purpose properties, the Washington Board of Tax Appeals rejected a taxpayer's zero value argument.¹⁸⁸ In *Northwest Cooperage*, the board stated that it could treat contaminated property as special purpose property by considering both the "value in use" and "value in exchange" of such property if necessary.¹⁸⁹ The

from property value for remediation cost); *Northwest Cooperage*, Nos. 36278-36280, slip op. at 5 (taxpayer's expert testified that buyers of contaminated property often discount purchase price by expected cost of cleanup).

¹⁸² See, e.g., *Inmar*, 112 N.J. at 605, 549 A.2d at 43-44; *Northwest Cooperage*, Nos. 36278-36280, slip op. at 16-18.

¹⁸³ *Inmar*, 112 N.J. at 605, 549 A.2d at 43-44; see also *Reliable Elec. Finishing Co. v. Board of Assessors*, No. 158325, slip op. at 17 (Mass. App. Tax Bd. Aug. 9, 1990) (Massachusetts Appellate Tax Board implied it would not accept dollar-for-dollar reduction in assessed value), *aff'd*, 410 Mass. 381, 573 N.E.2d 959 (1991); *Murray Pac. Corp. v. Brown*, No. 38037, slip op. at 10 (Wash. B.T.A. Nov. 9, 1990) (Washington board held that cleanup costs were proper reduction in both sales comparison and income capitalization approaches).

¹⁸⁴ *Inmar*, 112 N.J. at 605, 549 A.2d at 43-44.

¹⁸⁵ *Id.* at 608, 549 A.2d at 45.

¹⁸⁶ *Id.* at 606-07, 549 A.2d at 44-45.

¹⁸⁷ *Id.* Value in use or "[u]se value focuses on the contributory value of real estate to the enterprise of which it is a part, without regard to its highest and best use or the monetary amount that might be realized upon its sale." APPRAISAL OF REAL ESTATE, *supra* note 25, at 20.

¹⁸⁸ See *Northwest Cooperage Co. v. Ridder*, Nos. 36278-36280, slip op. at 16-18 (Wash. B.T.A. July 12, 1990); *Groves*, *supra* note 57, at 4.

¹⁸⁹ See *Northwest Cooperage*, Nos. 36278-36280, slip op. at 16-18. Value in exchange or exchange value is the monetary value of real property in a typical market. AMERICAN INSTI-

board reasoned that notwithstanding the customary value in exchange standard, certain situations require a measure of flexibility in order to determine market value.¹⁹⁰ Using such a flexible approach, the board found that the taxpayer's property had value to its owner or another person as a drum cleaning and recycling plant.¹⁹¹ The board concluded therefore that Northwest Cooperage's property had greater than nominal value for property tax purposes.¹⁹²

Other courts and tax boards have rejected taxpayers' contentions of nominal value when they have found that a property will have a future benefit once any contamination is cleaned up.¹⁹³ In *Appeal of Great Lakes Container Corp.*¹⁹⁴ for example, the New Hampshire Board of Tax and Land Appeals found that the property in question had "some sale value" despite cleanup costs of \$10 million because the taxpayer had not forfeited the land to the town for unpaid taxes.¹⁹⁵ The board reasoned that the value of the property was its future benefit to the taxpayer after pending federal litigation determined liability for cleanup.¹⁹⁶ The Supreme Court of New Hampshire affirmed the board's conclusion that the taxpayer had failed to meet the requisite burden of proof by not providing any evidence of the present value of the property's future benefit.¹⁹⁷

Similarly, in *Fjetland v. Brown*,¹⁹⁸ the Washington Board of Tax Appeals rejected a taxpayer's claim that its property had no value.¹⁹⁹ Although the property was presently unusable and was listed on the NPL, the board concluded that the property had present value based on its expected future benefits.²⁰⁰ The board reached this conclusion by relying both on the identification of PRPs other than the current

TUTE OF REAL ESTATE APPRAISERS, THE DICTIONARY OF REAL ESTATE APPRAISAL 112 (1984).

¹⁹⁰ *Northwest Cooperage*, Nos. 36278-36280, slip op. at 17; see also *Inmar*, 112 N.J. at 606, 549 A.2d at 44.

¹⁹¹ *Northwest Cooperage*, Nos. 36278-36280, slip op. at 18.

¹⁹² *Id.*

¹⁹³ See *Groves*, *supra* note 57, at 4.

¹⁹⁴ 126 N.H. 167, 489 A.2d 134 (1985).

¹⁹⁵ *Id.* at 169, 489 A.2d at 136 (taxpayer claimed that its property was unsaleable because cleanup costs greatly exceeded its maximum market value of \$399,200.48—taxpayer's purchase price in 1976).

¹⁹⁶ *Id.*

¹⁹⁷ *Id.*

¹⁹⁸ No. 37533 (Wash. B.T.A. June 5, 1990).

¹⁹⁹ *Id.* at 7.

²⁰⁰ *Id.* For an explanation of the board's approach, see *infra* notes 220-21 and accompanying text.

owner who would bear most of the cleanup costs, and on the likelihood that a potential purchaser would secure indemnification from the owner for any residual liability.²⁰¹

In contrast to the majority position, the Michigan Tax Tribunal has upheld taxpayers' claims of nominal property values in three separate cases.²⁰² The tribunal accepted the taxpayers' nominal value argument with very little analysis of property valuation principles and without requiring the taxpayers to prove the impact of the contamination on the value of their properties.²⁰³

For example, in *Community Consultants, Inc. v. Bedford Township*,²⁰⁴ the tribunal held that a property—which the state had ranked as the second or third most dangerous site in the state in light of the presence of hazardous substances there—was of nominal value for as long as the contamination was present.²⁰⁵ The tribunal reached its conclusion by relying on an assessor's testimony that there did not appear to be any market sales of hazardous waste sites in Michigan, and that a hypothetical buyer with knowledge of the contamination probably would not purchase the property in question.²⁰⁶ The tribunal also considered evidence that the property could not be put to any use while it was contaminated, and that the cleanup costs exceeded "even the most optimistic value" of a comparable uncontaminated property.²⁰⁷ The tribunal used the same approach in *Comerica Bank-Detroit v. Metamora Township*²⁰⁸ and *Bielat v. Macomb Township*²⁰⁹ to uphold taxpayers' claims on nominal value despite the taxpayers' lack of proof to support such contentions.

²⁰¹ *Fjetland*, No. 37533, slip op. at 7.

²⁰² *Comerica Bank-Detroit v. Metamora Township*, Nos. 103325, 110482, 112529, slip op. at 2 (Mich. Tax Trib. May 12, 1989); *Bielat v. Macomb Township*, Nos. 93707, 100295, slip op. at 2 (Mich. Tax Trib. Oct. 7, 1987); *Community Consultants, Inc. v. Bedford Township*, No. 86388, slip op. at 2 (Mich. Tax Trib. July 3, 1985).

²⁰³ See Groves, *supra* note 57, at 2-3.

²⁰⁴ No. 86388 (Mich. Tax Trib. July 3, 1985) (abandoned landfill contaminated by previous owner who had disposed known and unknown hazardous materials).

²⁰⁵ *Id.* at 1, 3.

²⁰⁶ *Id.* at 2-3.

²⁰⁷ *Id.* at 3.

²⁰⁸ Nos. 103325, 110482, 112529, slip op. at 12 (Mich. Tax Trib. May 12, 1989).

²⁰⁹ Nos. 93707, 100295, slip op. at 4-5 (Mich. Tax Trib. Oct. 7, 1987); see also Groves, *supra* note 57, at 3. Taxpayers in both cases basically contended that their properties were worthless due to the adverse effects of severe contamination. *Comerica Bank-Detroit*, Nos. 103325, 110482, 112529, slip op. at 2, 8-9; *Bielat*, Nos. 93707, 100295, slip op. at 2.

C. The Intermediate Position: Attempts to Measure the Impact of Contamination on Property Value

1. Case Law

In light of the conflicting case law on the validity of nominal valuations, a taxpayer may attempt to measure the impact of contamination on the value of the property. Many cases, however, have never reached the substantive issue of how to measure the effect of contamination on property value because they typically have found that taxpayers have failed to meet their burden of proving that the assessor's value was erroneous.²¹⁰ Unfortunately, the decisions that have rejected the taxpayers' valuations are not consistent regarding the amount of proof that the taxpayers must present to meet their burden.²¹¹ To add to the uncertainty, those cases that have addressed the issue of substantive valuation do not reflect a single clear method for valuing contaminated property.²¹²

An initial problem with the case law is that the amount of evidence necessary for a taxpayer to sustain its burden of proof varies from jurisdiction to jurisdiction. Some cases have found that taxpayers failed to meet their burden of proof even though the taxpayers presented substantial evidence.²¹³ At the same time, other cases have sustained taxpayers' claims merely on the basis that the properties were severely contaminated, and the cleanup costs exceeded the value of similar uncontaminated sites.²¹⁴ Further clouding the standard of proof issue, some courts and tax boards have held that taxpayers did not sustain their burden of proof, but have offered

²¹⁰ See, e.g., *Reliable Elec. Finishing Co. v. Board of Assessors*, No. 158325, slip op. at 20 (Mass. App. Tax Bd. Aug. 9, 1990) (taxpayer failed to prove cost of removing contamination and effect that cost would have on fair cash value of property), *aff'd*, 410 Mass. 381, 573 N.E.2d 959 (1991); Appeal of Great Lakes Container Corp., 126 N.H. 167, 169, 489 A.2d 134, 136 (1985) (taxpayer should have presented evidence of present value of property's future benefit in order to meet burden of proof); *Inmar Assocs. v. Borough of Carlstadt*, 112 N.J. 593, 609-10, 549 A.2d 38, 46 (1988) (one of two taxpayers appealing did not raise sufficient challenge to correctness of assessment).

²¹¹ Compare *Reliable Elec.*, No. 158325, slip op. at 4-11 with *Community Consultants, Inc. v. Bedford Township*, No. 86388, slip op. at 1, 3 (Mich. Tax Trib. July 3, 1985).

²¹² See *Northwest Cooperage Co. v. Ridder*, Nos. 36278-36280, slip op. at 12-13 (Wash. B.T.A. July 12, 1990); *Groves*, *supra* note 57, at 8.

²¹³ See, e.g., *Reliable Elec.*, No. 158325, slip op. at 4-11; *Groves*, *supra* note 57, at 5.

²¹⁴ See *supra* notes 204-07 and accompanying text; *Groves*, *supra* note 57, at 5; see also *Monroe County Bd. of Assessment Appeals v. Miller*, 570 A.2d 1386, 1390 (Pa. Commw. Ct. 1990) (relying on testimony that property contaminated by benzene was unmarketable, Commonwealth Court of Pennsylvania affirmed lower court's nominal value conclusion).

little or no discussion of the specific type of evidence that was lacking.²¹⁵

Another problem stems from the Washington Board of Tax Appeals and the Michigan Tax Tribunal developing significantly different approaches to valuing contaminated property. The Washington Board of Tax Appeals has applied two valuation methods to reflect the impact of contamination on property tax assessments.²¹⁶ The board uses a different approach depending on whether a property is currently in use or abandoned.²¹⁷ Rather than adopting either taxpayers' or assessors' valuations, the board so far has established its own assessment in each case.²¹⁸

In cases where property has had no present use as a result of its contamination, the Washington board has relied on the principle of "anticipation".²¹⁹ In these cases, the board measured the present value of a property's expected future benefits by applying a discount rate to the future value of the property for the estimated duration of the cleanup.²²⁰ In arriving at this methodology, the board reasoned that while a contaminated property may suffer from diminished marketability, it does not follow that the property is valueless.²²¹ The board stated that a property has value if, at some time in the foreseeable future, it will provide benefits.

The board based its valuation on a value of the property in an environmentally clean condition that was mutually agreeable to both taxpayer and assessor. It then discounted the expected future value of the property, taking into account the effects of inflation and depreciation.²²² The board used a discount rate that accounted for the additional risks associated with ownership of contaminated property,

²¹⁵ See, e.g., *Appeal of Great Lakes Container Corp.*, 126 N.H. 167, 169, 489 A.2d 134, 136 (1985).

²¹⁶ See *Northwest Cooperage*, Nos. 36278-36280, slip op. at 19-23 (modified income capitalization approach); *Lefevre v. Vanourk*, Nos. 35315-35318, slip op. at 8-9 (Wash. B.T.A. June 13, 1990) (present value of expected future benefits after cleanup analysis); *Fjetland v. Brown*, No. 37533, slip op. at 7-8 (Wash. B.T.A. June 5, 1990) (present value of expected future benefits after cleanup analysis); *Canary*, *supra* note 121, at 12-13.

²¹⁷ *Canary*, *supra* note 121, at 12-13.

²¹⁸ *Northwest Cooperage*, Nos. 36278-36280, slip op. at 21-24; *Lefevre*, Nos. 35315-35318, slip op. at 8-9; *Fjetland*, No. 37533, slip op. at 7-8. *But see Murray Pac. Corp. v. Brown*, No. 38037, slip op. at 10 (Wash. B.T.A. Nov. 9, 1990) (board found that taxpayer failed to meet burden of proof).

²¹⁹ "Anticipation" is the perception that value is created by the expectation of benefits to be derived in the future. APPRAISAL OF REAL ESTATE, *supra* note 25, at 32.

²²⁰ *Lefevre*, Nos. 35315-35318, slip op. at 8; *Fjetland*, No. 37533, slip op. at 8.

²²¹ *Lefevre*, Nos. 35315-35318, slip op. at 7; *Fjetland*, No. 37533, slip op. at 7.

²²² The board assumed that the rate of inflation either was equivalent to the rate of depreciation or was zero if the property had no improvement. *Lefevre*, Nos. 35315-35318, slip op. at 8; *Fjetland*, No. 37533, slip op. at 8; *Canary*, *supra* note 121, at 12.

such as the costs of stigma and the risk that cleanup might not be completed by the estimated cleanup date.²²³

For property that has a present use, the board used the income capitalization approach and made adjustments for the presence of contamination. The board reasoned that if a property was still in use, it had some value for property tax purposes, even if the present market might be limited to its current owner.²²⁴ In *Northwest Cooperage*, for example, the board estimated the income stream the property would have generated if it were uncontaminated. From this income stream figure, the board deducted extraordinary expenses for pollution monitoring and compliance expenses that a future purchaser would incur.²²⁵ The board also increased the capitalization rate to reflect the risks associated with owning contaminated property, including uncertainties about total cleanup costs, liability to third parties, availability of financing, and the impact of stigma on future marketability.²²⁶ The board then applied the adjusted capitalization rate next to the net income stream to determine the property's fair market value.²²⁷

In contrast to the Washington Board of Tax Appeals, the Michigan Tax Tribunal has taken a less sophisticated approach to valuing contaminated property. In *Comerica Bank-Detroit, Bielat v. Macomb Township*, and *Community Consultants*, the tribunal held that the value of each of the subject properties was nominal as long as contamination was present.²²⁸ The tribunal, however, provided little analysis or rationale for these conclusions.²²⁹ In fact, the tribunal only has referred to the specific valuation method it applied in one of the three cases that it has heard on this issue. In *Bielat*, it found that residential properties contaminated by leachate leaking from a nearby dumpsite suffered from functional and economic obsolescence.²³⁰ Without providing further explanation, the tribunal held that the cost approach was the most reliable valuation method in this situation.²³¹

²²³ *Lefevre*, Nos. 35315-35318, slip op. at 9; *Fjetland*, No. 37533, slip op. at 8.

²²⁴ *Northwest Cooperage Co. v. Ridder*, Nos. 36278-36280, slip op. at 18 & n.11 (Wash. B.T.A. July 12, 1990) (citing Patchin, *supra* note 6, at 13) (fact that property is unmarketable does not necessarily mean it is worthless if present owner uses it).

²²⁵ *Id.* at 23.

²²⁶ *Id.* at 19-23.

²²⁷ *Id.* at 23.

²²⁸ See *supra* notes 202-07 and accompanying text.

²²⁹ Groves, *supra* note 57, at 2.

²³⁰ *Bielat v. Macomb Township*, Nos. 93707, 100295, slip op. at 2, 4 (Mich. Tax Trib. Oct. 7, 1987).

²³¹ *Id.* at 5.

2. The Oregon Rule

In response to the problems that both taxpayers and local taxing authorities were experiencing in this new area of valuation, the Oregon DOR issued an administrative rule²³² regulating the valuation of contaminated property.²³³ The DOR attempted to address these problems by providing in the rule a clear methodology for valuing contaminated property.

The Oregon rule identifies the types of properties to which it applies, and establishes the standards by which taxing authorities are to determine the value of those properties.²³⁴ The rule's definition of "contaminated site" is limited to real properties on the NPL or on the Oregon Department of Environmental Quality's (DEQ's) inventory of confirmed releases, illegal drug manufacturing sites, and properties proved to be the location of a hazardous substance release.²³⁵

The DOR rule also provides a definition of "cost to cure". The term "cost to cure" includes all costs directly related to the cleanup of hazardous substances at a site, such as estimated removal, containment, and treatment costs;²³⁶ however, these costs are limited to their discounted present value after taxes.²³⁷ In addition to cleanup costs, the cost to cure may include the cost of "environmental audits, surety bonds, insurance, monitoring, and engineering and legal fees."²³⁸ The DOR defined "cost to cure" because the rule requires assessors to account for the cost to cure in their value estimates when market data from similarly contaminated properties are unavailable.²³⁹

Under the Oregon rule, an assessor must consider all three traditional valuation approaches in determining the value of a contaminated site: the sales comparison approach, the cost approach, and the income capitalization approach.²⁴⁰ Although the rule acknowledges that all three approaches may not be applicable to a given site, it requires that assessors examine each one for merit.²⁴¹

²³² OR. ADMIN. R. 150-308.205-(E) (1990).

²³³ Canary, *supra* note 121, at 7 (author was member of task force that drafted Oregon rule).

²³⁴ *Id.*; OR. ADMIN. R. 150-308.205-(E)(1)(a)-(b) (1990).

²³⁵ OR. ADMIN. R. 150-308.205-(E)(1)(a)(A), (B), (C), (D) (1990).

²³⁶ *Id.* at 150-308.205-(E)(1)(c).

²³⁷ *Id.*

²³⁸ *Id.*

²³⁹ *Id.* at 150-308.205-(E)(3); Canary, *supra* note 121, at 8-9.

²⁴⁰ OR. ADMIN. R. 150-308.205-(E)(3) (1990).

²⁴¹ *Id.*

For the sales comparison approach, the rule states that an assessor should use actual market data if such data exist. If there are no market data, the assessor may use sales of uncontaminated properties for comparison and make the necessary adjustments for costs. These adjustments include limitations that either the nature and extent of the contamination or governmental restrictions have imposed on the use of the property, increased costs to insure or finance the property, potential liability for the cost to cure, governmentally imposed restrictions on transferability of the property, and other market influences.²⁴²

If an assessor applies the cost approach, the assessor first must determine the value of the property as if it were clean.²⁴³ The assessor then may deduct the cost to cure as a measure of functional obsolescence.²⁴⁴ Under the income approach, the rule provides an assessor with several options. The rule prefers market rental data, but when such data are unavailable, an assessor can use the actual income a property generates.²⁴⁵ The assessor may adjust this income stream for the estimated annual cost to cure.²⁴⁶ Moreover, if the capitalization rate is derived from uncontaminated properties, the assessor should consider adjustments to reflect the risks associated with owning contaminated property.²⁴⁷ If, however, the assessor uses a capitalization rate from similarly contaminated properties, no adjustment is necessary.²⁴⁸ In the alternative, an assessor may estimate a property's income stream as if the property were environmentally clean and then deduct from that value the cost to cure.²⁴⁹

In sum, the Oregon rule provides a useful framework for valuing contaminated property by modifying the traditional valuation methods to account for contamination. This type of framework can eliminate many of the uncertainties and inconsistencies that both assessors and taxpayers have encountered in the case law.

V. A METHOD FOR ENSURING UNIFORM ASSESSMENTS OF CONTAMINATED PROPERTY

Not all owners of contaminated property can obtain assessments that reflect the impact of contamination on their property's value

²⁴² *Id.* at 150-308.205-(E)(3)(a)(A)-(E).

²⁴³ *Id.* at 150-308.205-(E)(3)(b).

²⁴⁴ *Id.*

²⁴⁵ *Id.* at 150-308.205-(E)(3)(c).

²⁴⁶ *Id.* at 150-308.205-(E)(3)(c)(A).

²⁴⁷ *Id.* at 150-308.205-(E)(3)(c)(B).

²⁴⁸ *Id.*

²⁴⁹ *Id.* at 150-308.205-(E)(3)(c)(C).

because some local taxing authorities take contamination into account²⁵⁰ while others do not.²⁵¹ Even when assessors recognize the impact of contamination on property values, the amount by which they reduce assessments may vary greatly as a result of uncertainty over how to measure that impact.²⁵² Assessments that lack any adjustment for the presence of pollution on property may violate state constitutional or statutory requirements that all property be assessed pursuant to a uniformly applied standard of market value.²⁵³ To ensure that assessors comply with uniformity requirements, each state should enact a specific valuation rule in the form of either a statute or an administrative regulation. A rule similar to Oregon's administrative regulation would create a valuation methodology that is both workable and equitable.

A. Deficiencies in Current Approaches to Valuing Contaminated Property

1. One Extreme: No Reduction in Property Value for Contamination

If property is contaminated, assessors should not be able to argue successfully that no value reduction is warranted to reflect the effects of contamination on property value for ad valorem tax purposes. Courts and administrative tax boards explicitly have rejected several of the assessors' policy and legal arguments supporting their refusals to recognize the effects of contamination on property value.²⁵⁴ The invalidity of other arguments that assessors have made, however, is not so clear.

The assessing community's fundamental environmental policy argument is that granting a tax reduction to a taxpayer who is responsible for cleanup would transfer some of the cleanup cost from that culpable polluter to other taxpayers in the form of a reduced

²⁵⁰ *E.g.*, *Reliable Elec. Finishing Co. v. Board of Assessors*, No. 158325, slip op. at 11-12 (Mass. App. Tax Bd. Aug. 9, 1990), *aff'd*, 410 Mass. 381, 573 N.E.2d 959 (1991); *Bielat v. Macomb Township*, Nos. 93707, 100295, slip op. at 3 (Mich. Tax Trib. Oct. 7, 1987).

²⁵¹ *See, e.g.*, *Firestone Tire & Rubber Co. v. County of Monterey*, 223 Cal. App. 3d 382, 391-92, 272 Cal. Rptr. 745, 751 (1990); *Inmar Assocs. v. Borough of Carlstadt*, 112 N.J. 593, 600-01, 549 A.2d 38, 41 (1988); *Northwest Cooperage Co. v. Ridder*, Nos. 36278-36280, slip op. at 8 (Wash. B.T.A. July 12, 1990).

²⁵² *Compare Reliable Elec.*, No. 158325, slip op. at 11-12 (assessor deducted amortized cost to cure from initial income approach estimate to arrive at market value) *with Bielat*, Nos. 93707, 100295, slip op. at 3 (assessor cut assessments in half to reflect impact of contamination).

²⁵³ *See supra* note 23 and accompanying text.

²⁵⁴ *See supra* notes 149-51, 161-62 and accompanying text.

tax base.²⁵⁵ Consequently, tax assessing authorities have argued that compliance with federal and state environmental laws compels a departure from state requirements that all property be assessed at the same percentage of market value.²⁵⁶ Courts and appellate tax boards have criticized this argument on the basis that state uniformity requirements do not allow assessors to examine property owners' culpability.²⁵⁷ These decisions have reinforced state constitutional and statutory mandates that assessors must treat polluters and innocent landowners similarly.²⁵⁸

Further, some assessors have argued that giving abatements to owners of contaminated property would encourage owners to pollute their properties.²⁵⁹ The reality that any tax savings attributable to contamination would be small in comparison to the possible massive civil and criminal liabilities illustrates the flaw in this contention.²⁶⁰ For example, in one Massachusetts case, an owner's taxes were \$42,000 in contrast to \$6.5 million in cleanup costs and \$600,000 in civil penalties.²⁶¹ Considering the disparity between property taxes and the costs of contamination, no rational property owner would pollute for such a minimal gain.²⁶² In fact, giving a tax abatement to owners of contaminated property may even promote efforts to clean up the environment. Owners of contaminated property might be more willing to report the presence of contamination if they know they can obtain a tax abatement. Assessments therefore should reflect the effects of contamination.

²⁵⁵ See *supra* notes 154-55 and accompanying text.

²⁵⁶ See *supra* note 142 and accompanying text.

²⁵⁷ See *supra* note 143 and accompanying text. If courts allowed assessors to refuse tax reductions on the basis of culpability, property assessment would not be equal or uniform. Such valuations would violate uniformity requirements because each assessment would depend on the particular assessor's ability to ascertain the taxpayer's culpability. Moreover, factors determining culpability might be unknown as of the assessment date.

²⁵⁸ *Id.* A similar argument is that polluters will be unjustly enriched by their wrongdoing if they receive a tax reduction. *Firestone Tire & Rubber Co. v. County of Monterey*, 223 Cal. App. 3d 382, 391, 272 Cal. Rptr. 745, 750 (1990). Although no court or tax board has addressed this argument, either would probably reject it in light of state uniformity requirements.

²⁵⁹ See, e.g., *Inmar Assocs. v. Borough of Carlstadt*, 214 N.J. Super. 256, 266, 518 A.2d 1110, 1115 (N.J. Super. Ct. App. Div. 1986), *aff'd, in part, and rev'd, in part*, 112 N.J. 593, 549 A.2d 38 (1988).

²⁶⁰ *E.g.*, 42 U.S.C. § 9606(b)(1) (1988) (civil penalties of up to \$25,000 each day for any willful violation, failure, or refusal to comply with cleanup orders); CAL. HEALTH & SAFETY CODE §§ 25189-25191 (West 1984 & Supp. 1991) (fines or criminal penalties for violations).

²⁶¹ *Reliable Elec. Finishing Co. v. Board of Assessors*, No. 158325, slip op. at 1-4 (Mass. App. Tax Bd. Aug. 9, 1990), *aff'd*, 410 Mass. 381, 573 N.E.2d 959 (1991).

²⁶² Brief on Behalf of Amicus Curiae, *New Jersey State Bar Association at 12, Inmar Assocs. v. Borough of Carlstadt*, 112 N.J. 593, 549 A.2d 38 (1988) (Nos. 26549, 26549).

In addition to policy arguments, assessors have offered purely legal arguments in support of their decisions to ignore the effects of contamination on market value. These arguments also may lack merit. For example, assessors have claimed that under certain circumstances the costs of cleanup are not transferable to a potential purchaser, and that therefore no value reduction is appropriate.²⁶³ According to these assessors, if other PRPs who will contribute to the cleanup costs exist, the risk that a buyer will be liable for cleanup costs decreases.²⁶⁴ Thus, the assessors argue that in situations involving PRPs other than the current owner, no reduction is necessary because a potential buyer will not have to reduce its offering price by the cost of cleanup.²⁶⁵

This argument, however, assumes that the identified PRPs will remain solvent. If these other PRPs become insolvent, the EPA may order a new owner to clean up the property unless the new owner can meet the requirements of CERCLA's narrow third-party defense.²⁶⁶ The buyer who becomes the new owner probably will not meet the requirements of the exception given that the assumption underlying the assessors' valuation is that a hypothetical sale is at arm's-length and with *full knowledge* of the contamination.²⁶⁷ Moreover, holding such a new owner liable is consistent with CERCLA's goal of increasing the pool of responsible parties in order to decrease costs to the public.²⁶⁸ Consequently, a likely result under CERCLA is that the cost of cleanup would be transferred to a purchaser.²⁶⁹

Even if a potential buyer attempts to protect itself by requiring an indemnity from the current owner, indemnification will not shield the potential buyer from liability in a cleanup action if the seller becomes insolvent.²⁷⁰ Potential buyers therefore will make adjustments in their offering prices to reflect the risk that the sellers might become insolvent.

Assessors also argue that where statutes restricting transfer of contaminated property are in force, cleanup costs cannot be trans-

²⁶³ See, e.g., *Firestone Tire & Rubber Co. v. County of Monterey*, 223 Cal. App. 3d 382, 391, 272 Cal. Rptr. 745, 750 (1990); *Northwest Cooperage Co. v. Ridder*, Nos. 36278-36280, slip op. at 8 (Wash. B.T.A. July 12, 1990).

²⁶⁴ *Northwest Cooperage*, Nos. 36278-36280, slip op. at 13-14.

²⁶⁵ *Id.*

²⁶⁶ 42 U.S.C. § 9607(b)(3) (1988); Note, *supra* note 63, at 416-18, 421-24.

²⁶⁷ 42 U.S.C. § 9601(35)(A)(i), (B) (1988).

²⁶⁸ See Note, *supra* note 63, at 415, 421.

²⁶⁹ Even assuming liability for cleanup costs is not transferable, assessors still would have to make adjustments for other costs of contamination. A potential buyer might make adjustments to the purchase price for the increased costs of financing, market stigma, legal fees for defending against property damage and toxic tort lawsuits, and limitations on use.

²⁷⁰ 42 U.S.C. § 9607(e)(1) (1988); see also Patchin, *supra* note 6, at 10-11.

ferred with the fee simple in a hypothetical sale.²⁷¹ This argument has merit and is probably the assessor's most persuasive argument. It nevertheless fails to take into account the fact that ECRA-like statutes are governmental restrictions on use of property. Under such statutes, the current owner is unable to change its use of the property, discontinue its use, or sell the property before incurring cleanup costs.²⁷² Any property whose highest and best use²⁷³ is so restricted inherently is worth less than one not so burdened. Furthermore, many states require assessors to consider the effect of governmental restrictions on value.²⁷⁴

Finally, assessors have argued that giving a value reduction for the presence of contamination would be speculative when cleanup costs are uncertain as of the assessment date.²⁷⁵ Although courts and administrative tax boards disagree over whether cleanup costs must be accurately determined before they can affect property value,²⁷⁶ potential buyers will adjust their offering prices to reflect the risks associated with known contamination regardless of whether future cleanup costs are precisely quantified. As a result, assessors should make every effort to account for the costs of contamination when valuing contaminated property.²⁷⁷ Nevertheless, it is not unreasonable for courts to require that owners seeking tax abatements provide some proof of estimated cleanup costs and the effects of those costs on value.²⁷⁸

2. The Other Extreme: Full Reduction in Property Value for Contamination

Taxpayers' use of the dollar-for-dollar reduction approach, often resulting in nominal valuations, also may fail to reflect accurately

²⁷¹ See *supra* note 158 and accompanying text.

²⁷² See *supra* notes 84–88 and accompanying text.

²⁷³ See *supra* notes 25–26 and accompanying text.

²⁷⁴ See *supra* note 27.

²⁷⁵ See *supra* notes 166–67 and accompanying text.

²⁷⁶ On one hand, the *Inmar* and *Northwest Cooperage* decisions held that assessors had to attempt to quantify the impact of contamination on value once the presence of contamination was confirmed. *Inmar Assocs. v. Borough of Carlstadt*, 112 N.J. 593, 609, 549 A.2d 38, 46 (1988); *Northwest Cooperage Co. v. Ridder*, Nos. 36278–36280, slip op. at 13 (Wash. B.T.A. July 12, 1990). On the other hand, the *Reliable Electronic* board refused to grant a tax abatement on the grounds that the taxpayer did not adequately prove either the costs of cleanup—even though the taxpayer estimated cleanup costs of \$6.5 million based on engineering studies—or the effects of those costs on market value. *Reliable Elec. Finishing Co. v. Board of Assessors*, No. 158325, slip op. at 4, 20 (Mass. App. Tax Bd. Aug. 9, 1990), *aff'd*, 410 Mass. 381, 573 N.E.2d 959 (1991).

²⁷⁷ See *Groves*, *supra* note 57, at 9.

²⁷⁸ *Id.*

the effects of contamination on property value. The *Inmar* court rejected a taxpayer's dollar-for-dollar reduction argument on the grounds that the \$450,000 cost of its cleanup contract was not conclusive on the question of value.²⁷⁹ The court's criticism of *Inmar*'s argument may be accurate because, under ECRA, *Inmar* could not have transferred its liability for cleanup to a potential buyer in a hypothetical sale.²⁸⁰ As discussed above, cleanup costs arguably may not be transferable if an ECRA-like statute is in place.²⁸¹

Further, the dollar-for-dollar reduction approach may underestimate or overestimate the actual decrease in property value in a given situation. If a taxpayer incurs the total amount of cleanup costs in the tax year in question, then a dollar-for-dollar reduction may be appropriate. If, however, a taxpayer incurs cleanup costs over the course of more than one year, then a deduction for the total cleanup costs in the first year would give the taxpayer a windfall. The dollar-for-dollar reduction for total cleanup costs is inappropriate in the latter situation because of the time value of money.²⁸² For example, the value of \$450,000 spent over five years is less than \$450,000 spent today because interest will accrue during the five-year period. A better approach thus is the one the Oregon rule requires: taking the discounted present value of \$450,000.²⁸³ While potentially overestimating the loss in property value attributable to contamination, the dollar-for-dollar approach also may underestimate this loss because it ignores the other costs and uncertainties associated with contamination.²⁸⁴

²⁷⁹ *Inmar*, 112 N.J. at 605, 549 A.2d at 43.

²⁸⁰ The *Inmar* facts, however, were not ideal for testing the validity of the dollar-for-dollar reduction approach because, as the New Jersey Tax Court found, *Inmar*'s contract obligation was not fixed as of the assessment date. *Id.* at 599, 549 A.2d at 40-41. Moreover, ECRA was not yet effective. See *supra* note 273.

²⁸¹ See *supra* note 271 and accompanying text.

²⁸² MARVIN A. CHIRELSTEIN, FEDERAL INCOME TAXATION 352 (1988).

²⁸³ OR. ADMIN. R. 150-308.205-(F)(1)(c) (1990). The *Inmar* court suggested another possible approach: treating cleanup costs as a capital improvement that could be depreciated over the beneficial life of the property. 112 N.J. at 609, 549 A.2d at 45. This approach would be valid only if the taxpayer incurred a fixed obligation, as opposed to mere potential liability for cleanup, in the year in question. Furthermore, it may not be appropriate to apply this income tax concept in the property tax context.

²⁸⁴ See *supra* notes 59-137 and accompanying text.

3. The Intermediate Position: Attempts to Measure the Impact of Contamination on Property Value

a. Case Law

The practice of establishing a valuation method for contaminated property on a case-by-case basis has many deficiencies. The most troublesome aspect of the case law is that neither taxpayers nor assessors can predict with any certainty how a court or administrative tax board will respond to their valuations. This is especially true if there is no precedent-setting case in their jurisdiction. This uncertainty results from the lack of a consistent methodology for valuing contaminated property and the wide variance among jurisdictions in the amount of proof required to sustain an assessment appeal.²⁸⁵ A consensus on how to value contaminated property has not developed yet primarily because this issue is relatively new for assessors, appraisers, tax boards, and courts.²⁸⁶

In addition, lack of certainty in the case law often leads to increased transactional costs. Without any reliable rules to evaluate the accuracy of their assessments, taxpayers appeal these assessments. Such unnecessary appeals waste scarce judicial resources and cost taxpayers money that could be used for cleanup. A final problem with relying on case law is that using adjudication to develop a coherent approach to valuing contaminated property will be a slow process. Courts cannot address each relevant issue until owners of contaminated property raise it on appeal. Few taxpayers, however, will be able to appeal their assessments in the face of legal, appraisal, and engineering fees that well may exceed any reduction in their taxes. The case law thus never may address all of the factors that assessors and appraisers consider necessary to accurate property valuation.

b. Oregon Rule

To avoid drawbacks of case-by-case development of rules for valuing contaminated property, each state simply could adopt the Or-

²⁸⁵ See *supra* notes 212-30 and accompanying text.

²⁸⁶ Patchin, *supra* note 6, at 9 (“[t]he development of techniques for valuing contaminated property is still in its infancy”). The case law also may not have reached a consensus as a result of the difficulty in obtaining relevant opinions. Some of the decisions addressing valuation of contaminated property did not consider existing case law. For example, none of the parties involved in the *Firestone* case, including the court, ever discussed the only appellate decision of any consequence on this issue, *Inmar*. See *Firestone Tire & Rubber Co. v. County of Monterey*, 223 Cal. App. 3d 382, 272 Cal. Rptr. 745 (1990).

regon rule. A wholesale adoption of the Oregon rule, however, might not be the best solution. The rule, as the first attempt by any state agency to enact this type of rule, has several flaws that any state seeking to adopt it should address. First, the Oregon DOR unnecessarily restricted its definitions of "contaminated site" and "cost to cure". In the rule's definition of "contaminated site", the DOR chose to include only one of the three DEQ lists of contaminated property—DEQ's inventory of confirmed releases—even though placement on *any* DEQ list would have a negative effect upon a property's value.²⁸⁷

Further, the DOR narrowed its definition of "cost to cure" to the *after tax cost* of a cleanup to the taxpayer that undertook it. The DOR in effect is requiring assessors to focus on the tax status of specific property owners rather than on the fair market value of their property.²⁸⁸ Such a restriction on the cost to cure is inappropriate because any potential buyer will incur the cleanup costs regardless of whether it is a corporation conducting a business on the property or an individual using the property for nonbusiness purposes. Both of these limitations appear to be policy choices that do not conform with traditional valuation principles.

In addition, the Oregon DOR did not address the types of adjustments that assessors need to make to the sales comparison and income capitalization approaches to account for the effects of market stigma and potential liability to third parties.²⁸⁹ The DOR may have excluded these two factors because the impact of these costs is somewhat unclear to the appraisal community. With regard to the cost approach, the rule does not specify whether an assessor may deduct the cost to cure, as a form of functional obsolescence, from either the value of both the improvements and the land in a clean condition or the value of the improvements alone. This distinction is important because functional obsolescence traditionally applies only to defects in the structures on the land. Thus, adapting functional obsolescence to the impairment of land use may be improper.²⁹⁰ Finally, with regard to the income approach, the DOR failed to specify which capitalization rate assessors should apply when they use the alternative technique of estimating a property's income stream as if it were uncontaminated and then deducting the cost to cure from that value.²⁹¹

²⁸⁷ Canary, *supra* note 121, at 8.

²⁸⁸ *Id.* at 9.

²⁸⁹ *Id.*

²⁹⁰ *Inmar Assocs. v. Borough of Carlstadt*, 112 N.J. 593, 608, 549 A.2d 38, 45 (1988).

²⁹¹ Canary, *supra* note 121, at 10.

B. A Proposed Rule for Valuating Contaminated Property

In light of the inherent deficiencies of developing rules for valuing contaminated property on a case-by-case basis, each state should promulgate its own statute or administrative rule, similar to the Oregon rule, to ensure that assessors will value contaminated property in conformity with the state's uniformity requirements. Such rules should require assessors to recognize the negative impact of contamination on market value regardless of an owner's culpability for the pollution, as well as establish a specific methodology for measuring that impact.

In order to develop a comprehensive and workable rule, each state should create a task force composed of appraisers, assessors, attorneys, taxpayers, and state environmental and tax officials.²⁹² The task force then, in a relatively short period of time, could draft a rule that addresses all the relevant factors necessary to valuing contaminated property.²⁹³

To ensure certainty and uniformity in the valuation of contaminated property, the statute or rule should be a mandatory requirement rather than a discretionary guideline.²⁹⁴ The form of the rule will depend on whether a state already has a comprehensive valuation statute or administrative regulation in place. If a state has a valuation statute, then the state legislature can amend that statute to include requirements regarding the valuation of contaminated property. On the other hand, if the state has an administrative body, such as the Oregon DOR, that regulates property tax assessments, then an amendment to the body's administrative rules might be more appropriate.

A viable rule for valuating contaminated property must inform assessors and municipalities that they cannot carry out environmental policy goals through the tax assessment machinery in violation of state uniformity requirements. Assessors thus no longer would disregard the effects of contamination on a culpable owner's property. Instead, they would have to treat both culpable and innocent landowners the same under state property tax laws.

Beyond requiring that assessments account for the impact of contamination on property value, the rule should establish a valuation methodology for measuring that impact. Specific provisions of the

²⁹² The Task Force for the Valuation of Contaminated Property in Oregon included representatives from each of these groups. *Id.* at 7.

²⁹³ The task force drafted the Oregon rule in six months. *Id.*

²⁹⁴ *See id.* at 8.

rule may vary from state to state because the environmental laws and taxation standards of each state differ. Nevertheless, all rules should have some of the same basic provisions.

A state's rule first should contain definitions of the terms "contaminated site" and "cost to cure", as does the Oregon rule. The definition of "contaminated site" should include real property that is on any federal or state list of contaminated sites,²⁹⁵ and whose value is adversely affected by virtue of being on that list. In addition, the definition should include sites where an owner can prove that there has been a release of a hazardous substance on its property. The definition of "contaminated site", however, should exclude sites where the contamination is limited to structures containing asbestos.²⁹⁶

A definition of "cost to cure" also is necessary because assessors will consider these costs when they apply the three appraisal methods. The definition should enumerate the types of costs covered in the rule as well as describe how to measure those costs. Cost to cure should include all costs directly related to remediation of hazardous substances²⁹⁷ but be limited to the *discounted present value* of the *remaining estimated amount* of cleanup. Using the discounted present value prevents a taxpayer from using the dollar-for-dollar reduction approach that the *Inmar* court rejected except when the taxpayer incurs all its cleanup costs in a single year.²⁹⁸

A state's contaminated property valuation rule only should require an *estimate* of cost to cure. By extending the definition of "cost to cure" to include both final and estimated costs, the rule will provide for the possibility that costs may increase in the future as environmental standards change.²⁹⁹ Assessors thus will have to consider the effects of contamination regardless of their inability to quantify those effects with precision.³⁰⁰ The rule also should set forth the type of proof necessary to support an estimate of cost to cure.³⁰¹ It should require property owners to offer objective evidence of cleanup costs,

²⁹⁵ For example, one could expect that a listing on the NPL, CERCLIS, or a state equivalent would adversely affect the value of properties appearing on any of those lists.

²⁹⁶ See *supra* note 1. The DOR decided to establish a separate rule for structures containing asbestos despite the task force's recommendation to include these sites. Canary, *supra* note 121, at 8.

²⁹⁷ See *supra* notes 66–67 and accompanying text.

²⁹⁸ See *supra* notes 279–84 and accompanying text.

²⁹⁹ See *supra* notes 120–21 and accompanying text.

³⁰⁰ See *supra* notes 142–76 and accompanying text.

³⁰¹ See Canary, *supra* note 121, at 9.

such as opinions of expert witnesses, environmental reports, and engineering studies.³⁰²

After defining "cost to cure", a state's rule should adopt the DOR's method of separately incorporating the effects of contamination into the sales comparison approach, the cost approach, and the income approach. States will need to address specific issues when adapting these three approaches to the valuation of contaminated properties. For example, with regard to the sales comparison approach, a state will need to decide whether to allow adjustments for market stigma and potential liability to third parties. Additionally, if the state has an ECRA-like statute, it must decide whether an adjustment for that type of governmental restriction is appropriate. With regard to the cost approach, the state may want to consider restricting the deduction for cost to cure, as a form of functional obsolescence, to defects in the structures on land. In fact, the cost approach may be better suited for a separate rule on the valuation of buildings containing asbestos. Finally, for the income approach, the state should require both an adjustment to the income stream to reflect the cost to cure and a capitalization rate that reflects the increased risks associated with owning contaminated property.³⁰³ The state must make clear which capitalization rate assessors should apply when they are using either an income stream that initially accounts for contamination or one that does not.

VI. CONCLUSION

Contaminated property is worth less than similar environmentally clean property because the costs and uncertainties involved in complying with federal and state environmental laws adversely affect the fair market value of contaminated property. All property tax assessments should reflect the decline in market value due to the presence of hazardous substances regardless of the owners' culpability. Most tax assessments, however, do not account for contamination because assessors either refuse to recognize the impact of contamination on property value or do not know how to measure that impact. The case law only adds a further layer of confusion to the problem of valuing contaminated property.

Even though courts and administrative tax boards have acknowledged that contamination affects property value, they have been

³⁰² See *id.*

³⁰³ See Canary, *supra* note 121, at 9-10.

unable to develop a coherent methodology for measuring the impact of contamination on value. Therefore, to ensure uniform tax assessments and minimize uncertainty, each state should enact a statute or administrative rule, similar to the Oregon DOR's rule, that sets forth a specific methodology for valuing contaminated property.

APPENDIX**1990 OREGON ADMINISTRATIVE
RULE 150-308.205-(E)****Valuation of Contaminated Property****(1) DEFINITIONS:**

(a) "Contaminated site" means real property that, on the assessment date:

(A) Is on the National Priority List of the Environmental Protection Agency;

(B) Is included by the Department of Environmental Quality in an inventory of confirmed releases pursuant to ORS 465.225;

(C) Is an illegal drug manufacturing site as defined in ORS 453.858; or

(D) Is demonstrated as provided under Section (2) of this rule to have had a release of a hazardous substance as defined in ORS 466.540.

(b) "Contaminated site" does not include any permitted release or permitted facility approved by the Department of Environmental Quality for storage or disposal of a hazardous substance.

(c) "Cost to cure" means the discounted present value of the estimated after tax cost of the remaining remedial work specific to the subject property to remove, contain, or treat the hazardous substance. Cost to cure may include the cost of environmental audits, surety bonds, insurance, monitoring costs, and engineering and legal fees. The costs must be directly related to the clean up or containment of a hazardous substance.

(2) DEMONSTRATING CONTAMINATION OF SITE:

A property is defined as a contaminated site under Section (1)(a)(D) above if it is shown that:

(a) The property has had a release of a hazardous substance. This will be demonstrated through the submission of reliable, objective information such as engineering studies, environmental audits, laboratory reports or historical records; and

(b) The release has been reported to the Department of Environmental Quality.

(3) APPRAISING CONTAMINATED SITES:

The true cash value of a contaminated site shall be determined in accord with this rule. The appraiser shall consider the Sales Comparison Approach, the Cost Approach, and the Income Approach. For a particular contaminated site, it may be that all three approaches cannot be applied, however, each shall be investigated for its merit. In all cases, actual market data are the most reliable indicators.

(a) The Sales Comparison Approach may be used to determine the true cash value of a contaminated site by comparison with verified sales of similarly contaminated sites. If no sales exist of property similarly contaminated, a comparison may be made to sales of the properties without contamination. Adjustment factors shall be developed to account for the influence of contamination based upon a cost to cure analysis. These factors shall be applied to the subject property.

Adjustments shall be considered for the following:

(A) Limitations upon the use of the contaminated site due to the nature and extent of the contamination or due to governmental restrictions related to contamination;

(B) The increased cost to insure or finance the property;

(C) The potential liability for the cost to cure;

(D) Governmental limitations and restrictions placed upon the transferability of all or any portion of the contaminated sites;

(E) Other market influences.

(b) The Cost Approach may be used to determine the value of the contaminated site without the contamination. The cost to cure may be deducted as a measure of functional obsolescence.

(c) The Income Approach should use market rental data. If market rental data are not available, the property's actual income may be used.

(A) The income stream may be adjusted to reflect the estimated annual cost of remedial work specific to the subject property to remove, contain, or treat the hazardous substance during those years the cost is incurred. The annual cost of remedial work may include the cost of environmental audits, surety bonds, insurance, monitoring costs, and engineering and legal fees. The costs must be directly related to the clean up or containment of a hazardous substance.

(B) If the capitalization rate is derived from properties with similar contamination, no adjustment should be made to that rate. If the

rate is developed from properties without contamination, or a built-up rate is used, consider adjustments for the increased present and contingent future risk of ownership, difficulties in future appreciation or depreciation, and the effect upon the ability to sell or transfer the property; that is, the liquidity of an investment in the property.

(C) Alternately, an income approach projecting the income stream as if the subject property was not contaminated, may be used when the cost to cure is deducted from the resultant value indicator.

(d) The market may respond to contamination in a variety of ways. In all cases, actual market sales and income data are the most reliable indicators.

Hist: Filed 9/20/89 and Eff. 12/31/89