

The Impact of Environmental Liability on Land Use Planning

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The threat of environmental liability discourages the resale and reuse of industrial and commercial property. This article discusses the source of environmental liability and reviews its effects on purchasers, lenders, and insurers. Planners must understand the pervasive and potentially devastating impacts of environmental liability on developed and virgin land.

Free alienation of real property has always been a reasonably well achieved goal. With the passage of various environmental statutes by Congress, however, a new barrier has sprung up to slow the purchase and sale of real estate. This barrier is environmental liability, and it has its largest impact on existing industrial and commercial property.

Historical Perspective on Real Property Law

In recent years, the laws affecting ownership of land in the United States have fundamentally changed. Under the common law generally adopted by the individual states from the old English system of law, property consisted of a bundle of rights. The owner of property was an owner of rights, whether they were mineral rights, water rights, or the right to exclusive possession of the land. Property entailed rights.

Early in the twentieth century the law recognized the ability of the government to regulate the use of these rights without compensating the owner. This regulation, largely expressed through zoning, permitted restrictions on the use of land so long as the restriction did not consume the entire bundle of rights. If the regulation did in fact consume the bundle, then the regulation constituted a "taking" and had to be compensated for by the government.

In 1980, Congress established a new bundle of property rights which entailed responsibilities. This new bundle had been developing for some time, because of dissatisfaction with the remedies available under the common law and zoning. While the common law had recognized responsibilities attached to the use of land, there had never been an omnipresent bundle of responsibilities associated with its ownership (except possibly the responsibility to pay taxes). The market's perception of land ownership is changing,

which affects the potential for reuse of many forms of real estate. The land use planner must factor this changing perception into proposals.

The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)

In 1980, during a lame-duck session, Congress hastily enacted an environmental statute known as the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA or "Superfund"). At the time it was heralded as one of the most frightening and promising of environmental statutes. Both of these descriptions have proven true. In part, the strength of CERCLA resides in its initially vague drafting, since clarified by the 1986 amendments.

The statute earned a well-deserved "quirky notoriety" with judges who attempted to interpret its extensive liability scheme. The legislative history of the statute is one of almost comical contradiction, making interpretation difficult at best. Still, this vagueness and contradiction are the elements that have made the statute so strong. Courts have been given wide latitude in fashioning liability for environmental harm. And they have been liberal in finding liability.

How CERCLA Works

CERCLA established a Hazard Response Trust Fund, the so-called "Superfund." The government uses this fund to clean-up hazardous waste sites known as "Superfund sites." The Superfund was initially funded by oil taxes, although it is intended to be refunded by individuals or corporations (parties) responsible for contaminat-

ing the sites. The idea is to get the sites cleaned quickly and litigate over who is to blame later.

Various state agencies and the Environmental Protection Agency (EPA) identify the Superfund sites. The EPA has the task of ranking these sites in priority order for cleanup. Once the sites are catalogued, the EPA attempts to identify the parties who were responsible for contaminating the sites. The statute establishes who will be liable as responsible parties subject to limited defenses. The parties the EPA initially identifies are known as Potentially Responsible Parties (PRPs). If the PRPs are willing, capable, and circumstances permit, the EPA may allow them to clean up the site themselves. Even if they are not willing, the EPA may select one or more of the PRPs and order them to clean the site.

Who is Responsible

There are six different classes of parties who may be responsible for the cleanup costs of a contaminated Superfund site. These are: (1) current owners of the real estate, (2) current operators of activities on the real estate, (3) past owners, (4) past operators, (5) those who transported hazardous substances to the site, and (6) those who generated the hazardous substances transported to the site.

These parties are "jointly and severally liable." The parties are joined with respect to the total cost of cleanup (that is, they cannot just clean their share). Moreover, any one party may be severed from the rest and required to pay the entire cleanup cost. Joint and several liability means that one party who contributed minimally to contaminating a site, yet who has "deep pockets," may be required to clean the site. Many people find the "deep pocket" theory of liability manifestly unfair, especially when coupled with true "strict liability."

The Elements of Liability

Strict liability, simply put, is liability without fault. Under strict liability one need not show negligence on the part of the defendant to recover from him. The classic tort liability scheme consists of four elements. First, the defendant must have some legally recognized duty. Second, he must breach that duty. Third, his breach of the duty must cause the injury. Fourth, the injury must result in damage to the plaintiff.

For example, take the simplified case of an automobile collision. Person *A* runs a stop sign and collides with *B*. *A*'s duty is to obey the stop sign. By failing to heed the sign, *A* breached a legally recognized duty. If *B*'s car or person are injured in the collision, *B* can recover damages. *B*'s burden of proof is not difficult. Assume, however, that *A* has no money, but *A* admits that he was distracted by *C* walking her dog without a leash in an area where dogs must be on a

leash. *C* has also breached a duty, but that breach was probably not a cause of *B*'s injury, at least not a foreseeable or "proximate" cause. In a case to recover damages from *C*, *B*'s burden would be difficult to carry. Finally, assuming *C* also has no money, what if the entire episode occurred in *D*'s parking lot? Does *D* have a duty in this situation? In a case against *D*, *B* would have trouble with all of the elements of the classic tort: duty, breach, causation, and damages.

CERCLA eases the burden on the plaintiff, usually the EPA, for all of these elements in the case of Superfund sites. The statute imposes a duty on any of the six classes of parties any time they deal with hazardous substances. The duty is simply to control the hazardous substances and keep them from being released to the environment. A party breaches that duty when a release or "threat of release" to the environment occurs. The duty is "strict" because there is no need for the plaintiff to prove negligence. The plaintiff only needs to show that the threat occurred. Why it occurred is irrelevant in a strict liability scheme. In comparison to the above auto collision example, if *A* proved that the stop sign had been knocked over or obscured by trees, he might not be liable for negligence, but a strict liability theory would hold him liable regardless. Fortunately for *A*, drivers are never held strictly liable.

The release of a hazardous substance need not cause any harm; in fact, release need not occur, only threat of release. The threat, however, must cause EPA or some other party (perhaps a state, city, or private individual) to react by cleaning the site. The clean-up cost represents the damages EPA may recover. The following section will examine these four elements more closely and discuss why CERCLA liability is so easy to fall into and why it is so devastating.

Duty: Hazardous Substances

CERCLA imposes a duty on those who handle, or unwittingly handled in the past, a category of chemicals now (or sometime in the future) designated as hazardous substances. At first blush, this sounds reasonable, but when one realizes the relative harmlessness of some of the chemicals listed, the range of CERCLA's effect can be quite startling.

Many hazardous substances are in routine household use. While some hazardous substances will kill, or cause mutations or serious injury, many are relatively innocuous. And whether innocuous or not, the public's exposure to some of these chemicals is extremely common. In fact it is easy to imagine that everyone has handled and disposed of some product containing a hazardous substance. For example, acetone is a major ingredient in fingernail polish remover; benzene is a major constituent of unleaded gasoline; phosphoric acid is an ingredient in Coca-Cola. All of these chemicals are hazardous substances.

Therefore, it is reasonable to assume that every business in America uses hazardous substances. Because the list of

hazardous substances encompasses so many commonly used chemicals, almost all manufacturing industries are major users.

Breach: Threat of Release

Another key to comprehending the range of CERCLA's application is an understanding of what constitutes a breach of the hazardous substance duty. The breach occurs when there is a threat of release to the environment of some hazardous substance. The threat is merely of release, not anything to do with danger or health effects. Danger is presumed since we are dealing with hazardous substances.

A release is movement of a hazardous substance from anything into the environment. The environment includes air, water, soil, and ground water. If the substance spills from a barrel to the ground, it is a release; if it seeps from a landfill into the soil, it is a release; if it evaporates from an open container, it is a release. Releases occur constantly, and anyone who handles a hazardous substance will have the impossible task of keeping track of it all.

Causation

Causation in the sense of physical danger or injury is not required. What is more startling is that causation in the sense of release is not required either. If the defendant places a hazardous substance in a landfill, he may be held liable even if the hazardous substance threatening release is different. The defendant need not cause the release. He must only be one of the six parties described earlier, for example, the property owner.

Damages

Damages include the cost of response and remedial action to clean the site. These costs can be quite substantial since the sites must be cleaned to exceedingly low levels. The average site cleanup cost in 1984 and 1985 exceeded twelve million dollars.

Defenses

There are only five real defenses to CERCLA liability, and none of them are very good. An act of God or an act of war is the first defense. These are both closely circumscribed. It has been argued by the EPA that a fire started by lightning striking a warehouse is not an act of God because it is foreseeable and preventable by lightning rods.

The second defense is that the EPA granted a permit for the release. The EPA is not likely to grant permits for the release of hazardous substances without substantial assurance of no possible harm. This defense is available to very few property owners.

The third defense is that the release is not a release.

There are four categories of releases that are specifically excluded. These are releases solely from the workplace (regulated by the Occupational Safety and Health Administration), releases from some engine exhausts, releases of some nuclear materials (regulated by the Nuclear Regulatory Commission and Department of Energy), and the normal application of fertilizer. This exception also applies to a very limited class of property owners.

A fourth defense is available if the hazardous substance arrived on the property because of acts of a third party with whom the owner had no dealings. This is available only if the owner took reasonable precautions to prevent such occurrence. This defense is fairly good if the owner is the victim of "midnight dumpers," but if the owner in any way agreed to receive the material or knew that it was coming, the defense is not good.

Finally, the fifth defense is that of an innocent landowner or innocent purchaser. If the owner came into possession of the land without knowledge that it was contaminated and made "all appropriate inquiry" without discovering its contamination, then he may be deemed innocent and without liability. All appropriate inquiry in the case of commercial property requires an extensive environmental audit. This audit must be performed by professional engineers (evaluating facilities, chemicals and discharges), geologists (evaluating soil and ground water conditions), and attorneys (performing title history searches, including leases). Environmental audits are expensive and invariably uncover negative information.

Effect of Liability

The effect of liability can be summarized very simply with actual case histories. A company purchased a tract of land for \$48,000 and the estimated cleanup bill was \$2 million. In another case, Maryland Bank & Trust Company foreclosed on a piece of property and learned that they had not only lost their security interest, but would also have to pay for the site's cleanup as its owner. Finally, insurers are being hit with coverage suits from their insureds. UTC, for example, sued 240 insurers for pollution coverage regarding its properties. In many cases the policies are standard Comprehensive General Liability policies written before CERCLA, which did not anticipate its absolute and retroactive liability scheme.

Insurers

While insurance companies are not subject to CERCLA liability, their reaction to it is important. If insurance companies reason that potential liability is great, they will charge high premiums. If, as many insurers contend, environmental impairment is not a random insurable event and instead a certain eventuality, they will refuse to insure entirely.

Insurance companies have incurred substantial, unanticipated losses for environmental damages. To reduce their losses, insurance companies are generally refusing any environmental impairment liability insurance and auditing policyholders to minimize risk. This has created a dire shortage of needed insurance. Where there are companies granting environmental policies, the policies are limited in scope, usually covering only sudden occurrences.

Lenders

Lenders are often placed in a Catch-22 position. On the one hand, they do not want to foreclose on potentially contaminated property. On the other hand, they want to protect their security interest. If banks have already loaned money, they might consider imposing restrictions on the activities of their borrowers to reduce the likelihood of CERCLA action. This activity, however, would be considered operation of the site and subject the lender to the same liability that foreclosure brings. Generally, a bank's involvement in the business affairs of a company handling hazardous substances is suicidal. The best tack for money already lent is to wait and see, and hope for the best.

With new loans, however, banks are in a better position to protect their investments. All financial institutions are expanding the methods they use to identify environmentally high-risk borrowers. Pre-loan environmental audits are common place. Soil tests are frequently required for existing industrial facilities. Costs are borne by the potential borrower, not the bank.

Many banks will require borrowers to perform continuous environmental audits during the life of the loan to ensure environmental compliance. This treads close to meddling in the affairs of the borrower, but most banks only require an independent auditor to report the audit results to the borrower's top management, forcing the borrower to stay informed.

Finally, many lending institutions will require the borrower to secure environmental impairment liability insurance. As noted above, however, insurance is scarce. And when it is available, insurance companies put policyholders through another set of hurdles. For many borrowers the insurance requirement essentially means that no loan will be available.

State Government

Some state governments have stepped into the CERCLA land transaction problem and added to the confusion. New Jersey, for example, passed the landmark Environmental Clean-up Responsibility Act (ECRA). The transfer of industrial property will not be approved by the state environmental agency until the site is cleaned of all contamination. Delays of several months in the transfer of property are common. The whole thrust of the statute is to prevent acquisition of liability by innocent purchasers.

Fortunately, states passing ECRA type legislation have been restricted to the northeast and California. It seems unlikely that either North or South Carolina will propose such legislation given the New Jersey experience.

Purchasers

CERCLA liability substantially deters purchasers of existing industrial property. The liability itself is frightening: the average site cleanup costs over \$12 million.

In addition, the acquisition of loans and insurance is difficult and expensive, if not impossible. Finally, there are often substantial delays in acquiring loan money to the point where the transaction may no longer be worth its original value.

The length of delays, the size of the additional transaction costs, and the viability of the sale itself will all be a function of the likelihood of finding contamination on the



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site. If the site is an existing industrial facility, it is more likely to have hazardous substances than if it is virgin property (although some property that appears clean is not). The higher probability leads to greater scrutiny of the site by the lender, purchaser, and insurer, which increases the costs of the site regardless of whether the site is clean to begin with.

Industrial site purchasers are increasingly subject to market pressures that force their selection of unspoiled, virgin property for commercial development. Virgin property must be cleared, landscaped, and developed. Moreover, such property is often far from desirable business districts. Because of the threats of environmental liability, virgin property will be selected over existing land with viable structures and superior location. The consumption of this virgin property is actually being propelled by the most powerful of environmental statutes. The irony is striking.

What the Planner Can Do

Planners must be aware of the difficulty surrounding the reuse of industrial and commercial property. Projected development into outlying areas should exclude land that has already had commercial uses. In addition, a higher percentage of outlying land should be zoned for commercial or industrial development; as businesses come and go, they will not reuse existing locations nearly as often as the planner might anticipate.

Another consideration is the acquisition of former industrial or commercial property by local governments for infrastructure or other uses. City and county governments are not excluded from liability (except through escheat from tax delinquency). If local governments purchase property outright or through eminent domain, they can be held liable for cleanup costs. Therefore, planners should not rely too heavily on projected reuse of commercial properties by the local government. Such properties, once audited, may turn out to be highly undesirable.

The ability of the planner to affect legislation may be limited; however, the following suggestions may prove valuable.

Local: Cover the Cost of Audits

At the local level, the planner may be able to institute regulations that will subsidize environmental auditing of commercial property designated for continued business use. This subsidy can be in the form of an actual payment to potential purchasers who commission the audit, or it can be performed by the local health and environmental agency. In either case, the local government should retain access to the report and permit its use by subsequent potential purchasers. In this way the local government will improve its land planning strategy while gaining valuable environmental information for the community.

State: Use Conversion Tax

At the state level, planners should make legislators aware of the problems encountered by New Jersey under the ECRA statute. Legislation to protect innocent purchasers should be drafted to prevent the transactional barriers created by ECRA.

In addition, a one-time use conversion tax would provide an incentive to companies to reuse existing industrial property. This type of tax would be imposed when non-industrial property was converted to industrial use. Industrial use would be defined as a particular level of hazardous substance use.

The size of the tax could be geared to the type of effect desired. If, on the one hand, the desired effect is simply to encourage companies to consider existing locations, then the tax should be equivalent to the additional transaction costs associated with existing industrial property. This would be approximated by the cost of an environmental audit of a similarly sized tract. If, on the other hand, the desired effect is to strongly encourage use of existing commercial property over undeveloped land, then the tax should reflect the relative risk between the two alternatives. The size of this tax would be quite substantial and could drive companies out of state.

Federal: CERCLA Amendments

Amendments to CERCLA will probably not occur for several years. But when amendments are passed, planners should be prepared to suggest taxes or other incentives to offset the market incentives to consume undeveloped land. This may prevent flight to neighboring states, but it might not prevent flight to overseas locations, which has already occurred.

Conclusion

CERCLA liability has propelled an undesirable environmental and land use phenomena: the consumption of undeveloped land for commercial and industrial uses. The planner must understand the effects of CERCLA liability in order to pursue legislation at the state and local level to alleviate the development pressures on virgin land and permit cost effective reuse of commercial and industrial property.

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