Tax Sale/Superfund: Federal Appellate Court Addresses Applicability of Third Party Defense

Walter Wright, Jr.
wwright@mwlaw.com
(501) 688.8839

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Co-Author: Matthew Fiorillo

The United States Court of Appeals for the Ninth Circuit ("Court") addressed whether a California tax-sale purchaser was entitled to a third-party defense provided by the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 ("CERCLA" or "Superfund"). See *Cal. Dep't of Toxic Substances Control v. Westside Delivery, LLC*, 888 F.3d 1085 (9th Cir. 2018).

The issue of whether a purchaser of a tax-sale property is entitled to this defense was described by the Court as a matter of first impression.

The California Department of Toxic Substances Control ("Department") had brought an action against Westside Delivery, LLC ("Westside") for recovery of response costs under CERCLA.

By way of background, Davis Chemical Company owned and operated a facility ("Site") from 1949 to 1990 in Los Angeles, California that recycled spent solvents it generated. In 1986, the title for the Site passed from Earnest Davis to the Davis Family Trust.

A study commissioned by the Environmental Protection Agency ("EPA") in 1996 revealed that the soil at the Site contained elevated levels of several hazardous substances. The Department devised a plan to remediate the contaminated site pursuant to CERCLA statutory authorities in 2002. Some of Davis Chemical Company's former customers assumed responsibility for implementation of the plan. However, they did not ultimately implement the plan.

Delinquent taxes allowed Westside to purchase the Site—which was not listed on the list of "Potentially Contaminated Parcels"—at a tax auction in 2009. From 2010 through 2015, the Department continued cleanup efforts at the Site under the plan. Once it finished cleanup, the Department filed a CERCLA cost recovery suit against Westside, seeking reimbursement of its expenses.

Westside asserted a CERCLA third-party defense. It argued that it was not liable because the release of hazardous substances at the Site was caused solely by third parties with whom Westside lacked a "contractual relationship." The United States District Court agreed that Westside was entitled to the defense. The Department appealed.

Congress enacted CERCLA in response to environmental and health risks posed by hazardous substances (a broadly defined term) releases. Unlike the Clean Air Act or Clean Water Act, CERCLA is not a forward looking statute that governs ongoing polluting activities. Rather, CERCLA imposes liability on parties who are responsible for past contamination of a facility or site.

CERCLA allows a state that has responded to a release or threatened release of hazardous substances to recoup its costs from the facility owner. Liability may sometimes be imposed regardless of responsibility for the release, even if the owner had nothing to do with placing the hazardous substances at the facility.

CERCLA provides certain affirmative defenses to escape liability for such costs, including a third-party defense. The third-party defense allows for parties to escape liability if the damage was caused solely by "a third party . . . or omission occurs in connection with a contractual relationship existing directly or indirectly with the defendant." 42 U.S.C. § 9607(b)(3).

Congress amended CERCLA in 1986 through the enactment of the Superfund Amendments and Reauthorization Act ("SARA"). SARA addressed third-party defense known as the innocent landowner defense. This defined "contractual relationship"—previously undefined in CERCLA—as:

[L]and contracts, deeds, easements, leases, or other instruments transferring title or possession, unless the real property on which the facility concerned is located was acquired by the defendant after the disposal or placement of the hazardous substances on, in, or at the facility, and one or more of the circumstances described in clause (i), (ii), or (iii) is also established by the defendant by a preponderance of the evidence:

(i) At the time the defendant acquired the facility the defendant did not know and had no reason to know that any hazardous substance which is the subject of the release or threatened release was disposed of on, in, or at the facility.

(ii) The defendant is a government entity which acquired the facility by escheat, or through any other involuntary transfer or acquisition, or through the exercise of eminent domain authority by purchase or condemnation.

(iii) The defendant acquired the facility by inheritance or bequest.

42 U.S.C. § 9601(35)(A) (emphasis added).

The defense is only available if the purchaser had no actual or constructive knowledge of the contamination at the site at the time of purchase. SARA thus clarified that a previous owner or other entity whose acts or omissions occurred in the past can be a third party. The fact that a previous owner may be a third-party means that a defendant purchaser could have a contractual relationship with all previous landowners, unless the landowner could qualify for innocent-landowner defense under SARA.

Westside proposed two main arguments for why it should be entitled to the third-defense.

First, it advanced the theory that it did not have a "contractual relationship" with Davis Chemical Company or the Davis Family Trust because the tax-sale was an intermediary.

The Seventh Circuit determined that federal law should be applied to the determination of whether a tax-sale would create a contractual relationship between the pre-tax-sale owner and the eventual purchaser. While it is generally true that state law determines whether a person has a property right and what the nature of that right is, federal standards govern the federal consequences of transferring that property right.

In short, state law determined what property interests, if any, Westside and Davis possessed in the Site. However, whether the occurrences or transactions that created and destroyed those interests constituted a "contractual relationship" between Westside and Davis was deemed governed by federal law.

The Court determined that the phrase "contractual relationship" should be construed broadly, based on a clause not limiting its definition and the statute's "catch all" clause. As to the phrase "contractual relationship," Congress was deemed to have at least intended to capture a voluntary transaction resulting in a change in ownership or possession. This was held to likely include involuntary acquisitions by the government.

The Court supported its conclusion with language from SARA. It also looked to an EPA finding that, after analyzing CERCLA and SARA, the federal agency determined that an "involuntary transfer or acquisition" includes an acquisition through tax delinquency. Therefore, it did not matter that the tax collector effectuated the transfer, only that the type of involuntary transfer at issue—i.e., a tax sale—created a "contractual relationship."

The Court then found that a government entity's acquisition of real property due to a tax delinquency is an "involuntary transfer or acquisition."

The definition of "contractual relationship" was added to CERCLA at the same time as the innocent-landowner defense. It was through the definition that Congress added the innocent-landowner defense. A typical private purchaser who buys property contaminated by a previous owner or possessor is entitled to the innocent-landowner defense only if the purchaser bought the property without actual or constructive knowledge of its contamination. Based on this, the Court determined that, if the defense was to be read as Westside suggested, it would create a "loophole that frustrates the defenses purpose" to only protect the truly innocent.

The Court noted that waiting until a defendant owner defaults on tax liens and purchases a contaminated site from a tax-sale, as Westside argued, would "scrape off" CERCLA liability. The EPA's statement that "there is no authority anywhere in CERCLA that would support the "laundering of liability" through a mechanism such as a tax sale" was also cited in support of its conclusion. Lender Liability Under CERCLA, 57 Fed. Reg. 18,372–73 (Apr. 29, 1992).

Ultimately, the Court determined that a tax-sale buyer, such as Westside in this case, has a contractual relationship with the pre-tax sale owner.

Westside next argued that, even if there was a contractual relationship, the pollution did not occur "in connection with" its contracted relationship with Davis.

The Court found this argument unpersuasive. If "in connection with" covered parties who only purchased the land, there would be no need for the "innocent purchaser" defense, as the third-party defense would duplicitously cover them. Instead, the Court found that, even in the uncertain world of CERCLA, it was doubtful that Congress went through the trouble of amending the statute to create a defense that no one would need.

The Court did find use for "in connection with" by applying it in the context of a defendant-landowner asserting a defense against liability for a previous owner or possessor's acts or omissions. The phrase "in connection with," then, is intended to filter out those situations in which the previous owner's polluting acts or omissions were unrelated to its status as a landowner.

In summary, this Court held that parties who purchase property through a tax-sale are contractually related, and thus not eligible for the third-party defense. Further, "in connection with" likely only applies to parties asserting a defense against previous owners.

A copy of the opinion can be downloaded here.