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TOXIC CLEAN UP OF AG PROPERTIES:

WHO WILL PAY?

by Karen Klonsky, Kim Norris,
and Rebekah Buckles

The agricultural community is increasingly aware that land owners can be held liable for cleaning up property contaminated with hazardous materials that are typically used in farm operations—even if the contamination is caused by others. Regulations and recent court cases indicate that liability can extend to agricultural lenders, real estate agents, rural appraisers, farm managers, neighbors, previous owners of the land, and tenants.

The basis for attaching liability to specific parties is open to legal interpretation. Attempts to clarify and limit liability are continuously being made through court rulings and introduction of new legislation. Uncertainty about potential liability for toxic clean-up costs has adversely affected access to real estate secured credit and salability of farm properties.

➤ Environmental legislation of the 1980s makes it possible for government agencies to order cleanup of contaminated property and recover cleanup costs. Such orders give rise to the question, "Who pays if contamination is found?" All parties—buyers, seller, operators, lenders, and others—involved with farm land are potentially liable for cleanup costs and are taking steps to reduce their risk exposure. At the same time, new strategies for financing toxic cleanups have been developed both in the public

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The Legal Roots

In the 1980s, Federal environmental legislation gave cleanup of contamination a major boost. Commonly referred to as "Superfund," the Comprehensive Response, Compensation, and Liability Act of 1980 (CERCLA) and its 1986 extension, the Superfund Amendments and Reauthorization Act (SARA), gives federal government agencies such as the Environmental Protection Agency (EPA) the authority to order corrective action and recover cleanup costs incurred by the government. Various other statutes also allow the government to recover costs. They include the Resource Conservation and Recovery Act (RCRA, also referred to as the Solid Waste Disposal Act), the Toxic Substances Control Act, the Clean Air Act, the Safe Drinking Water Act, and the Clean Water Act.

Perhaps the most important distinction between Superfund and other environmental legislation is that Superfund allows public and private liability actions against parties other than the current owner or operator of the contaminated site. In particular, the EPA or other injured parties may sue for recovery of cleanup costs from:

- The current owner or operator;
- Any party who owned or operated the facility/property at the time disposal of hazardous materials occurred;
- Any party who contracted or otherwise arranged for disposal of hazardous materials;
- Any party who accepted hazardous materials for transportation or disposal.

The term "owner" has been broadly interpreted to mean the owner, lessee, sublessee, or agent of the owner. Moreover, liability is "joint and several," meaning that any identified party can be held responsible for any part or all of the cost of the cleanup.

Superfund includes an exemption for lenders when they hold real property as a security interest but do not participate in the management of the business. Despite this exemption, several court cases have held lenders liable for cleaning up contaminated property. Although these cases have all involved commercial properties, they have been interpreted to hold for any type of real property, including farm land.

These cases strongly suggest that a lending institution taking ownership of contaminated property through foreclosure may be held liable for cleanup, even though the property was only loan collateral at the time the contamination occurred. Such rulings have been construed to mean that any "deep pocket" in the chain of title to a contaminated property may be held liable for its cleanup.

Even where land is not held as collateral, a lender may be held liable for cleanup costs if it has been involved in the daily operations of the business or has exercised its "capacity to influence" business decisions. This interpretation of Superfund regulations could be construed to mean that cleanup costs may be recovered from almost any party to business transactions involving real farm property.

A proposed EPA rule attempts to establish some boundaries for actions that may be taken by secured lenders without being considered to be participating in managing the facility. These actions would include requiring a cleanup before lending or during the life of a loan, requiring assurances from the owner or operator of

compliance with environmental rules and regulations, etc. As yet, however, this rule has not been formally adopted by EPA.

The legal considerations related to petroleum contamination differ from legal aspects of other contamination, such as pesticide contamination. Petroleum spills and leaks are exempt from cleanup under Superfund. Other federal statutes, such as RCRA and the Clean Water Act, provide authority to EPA for petroleum cleanup orders and cost recovery. The petroleum exclusion to Superfund is significant because it precludes suing a previous owner or operator under Superfund provisions, even if they caused the contamination. While cost recovery from third parties may be possible under state law and RCRA, it is not as well established as liability under Superfund.

Under state law, liability can also be assigned under a fraud or fraud-related cause of action. This is especially important to real estate agents, brokers, and appraisers who may be liable if it can be shown that they misrepresented or failed to disclose information concerning the condition of a property. Under California law, real estate agents and brokers are required to conduct visual inspections of property and reveal to buyers in writing any facts that might influence the value of the property. These provisions also apply to a lease agreement arranged by real estate agents.

Reducing Buyer and Lender Risks

Because of the potential environmental liability associated with farm real estate, environmental site assessments (ESA) are becoming common practice when property is sold and for some ag loans. A qualified third party usually conducts the ESA, and it typically consists of three phases.

Phase 1 generally includes: (1) inspection of site, (2) review of public agency files, (3) review of site history, (4) investigation of regulatory compliance, and (5) review of aerial photos. For farm properties, questions about pesticide use and storage are always asked. For example, have pesticides ever been applied to the property? If the answer to this question is yes, a description of storage and rinsing facilities is

requested, and the site is visually inspected. In addition, any landing strips used for crop dusters are examined.

The results of Phase 1 will determine whether or not Phase 2 is necessary. The second phase generally consists of (1) checking for PCB in transformers and asbestos in buildings, (2) testing sub-surface soils for toxic substances, (3) testing surface, runoff, and sub-surface water, and (4) planning clean up activities if they are determined to be necessary.

Phase 3 is the clean up itself. The firm that conducts the ESA may conduct the clean up, but not necessarily. Clean up may entail disposing of empty containers or removing contaminated soil. Such activities can only be carried out by licensed firms, and hazardous materials deposited only at licensed waste disposal sites.

As environmental reports become standard operating procedure for real estate transactions, contaminated properties will be cleaned up as they change hands. It should be emphasized that catastrophic cleanups on agricultural properties are rare. If there is a problem, cleanup can usually be included in the sales contract in a variety of ways. For example, one California farm found a leaking underground storage tank contaminating an 8 foot circle to a depth of 21 feet. The cost of the soil removal and a new over-

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head tank was \$4,000 and was paid by the purchaser of the farm property before the sale was finalized. Also, if there is a contamination problem on the property in the future, the seller will be able to use the ESA as evidence that the problem occurred after the ownership transfer.

Individual lending institutions have developed their own policies with respect to environmental liability. In general, bankers do not require an ESA for all loans where land is collateral. However, virtually all banks are developing some sort of preliminary questionnaire for agricultural properties to determine whether or not a full scale ESA is appropriate. These questionnaires focus on (1) past uses of the property, (2) the presence of underground storage tanks, pumps, holding ponds, storage facilities for toxic substances, and (3) practices for clean up of equipment and disposal of toxic materials.

Other forms of protection for lenders are written into agricultural loan agreements, including language that indemnifies lenders in case toxic materials are found on the property. This approach has been common practice with commercial loans for the past decade. However, such language cannot protect a lender from an insolvent borrower. In most cases lenders prefer to place the property in receivership and technically avoid taking possession of the property.

In spite of these safeguards, lenders often confront significant cleanup expenses on foreclosed property. For example, Farmers Home Administration in California spent \$1.6 million between December 1987 and May 1991 to clean up 22 contaminated properties.

As with ag loans, farm leases have also begun to include language pertaining to the potential contamination of property by the tenant. Although such language has been common in most commercial leases for at least 10 years, it has just shown up in farm leases during the last few years. While a commercial lease may include up to 20 pages of indemnification, agricultural leases typically include only a couple of pages. Of course, the lease can protect the land owner only if the tenant is solvent.

At the same time, some land owners are pressing their insurance companies to pay for environmental clean up under their Comprehensive General Liability (CGL) insurance policies. Fierce court battles are being waged between the insured and their insur-

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ance carriers over liability coverage for environmental claims. In 1990 alone there were at least ten federal and state appellate court decisions regarding coverage for environmental claims, and the decisions have been split even within jurisdictions.

In one case, the California Supreme Court held that, under the CGL policies involved in that case, government-mandated, cleanup costs constitute damages which an insurer is legally obligated to pay (AIU Insurance Company versus Superior Court, 1990). This ruling effectively counters insurance companies' claim that court-ordered cleanup costs do not constitute "damages," and that improper disposal of hazardous waste does not constitute "property damage". This ruling also confirms the long-standing rule followed by the courts that ambiguities in insurance policies are resolved against the party responsible for drafting the policy language.

More recent litigation has focused on the interpretation of "pollution exclusion" clauses that became a part of CGL policies during the 1970s. These clauses typically exclude pollution damage that is not "sudden and accidental" from coverage. State courts are split as to the interpretation of "sudden and accidental." We conclude that CGL insurance may provide some compensation for hazardous site cleanups but is by no means certain.

New Financing Approaches

Until recently, the only solutions available to owners of contaminated property were: (1) pay for cleanup out-of-pocket, (2) claim cleanup costs against available insurance policies, (3) ignore the cleanup orders and face criminal action, or (4) file for bankruptcy, effectively transferring liability to any creditor(s) taking title to the foreclosed property. Moreover, lending institutions have been unwilling to finance toxic cleanups because the land used for collateral is contaminated.

These circumstances have resulted in what has come to be known as "toxic gridlock." That is, vast amounts of time and money are spent battling over clean up liability in the courts, while property remains contaminated. "Toxic gridlock" is gradually giving rise to some innovative programs that can facilitate toxic site clean ups by defraying or delaying the costs.

Several states have established cleanup funds to assist property owners in cleaning up contamination on the property. These funds vary in eligibility rules, the size of cleanup targeted, and the source of revenue.

In Illinois a Response Fund was created in 1990 to help finance large-scale environmental cleanup after a "catastrophe." It is being administered as the Agrichemical Containment Program in the Illinois Department of Agriculture. An annual fee of \$500 is required to establish eligibility for assistance. Participants in the program will be reimbursed up to half a million dollars with a 10 percent or \$25,000 deductible (whichever is more).

Minnesota enacted similar legislation in 1989 to provide assistance for smaller cleanups costing up to \$200,000. The Ag Chemical Response and Reimbursement Account (ACCRA) was created by the state's Groundwater Protection Act and is funded by 2 percent surcharges on pesticides and fertilizers and various licenses. The program reimburses up to 90 percent of cleanup costs up to \$100,000 and 100 percent of the costs between \$100,000 and \$200,000 with a \$1,000 deductible.

Most states have programs to help pay for voluntary removal of underground storage tanks. The California legislature recently passed the Underground Storage Tank Cleanup Fund Act. Under this measure, the State Water Resources Control Board (SWRCB) administers a cleanup fund to help eligible owners and operators of underground storage tanks pay for the costs of cleaning up contamination caused by leaking tanks. The program will not pay for tank removal and/or replacement, however. Qualifying claims are approved by lottery.

The Environmental Cooperative Solution (ECS) is a quasi-public pilot program in California undertaken by the California Bankers Association with the support of key regulatory agencies.

ECS brings landowners, lenders, regulatory agencies, and cleanup companies to the negotiating table to create cleanup and financial arrangement that works to the benefit of all parties. With ECS, the structure of the loan provides for cleanup to be completed before the lender takes a lien position. An "unbankable" toxic cleanup loan is rendered "bankable" if two criteria can be met. First, that alternate collateral can be utilized during the cleanup phase of a project. Deferred payments to the cleanup company performing the remedial services are usually involved. Second, that following cleanup, regulatory sign off can be structured to allow the lending institution to take a collateral lien position against the property for the term of the loan. While ECS cannot be considered a panacea, it has the potential to move a cleanup forward more quickly than might otherwise be the case.

The Future

The total cost of cleanup will continue to increase unless efforts are made to avoid future contamination and more cost effective remedial technologies are developed. This will eventually mean fewer cleanups at lower costs. Already many new state regulations and programs are targeted at preventing pollution. For example, diking pesticide and fertilizer storage facilities will soon be required nationwide.

One of the major cost components of clean ups is the removal of contaminated soil. Currently, contaminated soil is shipped to hazardous waste landfills that are often in other states. For example, soil has been shipped from farms in Colorado to Idaho and from Michigan to Texas. This movement of soil is extremely costly. It also allows for the possibility of an environmental accident in transit.

Many professionals in the field feel that on-site containment will inevitably be the most viable method for cleanup since it avoids the costs and interstate disputes connected with transporting contaminated soil. However, on-site containment has already



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met with opposition from nearby residents who want complete cleanup of a pollution problem they did not create. This type of debate will become increasingly common particularly with regard to large-scale cleanups.

Low cost alternatives for disposal of pesticides and pesticide containers are being developed. Most states have hazardous waste collection programs that allow the public to dispose of limited quantities of certain materials on specified collection days.

Pesticides registered for use can legally be disposed of by applying them at the label rate to the crop and field for which they were originally intended. Rinsate can also be applied to the

field under certain conditions. However, laws regarding rinsate vary from state to state.

Regulations and alternatives available for container disposal also vary from state to state. Most states are currently reviewing alternatives to burning containers. Minnesota is proposing that growers

return open containers to dealerships while other states do not allow dealers to handle open containers. In 1992 North Dakota container disposal will be paid for from a surcharge on agricultural chemical sales and a container disposal fee. In California, most counties charge a \$3 fee per container for disposal in Class I disposal sites. Other options involve returnable, reusable containers and recyclable containers. New ways to recycle containers for reuse or energy generation must be found before these alternatives can become widespread.

As various groups successfully lobby to limit their liability for toxic cleanup and other safeguards improve, the number of deep pockets that can be tapped to pay for cleanup will decrease. At the same time, there will be increased state involvement in developing public sector cleanup funds and levying moneys to finance those funds. Undoubtedly, industry will increasingly share the cost of cleanups through a combination of taxes, surcharges, and voluntary contributions to cleanup funds. **□**