SALES OF MILITARY BASES AND SURPLUS SUPPLIES POSE ENVIRONMENTAL TRAPS

The federal government recently announced plans to close or consolidate hundreds of military facilities; this will have a serious effect on local economies. However, environmental liabilities could hamper efforts to convert these properties to government or private interests. This article provides strategies for limiting these liabilities.

by Larry Schnapf

With the end of the Cold War, the federal government has announced plans to close or consolidate hundreds of military installations and weapons manufacturing facilities across the country that were owned or operated by the Department of Defense (DOD) and the Department of Energy (DOE). The closings and consolidations will result in job losses that could devastate the economies of the local communities. To soften the adverse economic impact on the surrounding communities, the federal government hopes to convert the closed bases to local government or private interests for redevelopment. However, environmental liabilities associated with these federal properties have hampered these efforts.

This article discusses the federal liabilities associated with these DOD and DOE properties and provides strategies for limiting this potential liability.

Military installations can be attractive properties for developers and local communities because these facilities typically have highly developed infrastructures, such as paved roads, office buildings, and schools. In many cases, the bases come equipped with airports and golf courses. As a result, the bases can be used by communities to provide such needed basic services as schools, housing, or parkland that the towns could not oth-

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erwise afford to build. The communities can also use the facilities to generate revenues by leasing or selling the existing infrastructures. Finally, if the installations are sold to private developers, the redevelopment can act as a source of jobs.

However, many of the federal installations bases have been heavily contaminated with a variety of hazardous substances. Until the 1970s, toxic and radioactive wastes were often either dumped on the ground or buried or poured into unlined pits or lagoons at many of the federal facilities. Indeed, the first 86 bases that were slated for closure contained over 500 individual hazardous waste sites that had to be cleaned up, and 15 of these bases have been placed on the National Priorities List (NPL) or Superfund list.

CERCLA Liability for Federal Facilities

Developers and local governments have been reluctant to acquire these properties because they fear that they will be held liable for the cleanups under the federal Comprehensive Environmental Response, Compensation and Liability Act of 1986 (CERCLA).[1] Under this law, owners and operators of a site that is contaminated with hazardous substances will be strictly liable for all cleanup costs associated with the property even if they did not place the hazardous waste on the site or were not responsible for the discharge. Some cases have held that property owners who had title to property while hazardous wastes were migrating or leaking, but who did not deposit the wastes, are liable for the cleanup costs of the contaminated property.[2] Thus, local governments or developers who acquire title to contaminated facilities could be liable for the cleanup costs associated with those facilities.

There are only three affirmative statutory defenses that a landowner could assert under CERCLA, although some courts have allowed defendants to raise common-law equitable defenses as well.[3] The defense most often raised is the third-party defense. However, to establish the third-party defense, a landowner must establish by a preponderance of the evidence that the release and resulting damages were caused solely by an act or omission of a third party other than an employee or agent of the defendant and that the act did not occur in the context of a direct or indirect contractual relationship with the defendant. Furthermore, the landowner must demonstrate that it exercised due care with respect to the hazardous substances, taking into account the characteristics of the hazardous material and the circumstances or facts involved and also took precautions against foreseeable acts or omissions of any third parties and the consequences that could foreseeably result from such actions or omissions.

CERCLA specifically defines "contractual relationship" as including "land contracts, deeds or other instruments transferring title or possession." As a result, courts have so narrowly construed the scope of the third-party defense that it is virtually meaningless. For example, by virtue of its contractual relationship with its tenant, a landlord will not be able to raise the third-party defense to CERCLA liability contamination resulting solely from operations of its tenant.[4] In addition, a sublease has been held to constitute a sufficient indirect contractual relationship to preclude a lessor from successfully pleading the third-party defense.[5] Under this interpretation, only the acts of trespassers, adjacent landowners, or midnight dumpers could be used by a landowner as third-party defense[6] and only then if the landowner demonstrated it had exercised due care.

In order to reduce this harsh application of the third-party defense to purchasers who acquire title to property that is already contaminated, Congress adopted in 1986 an "innocent purchaser's defense" that completely exonerates such a purchaser from liability. To take advantage of this affirmative defense, the owner or operator must establish that it did not know and had no reason to know that any hazardous substances were disposed of at the facility. To establish that it had no reason to know of the contamination, a purchaser must demonstrate that it took "all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability." In determining whether there was an "appropriate inquiry," CERCLA requires that a court take into consideration any specialized knowledge or experience of the innocent owner, as well as the relationship of the purchase price to the contaminated property, commonly known or reasonably ascertainable information about the property, and whether the presence of contamination was obvious or could be detected by an appropriate site inspection.

In enacting this innocent purchaser's defense, Congress attempted to establish a course of conduct in real estate transactions, and it is certain that such sophisticated buyers as real estate developers must perform detailed site investigation to take advantage of this defense.[7] In addition, those

involved in commercial transactions will be held to a higher standard than persons acquiring residential property for personal use.[8] The duty to inquire will be measured at the time the property was acquired, and the higher standard by which landowners' actions will be judged will be raised with increased public awareness of environmental hazards.

CERCLA Transfer Provisions for Federal Facilities

In 1986, Congress added Section 120(h) to CERCLA, requiring any federal agency that transferred federal property on which hazardous substances were stored, released, or disposed of to place notices in the contracts identifying the kinds and volumes of wastes at the property.[9] This section also required the conveying agency to include covenants in the contract that any necessary remedial action required under CERCLA regarding hazardous substances had been completed and warranting to perform any additional remedial action that may be required regarding hazardous substances remaining on the property. However, the federal agencies were not required to make such covenants to parties that would qualify as potentially responsible parties (PRPs) under CERCLA.

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For a variety of reasons, Section 120(h) did not in practice provide purchasers of government properties with much protection. First, the government is required only to give the covenants to transferees who would not qualify as PRPs. Since current property owners may be PRPs, it would appear that this section would apply only to lenders and innocent landowners. However, it is difficult to see how any purchaser of a military installation could qualify as an innocent landowner because the requisite due diligence would almost certainly give the purchaser reason to know that hazardous substances may have been disposed of at the property.

Second, the regulations promulgated by the Environmental Protection Agency (EPA) to implement the provisions of Section 120(h) narrowly construed the obligations of federal agencies.[10] In the final rule, the EPA said the notice covenant requirement applied only to property that was contaminated during the time the government owned the property. The agency further limited the protection of Section 120(h) when it declined to extend the notice and covenant requirement to properties that the government had acquired through foreclosure. Finally, the regulations did not specifically define what constituted a "transfer" of real property. As a result, it was unclear whether leases or easements granted by the government would fall within the scope of Section 120(h).

Purchasers and lessors of federal properties received some relief when the Court of Appeals for the District of Columbia ruled in *Hercules, Inc. v. EPA*[11] that EPA improperly limited the reach of Section 120(h) to properties that were contaminated when the government owned the land. However, the court did not find that EPA acted improperly when it failed to determine whether leases fell within the meaning of transfers of real property that were covered by the section.

Another obstacle to speeding the conversion of defense facilities to civilian use was the EPA's view that CERCLA prohibited the federal government from transferring any federal property until all remedial action that was required at the site had been completed, even if only discrete and isolated areas were contaminated. Most of the acreage at the preponderance of federal facilities is uncontaminated, yet, under this interpretation, the facilities could not be transferred until all of the contamination was remediated. In many situations, there is limited soil contamination but extensive groundwater contamination. Under the EPA interpretation, these facilities could not be transferred until the groundwater was remediated, which could take as long as 20 years if conventional pump-and-treat technology is used.

Faced with the prospect of federal facilities being idled by lengthy cleanups, Congress passed the Community Environmental Response Facilities Act in 1992 that allows the government to essen-

tially subdivide federal properties and convey the uncontaminated parcels.[12]

Under the law, the agency that owned or operated the federal facility must perform what amounts to a phase I investigation and determine whether hazardous substances or petroleum have been stored for more than one year and whether there has been a release of such substances. For the 100 or so bases that have already been approved for closure, the DOD has 18 months to identify contaminated parcels. For all future installations, the 18-month investigation period begins when the base closure is ordered. State governments are required to review those parcels that are identified as being uncontaminated and must object within 90 days; otherwise, the states will be deemed to concur with the conclusion that the property is uncontaminated. If the site is listed on the NPL, the EPA must indicate whether they agree within 90 days.

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The amendment also clarified that the covenant that all remedial action has been performed simply means that a remedy has been installed and is properly working. The covenant does not mean that the contamination has been reduced below the designated cleanup standards.

The law did not resolve the issue of whether leases were covered by Section 120(h). Instead, the amendment simply required the agency owning or operating the federal facility to notify the state in which the facility is located of any lease that will extend beyond the facility closure date.[13]

It is unclear how much protection this amendment will provide purchasers of federal facilities. The uncontamination determination does not cover properties in which hazardous substances or petroleum products were stored for less than a year. Furthermore, although the government agency is required to perform what amounts to a phase I investigation, it is also unknown whether the purchaser could rely on this investigation to satisfy the due diligence requirements of the innocent purchaser defense. If the purchaser cannot qualify as an innocent purchaser, the government is not required to provide the purchaser with the covenants warranting that the remedial work has been performed. In addition, the amendments do not limit the liability that purchasers may face under other federal laws or state environmental laws.

Purchasing Surplus Government Supplies

Another area of potential concern is sales of surplus government supplies such as cleaning and polishing compounds, paints and varnishes, preservatives and sealing compounds, adhesives, and oils and greases. While the Federal Property Management Regulations prohibit the federal government from selling hazardous wastes, there are few restrictions on the sales of hazardous materials. The Defense Reutilization and Marketing Service (DRMS) determines whether a particular material qualifies as a hazardous waste. However, this agency's definition of hazardous waste sometimes conflicts with the definition of hazardous waste under the regulations implementing the Resource Conservation and Recovery Act (RCRA).[14] Under the DRMS approach, hazardous substances are to be identified as hazardous waste only if they fall within the list of hazardous wastes contained at 40 C.F.R. §261.31. Thereafter, the agency will classify hazardous materials as hazardous wastes only if they cannot be reused within DOD.

However, the list of hazardous wastes that the DRMS uses is just one of the four categories of waste streams that the EPA has classified as Listed Hazardous Wastes. In addition to the Listed Hazardous Wastes, materials may also be regulated as hazardous wastes if the wastes exhibit any of the following four hazardous waste characteristics: ignitability, corrosivity, reactivity, and toxicity.[15]

Another area of conflict between the EPA and the DRMS is the treatment of sales of surplus materials. A material that is discarded will be considered a waste that may be regulated as a hazardous waste if it exhibits one of the hazardous waste characteristics or is a Listed Hazardous Waste. In determining whether a material is discarded, the EPA will look to see if it is being used for its original intended use. The DRMS just determines whether the material is to be reused. For example, if a purchaser intends to buy lubricating oil for burning in a boiler or plans to purchase a decon-

taminating solution for use as a weed killer, the DRMS would consider these transactions to be sales of useful products that may be hazardous materials but are not hazardous wastes that are subject to RCRA. However, the EPA would consider the transactions to be sales of hazardous wastes because the materials are not being used for their original intended purpose. As a result, the buyer could be found liable under RCRA for improperly handling or transporting hazardous wastes or could be liable under CERCLA as a person who arranged for the disposal of hazardous substances.

Similarly, DRMS generally does not place limits on the time that hazardous materials may be stored. However, under the EPA regulations, materials that are kept beyond their expiration date or that are allowed to accumulate beyond a certain period of time may become subject to regulation as hazardous wastes.

Further complicating the problem is that the government does a poor job of identifying hazardous materials or informing buyers of applicable requirements regarding the handling, transportation, or disposition of the materials. The problems seem greatest at the local auction sales as opposed to sales conducted by the national sales office because the local field offices frequently have not received adequate training in identifying and labeling hazardous materials. Indeed, a recent GAO report found that the local field offices failed to properly identify nearly 30% of the materials as hazardous materials.

It is important to know that when the DOD sells the materials through its national sales program, the government contract gives the DOD the right to conduct surveillance to ensure that the materials are used and disposed of properly. The buyer is also required to submit a statement of intent.

Strategies to Follow When Purchasing Federal Facilities or Materials

Prospective developers of former military installations should take the following steps prior to acquiring title to minimize their potential liability under federal or state environmental laws:

☐ Do not rely on the federal government investigations indicating that the parcel is not contaminated. Remember that the federal government is required only to perform investigations on properties on which hazardous substances were stored or disposed of for more than one year. Furthermore, the agency required to perform the investigation is likely anxious to discard the property and thus has every incentive to minimize the environmental threats posed by the property.

☐ Similarly, do not be swayed by the fact that the state government has not objected to the uncontaminated designation. Under Section 120(h), state approval will be assumed if the state does not object within 90 days. Given the limited staffing in most state environmental agencies, the potential purchaser should not assume that state silence means the state agrees with the conclusions of the federal agency seeking to transfer the property. The potential purchaser should contact the state environmental agency and verify that the state agrees with the federal investigation's conclusions. Such a purchaser should also determine whether the state has incurred any investigatory or cleanup costs associated with the property inasmuch as many states have lien statutes that allow the state agencies to impose liens on contaminated property that could encumber title.

☐ The potential purchaser should retain its own environmental consultant to review independently the federal investigation reports and to perform its own environmental due diligence investigation to verify the accuracy of the federal investigation. Because the contractual covenants and warranties that the federal governmental agency will make will be limited to hazardous substances remaining at the property at the time of the transfer, it is imperative that the potential purchaser identify all areas of environmental concern (AOCs). This will ensure that in the event a cleanup is necessary in the future, the purchaser can demonstrate that the federal government should have the responsibility to remediate the contamination. It may also be necessary for the potential purchaser to perform its own environmental due diligence because it is unclear whether the Section 120(h) investigation would qualify as the due diligence necessary to preserve the innocent purchaser's defense under CERCLA.

As part of the due diligence investigation, it is also important to determine whether any state or federal environmental liens have been placed on the property. If the facility has been placed on the federal facilities portion of the NPL, an effort should be made to have the parcel that is to be conveyed delisted from the NPL.

☐ If a decision is made to proceed with the transaction, potential purchasers should carefully review the Section 120(h) contractual covenants

made by the government regarding remediation that has been performed at the site and that the government warrants it will perform in the future. In light of the *Hercules* decision, the covenants should not be limited to contamination due to releases that occurred during the time the government owned the property. Instead, the covenants should broadly apply to any and all contamination that has been identified at the property at the time of the transfer. Remember that the government will try to draft the definition of "completion of remedial activities" to refer to the completion of the construction of the treatment system (e.g., installation of groundwater treatment wells) and not the attainment of cleanup levels. The purchaser should demand that the government commit to take whatever action is necessary to bring the contaminant concentrations down to acceptable cleanup levels.

Purchasers of surplus supplies should take the following steps to minimize their potential liability:

☐ Independently determine whether the materials are hazardous wastes and do not rely on any sales brochures or representations by the DRMS. The potential purchaser should request copies of MSDS, confirm whether the material contains Listed or Characteristic Hazardous Wastes, verify the expiration date of the material, and determine whether its intended use is different from the use by the government.

☐ Do not rely on acceptance by the DRMS of the statement of intent as evidence that the intended use of the materials is acceptable or will not result in the materials being reclassified as hazardous wastes. These forms are usually just placed into the file with nothing more than a cursory review. Similarly, do not assume that the government will use its contractual surveillance rights to prevent a use that will convert the materials into hazardous wastes, because the DOD generally fails to exercise its rights.

☐ Independently determine the applicable EPA or Department of Transportation requirements for handling, transporting, or storing the materials.

The conversion of military installations to civilian use may be crucial to many local economies and could prove to be sound investments to private developers. If prospective purchasers conduct appropriate environmental due diligence and carefully negotiate the covenants regarding the environmental conditions of the property, the environmental liabilities associated with these properties can be minimized. ■

Notes

1 42 USC §§ 9601 et seq.

2 For a more detailed discussion of the liability of prior owners or operators of contaminated property, refer to the Fall 1991 issue of *The Real Estate Finance Journal*.

3 Sunnen Prods. v. ChemTech Indus., Inc., 658 F. Supp. 276, 278 n.3 (N.D. Ala. 1987); Mardan Corp. v. C.G.C. Music, Ltd., 600 F. Supp. 1049 (D. Ariz. 1984); Violet v. Picillo, 648 F. Supp. 1283 (D.R.I. 1986); United States v. Mottolo, 605 F. Supp. 898, 909 (D.N.H. 1985).

4 United States v. South Carolina Recycling & Disposal, Inc., 653 F. Supp. 984 (D.S.C. 1984); United States v. Time Oil, No. 85-478TB (W.D. Wash. 1988); United States v. Monsanto, 858 F.2d 160 (4th Cir. 1988).

5 Washington v. Time Oil Co., 687 F. Supp. 529 (W.D. Wash. 1988).

6 EPA "Guidance on Landowner Liability under Section 107(a)(1) of CERCLA, De Minimis Settlements under Section 122(g)(1)(B) of CERCLA, and Settlements with Prospective Purchasers of Contaminated Property," June 6, 1989 at 15 [hereinafter EPA Landowner Guidance].

7 SARA Conference Committee Report at 187.

8 EPA Landowners Guidance at 11–12; SARA Conference Committee Report at 187.

9 42 USC § 9620(h)(1).

10 55 Fed. Reg. 14,208 (Apr. 16, 1990).

11 938 F.2d 276 (D.C. Cir. 1991).

12 Pub. L. No. 102-426, 106 Stat. 2175.

13 42 USC § 9620(h)(4)(A).

14 42 USC §§ 6901 et seq.

15 40 CFR § 261.20.