TAX BUYERS BEWARE: COURT FINDS CERCLA LIABILITY FOLLOWING TAX SALE

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The Ninth Circuit Court of Appeals recently ruled that California was entitled to pursue its costs for remediating contaminated property from a buyer in a tax sale who took title to the property long after the contamination had occurred. In *California Department of Toxic Substance Control v. Westside Delivery LLC*, [1] the court rejected the tax buyer's claims that it had no "contractual relationship" with the owner who caused the contamination and held that even involuntary transfers, mediated by a taxing district, are sufficient to create the contractual relationship necessary for liability under the Comprehensive Environmental Response Compensation and Liability Act ("CERCLA"). [2] While tax buyers have always been advised to perform some level of due diligence, this decision raises the stakes substantially.

CERCLA states explicitly that a person is not liable for contamination caused by a third party with whom the person has no contractual relationship. [3] Courts initially construed the third party defense broadly finding that current owners have contractual relationships with prior owners in the chain of title. In the 1986 amendments to CERCLA, Congress defined "contractual relationship" to create the "innocent purchaser" defense which allowed a buyer to show that it was not liable despite a contractual relationship with past owners provided it had no knowledge of the contamination despite performing due diligence before the purchase.

In those same amendments Congress also provided that public entities which took properties through any involuntary transfer or acquisition were not in a contractual relationship and therefore were not liable. As a result, the taxing entity is not liable when it takes property through a tax sale. At least one district court previously held that tax buyers were not liable because of the lack of a contractual relationship. [4]

In *Westside Delivery* the tax buyer took title to contaminated property through a tax sale. Prior to the sale, the state had investigated contamination on the property and identified a remedy. Despite the purchase, the state continued to remediate the property and then sued the tax buyer to recover its response costs. The lower court granted summary judgment to the buyer agreeing that it had no contractual relationship with the prior owner and, therefore that the buyer was entitled to the CERCLA third party defense.

The Ninth Circuit reversed, taking a much more expansive view of the definition of "contractual relationship." The court noted that such relationships could be direct or indirect and voluntary or involuntary. The court noted that CERCLA defined "contractual relationship" so that the plain meaning of those terms did not apply and that any state law characterization of the transaction was not relevant. The court held that it was sufficient that there was a transaction in which the property passed from the prior owner to the tax buyer. The court held that even if the transaction could be viewed as more attenuated due to the taxing body's involvement, there still was a transfer of title and that was sufficient to create the contractual relationship necessary to negate the third party defense to CERCLA liability.

The court's decision puts tax buyers in a difficult bind, especially in the Ninth Circuit. Tax buyers make money by collecting interest on redemption payments or by picking up good properties at a bargain. It is a low margin business which doesn't encourage due diligence. Often, it may not be legally possible for tax buyers to perform the required due diligence to avoid CERCLA liability because they have no right to enter a property until they buy it. Without that, they have no defense if the property turns out to be contaminated. On the other hand, in this case as in others, a cursory evaluation or records review or even site observation would have suggested a problem. If there is a problem, the tax buyer can decide whether further diligence is warranted and available, whether other options exist to address liability, or whether to walk away from the purchase. The bottom line is that a tax buyer needs to perform some level of environmental due diligence before taking title if it wants to try to avoid CERCLA liability.

Notes
[1] No. 16-56558, 2018 WL 1973715 (9th Cir. Apr. 27, 2018)
[2] 42 U.S.C. 9601 *et seq*.
[3] 42 U.S.C. 9607(b)(3)
[4] *Continental Title Co. v. Peoples Gas Light & Coke Co.*, No. 96 C 3257, 1999 WL 753993.| (N.D. Ill. Sept. 15, 1999).

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