COMMENTARY

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ENVIRONMENTAL LAW

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A Case Study in Valuing Contaminated Property

Last month, the Commonwealth Court decided a case that is worth some study for environmental lawyers about how to value contaminated property. *Appeal of Harley-Davidson Motor*, No. 159 C.D. 2013 (Pa. Commw. Ct. Oct. 30, 2013), is a tax case; worse, it's a property tax case. You may have burst into hives just thinking about a property tax case, but it raises issues worth thinking about in the context of environmental litigation and managing liabilities in transactions.

Harley-Davidson addresses the question of how to value contaminated property when responsible parties have entered into an agreement to complete the cleanup. The trial court accepted the opinion of one of the taxing jurisdictions—the school district—that the property value ought not to be reduced by the cost of cleanup, but instead by a percentage to reflect "stigma." The Commonwealth Court reversed and remanded.

Harley-Davidson owns a motorcycle manufacturing plant in Springettsbury Township, York County. The United States operated the York Naval Ordnance on the property until 1964. Harley-Davidson's predecessor made bomb casings on the property until 1980. Motorcycle manufacturing began in 1973.

The property is contaminated. Responsibility for that contamination gave rise to some litigation with which Superfund practitioners may be familiar. In *Harley-Davidson v. Minstar*, 41 F.3d 341 (7th Cir. 1994), cert. denied, 514 U.S. 1036 (1995), Judge Richard Posner held that under Section 107(e)(2) of the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), 42 U.S.C. § 9607(e)(2), private indemnification agreements could be enforced to defeat Harley-Davidson's contribution claim against other private parties.

Harley-Davidson and the United States entered into a settlement agreement in 1995 to allocate between them the costs of addressing the contamination. Ultimately, the site was the first enrolled in the Environmental Protection Agency's One Cleanup Program.

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The EPA announced the One Cleanup Program in 2003. The idea was to coordinate the different federal cleanup programs—hazardous substance response under CERCLA, hazardous waste remedial action under the Resource Conservation and Recovery Act, 42 U.S.C. §§ 6901-991i, and PCB cleanup under the Toxic Substances Control Act, 15 U.S.C. §§ 2601-97, for example—with state programs. A site with a contamination problem could then proceed under one of the programs and satisfy all of them, under certain conditions. It was an administrative elaboration on some of the authorities enacted in the 2002 CERCLA amendments. (See 42 U.S.C. § 9628.)

In the case of the York facility, Harley-Davidson was addressing the site through Pennsylvania's Land Recycling Program under the Land Recycling and Environmental Remediation Standards Act, 35 Pa. Stat. Ann. §§ 6926.101-.908, known as Act 2. Because Harley-Davidson had committed to implement the remedy and because it had a cost-sharing agreement with the United States, the school district argued that no buyer of the property from Harley-Davidson would have any liability for the environmental contamination. Therefore, reasoned the taxing authority, the environmental condition of the property does not really reduce its value.

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Valuing property presents conceptual difficulties, as can be seen in "The Art of Valuation," by James Cummings Bonbright, Arlo Woolery, James Walter Martin and Ronald B. Welch. In general, it is the amount that a willing buyer will pay a willing seller for the property. When the property is not changing hands, appraisers and courts often use three methods to value property: (1) comparable sales; (2) capitalized income; and (3) replacement cost. The General County Assessment Law recognizes those three methods, as can be seen in *Jackson v. Board of Assessment Appeals of Cumberland County*, 950 A.2d 1081 (Pa. Commw. Ct. 2008).

A liability associated with a property becomes a deduction from the value if clean. One way to think about the size of the liability properly deducted from value is to estimate the cost of cleaning up. The cost-to-cure contamination could be treated as the negative value of the contamination. That was the approach suggested by Harley-Davidson.

But in the specific case of Harley-Davidson's plant, any likely buyer would probably not have had to pay the full cost of the cleanup. Harley-Davidson and the United States had agreed to do the work. They would probably do so. Therefore, any likely purchaser could treat the property as if it did not carry with it any liability. Indeed, the school district pointed out that the Act 2 program allows for entry into a buyer-seller agreement among a seller, a purchaser and the Pennsylvania Department of Environmental Protection under which the purchaser would be insulated from enforcement actions to require a cleanup during the time that the seller complies with Act 2. Accordingly, one might say that should Harley-Davidson have marketed the property, it could have demanded the "clean" price for it.

Allowing no deduction for contamination seems wrong as well. Until the property is cleaned up, it is not clean. A commitment to clean up is not the same as performance under the commitment. Therefore, one might argue, no one would pay the full clean price for a property, even if someone else were obligated to clean it up. Moreover, the buyer-seller agreement is not perfect protection for the purchaser and entails some restrictions on the use of the property. Accordingly, it is not costless to the purchaser. The school district's appraiser in *Harley-Davidson* opined that a 5 percent reduction from the clean value of the property appropriately reflected the stigma associated with a contaminated property and took all of this into account.

Harley-Davidson sought a reduction for the full cost to cure. However, the trial judge took issue with the expert Harley-Davidson used because he had never managed an Act 2 cleanup to completion. That concern warrants a digression.

The expert had experience with CERCLA and other cleanups. By rejecting his expertise to value an Act 2 cleanup, the trial judge in effect held that Act 2 cleanups are so much less expensive than cleanups under other programs that an expert opinion based on experience in other programs necessarily overstates the cost of an Act 2 remediation.

That is a remarkable opinion, given that this cleanup was being done under the One Cleanup Program, and counts as a federal remediation. Either Act 2 is not really cleaning up or every other program really demands unnecessary expenditures. Maybe we already knew that, but here is a court saying so.

The trial court accepted the school district expert's 5 percent stigma reduction. The Commonwealth Court reversed. It held that the 5 percent reduction was based on no underlying evidence. There was no reason why the expert chose 5 percent rather than 10 percent or 20 percent. Accordingly, the Commonwealth Court remanded for reconsideration of the adjustment to the assessment for tax purposes. The Commonwealth Court was at pains to avoid directing the common pleas court to adopt a cost-to-cure reduction, but implied rather broadly that cost-to-cure was a way to approach the problem.

This case offers a specific instance of a general problem. If the value of contamination becomes an issue in a transaction or in litigation, one has to figure out whether the value is the net of others' contribution toward the work. In many cases, a person that acquires property may have others to pursue should it have to clean up. Prior owners or occupants of the property that caused the contamination may owe a share of the costs of clean up, or they may be protected by contract or by the doctrine of caveat emptor. Their obligations may have been established, such as in *Harley-Davidson*, or they may be entirely contingent. Does the (negative) value of contamination include all the contractual and noncontractual obligations to address it, or not?

One might argue that all of the other rights and obligations are not attached to the real estate, and therefore do not affect the value of the property. But unless contamination really affects one's ability to use a property, the liability associated with contamination has some of the same features. It is a conundrum that may have no neat solution. We may have to read tax cases to find out what the courts have to say. •