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Lessee Liability for Environmental Contamination

Can a lessee who has not engaged in any activities that could result in contamination of the leased site be responsible for cleaning up pre-existing contamination at the site? Under certain circumstances, the answer is yes.

Applicable Environmental Law

The issue of lessee liability for hazardous substance contamination generally arises under the Federal Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA").[1] First, by its terms CERCLA imposes liability upon a broader class of persons than most other environmental statutes. Second, and perhaps as a result of the first, the majority of litigated federal cases regarding environmental liability exposure arise under CERCLA. Third, as discussed below, CERCLA imposes liability for remediation of a "release" or "threat of a release" on current and certain former "owners" and "operators" of the property at the time of "disposal" of the hazardous substances.[2] The terms "owners" and "operators" are operative concepts under many other federal and state statutes, most of which have not themselves been litigated extensively.

Specifically, responsible parties are defined by CERCLA to be:

1. The current owner or operator of a site;
2. Any person who owned or operated the site when the disposal of hazardous substances occurred;
3. Any person who arranged for the treatment, disposal or transportation of a hazardous substance to the site from which the release has occurred or may occur; or
4. Any person who transported a hazardous substance to a site from which a release or threatened release occurs.

There is strict, joint and several liability among the responsible parties. This means that cleanup liability is imposed on "owners" and "operators" of contaminated property without regard to fault, whether or not they participated in the activity that caused the contamination, or the period during which the contamination occurred.

The liability of a lessor generally follows from its status as "owner" of the property. The issue is not as clear with respect to lessees. The central question is whether or not, by virtue of lease and sublease transactions, a lessee would likely be deemed an "owner" or "operator" of the site under CERCLA.

It is established that a lessee will be liable as an "operator" when it has generated or stored hazardous substances on the leased property during the term of its lease.[3] In *United States v. South Carolina Recycling & Disposition, Inc. ("SCRDI")*, owners of a four-acre site in South Carolina orally agreed to lease a portion of the site to a chemical company for storage of chemicals beginning in 1972. In 1973, the site was orally subleased to a waste brokering and recycling operation. The chemical company and South Carolina Recycling were held to be jointly and severally liable under CERCLA as operators. The court also added, however, that the chemical company, as lessee/sublessor, "essentially stood in the shoes of the property owners," and thus could be liable as an "owner of the property" (see discussion below).[4] In addition, if the lessee caused the contamination, the lessee will be liable even if the lease has ended.[5]

While it is settled that a lessee will be liable for the consequences of its own waste disposal practices, the threat of liability as a current "owner" or "operator", discussed below, is far more threatening because the lessee could be held liable for the acts of prior landlords or tenants.

Lessee Liability for Contamination Caused by Others: Operator Liability

There are few cases which address a lessee's responsibility as a current operator for contamination of a leasehold site when the contamination was caused by others. In *Nurad Inc. v. Wm. E. Hooper & Sons, Co., et al.*,[6] the Fourth Circuit Court of Appeals refused to impose liability on a lessee of a building for contamination adjacent to the building that occurred during the tenant's leasehold as a result of underground storage tanks built by the prior property owner. The court held that the lessee did not qualify as an "operator" since the lease was limited to the building's interiors and did not include the underground storage tanks. The court noted that liability extends to any person who operates a "facility" and that a person operates a facility only if it has authority to control the area where the hazardous substances are stored. While the tenants had access to the area where the tanks were located and had parking facilities in the vicinity of the tanks, the court concluded that access and proximity to the tanks were insufficient to support a finding of "operator" status under CERCLA.

Similarly, in *United States v. National Bank of Commonwealth*,[7] the district court held that a current lessee of one portion of a building was not liable for contamination remaining from previous operations in another portion of the same building. In that case, the previous owner had operated an electroplating plant on the property. The tenant leased a portion of a building on the site, eventually leasing the entire building. The tenant discovered drums of hazardous substances in the leased building that were ultimately removed by the owner. The court concluded that the tenant had not exercised sufficient control over the area to be considered an "operator." Thus, while the case law is not well developed, it appears that a lessee will not be liable for pre-existing contamination on the site unless the lessee somehow exacerbates the contamination or controls the facilities that caused the contamination.

In neither *Nurad* nor *National Bank* did the courts address (and perhaps the parties did not raise) the issue of "owner" liability (discussed below).

Lessee Liability as "Owner" of Leased Site with Pre-Existing Contamination: Exercise of Control Test

A more difficult question is whether a lessee can be held liable as a current "owner" for pre-existing contamination discovered on a leased site where the lessee would not be considered an operator. The issue of the CERCLA liability of a lessee who does not have actual possession of the leased contaminated property (and who, by virtue of being a lessee, also does not have title thereto) has not been extensively litigated. The few CERCLA cases that have addressed the issue have been in the context of (1) a lessee who has subleased the property and does not have actual possession of the site and (2) a sale-leaseback transaction pursuant to which the master lessee retained responsibility for sub-lease arrangements. Such cases do not yield a clear standard of liability; the most consistent standard to be derived from these few cases appears to be that even when a lessee/sublessor is not actually operating the contaminated property, the lessee/sublessor can be held liable under CERCLA as an "owner" if the lessee/sublessor exercises a degree of control over the property that would allow conferring ownership status on the lessee/sublessor.[8]

In *SCRDI*, the court stated in relevant part that, as a general rule, a sublessor who allows property under his control to be used by another (*e.g.*, the sublessee) in a manner that endangers third parties or that creates a nuisance is, along with the sublessee, liable for the harm.[9] While this may appear to be a broad standard, the facts of *SCRDI* may be distinguishable insofar as the *SCRDI* court also determined that the lessee/sublessor was an "operator" of the contaminated property. This conclusion was based on a finding that, while the sublessee was the party actually engaging in hazardous waste handling and disposal activities at the property (and thus contaminating it), one of the sublessee's officers was an employee of the sublessor and had apparent authority to act on behalf of the sublessor. In addition, the sublessor was a

joint venturer with the sublessee in the hazardous waste handling activities at the property.[10]

In *United States v. A & N Cleaners & Launderers, Inc. ("A & N")*, the defendants owned a commercial strip mall in Putnam County, New York. A & N Cleaners & Launderers operated a dry cleaning facility on the site pursuant to a sublease with the defendants' sole lessee, Marine Midland Bank. Improper disposal practices by A & N Cleaners & Launderers eventually contaminated nearby wells. The EPA incurred $3 million in cleanup costs. It was uncontroverted that the defendants were not involved in any contaminating activities. In holding Marine Midland Bank, the lessee/sublessor, liable under CERCLA, the court was persuaded by the fact that the lessee/sublessor had substantial control over the contaminated property so as to place it essentially in the shoes of the property owner. Specifically, the sublease gave the sublessor the right to sublet all or part of the property and to evict tenants, and the sublessor was not obligated to notify the landlord/owner of such events; the sublessor had the discretion to determine the use of the property by its sublessees; the sublessor had the authority to collect all rents from existing sublessees and to enforce all obligations; the sublessor was obligated to keep the entire premises in good condition and repair at all times, and to comply with all governmental rules and regulations for the correction, prevention and abatement of nuisances, and in fact exercised such responsibilities; and both the landlord/owner and the sublessees looked to the sublessor as the party exercising control over the use and maintenance of the property. Thus, the court concluded that the sublessor enjoyed the rights and bore the obligations of an "owner" as the term is commonly understood.[11]

In a recent California decision, *Nestle USA Beverage Division, Inc. v. Overmyer* ("*Nestle*"),[12] the court found the master lessee in a sale and leaseback transaction liable for cleanup costs as an "owner" under CERCLA. Overmyer sold a warehouse property to David B. Levine and then leased it back from him as master lessee. Under the lease agreement with Levine, Overmyer retained full responsibility for executing sub-lease agreements and for the operation, replacement, maintenance and management of the property. Overmyer had to obtain Levine's consent for alterations and repairs costing more $50,000 and Levine had the right to inspect improvements. A portion of the property was leased by a coffee company that constructed a freeze-drying system. Soil and groundwater contamination caused by chemicals used in the freeze-drying system was discovered in 1989. Nestle, the predecessor-in-interest to the coffee company, sought contribution from Overmyer and argued that Overmyer was an operator of the site; Overmyer argued that its lack of involvement in the contamination activity prevented it from being an operator. The court concluded that Overmyer played no part in the day-to-day management and, therefore, could not be deemed an operator under CERCLA. Nestle also argued that, as a master lessee, Overmyer "stood in the shoes of the owner" and thus should be considered an owner for purposes of CERCLA liability. Overmyer appeared to have the advantages of ownership without the investment of capital. The lease with the coffee company was for twenty years and Overmyer paid the taxes, insurance and operation and maintenance costs. According to the court, "[t]hese provisions so change the nature of the landlord-tenant relationship that Overmyer must be considered the owner for purposes of CERCLA."

Conclusion

From these cases, it appears that a tenant who leases a site will not be liable as an "operator" in connection with contamination existing at the site unless the lessee exercises control over or responsibility for the contaminated area or contaminating processes, such as operating underground storage tanks that result in releases. In addition, it is unlikely that a tenant would be considered liable as an "owner" of the site if the lessee exercises only those rights customarily attributable to a lessee. If the lessee decides to sublease the premises, however, a court may characterize the lessee as a current owner of the site and impose liability under CERCLA. In light of these decisions, it seems prudent for lessees to undertake the level of environmental due diligence currently regarded as customary for purchasers of real property.

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[1] 42 U.S.C. §§ 9607 *et seq.* Other potential sources of liability include the Resource Conservation and Recovery Act, 42 U.S.C. §§ 6901 *et seq.*, and applicable state law.

[2] 42 U.S.C. § 9607(a).

[3] *United States v. South Carolina Recycling & Disposal, Inc.*, 653 F. Supp. 984 (D.S.C. 1986), *aff'd*, 858 F.2d 160 (4th Cir. 1988), *cert. denied*, 490 U.S. 1106 (1989).

[4] *Id.* at 1003. See also *Weyerhaeuser Co. v. Koppers Co.*, 771 F. Supp. 1420 (D. Md. 1991) (lessee who operated wood treatment plant liable for 60% of cleanup costs).

[5] *Caldwell v. Gurley Refining Co.*, 755 F. 2d 645, 651-52 (8th Cir. 1985).

[6] 966 F.2d 837 (4th Cir. 1992).

[7] 1990 U.S. Dist. LEXIS 18925 (W.D. Pa. Apr. 23, 1990) .

[8] *South Carolina Recycling & Disposal, Inc.*, 653 F. Supp. at 987; *United States v. A & N Cleaners & Launderers, Inc.*, 788 F. Supp. 1317, 1332-33 (S.D.N.Y. 1992).

[9] 653 F. Supp. at 1003.

[10] 653 F. Supp. at 1003-05.

[11] 788 F. Supp. at 1333-34.

[12] 1998 WL 321450 (N.D. Cal.) (Mar. 27, 1998) (not reported in F. Supp.).

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired. For more information, please contact Margaret Murphy or Mehran Massih of this Firm at (212) 848-4000.

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