Public Land and Resources Law Review

Volume 0 *Case Summaries 2018-2019*

California Department of Toxic Substances Control v. Westside Delivery, LLC

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California Department of Toxic Substances Control v. Westside Delivery, LLC, 888 F.3d 1085 (9th Cir. 2018)

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The Ninth Circuit's recent decision in *California Department of Toxic Substances Control v. Westside Delivery, LLC* reminds prospective purchasers of tax-defaulted property of their responsibility for due diligence. The case addressed the reach of the third-party defense to a CERCLA cost recovery action. The court determined that CERCLA's third-party defense did not apply to a company which purchased a contaminated property at a tax auction because of its "contractual relationship" with the former owner-polluter and because the relevant contaminating acts occurred "in connection with" the prior polluter's ownership of the site.

I. INTRODUCTION

The primary issue in *California Department of Toxic Substances Control v. Westside Delivery, LLC*[1] was one of first impression for the United States Court of Appeals for the Ninth Circuit—whether the Comprehensive Environmental Response, Compensation, and Liability Act's ("CERCLA") third-party defense extends to a tax-sale purchaser of a contaminated property.[2] Specifically, the court sought to determine whether, under CERCLA, a tax-sale purchaser of a contaminated site had a "contractual relationship" with the prior owner-contaminator and, if so, whether the pollution at issue in the litigation occurred "in connection with [their] contractual relationship."[3] For its analysis, the court emphasized CERCLA federal law, not state law, would control.[4] The court ascertained that Congress intended to treat tax-sale purchasers the same as ordinary purchasers when the CERCLA-related Superfund Amendments and Reauthorization Act ("SARA") was enacted.[5] Moreover, the court held Westside Delivery, LLC ("Westside"), the tax-sale purchaser of the contaminated site, had a contractual relationship with that property's prior owner, as that term is defined in CERCLA.[6] Finally, the court concluded that the prior owner's contaminating acts—its release of hazardous substances while owning the property—occurred in connection to its contractual relationship with Westside.[7]

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1. 888 F.3d 1085 (9th Cir. 2018).
2. *Id.* at 1088.
3. *Id.* (quoting 42 U.S.C. § 9607(b)(3) (2018)) (discussing the third of CERLA's three affirmative defenses to liability).
4. *Id.* at 1093–1094.
5. *Id.* at 1091–1092, 1098; *see also* Pub. L. No. 99-499, 100 Stat. 1613 (1986).
6. *Id.* at 1091–1092.
7. *Id.* at 1101.

II. FACTUAL AND PROCEDURAL BACKGROUND

The Davis Chemical Company ("Davis") owned a facility ("Site") in Los Angeles where it recycled used solvents from 1949 to 1990.[8] The California Department of Toxic Substances Control ("DTSC") ordered Davis to stop all hazardous-waste-related activities in October 1990.[9] Two years later, the United States Environmental Protection Agency ("EPA") recommended that DTSC investigate and remediate the Site.[10] DTSC then identified former Davis customers as potentially responsible parties ("PRPs") that might be liable for remediation costs pursuant to CERCLA, but never successfully implemented a remediation agreement.[11] During DTSC's efforts to locate other PRPs to bear remediation costs, the Los Angeles County Tax Collector held a tax auction in August 2009 because Davis had failed to pay the Site's property taxes.[12] Westside submitted the highest bid for the Site and received a tax deed in September 2009.[13] Importantly, the tax auction materials advised bidders that they bore the responsibility to investigate the Site, notwithstanding the site's absence from a "not exhaustive" list of "Potentially Contaminated Parcels" included in those auction materials.[14] Subsequent to 2009, Westside did not conduct any operations at the Site.[15]

Meanwhile, from 2010 to 2015, DTSC remediated the Site and later brought a cost recovery action against Westside under CERCLA.[16] In turn, Westside asserted CERCLA's third-party defense, which shields a party from liability if it can demonstrate that the damages from a release or threat of release of hazardous substances were caused solely by an actor other than "one whose act or omission *occurs in connection with a contractual relationship*, existing *directly or indirectly*, with the defendant."[17] Westside argued that the third-party defense precluded it from liability because other third parties, including Davis, caused the Site's contamination and because Westside did not enter a contractual relationship with those third parties under CERCLA.[18] The district court agreed and awarded Westside summary judgment, after which DTSC appealed to the Ninth Circuit.[19] The Ninth Circuit reversed that district

8. *Id.* at 1089.
9. *Id.*
10. *Id.* (A group of environmental consultants also completed a study in 1996 which found that the Site's soil possessed several hazardous substances at elevated levels.).
11. *Id.*
12. *Id.*
13. *Id.*
14. *Id.*
15. *Id.*
16 *Id.*
17. *Id.* at 1089–1091 (citing 42 U.S.C. § 9607(b)(3)) (emphasis added).
18. *Id.* at 1089–1090.
19. *Id.* at 1090.

court ruling and remanded the case to determine the extent of Westside's liability and its related required contribution toward cleanup costs.[20]

III. ANALYSIS

To analyze the two principle issues in this case—whether the tax deed created a contractual relationship as interpreted by CERCLA, and whether the relevant contamination occurred in connection with that contractual relationship[21]—the court discussed both CERCLA and connected laws, including the clarifying SARA amendments, their related defenses and definitions, and the California tax-sale structure.[22]

A. CERCLA & SARA

CERCLA, a strict liability statute, was enacted "in response to the serious environmental and health risks posed by industrial pollution."[23] Relevant to this action, CERCLA's framework permits a state to recover its costs of responding to a "release" or "threatened release" of hazardous substances from a site's owner, even if the owner did not place the substances at the site.[24] The critical element requires the defendant-owner to have owned the site at the time when the state responded.[25] The court conducted a thorough examination of the term contractual relationship in the 1986 SARA, a statute "aimed at speeding cleanup and forcing quicker action by the EPA."[26] SARA included the "innocent-landowner defense" as a new type of third-party defense and gave definition to the formerly undefined term "contractual relationship."[27] The statute provides, in relevant part, that "[t]he term 'contractual relationship' includes, *but is not limited to*, land contracts, deeds . . . or other instruments transferring title

20. *Id.* at 1088–1089.
21 *Id.* at 1088.
22. *Id.* at 1092–1093 (citing Carloss v. County of Alameda, 194 Cal. Rptr. 3d 784, 791, 794 (Cal. Ct. App. 2015) (discussing California's tax-sale system for context with the contractual relationship analysis); CAL. REV. & TAX. CODE §§ 126, 3436, 3691(a)(1)(A) (In California, the tax collector must attempt to sell a tax-defaulted property at an auction directly to a private party.)).
23. *Id.* at 1090 (quoting Burlington N. & Santa Fe Ry. Co. v. United States, 556 U.S. 599, 602 (2009)); *see also* Marsh v. Rosenbloom, 499 F.3d 165, 178 (2d Cir. 2007) (also discussing CERCLA, at 42 U.S.C. § 9601(9)(b), as reactionary in that it "'looks backward in time and imposes wide-ranging liability' on parties who are in some way responsible for contaminating a facility").
24. *Id.* at 1090 (citing Chubb Custom Ins. Co. v. Space Sys./Loral, Inc., 710 F.3d 946, 956–957 (9th Cir. 2013)).
25. *Id.* (citing California Dep't of Toxic Substances Control v. Hearthside Residential Corp., 613 F.3d 910, 911 (9th Cir. 2010)).
26. *Id.* at 1091 (quoting Carson Harbor Vill., Ltd. V. Unocal Corp., 270 F.3d 863, 887 (9th Cir. 2001)).
27. *Id.*

or possession."[28] The innocent-landowner defense applies only when a private, nongovernmental purchaser did not have actual or constructive knowledge of contamination at the time of purchase, or when the facility was acquired by inheritance.[29] The court recognized that SARA "clarified" that a third party can include prior owners whose acts or omissions occurred in the past.[30] The court reasoned that "a defendant landowner has a contractual relationship with all previous landowners—or, at least all previous landowners in the chain of title—unless the defendant-landowner can qualify for the innocent-landowner defense."[31]

Additionally, the court addressed the role of state law in the analysis of whether a contractual relationship existed between Davis and Westside.[32] The court found no "plain indication"[33] that Congress intended that state law should be used to interpret whether an instrument or transaction creates a contractual relationship under SARA.[34] Accordingly, the court used the federal CERCLA statutes to ascertain whether the transactions related to Davis's and Westside's property interests amounted to a contractual relationship.[35]

B. Contractual Relationship

The court then analyzed Westside's tax-sale purchase through two lenses, both of which led to the same conclusion: a contractual relationship existed between Westside and Davis.[36] Because a tax sale could be viewed as either a single or two transactions—one between the government and the defaulting landowner and another between the government and the subsequent purchaser receiving a new title—the court clarified that under California's tax sale structure, the government never acquires a possessory interest in tax-defaulted property sold at an auction to a private party.[37]

To begin, the court assessed the relationship between Westside and Davis under a single transaction view.[38] The court determined that the definition of "contractual relationship" should be broadly construed.[39] The

28. *Id.* at 1091–1092 (citing 42 U.S.C. § 9607(b)(3)) (emphasis added).
29. *Id.* at 1092 (citing 42 U.S.C. § 9601(35)(A)).
30. *Id.* (citing *Carson Harbor Vill.*, 270 F.3d at 887).
31. *Id.* (citing Buffalo Marine Servs. Inc. v. United States, 663 F.3d 750, 755, 758 (5th Cir. 2011) (referring to the Oil Pollution Act); United States v. CDMG Realty Co., 96 F.3d 706, 716 (3d Cir. 1996)).
32. *Id.*
33. *Id.* (citing Mississippi Band of Choctaw Indians v. Holyfield, 490 U.S. 30, 43 (1989)).
34. *Id.*
35. *Id.* at 1094.
36. *Id.*
37. *Id.*
38. *Id.* at 1095.
39. *Id.* (citing San Luis & Delta-Mendota Water Auth. v. Haugrud, 848 F.3d 1216, 1229 (9th Cir. 2017) (The contractual relationship definition "contains both an 'includes, but is not limited to' clause and a 'catch-all' clause." (internal citation omitted)).

court looked at use of the phrase "other involuntary transfer" under the definition of "contractual relationship" and found that it necessarily implies that a contractual relationship can exist even where property is transferred without both parties' consent, such as a tax sale.[40] Because the tax deed divested Davis's interest in the Site and vested Westside with the right to possession, the property was transferred, albeit involuntarily, through a tax collector; the court found that this involuntary transfer fit within the accepted and broad "contractual relationship" definition.[41]

Next, the court concluded that a contractual relationship existed even if the tax sale was construed as two transactions.[42] While the relationship between the state and Westside was clearly a direct contractual relationship, the court looked to the innocent-landowner defense again to clarify that a contractual relationship also existed between Davis and the state.[43] Because that exception only applies if the defendant is a government entity, the court found that the state's acquisition of tax-delinquent property constituted an involuntary transfer.[44]

Ultimately and through a comprehensive view of CERCLA, the court determined that Congress, by narrowly construing the innocent-landowner defense and broadly defining "contractual relationship," did not mean for CERCLA to apply to tax sale purchasers differently from others.[45] Rather, the court concluded that Congress intended the innocent-landowner defense to be the *sole* defense for private buyers of land contaminated by previous owners, quoting the EPA's own statement that "'there is no authority anywhere in CERCLA that would support the laundering of liability' through a mechanism such as a tax sale."[46]

Accordingly, the court held that Westside, the tax-sale purchaser, had a contractual relationship with Davis, the pre-tax-sale owner, with regard to the Site's transfer.[47] In doing so, the court rejected Westside's three arguments that it had no relationship of any kind with Davis, that the tax sale broke the chain of title, and that extending "contractual relationship" to include a tax sale would render the third-party defense

40. *Id.* (referencing 42 U.S.C. § 8601(35)(A); Penn Terra Ltd. V. Dep't of Envtl. Res., 733 F.2d 267, 272 (3d Cir. 1984)).
41. *Id.* (citing 42 U.S.C. § 9601(35)(A)).
42. *Id.* at 1095–1096.
43. *Id.* at 1096.
44. *Id.* (construing 42 U.S.C. 9601(35)(A)(ii)) (comparing 42 U.S.C. § 9601(20)(D) and 40 C.F.R. § 300.1105(a)).
45. *Id.* at 1097 (citing FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 133 (2000) ("goal when construing complex regulatory statute is to 'interpret the statute as a symmetrical and coherent regulatory scheme and fit, if possible, all parts into an harmonious whole'"); *Carson Harbor Vill*., 270 F.3d at 880, 883 (Through the contractual relationship definition, Congress added the innocent-landowner defense, intending narrow applicability for fear of abuse.).
46. *Id.* at 1098 (citing National Oil and Hazardous Substances Pollution Contingency Plan; Lender Liability under CERCLA, 57 Fed. Reg. 18,344, 18,372–18,373) (Apr. 29, 1992)).
47. *Id.* at 1100.

meaningless.[48] The court stated that, because Congress explicitly defined "contractual relationship," its definition controlled.[49] Further, the court reiterated that state law did not govern, and thus, the chain of title argument was moot because it already found an indirect contractual relationship through the involuntary tax-sale transfer.[50] Finally, the court clarified that the "traditional" CERCLA third-party defense applies where the property was previously contaminated, but only by "true" third parties like vandals or midnight dumpers, or was contaminated "*after* the defendant acquired the property."[51]

C. In Connection With

Westside argued that Davis's acts and omissions which contaminated the Site did not occur "in connection with a contractual relationship, existing directly or indirectly, with the defendant," entitling it to CERCLA's third-party defense.[52] The court found Westside's narrow interpretation of "in connection with" incompatible with Congress's intent for the innocent-landowner defense; such a reading would allow nearly every defendant to escape liability by claiming that the real-estate contract or deed did not "relate to . . . hazardous substances."[53] Instead, the court determined that where a defendant-landowner raises a liability defense due to a previous owner or possessor's acts or omissions, the "in connection with" requirement is intended only to limit liability transfer where the "previous owner's polluting acts or omissions were *unrelated to its status as a landowner*."[54] Because the court found that Davis released hazardous pollutants as owner of the Site, it determined, those acts occurred "'in connection with' its contractual relationship with [Westside]."[55]

IV. CONCLUSION

The decision in *California Department of Toxic Substances Control v. Westside Delivery, LLC* means CERCLA's third-party defense will rarely apply to tax-sale real estate buyers attempting to assert that defense in response to a cost recovery action, at least those under Ninth Circuit jurisdiction. Precedent now limits that defense while establishing the constructive notice requirement is easily satisfied. Though extensive due diligence is usually difficult to conduct in a tax auction setting given their rapid-fire nature, the ruling nevertheless reminds buyers of both their environmental responsibilities and their responsibility to investigate.

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48. *Id.* at 1099.
49. *Id.*
50. *Id.*
51. *Id.* (emphasis in original).
52. *Id.* at 1099–1100 (citing 42 U.S.C. § 9607(b)(3) (Court raising a limiting principle because "connections" are indeterminate).
53. *Id.*
54. *Id.* at 1101 (emphasis added).
55. *Id.*