UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

OFFICE OF
ENFORCEMENT AND
COMPLIANCE ASSURANCE

April 19, 2004

MEMORANDUM

Subject: Transmittal of "Institutional Controls: Third-Party Beneficiary Rights in Proprietary Controls"

From: Susan E. Bromm, Director /s/
Office of Site Remediation Enforcement

To: Director, Office of Environmental Stewardship, Region I
Director, Environmental Accountability Division, Region IV
Regional Counsel, Regions II, III, V, VI, VII, IX, and X
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The purpose of this memorandum is to distribute the attached document entitled, "Institutional Controls: Third-Party Beneficiary Rights in Proprietary Controls." This document was drafted with assistance from the EPA Regions and cleanup program offices through the National Institutional Controls Enforcement Policy Workgroup. The document provides information, primarily for EPA attorneys, on designating third-party beneficiaries in proprietary institutional controls to ensure more effective controls by affording an additional means of enforcement.

The attached document focuses on the narrow subject of third-party beneficiary rights and should be viewed as a supplement to EPA's more comprehensive guidance on institutional controls. For a more detailed discussion related to proprietary controls and other institutional controls, please see "Institutional Controls: A Guide to Identifying, Evaluating, and Selecting Institutional Controls at Superfund and RCRA Corrective Action Cleanups" OSWER 9355.0-74FS-P (2000); and, the forthcoming document entitled, "Institutional Controls: A Guide to Implementing, Monitoring, and Enforcing Institutional Controls at Superfund, Brownfields, Federal Facility, UST, and RCRA Corrective Action Cleanups" (www.epa.gov/superfund/action/ic).

For your reference, I have also attached a list of participants on the National Institutional Controls Enforcement Policy Workgroup, including the Regional IC Legal Coordinators that you designated in October 2003. I appreciate their hard work on this document. We look forward to our continued work with this workgroup to improve our use of institutional controls and hope they serve as a valuable resource to the Regions.

If you have questions or comments please contact me; K.C. Schefski at (202)564-8213, schefski.kenneth@epa.gov; or, Melissa Franolich at (202)564-6300, franolich.melissa@epa.gov.

Attachments

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Institutional Controls:
Third-Party Beneficiary Rights in Proprietary Controls

I. Purpose

To minimize the potential for human exposure to contamination and protect the integrity of engineered remedies, EPA uses institutional controls (ICs) to restrict the use of properties not suitable for unrestricted use and unlimited exposure.[1] Proprietary controls represent one category of ICs used by EPA. Generally, proprietary controls will take the form of easements or real covenants – referred to collectively as servitudes. State law governs the use of servitudes. Typically a servitude involves the granting of an interest in real property from one party (grantor) to another party (grantee) through a written agreement, which is then recorded in the local land records. For example a property owner (grantor) may agree to restrict the drilling of groundwater wells on its property and grant the right to enforce this restriction to another party (grantee – sometimes also referred to as a "holder").

If a proprietary control involves the granting of a property interest, EPA may be limited in its ability to accept that interest and to enforce the institutional control, because EPA must have the statutory authority to acquire an interest in real property. For cleanups under the Resource Conservation and Recovery Act (RCRA), EPA does not explicitly have this authority. For cleanups under the Comprehensive Environmental Response, Compensation, and Liability Act (Superfund or CERCLA), EPA does have the authority to acquire an interest in real property; however, that authority is limited.

The purpose of this guidance is to explain an approach the EPA Regions should consider at both Superfund and RCRA Corrective Action cleanups that will allow EPA to maintain the right to enforce a proprietary control when it is determined that EPA will not be the grantee of a property interest. The Regions may accomplish this goal by designating EPA as a third-party beneficiary in a proprietary control agreement. The Regions may use this approach under any circumstance where EPA enforcement may help ensure the reliability of the control. Part II of this document briefly explains limitations on property acquisition by the United States under CERCLA and RCRA. Part III then explores the use of third-party beneficiary rights to provide

[1] *See A Site Managers Guide to Identifying, Evaluating, and Selecting Institutional Controls at Superfund and RCRA Corrective Action Cleanups*, OSWER 9335.0-74FS-P (2000) (hereinafter Identifying, Evaluating, and Selecting ICs).

for EPA enforcement authority.[2]

This document provides guidance exclusively to employees of the U.S. Government. This document does not create any legally binding requirements, does not substitute for EPA's statutes and regulations, and interested parties are free to raise questions and objections about the appropriateness of the application of this guidance to a particular situation. EPA may change this guidance in the future.

II. CERCLA § 104(j) Authority and Requirements

Pursuant to § 104(j)(1) of CERCLA, EPA may, in its discretion, acquire real property or interests in real property needed to conduct a remedial action. EPA may acquire such interests through "lease, purchase, condemnation, or otherwise." However, prior to acquisition, EPA must obtain an assurance from the State in which the property is located that the State will accept transfer of the real property interest following completion of the remedial action.

A State assurance must be secured prior to EPA's acquisition of an interest in real property and, pursuant to the National Contingency Plan (NCP), must be by contract, cooperative agreement, or otherwise. 40 C.F.R. § 300.510(f). Unlike other assurances EPA must obtain from the State (e.g., operation and maintenance (O&M) assurances under § 104(c)), section 104(j)(2) applies to both Fund and Enforcement-lead cleanups. Therefore, any time EPA seeks to acquire an interest in real property under CERCLA, the Agency must first obtain the necessary assurance from the State. If the State or other entity agrees to directly acquire the interest in real property, without EPA as an intermediate grantee, the § 104(j) requirements are not relevant.

EPA generally will not hold an interest in real property past completion of the remedial action. For purposes of §104(j), the NCP designates completion of the remedial action as the point at which O&M measures would be initiated pursuant to § 300.435(f) of the NCP. Typically, the State will be the most appropriate entity to accept transfer of an interest from EPA, particularly at Fund-lead sites where the State must also provide assurances that any ICs selected are in place, reliable, and will remain in place after the initiation of O&M. 40 C.F.R. § 300.510(c)(1). Additionally, at certain sites, EPA and a State may determine that a local government is best suited to take the property interest. Under § 104(j)(3), a Federal, State or local government accepting the transfer of an interest in real property does not incur CERCLA liability by acquiring an interest pursuant to § 104(j).

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[2] This guidance focuses on the use of the third-party beneficiary approach in conjunction with a proprietary control. For a more in depth discussion of implementing, monitoring, and enforcing proprietary controls, and other ICs, please see the forthcoming EPA guidance entitled, *Implementing, Monitoring, and Enforcing Institutional Controls at Superfund, Brownfields, Federal Facility, UST, and RCRA Corrective Action Cleanups* (expected release in 2004) (hereinafter Implementing, Monitoring, and Enforcing ICs).

There is no equivalent RCRA authority to that of CERCLA § 104(j). Therefore, if EPA provides oversight or is otherwise involved in a non-CERCLA cleanup, EPA is not expressly authorized to acquire real property. However, the State may have such authority under State law.

III. Third-Party Beneficiary Rights

Although EPA generally will not retain title to an interest in real property past completion of the remedial action under CERCLA, and has no explicit authority to hold a property interest under RCRA, in many States EPA may still be able to enforce an easement or covenant as a third-party beneficiary. This means that another party, such as the State, would serve as the grantee, while the easement or covenant would specifically provide third-party beneficiary rights of enforcement to EPA.

The third-party beneficiary doctrine is most often associated with the law of contracts. However, an increasing number of State courts and in some cases State legislatures have applied the concept to servitudes.[3] This recognition is consistent with the general trend of dispensing with antiquated legal principles of real property transactions and instead focusing on the intent of the parties to the agreement. As evidence of this increased acceptance, the Restatement (Third) of the Law of Property has adopted the third-party beneficiary doctrine and states that the benefits of a servitude may be "held by many different holders in different capacities, concurrently and successively. . .the parties to a transaction creating a servitude may freely create benefits in third parties, whether the servitude is a covenant, easement, or profit." Restatement Third of Property (Servitudes), § 2.6, cmt. c-e (2000).

The following section provides information on important considerations regarding the use of proprietary controls and designating EPA as a third-party beneficiary. The Regions should take these considerations into account prior to making a decision whether to use a proprietary control and the third-party beneficiary approach. Once the Regions decide to designate EPA as a third-party beneficiary to a proprietary control, the Region can memorialize this designation by adding an additional clause to the proprietary control agreement. For drafting assistance please contact the Office of General Counsel (OGC) and the Office of Site Remediation Enforcement (OSRE).

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[3] *See e.g.*, Wisc. Stat. § 236.293. Some States have enacted legislation that specifically creates covenants for use in conjunction with cleanups, which provide for third-party beneficiary enforcement rights. *See e.g.*, Colo. Rev. Stat. § 25-15-319(I)(f). Laws such as Colorado's may become more prevalent with the recent drafting of a Uniform Environmental Covenants Act, which also provides for enforcement by entities other than the grantee. *See* www.law.upenn.edu/bll/ulc/ueca/2003final.htm.

A. Identify a Grantee

The first step the Region should take when considering the use of a proprietary control is to identify an appropriate and viable grantee – this step should be taken prior to remedy selection.[4] EPA cannot serve as a third-party beneficiary unless there is a grantee. As noted, at Fund-lead sites addressed under CERCLA this will most often be the State. The State may also serve as the grantee at an Enforcement-lead site and at RCRA sites undergoing corrective action. However, in some circumstances a State may be unwilling or unable to serve as a grantee. For example, the State may lack the necessary resources to effectively monitor and enforce the control or the State environmental agency may not have the legal authority to hold an interest in real property. At a Fund-lead site this would usually require selecting a remedy that does not rely on a proprietary control, because the State would be unable to provide an adequate assurance that the IC will remain in place during O&M, as required by the NCP.[5] 40 C.F.R. § 300.515(c)(1). At Enforcement-lead and RCRA corrective action sites where the State cannot or will not serve as a grantee, the most likely grantee would be a viable responsible party.

Regions may also consider entities other than the State or a responsible party. Alternative grantees should have both an adequate interest in ensuring the effectiveness of the IC and the financial and organizational capabilities to monitor and enforce the proprietary control as long as the control is needed. Alternative grantees would include entities with sufficient interests in ensuring the long-term protectiveness of the remedy, including, local governments or certain nonprofit organizations. In the event that a current owner intends to sell the property, the conveyance by deed may also include the owner/seller retaining a reserved interest in the property in order to implement a proprietary control.[6]

Grantees and third-party beneficiaries typically have different rights and responsibilities. Generally, as a third-party beneficiary EPA will simply gain the right to enforce the proprietary control and nothing more. A grantee, as the recipient of an interest in the property, will usually have additional rights and responsibilities with respect to the property, either expressly provided in the agreement or as a matter of State law. For example, a grantee may also secure rights of

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[4] For additional guidance on using proprietary controls see *Identifying, Evaluating, and Selecting ICs, supra* note 1*;* and, the forthcoming document on *Implementing, Monitoring, and Enforcing ICs, supra* note 3.

[5] The Region should strive to identify potential grantees and any limitations on a potential grantee's willingness or ability to serve in that capacity prior to remedy selection (i.e., during the RI/FS for CERCLA cleanups and the RFI/CMS for RCRA cleanups). Since the Region may not know at the time of remedy selection whether the response will be Fund or Enforcement-lead, several viable grantees should generally be identified.

[6] If the Region cannot identify a financially viable and otherwise appropriate grantee, a proprietary control will usually not be an effective IC and a remedy that does not require a proprietary control should generally be selected.

access for monitoring and inspecting compliance with the IC – access rights provided for in a covenant or easement usually constitute an interest in real property. As a matter of real estate law, the grantee may also be the party responsible for initially recording the document in the appropriate local recorders office, responding to notices of foreclosure, and future re-recordings of the agreement to comply with a marketable title statute.

The Region should work with a grantee to identify each party's roles and responsibilities, both pursuant to the covenant and in general, to monitor, maintain, and enforce any ICs. These roles and responsibilities may then be documented through an IC implementation plan produced during the remedial design phase. For example, while a grantee may take on the primary enforcement and monitoring roles pursuant to a proprietary control, EPA will also conduct five-year reviews and may undertake more frequent monitoring as necessary. Understanding these roles and responsibilities will result in a more effective IC.

B. Legal Research

With respect to the potential designation of EPA as a third-party beneficiary, the site attorney should conduct some general research on the law of the State where the property is located. This research should be done during the planning stages of the response action and focus on the following two questions: 1) whether the State has recognized the applicability of third-party beneficiary doctrine to traditional real estate instruments, either through judicial opinion or State legislation; and 2) whether State law indicates whether a third-party beneficiary interest is or is not an interest in real property.

The lack of a clear answer to the first question will not necessarily preclude the Region from naming EPA or another entity as a third-party beneficiary to a proprietary control. Generally, unless the site attorney discovers a recent opinion or statute that explicitly rejects the doctrine, the Region should utilize this approach to provide an additional layer of authority to ensure compliance with an institutional control. However, the lack of definitive support should be used to assess the long-term reliability of the control. If research does not reveal direct support for this approach, the Region should not place a great deal of reliance on EPA's authority to enforce the restrictions.

If a State court or statute indicates that a third-party beneficiary interest is an interest in real property, then the Region should consider the limitations set forth in CERCLA § 104(j) and consult with OGC and OSRE. While State law is not the only consideration, if EPA determines that 104(j) does apply, this may preclude the benefits of EPA acting as a third-party beneficiary. Generally, because this doctrine evolved from the law of contracts third–party beneficiary rights typically do not constitute interests in real property. A factor a court might consider in relation to this issue is whether EPA's third-party beneficiary rights differ from those of the grantee. Therefore, the Regions should generally limit EPA's third-party beneficiary authorities to enforcement rights and the right to approve and termination or modification of the document.

Importantly, even if a third-party beneficiary right is not an interest in property, the

Region should still ensure that the proprietary control agreement is drafted in accordance with the laws of the State, recorded in the land records, and that any prior recorded interests will not impede the long-term reliability of the institutional control.[7] For more direction on these issues, the Regions should contact OGC.

C. General Considerations

Regions should consider the third-party beneficiary approach whenever a proprietary control is used. An example would be at a Fund-lead site where the State will almost always serve as the grantee to the proprietary control. EPA may be designated as a third-party beneficiary to the agreement in order to strengthen the effectiveness of the control by providing an additional means of ensuring compliance. Furthermore, the Regions should not limit the class of parties who may act as third-party beneficiaries to EPA. The Regions should look to other financially and otherwise viable parties with legitimate interests in ensuring the control remains in place to act as third-party beneficiaries (e.g., neighbors, local governments, environmental and civic organizations).

IV. Conclusion

Third-party beneficiary rights provide an additional IC tool to help ensure the effectiveness of the remedy. A Region wishing to utilize this tool should conduct initial research into the law of the State in which the control will be used. This research should help the Region determine whether using third-party beneficiary rights is a viable and reliable option. Once this research is completed, the Region should work with OGC and OSRE to determine specific drafting requirements.

For more information or questions regarding this document please contact K.C. Schefski, OSRE, (202)564-8213; for site-specific questions please contact Melissa Franolich, OSRE, (202)564-6300 and Steve Hess, OGC, (202)564-5461.

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[7] Real property interests in a given property are subject to a system of priority according to the order in which they are recorded in most States. To avoid a situation where a proprietary control is subordinate to a prior or "senior" interest, a thorough title search should be performed to identify all parties holding prior interests in the property from whom subordination agreements may be required. Unrecorded interests, such as leases, may also need to be subordinated to ensure that lessees abide by the easement/covenant. A subordination agreement is a legally binding agreement by which a party holding an otherwise senior lien or other property interest consents to a change in the order of priority relative to another party holding an interest in the same real property. Obtaining a subordination agreement helps ensure that the IC is enforceable against all parties with an interest in the property and not extinguished if a superior lien holder forecloses on the property.

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