

# Environmental Contamination and Proximity

*By Michael V. Sanders, MAI, SRA*

## The Assignment

This litigation was certified as a class action involving two tracts of homes adjacent to Wyle Laboratories, a large and rather secretive testing facility in Southern California that was ultimately found to have significant environmental issues. We were engaged as appraisal experts on behalf of one of the defendant developers who faced allegations of inadequate or incomplete disclosure of issues relating to Wyle Laboratories, among other things. Even though the counsel for the other developer elected to retain their own experts, there was discussion of joint retention on behalf of both developers, which is not uncommon when the interests of the codefendants are closely aligned. The task was to evaluate claims of value diminution associated with the disclosure issues and adjacent environmental disamenities and to critique the opinions of the opposing appraisal expert. The case was filed in the California Superior Court, but the parties agreed to use judicial reference in lieu of a jury trial, settling after expert depositions were completed.<sup>1</sup>

## Class Action Litigation

A class action is “a lawsuit in which a single person or a small group of people represents the interests of a larger group.”<sup>2</sup> The purported advantage of a class action is to avoid a multiplicity of lawsuits in situations involving a large number of potential plaintiffs, aggregating individual claims into a single representational lawsuit. Among the requirements to maintain a class action are commonality with respect to legal and factual issues and a presumption that the claims of the class representatives are typical of the class in general. Members of a proposed class are automatically included, unless they affirmatively make a decision to opt out. Class action lawsuits brought in fed-

- 
1. At the request of the client, specific information regarding the identities of the parties and properties has not been disclosed.
  2. Bryan A. Garner, ed. *Black's Law Dictionary*, 2nd pocket ed. (St. Paul, MN: West Group, 2001), 105.

eral district courts are governed by the Federal Rules of Civil Procedure, which also govern class actions in some states (not California). Other states prohibit or limit the types of claims that may be brought as class actions. In general, class litigation is relatively uncommon in real estate matters and is vigorously opposed by defense counsel because of the potential damages involved.

## The Subject Properties

The subject project is a low-density residential community encompassing approximately 217 homes. The topography is rolling. Lot sizes range upwards from about 20,000 square feet, although pad areas are typically smaller. Some sites enjoy average to good area views. The project was built between 1999 and 2001 and includes three product types, with floor plans ranging from 2,400 to 3,900 square feet. The product is relatively comparable to other homes of similar size and recent vintage in the general area. Initial builder sales took place over a time period from March 2000 through March 2002, with a large number of subsequent resale transactions. As part of each original sale transaction, buyers were provided with the following disclosures:

- Nearby property is zoned commercial. Developer makes no representation as to what type of business or businesses will be built on this site, or when such development may occur.
- This subdivision is located adjacent to Wiley [sic] Labs, an industrial research facility. All inquiries regarding Wiley Labs and the nature of any activities conducted at the facility should be addressed to Wiley Labs.

## Wyle Laboratories

Wyle Laboratories is a 429-acre site located adjacent to the subject project. The facility opened in 1957 and has performed physical tests on a variety of military and aerospace components as well as consumer products, typically under extreme conditions. The nature of these activities was not well known, leading to a listing on the California Abandoned Site List in 1983 due to a lack of information and the high level of security that limited access to the property. A preliminary assessment by the California Department of Health Services (DHS) in 1988 recommended no further action by the California Environmental Protection Agency (EPA), and a 1988 assessment by the US EPA concluded that no further action was necessary.

The only item of concern on the Wyle property noted in a Phase I environmental site assessment in connection with development of the subject project was a leaking underground storage tank (LUST) identified on the state LUST database, which had reportedly received case closure. Soil and groundwater tests in 1999, however, revealed

on-site contamination with trichloroethylene (TCE) and other volatile organic compounds (VOCs). A joint investigation by the local Regional Water Quality Control Board (RWQCB) and the California Department of Toxic Substances Control (DTSC) in 2001 indicated the need for further soil and groundwater characterization, leading to the subsequent discovery of several contaminants, including dichloroethylene (DCE), vinyl chloride, perchloroethylene (PCE), perchlorate, lead, benzene, polychlorinated biphenyls (PCBs), N-Nitrosodimethylamine (NDMA), and hydrazine. A California RWQCB memorandum in July 2003 noted that VOCs were the primary contaminants of concern, present in concentrations of concern in a few isolated source areas of the site. On-site contamination was also confirmed after a preliminary assessment and site inspection by the US EPA in November 2003, which was made available to the public by mid-2004.

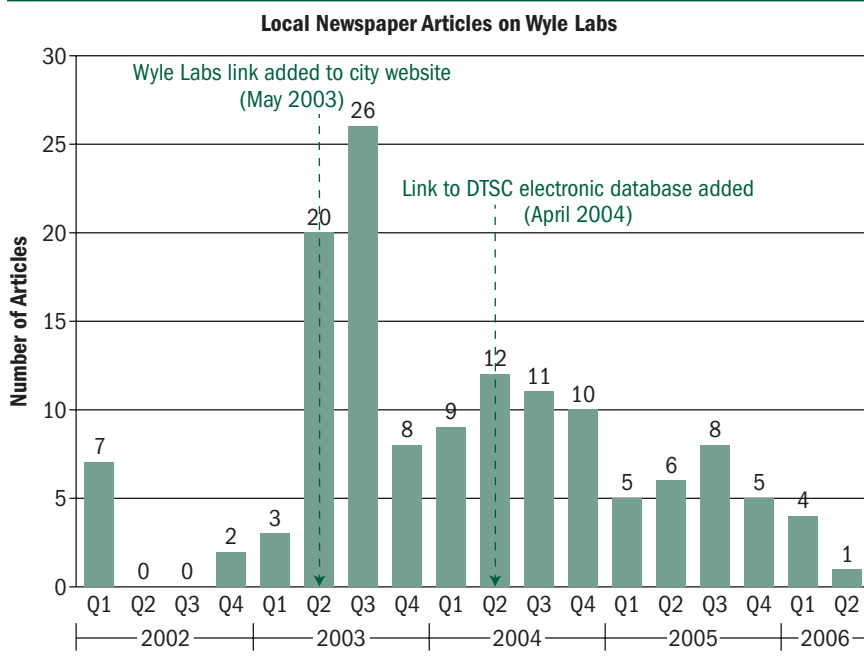
The closure of the Wyle facility was announced in January 2002, at roughly the same time the lawsuits were filed against the developers of the adjacent homes. The property was sold for residential development in November 2002, although Wyle is believed to have continued operations for a period thereafter, with the facility reportedly closed in 2004.

Concerns over contamination at Wyle Laboratories began to mount, with the city adding a Wyle link to its website in May 2003 and presenting extensive reports at city council meetings during May through July of 2003. Agency testing performed on water exiting an ephemeral stream on the Wyle property near the boundary of the subject project in 2003 reported low concentrations of VOCs in surface water (below maximum contaminant levels for drinking water), consistent with samples from Wyle dating back to 1999, and noted that the contaminants evaporated to nondetectable levels a very short distance from the site.

Wyle submitted a work plan for the investigation and remediation of soil and groundwater in June 2003. The DTSC signed an order with Wyle and its successor-in-interest in October 2003 for full characterization and cleanup, with a groundwater treatment system in operation since 2004. Testing in mid- to late 2004 confirmed the off-site migration of contamination from the Wyle property to adjacent residential neighborhoods on the opposite side of the facility (away from the subject project), and vapor extraction systems were installed to supplement on-site cleanup efforts.

There was extensive media coverage of Wyle Laboratories in the local press. The coverage began with the lawsuits filed against the subject and adjacent developer in early 2002 and spiked in mid-2003 and again in the second quarter of 2004, coinciding with the city's response to a grand jury report about Wyle Labs and tests confirming the off-site migration of contamination from the property. This media coverage is graphed in Exhibit 1.

### Exhibit 1



## The Complaint

The complaint in this matter was filed in early 2002, along with a similar lawsuit against the developer of the adjacent project. The three major issues identified in the complaint were as follows:

1. Deceptive disclosure about Wyle Labs
2. Failure to disclose anything about an adjacent battery disposal site
3. Deceptive disclosure about future development

### Deceptive Disclosure about Wyle Labs

The complaint stated that

- The Wyle site is “designed primarily for testing various hazardous and dangerous substances, systems, and munitions, including ordnance systems, weapon systems, remediation, and environmental matters.”
- “Wyle Labs is identified by the EPA as a ‘large quantity generator’ of hazardous waste.”
- “Wyle Labs is located in [an area] zoned for heavy industrial use . . . [with] potential harmful environmental conditions resulting from this industrial usage.”

- “The soil and water on or near the . . . Wyle Property has been contaminated by multiple toxic chemicals.”
- “Wyle Labs is a potential noise nuisance.”
- “The Homes are located in a fire hazardous area.”
- “Wyle is *not* spelled ‘Wiley.’”

### **Failure to Disclose Anything about an Adjacent Battery Disposal Site**

According to the complaint, the adjacent battery disposal site had been designated as a Superfund site by the EPA.<sup>5</sup> “Although the Superfund ‘clean-up’ was completed in 1988, highly toxic and hazardous battery chemicals . . . remain buried at the site encased in treated soil and concrete.”

### **Deceptive Disclosure about Future Development**

The complaint stated that while disclosures were made regarding potential future developments in the immediate area, there was “no reference to any potential extension of [a major roadway]” and “no reference to a large [drugstore] that would soon be built as the anchor store in what would become a large commercial site adjacent.”<sup>4</sup>

### **Certification as Class Action**

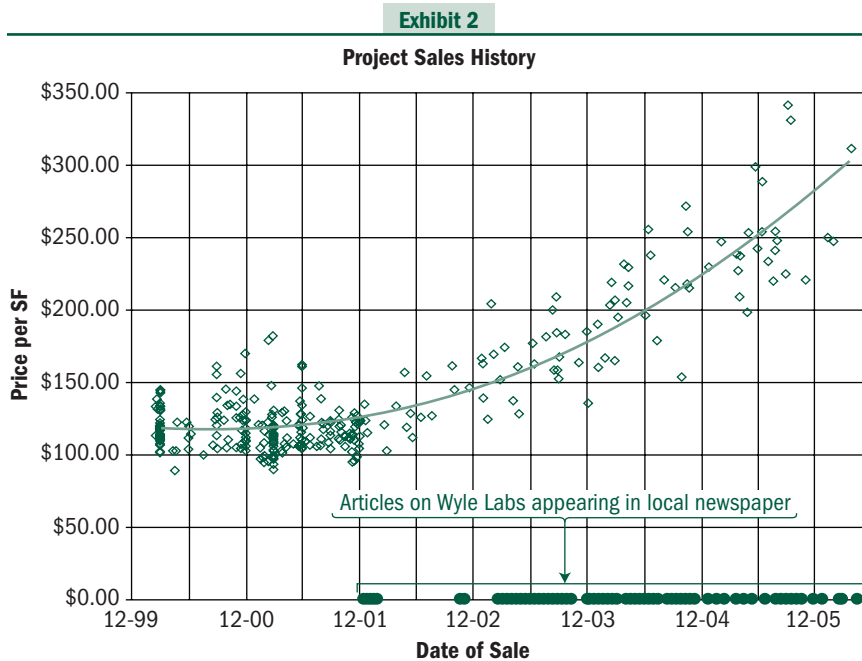
The case was filed as a class action. The class was ultimately certified, despite defense motions to decertify the class. Instead of a jury trial, the parties elected to use judicial reference, an alternative to litigation in California whereby a referee (a retired judge, in this case) effectively hears the case and renders a statement of decision to the trial court, which becomes the judgment of the court. Although the procedure has some similarities to arbitration (another method of alternative dispute resolution), there are significant differences. Referees are judicial officers who are required to follow the law and rules of evidence, and decisions made by judicial reference are subject to review (appeal), like other court decisions. Interestingly, the companion case involving the adjacent tract of homes with nearly identical allegations was not certified as a class action, and the court declined an order of reference in lieu of trial by jury. So much for predictable results.

- 
3. *Superfund* refers to the US EPA’s program for addressing abandoned hazardous waste sites. It is also the name of the fund established by the Comprehensive Environmental Response, Compensation and Liability Act of 1980. This law allows the EPA to clean up such sites and compel the responsible parties to perform cleanups or reimburse the government for such cleanups.
  4. An order by the judicial referee subsequently dismissed claims relating to the alleged nondisclosure or concealment of the adjacent commercial development, including road extensions.

## Market Data Analysis

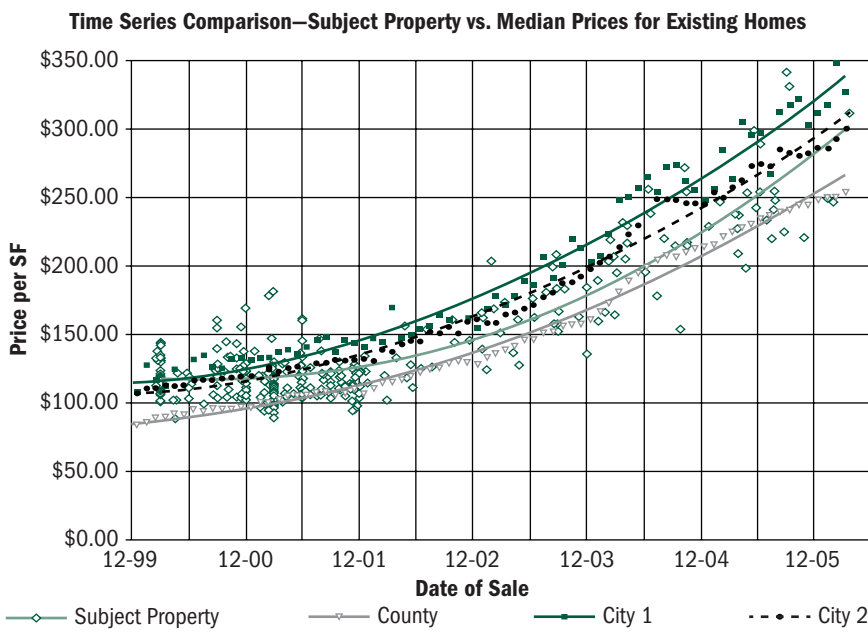
A comprehensive summary of sale transactions within the subject project was assembled using data from public records and other sources. This data was used to construct a time series analysis of square foot prices from March 2000 through April 2006. There were 28 initial closings in March 2000 at prices ranging from \$100-\$145 per square foot. Unit prices generally showed little overall change during 2000 and 2001, averaging about \$118 per square foot. Since January 2002, when the developer's marketing program was nearly complete, price trending showed an increase of nearly 142% through April 2006. This data is depicted in Exhibit 2, including an overlay showing the volume of Wyle media coverage in the local newspaper over the time period in question. Although this coverage was almost uniformly negative, there was no apparent impact on the sales velocity or rate of appreciation.

Of particular interest is whether prices in the subject project behaved differently from the market as a whole. An additional time series shown in Exhibit 3 depicts the same data for the subject project, along with monthly median square foot prices for existing homes in the county, the subject city, and an adjacent city from January 2000 through April 2006.<sup>5</sup> While the trend lines for both cities are above the line for the subject project because the subject homes are larger and



5. The subject project is located in City 1 but is adjacent to the city limits of City 2.

Exhibit 3



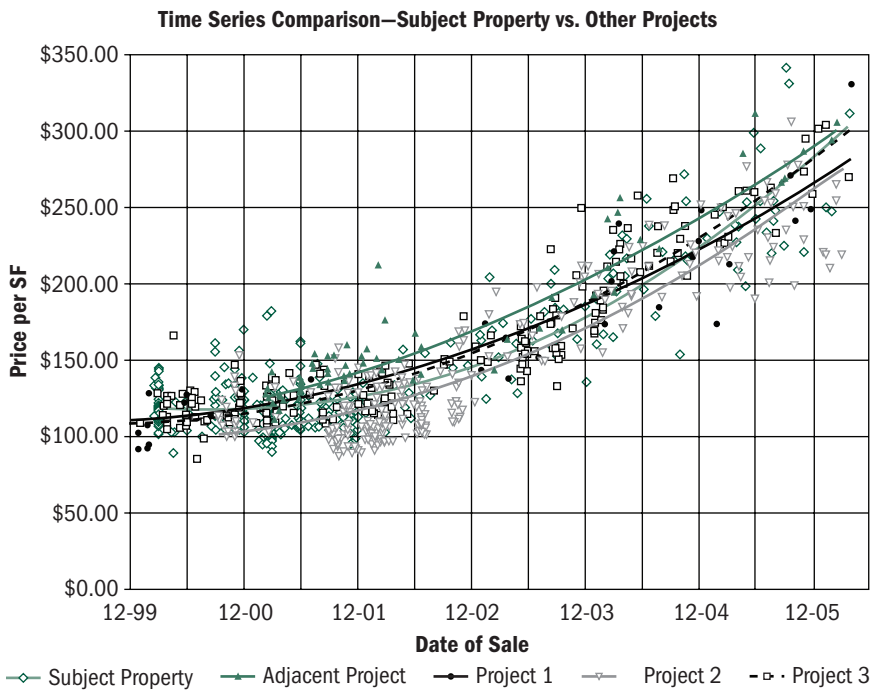
more expensive as compared to the broader market, all three trend lines track fairly closely with the subject project since early 2002.

Exhibit 4 depicts a similar time series analysis, comparing the subject project to the adjacent project (also in litigation with similar allegations) and three other developments. Project 1 is a competitive project located in the same city but distant from Wyle Labs or the former battery recycling site. Projects 2 and 3 are further away but were selected for comparison because both were identified in the declaration of one of the class representatives as being alternatives considered in conjunction with their purchase of a home in the subject project. In this case, the product is generally comparable in terms of size and overall appeal. All projects reflect price trends that track closely with the subject from January 2002 through April 2006.

Exhibit 5 shows comparative appreciation rates for the subject project relative to median monthly prices for the county and two cities between January 2002 and April 2006. Exhibit 6 compares appreciation rates for the adjacent project and other comparable projects in the same period. The subject's total appreciation over this time period is 141.9%, reflecting the top end of the range in comparison to the balance of the data.

Evidence suggests that resale disclosure statements in the subject project have varied widely. Nineteen homeowners were dismissed

**Exhibit 4**



**Exhibit 5**

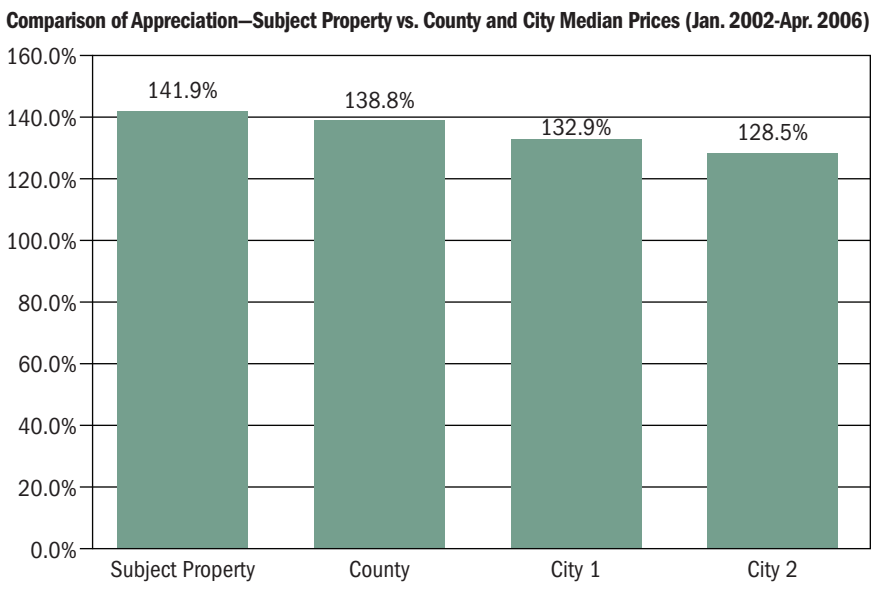
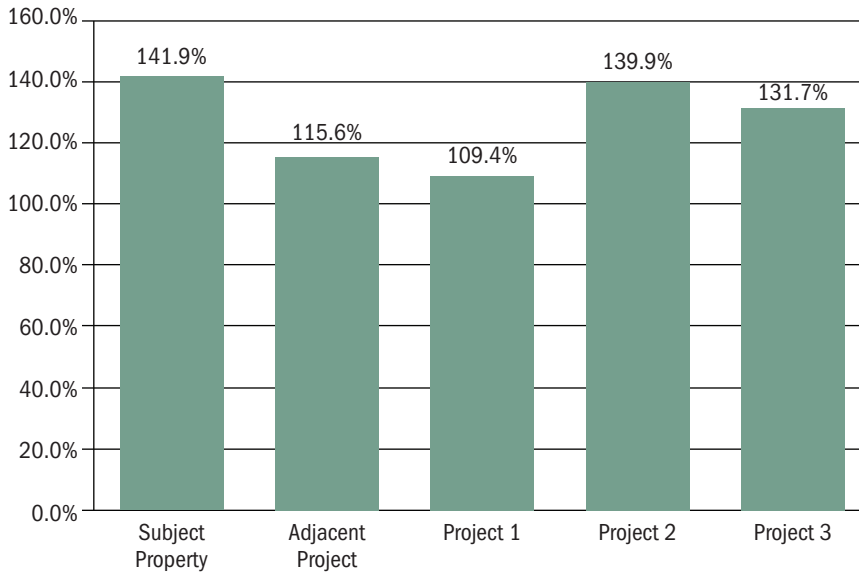




Exhibit 6

Comparison of Appreciation—Subject Property vs. Other Projects (Jan. 2002-Apr. 2006)



from the class by order of the judicial referee in May 2005 for failing to make proper written disclosures to subsequent buyers regarding the issues in the lawsuit, including Wyle Labs or the battery recycling facility. We were, however, provided with written disclosures by six original homeowners that were acknowledged and signed by subsequent purchasers. These resales were plotted on the original time series, shown in Exhibit 7. The location of these data points relative to other sales transactions and the trend line does not indicate that such disclosures materially affected the prices paid for the properties, nor do aggregate marketing times or sale-to-list price ratios suggest a significant variance from the market.

A similar analysis was performed for sales of properties abutting Wyle Laboratories and the former battery recycling site, one of which also included a written and signed disclosure on resale. The transactions noted are well distributed throughout the data range, indicating no material impact on the prices paid for such properties (see Exhibit 8).

Additional analyses were performed using a citywide database of MLS sales with the following characteristics:

- Minimum lot size of 15,000 square feet
- Built between 1990 and 2004
- Gross living area of 2,000 to 5,000 square feet
- Sold between January 2004 and early September 2005

Exhibit 7

Subject Property Sales History

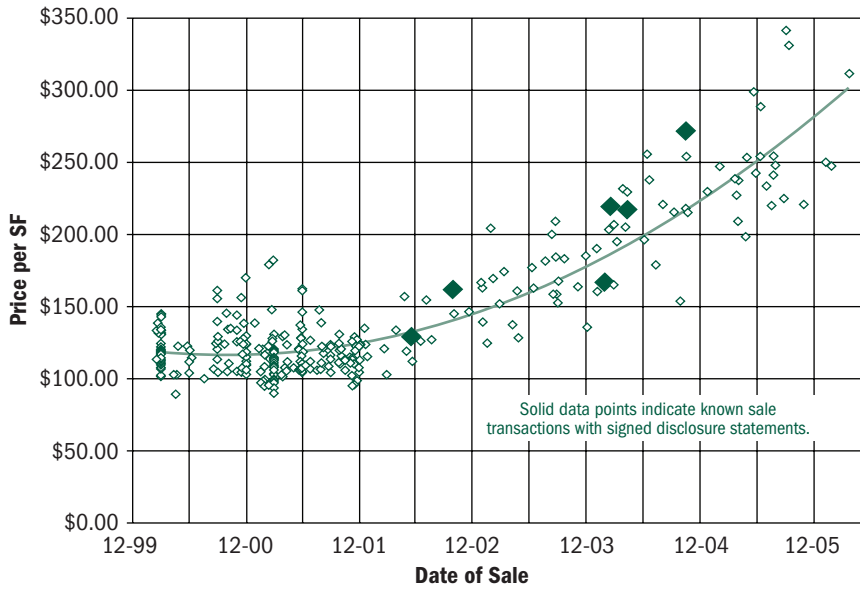
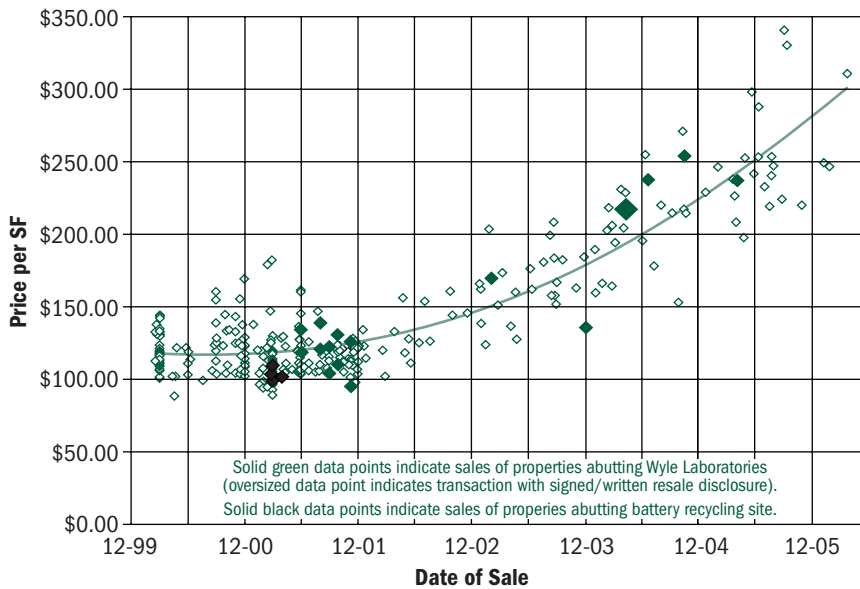


Exhibit 8

Sales of Abutting Properties



A total of 138 sales transactions were assembled. Four of these were ultimately discarded because three could not be verified with public records and one resold immediately for a significantly higher price.<sup>6</sup> Descriptive statistics do not indicate that homes in the subject or adjacent projects sell for markedly different prices compared to the broad market, nor is there any apparent negative impact on marketing time or sale-to-list price ratio (see Exhibit 9).

**Exhibit 9**

No.	Location	Lot (sq. ft.)	Built	GLA	Garage	List Price	Sold Price	COE	Price/ Sq. Ft.	DOM	Sale/ List
45	Subject Project										
	Adjacent Project	33,184	2001	3,374	3.467	\$764,673	\$755,511	10/06/04	\$225.85	60	98.8%
89	Other Properties	26,665	2001	3,212	3.303	\$734,666	\$718,904	01/23/05	\$227.38	63	97.9%

This same data was used for multiple regression analysis (see Exhibit 10), with consideration of the following independent variables and their impact on selling price:

- Date of sale (measured in months from January 2004)

**Exhibit 10**

**SUMMARY OUTPUT**

**Regression Statistics**

Multiple R	0.791550260
R Square	0.626551814
Adjusted R Square	0.602651130
Standard Error	74,060.68
Observations	134

**ANOVA**

	df	SS	MS	F	Significance F
Regression	8	1.1503E+12	1.43788E+11	26.21480692	2.07957E-23
Residual	125	6.85623E+11	5484984409		
Total	133	1.83593E+12			

	Coefficients	Standard Error	t Stat	P-Value	Lower 95%	Upper 95%
Intercept	191,846.07	51,144.90	3.751030521	0.000268193	90,623.97	293,068.17
Sale Month (from January 2004)	9,378.72	1,187.56	7.897454284	1.25322E-12	7,028.38	11,729.05
Lot Size (square feet)	1.13	0.38	2.998991913	0.003269453	0.38	1.87
View	22,905.16	15,144.84	1.512406883	0.132954548	-7,068.36	52,878.67
Age (years)	-1,941.95	1,984.39	-0.978616426	0.329659745	-5,869.30	1,985.39
Gross Living Area (square feet)	99.58	13.64	7.299948490	2.94257E-11	72.58	126.57
Garage (spaces)	11,335.63	10,102.36	1.122077957	0.263980069	-8,658.19	31,329.46
Pool	86,076.88	17,104.22	5.032492757	1.64471E-06	52,225.50	119,928.26
Location (WPH/Centex)	19,783.39	15,255.65	1.296791176	0.197091734	-10,409.43	49,976.22

6. This transaction also reflected the lowest listed and sold prices among the data considered.

- Lot size (square feet)
- View (yes or no)
- Age (years)
- Gross living area (square feet)
- Garage (number of spaces)
- Pool (yes or no)
- Location within the subject or adjacent projects (yes or no)

The coefficient of determination ( $r^2$ ) is approximately 63%, indicating a significant amount of unexplained variation in the model. This is not necessarily unexpected because there are a number of factors—upgrades, condition, landscaping, other site improvements, and so on—that were not included as additional independent variables for practical purposes. Importantly, the  $F$  statistic, which measures the strength of the relationship between the dependent variable (price) and the independent variables, is highly significant. Coefficients for the independent variables have expected values and signs, although coefficients for the date of sale, lot size, gross living area, and pool are the only ones significant at better than the 10% level.<sup>7</sup> Although it is not considered statistically significant, the item of interest is the coefficient for location, indicating a *positive* value of nearly \$20,000 for homes in the subject and adjacent projects.

A report was ultimately prepared documenting opinions and conclusions. As part of the discovery process, this report and the accompanying workfile were produced in advance of deposition, which followed the depositions of the plaintiffs' expert witnesses.

## Opinions of Opposing Experts

The plaintiffs' case regarding damages relied on two experts. The primary expert was a real estate appraiser, whose opinions also incorporated a contingent valuation survey performed by a market research consultant. Documents were deposited in advance of deposition, giving us an opportunity to review the opposing expert's material and draft proposed deposition questions. Although the opposing appraisal expert signed several declarations attesting to certain opinions, no formal report was actually prepared. As a result, the opinions expressed in deposition were effectively considered an oral report under USPAP Standards Rule 2-4.

The plaintiffs' appraisal expert required three separate sessions, the third of which we attended in person in an effort to focus attention on important questions for which there were still no concrete

---

7. All are significant at better than the 1% level. While eliminating other variables results in an improved  $F$  statistic, the coefficient of determination ( $r^2$ ) and coefficients for remaining independent variables show relatively little change.

answers. Following completion of the final deposition session and review of the transcripts and file documents, an appraisal review report was prepared under Standard 3 of USPAP, which supplemented the report documenting our affirmative opinions and conclusions.

The plaintiffs' major claim was that class members overpaid for their properties, based on the allegation of insufficient disclosure of nearby environmental nuisances by the developer. Some of the appraisal opinions and related issues identified were as follows:

- To calculate lost appreciation, the appraiser for the plaintiff compared appreciation rates for the subject project and other properties (control group) over differing time periods that did not have consistent growth rates. The appraiser then extrapolated the difference over an anticipated holding period. The data and analysis were riddled with errors, and when analyzed carefully, the data actually demonstrated that properties in the subject project *outperformed* properties in the control group.
- Opinions were offered regarding a “stigma impact” based on a review of articles that were contained in the appraiser’s file. In deposition, it was clear that the appraiser knew little about the articles, many of which did not support the appraiser’s opinions.
- Reliance was placed on a consumer survey performed by the expert market research consultant. The appraiser did not quote the results of the survey accurately, had no apparent knowledge of the technique employed (contingent valuation), and did not even have a copy of the survey in the workfile. The use of survey methodology in lieu of empirical market data was a significant criticism.<sup>8</sup>
- The appraiser misrepresented having experience in appraising homes in the geographic area of the subject project and was forced to acknowledge as much in the deposition.
- The plaintiff’s counsel asked the appraiser to assume that original disclosures were inadequate or incomplete, without the appraiser reviewing the actual disclosures or environmental data available at the time, and without employing an extraordinary assumption regarding the inadequacy of such disclosures and the potential impact on opinions or conclusions if found to be false.
- The appraiser further stated the opinion that the disclosures were inadequate but acknowledged having no specific training with respect to disclosure duties, effectively offering opinions well outside the appraiser’s area of expertise.

---

8. Although the court accepted the contingent valuation testimony of the plaintiffs’ market research consultant in an opposition to motion for summary judgment, the court ultimately granted a motion in limine precluding this expert from testifying at trial.

- While commenting that class members overpaid for their properties, the appraiser did not value the class representatives' properties at the time of purchase and could not even identify them on an aerial photograph of the project during deposition.
- The appraiser testified that because the assignment did not involve a federally related transaction, USPAP did not apply. This statement is clearly contrary to the California Business and Professions Code, which states that “the Uniform Standards of Professional Appraisal Practice constitute the minimum standard of conduct and performance for a licensee *in any work or service performed that is addressed by those standards* [emphasis added].

## Case Disposition

Notwithstanding the environmental nature of the case, the plaintiffs' damage claims did not include health impacts or even allegations that their properties were contaminated, instead they related only to loss of property value from proximity impacts. Mediation claims and settlement offers are confidential and will not be discussed here. The ultimate opinion of the plaintiffs' appraisal expert, using flawed analysis, was approximately \$157,000 per home for “lost appreciation,” or slightly over \$34 million.

After the completion of expert depositions in mid-2006, a \$700,000 settlement was reached and finalized in late 2006. The plaintiffs' attorneys reportedly worked on the case for more than 6,000 hours, settling for \$210,000 in attorney fees (30% of the settlement amount) plus approximately \$150,000 for the reimbursement of costs. Allocated over the 185 class members remaining at the conclusion of the litigation, the average recovery per homeowner was slightly over \$1,800. In addition to the primary payment of \$700,000 on behalf of the class members, it was agreed that defendants would also pay expenses associated with the settlement.

As a side note, the plaintiffs' counsel subsequently proposed to publish our report and related documents on their public website. This was presumably to help their clients understand the reasons for the settlement, although such information was not restricted to these clients. It was in the interest of our client as well to have plaintiff class members understand and consent to the settlement. However, this was clearly not consistent with standard assumptions and limiting conditions that restrict the rights of publication or dissemination without prior written consent. A potential problem was that our retention (including standard assumptions and limiting conditions) was a contract with our client, not with the opposing counsel or their clients. An agreement was ultimately reached with the plaintiff counsel requiring removal of our report and related documents from their

website but granting permission to provide a copy of our report to plaintiff class members upon request, contingent upon their signature of an acknowledgement and release drafted by our attorney.

