

STATE OF MINNESOTA
HARMFUL SUBSTANCE COMPENSATION BOARD

In the matter of the proposed new permanent rules relating to compensation for property damage losses

STATEMENT OF NEED
AND REASONABLENESS

I. INTRODUCTION

The Hazardous Substance Injury Compensation Board (Board) was created by the 1985 Legislature (Laws 1985, 1st special session, chapter 8) as part of revisions to the Minnesota Environmental Response and Liability Act (MERLA), Minnesota Statutes, Chapter 115B. These revisions were codified as Minn. Stat. Sections 115B.25 - 115B.37. The Board was established as a new state agency to administer a \$2 million Hazardous Substance Compensation Account (Account), now located within the State Environmental Fund. The Board's primary responsibility was to investigate claims of certain types of property damage or personal injury caused by the release of hazardous substances into the environment, and to compensate eligible persons from the account for certain types of losses. Amendments to the Board's statute in the 1989 legislative session expanded the scope of substance releases eligible for compensation to include releases of agricultural chemicals and

petroleum compounds and the Board's name was changed to the Harmful Substance Compensation Board.

The Legislature directed the Board to adopt rules describing various aspects of this compensation system and also authorized the Board to adopt additional rules including those which are the subject of the rulemaking. The Board has, to date, adopted rules governing board procedures, the value of household labor lost due to eligible injury or disease, death benefits, and attorney's fees. The currently proposed rules governing compensation for property damage losses provide specific criteria for evaluating eligibility of claimants under the terms of the statute, including the special circumstances of persons buying or selling property with damage losses, and set forth criteria for fairly evaluating the extent of such losses due to harmful substance releases in Minnesota.

II. STATEMENT OF THE BOARD'S STATUTORY AUTHORITY

The Board's statutory authority to adopt rules relating to compensation for property damage losses is set forth in Minn. Stat Section 115B.34, Subd.2, (1989) which states: " The Board may adopt rules governing approval of appraisals, criteria for establishing a hardship, and other matters necessary to administer this subdivision."

III. STATEMENT OF NEED

The need to adopt the proposed Minn. Rules Parts 7190.11³ through 7190.2010 arises from the need of property owners, in varying circumstances, to receive fair and equitable compensation for losses which can be attributed to harmful substance releases. Property damage claims make up greater than 90% of all applications received and 100% of all claims compensated by the Board to date, yet the statute is brief in setting forth the eligibility criteria and considerations for awarding such claims.

Eligibility requirements set forth in the statute limit compensation to losses at the claimant's principal residence yet the statute does not provide criteria for clearly and fairly distinguishing a claimant's principal residence, particularly for property owners who are in transition between two residences. The Board's struggle to fairly decide these claims in the past is indicative of the need for rules to govern such decisions and the need to make future decisions consistent. As explained in the text to follow, it is also necessary for the Board to consider the timing of the claimant's decision to purchase or sell a given property relative to the discovery of the property damage and associated losses.

Based on the Board's investigations of property damage claims for replacement or decontamination of drinking water supplies, the

Board recognizes a distinction between replacement costs for properties served by private wells and community assessments for municipal drinking water supplies which generally provide additional community benefits. The proposed rules address the need for identifying and limiting compensation to the claimant's true replacement expenses and to exclude payment for other community benefits from municipal water supplies, i.e. fire protection and improved property values.

IV. STATEMENT OF REASONABLENESS

The proposed new rules are reasonable because they provide a fair and consistent basis for the Board's consideration of all property damage claims.

Part 7190.1100 Definitions

This proposed rule sets forth definitions of words or phrases used in the rule. It is reasonable to define these terms to shorten the language in the rule and clarify possible ambiguity.

In particular, **residential homestead** is defined because it is a key determinant in establishing the claimant's principal residence under Part 7190.1120. More explanation of this definition is found under Part 7190.1120.

Part 7190.1110 Principal Residence

Minn. Stat. Section 115B.34, Subd. 2 provides that losses compensable by the account for property damage are limited to specific losses caused by damage to the principal residence. It is reasonable to establish criteria for qualifying a claimant's property as a principal residence given the wide range of circumstances under which a claimant may own residential property.

Part 7190.1120 Current Principal Residence

Part 7190.1120 defines current principal residence as the property that is the claimant's residential homestead. Part 7190.1100 defines residential homestead as the property that qualifies as the claimant's homestead under Minnesota Statutes Chapter 273.124, i.e. for tax credit purposes. By establishing this definition of residential homestead as a necessary determinant for principal residence, a consistent and easily verifiable means of identifying residential property is established. This definition requires that the claimant must both own and reside at the property. Ownership of the property is required under Minn. Stat. 115B.30, subd. 2, which provides that damage to real property in Minnesota owned by the claimant is eligible for compensation from the account if the damage results from the presence in or on the property of a harmful substance released from a facility.

The residential homestead requirement appropriately excludes all other residences, such as vacation homes or rental property, and business property, as is the intent of the statute in limiting compensation to a principal residence. Furthermore, Chapter 273 addresses the circumstances of property owners where a property is both a residence and also has business, agricultural, or other uses. Under the definitions in Part 7190.1100, a deviation from Chapter 273 is made to limit the amount of property on a family farm which can qualify as a residential homestead and principal residence. It is reasonable to limit family farm property to the residence itself and as much of the land surrounding the homestead not exceeding one acre, to exclude losses for agricultural land and other farm buildings from eligibility for reimbursement. Such reimbursement would exceed the Board's statutory authority to reimburse for losses caused by damage to the principal residence.

Part 7190.1120 further specifies that the claimant's residential homestead must be owned and occupied by the claimant, and used for purposes of a homestead as of the date of discovery of contamination, not the date of assessment. It is reasonable that the determination of principal residence be made without regard to whether residency on that date would qualify the claimant for homestead tax credit in the year of the date of discovery of contamination because the tax laws set forth separate qualifying dates relative to the preparation of assessments, which are not relevant to the Board's decision.

It is reasonable that the principal residence must be owned and occupied by the claimant and used for purposes of a homestead as of the date of discovery of contamination because it is consistent with the intent of the Board's statute that victims of harmful substance releases be compensated for their losses. A claimant who owns and occupies a property at the time of the discovery of contamination is forced to suffer the losses associated with the property damage and is, therefore, a victim of the contamination. A claimant who chooses to own and reside at a property after the contamination of the property is known, is not a victim of the contamination because the claimant knowingly came to the problem and may in fact have benefitted by purchasing the property at a reduced cost.

Without this rule, a person purchasing property in Minnesota after the discovery of the property damage and with full knowledge of the amount of compensable loss could potentially buy the property at a discount and take advantage of the Board's compensation, thus receiving a financial benefit. In addition, the seller of the property could be eligible for a hardship loss in the sale. Thus, without the rule limitation as proposed, the Board could potentially reimburse both the buyer and the seller for the same property damage.

Under Minn. Stat. Section 115B.03 of MERLA, a property owner will be liable for damage caused by a release if the person had the

required knowledge and "engaged in conduct associating that person with the release". Purchasing contaminated property at less than market value is one factor which may be considered as conduct associating a person with the release.

To avoid duplicate reimbursements for the same property loss following the sale of contaminated property and consistent with MERLA language, it is reasonable that the Board establish by rule that a person purchasing after the contamination is known has chosen to assume responsibility for any subsequent loss and is not eligible for reimbursement. The seller of the property remains eligible for losses incurred during or prior to the sale (under Part 7190.1170).

Exceptions to this rule are described under Parts 7190.1130 through 7190.1170.

Part 7190.1130 Residence Owned But Not Occupied

In circumstances where a property owner does not reside at the property for reasons of marital separation or divorce, or is a resident of a nursing home or boarding care facility, it is reasonable that the property not be excluded as the principal residence because these situations represent personal hardship circumstances which make the owner unable to occupy the property. The language is consistent with similar language found in Minn.

Stat. Section 273 for determining residential homestead.

Part 7190.1140 Property Purchased After The Date Of Discovery.

The proposed rule makes an exception for property purchased after the date of discovery of contamination where a claimant can show that a written contract was made to purchase the residence prior to the date of discovery of contamination. It is reasonable that a person with a purchase contract made prior to the discovery of contamination be eligible because this person did not knowingly assume responsibility for the losses at the time of the contract and is not free to abandon the purchase after the discovery of contamination has been made.

The proposed rule also makes an exception where the claimant purchased the property after the contamination was known but can show that there existed a reasonable expectation that the property damage would be fully remedied by public or other funding sources without cost to the claimant. For example, such expectation might be caused by government assurances regarding available funding which is later found to be unavailable or limited in its application, as has occurred in past claims submitted to the Board. It is reasonable to provide this exception to the rule, because the claimant in this situation did not knowingly assume responsibility for the loss.

Part 7190.1150 Intended Principal Residence

This part provides that a property purchased by the claimant prior to the date of discovery of contamination with intent to own and occupy a new residence, including construction of a new residence, be eligible as the claimant's intended principal residence even though the claimant did not reside at the property on the date of discovery of contamination. It is reasonable that a property which the claimant either owns or is clearly committed to purchase be eligible because the property owner is forced to suffer any loss due to the contamination and does not, at the time the damage is discovered have any reasonable means of avoiding the loss. It is reasonable that the claimant demonstrate to the Board their intent to own and occupy a principal residence through documents or other actions to assure that the criteria established in the rule are being met. Property purchased for uses other than a principal residence is not eligible under this proposed rule.

Part 7190.1160 Past Principal Residence

Part 7190.1160 provides for a homeowner who has made a commitment to move to a new home, placed the former home on the market for sale, and subsequently moved to the new home prior to the date of discovery of contamination. On the date of discovery of contamination, the property is owned by the claimant, vacant, and actively on the market for sale. The claimant is forced to

continue with attempts to sell the property in the face of a sudden and unexpected decline in the marketability of the property. As the owner and seller of the property, the claimant is responsible for costs to provide a safe drinking water supply and may be forced to suffer a loss in the sale. If the property cannot be sold, the claimant is forced to pay expenses to maintain the property. It is reasonable that losses for this property, called the past principal residence, be eligible for compensation, because the claimant is a victim of the contamination and did not knowingly assume responsibility for the loss. The property is not rental, business, or vacation property, and meets the Legislature's intent to compensate for a principal residence.

Part 7190.1170 Residential Property That Has Been Sold

This section provides that persons selling property be eligible for reimbursement for their expenses to replace or decontaminate the water supply if the claimant realized the loss prior to or during the sale and the property was the residential homestead of the claimant on the date of the discovery of contamination, even though the claimant is not the current resident of the property. It is reasonable that a claimant selling property under these circumstances be compensated for these expenses, because, as the seller, the claimant is forced to suffer the loss. Persons selling residential property with damage to the drinking water supply usually must provide for the replacement or decontamination of that

drinking water supply in order to sell the property. Lenders generally will not approve loans for a property without a potable drinking water supply. Any municipal assessment against the property is usually paid by the seller in the sales agreement. It is reasonable that this rule give compensation to the seller in making the property marketable and may, moreover, in the case of the hardship sale of a residence, reduce the amount of compensation which the Board might otherwise award to the seller for loss in the sale.

As described in Part 7190.1120, the buyer of the property in this situation is not eligible for compensation because the buyer made the purchase with knowledge of the contamination and, therefore, assumes responsibility for any loss not otherwise paid by the seller.

Part 7190.1180 Two Properties May Qualify

The Board recognizes that a person in transition from one principal residence to another can potentially have ownership (or commitment to ownership) of two residences on the date of discovery of contamination, meeting the criteria described in these proposed rules for current principal residence, intended principal residence, or past principal residence. This situation can occur as

part of the normal practice of changing residences. It is reasonable that more than one property may be eligible because the claimant may potentially be a victim of property damage at either location and did not knowingly assume responsibility for the loss. The properties are not business, rental, or vacation property.

Part 7190.1190 Eligible Losses Related to the Replacement or Decontamination of the Primary Source of Drinking Water

Part 7190.1190, Subpart 1, limits compensation for replacement or decontamination of the drinking water supply to cover only those expenses which provide equivalent safe drinking water to the claimant's property. This would include construction costs for a replacement private well on the claimant's property, as well as individual service connection costs from the claimant's property to an existing municipal system. It would not include additional municipal expenses assessed to the claimant for new construction of a municipal water supply and distribution system.

In deciding these types of claims to date, the Board has determined that municipal drinking water systems provide community benefits which go beyond the basic replacement of a drinking water supply. Municipal water systems are often designed to provide adequate supply and pressure for community fire protection and expansion capability for future community growth. A municipal water supply is considered a municipal improvement and generally enhances

individual property values.

A municipal water supply can generally be described in three parts: 1) the supply (one or more wells, pumps, treatment systems, storage tank), 2) the distribution system (piping from the supply to residential streets), and 3) the individual service connection (service piping from the street to the house plumbing). Each municipality is different in terms of community needs, and the related design and enhancement features of the water supply and distribution system.

Funding mechanisms and residential property assessments also differ greatly from one community to the next. Multiple government funding sources are available to communities to assist in paying for system construction where contamination of the previous source of drinking water is discovered. Community residents are frequently assessed the remaining portion of the construction expense after all other sources of funding have been applied.

The Board has found no single, clear and consistent formula for identifying those water supply and distribution system expenses assessed to the property owners, which relate solely to the replacement of drinking water supply to affected claimants and separating those expenses from the additional costs (more pipe, larger pipe sizes, larger well capacity, larger storage capacity, etc.) required for fire protection, expandability, and service to

non-affected residents. Such a calculation would require that the Board also factor out any portion of other funding sources which may have been applied by the municipality to fairly determine the portion of the claimant's individual assessment which relates to the replacement of the claimant's drinking water.

For this reason, it is reasonable that the Board limit payment of municipal system expenses to only those portions of the system which are shown to directly service the claimant's property and provide a safe drinking water supply. This would include hook-up expenses from the main pipe in the street to the house, whether billed directly to the claimant or assessed as a portion of the municipal expense if that portion can be determined. To reimburse for any portion of the construction of a new municipal supply or distribution system would place the Board in a position of providing for a community and property improvement in excess of the true replacement cost. The Board recognizes that a minor extension of an existing distribution system to a claimant's residence for the purpose of providing a replacement water supply to that residence may be compensable.

In subpart 2, it is reasonable to limit reimbursement for replacement or decontamination of a drinking water supply to only those drinking water supplies which were operational and in use by the property owner on the date of discovery of contamination

because to do otherwise would place the Board in the position of providing a property improvement, that is to provide a functional water supply where one did not exist previously. An exception, found in subpart 3, is made for a drinking water supply which is under construction or which is under a contract for construction at the time of discovery of contamination. It is reasonable that such a supply be eligible for replacement expenses which exceed the anticipated expenses of the contract because the claimant was under obligation to pay for the supply prior to any discovery of the property damage and is, therefore, a victim of any increased expenses caused by the contamination.

Part 7190.2000 Hardship

Part 7190.2000 further clarifies the definition of hardship provided in the statute. The scope of hardship circumstances is properly determined by the Board's evaluation of individual circumstances because it is difficult to anticipate the many types of hardship which force an owner to sell a property. Loss of household income is one such circumstance which the Board has encountered in past claims which is not specifically listed in the statute. The list provided in the proposed rule also does not preclude the Board from identifying additional hardship circumstances.

The Board has also recognized the difficult circumstances of property owners who, in the normal course of changing residences, have committed to the purchase of a new residence and are attempting to sell a former residence at the time that the contamination is discovered (also described as past principal residence under Part 7190.1160). Such a claimant is not free to abandon the effort because of suddenly unfavorable market conditions. As of the date of discovery of contamination, the claimant is forced to continue to market and/or maintain the property. Because these market conditions are a direct result of the contamination and could not be anticipated as a normal risk of real estate transactions, it is reasonable that these circumstances be included within the definition of hardship circumstances which force the claimant to sell the property and that such claimants be eligible for compensation.

Part 7190.2010 Eligible Losses Associated with the Need to Maintain Two Residences

Minn. Stat. 115B.34, Subd. 2 (3) as amended in 1989 provides that compensable losses include "losses incurred as a result of the inability of a property owner in hardship circumstances to sell the property due to the presence of harmful substances, limited to the increase in costs associated with the need to maintain two residences". The statute does not specify the types of costs

associated with maintaining a residence which would be eligible nor does it consider the typical costs associated with property maintenance during the period a home is on the market which may be unrelated to the chemical contamination.

It is reasonable to specify costs associated with the need to maintain two residences to include essential utilities, property tax, mortgage interest, and necessary homeowner's insurance to make it clear to potential claimant's the types of costs which are compensable. Mortgage interest expense, and not total mortgage expense, is specified because the Board recognizes that mortgage principal is generally recovered in the sale.

It is reasonable that compensation for losses to maintain a residence under the statute be limited to only those losses which were incurred after the home had been on the market for a period of time equal to the average days on the market for homes without contamination in that locale and year to eliminate the other market conditions which would have affected the home's date of sale. Costs to maintain a property during the average time on the market are presumed to be due to typical market conditions and not due to the contamination. Average days on the market is best determined by a professional analysis of the multiple listing service data of local realtors for a given locale and year.

It is reasonable that repair and maintenance expenses necessary to maintain the value and marketability of a property be compensable in order to expedite the sale and minimize the claimant's loss.

V. SMALL BUSINESS CONSIDERATIONS

Because the Board awards compensation only to eligible persons with eligible personal injury or property damage at the person's principal residence, and the statute explicitly excludes occupational exposure the rules have no impact on small business. The proposed rules are exempted from small business considerations in rulemaking under Minn. Stat. Section 14.115, subd. 7 (b).

VI. CONCLUSION

Based on the foregoing, the proposed rules relating to compensation for property damage losses are both needed and reasonable.

December 2, 1991

Dated

Jean Small Johnson

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