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Notes from the Chair

Lawrence Schnapf, *Chair*
Committee on Environmental, Energy and Natural Resources Law, Business Law Section

A continuing complaint of environmental lawyers involved in business and real estate transactions is that they are frequently brought into a deal at the last minute after the business deal has been negotiated and the contract has been drafted. Often times, a real estate or corporate lawyer will contact ask the environmental lawyer to take a quick look at an environmental report that is "clean" or just make sure there are no "deal killers." Indeed, this practice is so commonplace that I once drafted the Ten Commandments with the first being "Don't Wait To Contact the Environmental Lawyer Until The Night Before the Closing."

Sometimes, the deal lawyers in a firm do not contact their environmental colleagues because they do not recognize there is an environmental issue. Other times, the "business people" do not want to involve the environmental lawyers because they fear that they will kill the deal. The irony is that environmental lawyers have more tools in their toolbox now to address environmental issues if the issues are identified and addressed early enough in the deal negotiations.

In this issue, we illustrate some of the ways that environmental lawyers can actually help extract value in transactions. Our issue editor, Cynthia Retallick, has done a wonderful job of assembling an outstanding roster of experienced practitioners who have written cutting edge pieces on many of the key environmental issues encountered in transactions.

This issue illustrates how environmental lawyers in general and our committee in particular can serve as an important resource to business lawyers. During the past year, our committee has hosted a highly successful environmental law basics webinar series that was designed for business lawyers and environmental lawyers who needed a refresher course. At the spring meeting, we sponsored a program on identifying and allocating environmental liabilities in transactions. This summer, we will be hosting a program that will focus on drafting and negotiating environmental issues in business transactions.

Speaking of our committee, we have some exciting news to announce. First, our current program vice chair, David Roth, has been approved to assume the reins of the committee beginning with the summer meeting. David has done a wonderful job reviving our committee's programming and interaction with other Business Law Sections.

I am also pleased to announce that our committee book "Environmental Issues in Business Transactions" is in the final galley proofing stage. The book will be published in time for the summer meeting. Thanks to all of our authors and editors for their hard work and outstanding contributions.

The next committee project will be a forms project where we will cobble together examples of environmental provisions that are used for a wide range of contracts and deal structures. This project would be an excellent opportunity for younger lawyers to learn about contract drafting and negotiating. If you are interested in working on this project, please let me know.

Finally, by the time David Roth takes over as committee chair, we will have a new committee name that will be less a mouthful and more memorable than the current name. Look out for the announcement over the coming weeks.

Lender Liability Year-In-Review: 2010

By Larry Schnapf, Esq.[1]

With the country still reeling from the effects of the Great Recession and suffering from unprecedented levels of foreclosures, financial institutions have become popular targets in lawsuits seeking to share the pain of busted transactions. Not surprisingly, lenders were involved in a number of notable environmental lawsuits in 2010. This article will review those cases and provide some lessons learned for lawyers representing lenders with sites that have environmental issues.

I. OVERVIEW OF LENDER LIABILITY UNDER ENVIRONMENTAL LAWS

Many non-traditional lenders who never thought they would have to foreclose on collateral are now finding themselves confronted with that option. Thus, it is useful to review the liabilities and protections available to lenders and investors under environmental laws.

A. Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA")

The federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA")[1] law imposes strict and joint liability on past and current owners and operators of properties contaminated with hazardous substances as well as generators and transporters of hazardous substances.[2]

CERCLA contains a secured creditor exemption that excludes from the definition of "owner or operator" any person who "holds indicia of ownership primarily to protect the security interest" in a vessel or facility which person will not be liable as an owner or operator if that person does not "participate in the

[1] Schnapf Law Offices, New York, NY.

management" of the facility or vessel.[3] This exemption can insulate a secured creditor from liability during the administration of a loan, including workouts, so long as the lender's actions during the life of a loan do not constitute exercising managerial control over the operations of its borrower.

It is important to emphasize that in order to qualify as a secured creditor, the lender only has to show that it holds "indicia of ownership" PRIMARILY but not SOLELY to protect its security interest. The mere fact that a secured creditor derives some profit or income from the transaction will not cause the lender to forfeit its immunity so long as the security interest is primarily to secure repayment of a loan or performance of some obligation. An example of a situation where a holder of a lien might not be considered to be having indicia of ownership primarily to protect a security interest could be purchasers of discounted or distressed notes who are taking the notes primarily for the income stream or investment potential.

What about a bank that acquires shares in its borrower, high interest subordinated notes, or other debt instruments as part of a financing arrangement, workout or bankruptcy reorganization? Would a bank be deemed to no longer be primarily protecting its security interest and therefore lose its safe harbor by virtue of holding stock? Unfortunately, there are no objective criteria for determining when a secured creditor holds "indicia of ownership primarily to protect its security interest." Courts will examine the facts of a particular transaction to determine the reason why the lender held indicia of ownership.[4] Moreover a bank seeking to take advantage of the secured creditor exemption would have the burden of proof to initially establish that it was entitled to the exemption.[5] A decision by the Court of Appeals for the Second Circuit following a series of complicated rulings illustrates how an investment bank which simply held stock in a reorganized company can be drawn into a CERCLA contribution action in *In Re Duplan Corp. et al. v. Esso Virgin Islands, Inc.*[6] Some financial institutions have also had to guarantee the environmental obligations of non-banking subsidiaries.[7]

Originators of loans that are to be securitized have assumed that they could benefit from the safe harbor provided by the secured creditor exemption if forced to buy back defaulted loans. Although there are no published or known cases addressing these issues, it is quite possible that banks that originate and sell loans like commercial mortgage-backed securities ("CMBS") may not qualify for secured creditor exemption as they are not holding indicia of ownership primarily to protect security interest but instead are being driven by fee profits. This potential exposure was illustrated in *LaSalle Bank National Association v. Lehman Brothers Holdings, Inc.*[8]

The CERCLA secured creditor exemption also provides limited protection to lenders during foreclosure.[9] After foreclosure, a secured creditor may maintain business activities, wind up operations, undertake a response action in accordance with the National Contingency Plan ("NCP") or under the direction of an on-scene coordinator, or otherwise take any other actions to preserve, protect or prepare the vessel or facility prior to sale or disposition provided the lender tries to sell, release or otherwise divest itself of the facility or vessel at the earliest practicable, commercially reasonable time, and on commercially reasonable terms after taking into account market conditions and legal or regulatory requirements.

Many real estate investors are purchasing distressed debt or acquiring rights to property through tax sales without actually taking title to the land. This strategy is not without risk as illustrated in *United States v. Capital Tax Corporation.*[10] A lender foreclosing on a mezzazine loan also needs to be concerned about environmental compliance since it will be taking an interest in the entity that owns or controls the land. In other words, if that entity has liability, the lender could succeed to that liability as the owner of that entity.

The CERCLA secured creditor exemptions do not provide liability relief for other federal laws such as for the cleanup of polychlorinated biphenyls ("PCBs") or for complying with the lead-based paint disclosure rules promulgated under the Toxic Substance Control Act.[11] Similarly, the CERCLA secured creditor exemption does not provide any liability relief for state or common law claims.

A lender who fails to qualify for the secured creditor exemption may seek the protection of a number of CERCLA statutory defenses. The most commonly asserted defenses are the Third Party defense[12] and the Innocent Landowner defense.[13] Most courts have narrowly construed the Innocent Landowner defense and if a purchaser did not discover contamination prior to taking title but contamination is subsequently discovered, courts will usually conclude that the purchaser did not conduct an adequate inquiry and, therefore, not be eligible for the defense.[14]

Since 2002, a lender may also seek liability protection as a Bona Fide Prospective Purchaser ("BFPP").[15] Under the BFPP, a purchaser may knowingly acquire contaminated property and not be liable for remediation if it conducts a pre-acquisition "all appropriate inquiry" ("AAI") into the past use and ownership of the property and complies with post-acquisition "continuing obligations." The post-acquisition obligations are similar to the "due care" obligations under the Third Party Defense.

If a lender's collateral is affected by an off-site source of contamination, it might also qualify for the Contiguous Property Owner ("CPO") defense.[16] Like the BFPP, a lender seeking CPO protection will have to conduct AAI to establish that it did not know or have reason to know of the existence of contamination.

B. Resource Conservation and Recovery Act ("RCRA")

The federal Resource Conservation and Recovery Act ("RCRA")[17] regulates the generation, storage, handling, transportation and disposal of hazardous waste. Owners or operators of facilities that treat, store or dispose of hazardous wastes ("TSDF") must comply with certain operating standards and may also be required to undertake corrective action to cleanup contamination caused by hazardous or solid wastes pursuant to a permit[18] or a corrective action order.[19] The government may also issue orders for injunctive relief to address hazardous wastes posing an "imminent and substantial endangerment" to public health and the environment.[20] However, unlike CERCLA, private parties are not entitled to recover their cleanup costs.

The RCRA secured creditor's exemption is similar to the CERCLA provision, but it is limited to underground storage tanks ("USTs"). The RCRA secured creditor's exemption provides that a lender who has indicia of ownership in a UST system (i.e., one or more USTs) or property containing a UST system will not be liable as an owner or operator of the UST system if:

- The indicia of ownership is held primarily to protect a security interest;
- The lender does not participate in the management of the UST system; and
- The lender is not engaged in petroleum production, refining or marketing.[21]

The RCRA secured creditor exemption will not insulate a lender from liability as an owner or operator of a RCRA TSDF or a generator-only facility. Thus, it is important for lenders to properly manage any wastes left when foreclosing or taking over control of borrower's operation that is regulated under RCRA.

The RCRA secured creditor exemption also does not insulate lenders from potential liability under the citizen suit provision of section 7002.[22] This section allows private parties to seek injunctive relief to compel persons who contributed to the past or present handling, storage, treatment, transportation or disposal of hazardous waste that is posing an "imminent and substantial endangerment" to public health and the environment.[23]

C. Clean Water Act ("CWA")

The federal Clean Water Act ("CWA")[24] has been a surprising source of liability to lenders during the Great Recession. The law requires owners or operators of facilities that discharge pollutants into the nation's waters to obtain permits. The CWA not only applies to traditional wastewater discharges but also properties that present storm water discharges from construction sites. Unlike CERCLA or RCRA, the CWA does not have a secured creditor exemption. Thus, banks will be considered owners or operators of these properties and are responsible for complying with the full panoply of environmental laws associated with their development. As builders continue to default on construction loans, states are increasingly turning to banks to ensure that partially completed developments remain in compliance with environmental laws.

Despite this potential CWA liability, banks have not historically addressed environmental compliance prior to foreclosing on these abandoned construction projects. Under the CWA and state versions of that law, developers and builders are required to obtain storm water permits, develop storm water pollution prevention plans ("SWPPPs"),[25] and implement erosion and sediment control measures. These requirements are the reason that construction projects have those ubiquitous black and orange silt fences. Often times, builders will erect temporary control measures and will not construct permanent storm water management structures until the entire project is completed. The temporary storm water measures can deteriorate during the time it takes for a bank to take control of a defaulted construction project. Thus, it is important for lenders foreclosing on unfinished construction projects to ensure that these sites are stabilized and that storm water controls are maintained to avoid incurring fines that can quickly accumulate.[26]

Some states have implemented specific policies directed at foreclosing lenders. For example, Georgia requires a lender or other secured creditor that acquires legal title to a construction site to file a new Notice of Intent either seven days before beginning work at the construction site or 30 days prior to acquiring legal title to the construction site. North Carolina expects lenders to contact the Department of Environment and Natural Resources ("DENR") immediately upon taking control of property. If remedial measures are required, the bank would be expected to enter into an administrative order.

Another area of potential liability is construction projects that require dewatering to prevent shallow groundwater from infiltrating into foundations or subsurface parking structures. The dewatering systems usually collect the groundwater and discharge it into the storm water system. Such discharges will likely require obtaining and complying with a National Pollutant Discharge Elimination System ("NPDES") permit from the state environmental agency or the EPA if the state has not been approved to issue such permits. The NPDES permits may contain ongoing monitoring and treatment conditions for discharges containing metals, petroleum or other contaminants that may be present in the groundwater regardless of the source of the contamination. Prior to foreclosing on such projects, the lender should determine if such permits are required, have been obtained, and if the property is in compliance. If not, it would be advisable for the lender to contact the appropriate regulatory agency to make sure the lender does not inadvertently become responsible for past violations associated with the permit. It may also be possible that the permit may no longer be necessary.

Lenders should also verify if the property contains or contained wetlands prior to the start of construction activities. Developers may have engaged in unauthorized filling or dredging of wetlands. A foreclosing lender could be required to restore illegally destroyed wetlands. In addition, a developer that did obtain a wetlands permit may have had obligations to create replacement wetlands (known as mitigation) or make mitigation payments to a mitigation bank. In a recent case, a Florida bank had to enter into a consent order where it had to develop and implement a wetlands mitigation plan.

D. Clean Air Act ("CAA")

Lenders taking control or foreclosing on abandoned construction projects may need to implement measures to reduce airborne dust under the CAA.[27]

Renovation or demolition projects that disturb certain amounts of asbestos-containing building materials ("ACBM") have to comply with certain notification and workpractice procedures and use asbestos-licensed contractors. Lenders taking control of partially demolished structures or buildings with ACBM must ensure that the ACBM workpractices are followed to minimize emission of asbestos fibers into the air.[28]

E. Toxic Substance Control Act ("TSCA")

Under TSCA, owners and operators of certain properties constructed prior to 1978 may have to comply with a number of requirements relating to lead-based paint ("LBP").[29] In general, foreclosure sales are exempt from the LBP disclosure requirements. However, once a lender takes title to such property it may have to comply with the full panoply of LBP requirements. This will include providing mandated notices to tenants and purchasers about the existence of LBP and complying with certain workpractices when performing repairs, renovations or painting that will disturb painted surfaces containing LBP.[30]

F. Liability for Environmental Conditions Under State Environmental and Common Laws

Many states have adopted their own secured creditor exemptions for their state superfund laws. These state exclusions will vary in terms of the scope of the protection and the permitted activities. Like the CERCLA and RCRA secured creditor exemptions, most states do not provide protection against other statutory or common claims.[31] Lenders should carefully review the provisions of state lender liability laws and the scope of environmental disclosure laws as part of their loan due diligence.

G. Liability of Lenders for Inadequate Disclosure of Environmental Conditions

Many states have statutes that require owners of property to disclose the existence of contamination to prospective purchasers. Lender liability statutes in those states generally do not provide protection for common law claims or for failing to comply with the disclosure requirements.[32] Borrowers often confuse a lender concluding that a Phase 1 was acceptable with a determination that a property is "clean."[33] The Phase 1 may identify environmental conditions that fall within a lender's risk tolerance. Indeed, during the credit bubble, many loan orginators were not concerned about environmental issues since they knew they would be selling the loans to the CMBS collective and thus were not exposed to collateral or payback risk.

I. Environmental Liability Associated with Bank Offices

Financial institutions can also face environmental risk associated with properties the banks themselves acquired pursuant to a bank's mergers or acquisitions activities. The poster child for such potential liability is the Swan Cleaners/Sun Cleaners Area Ground Water Plume site in Wall Township, New Jersey. Two dry cleaners had formerly operated at the site that is currently a bank branch office owned by Bank of America ("BOA"). The dry cleaners discharged tetrachloroethylene (PCE) into the on-site septic system where it eventually migrated into the groundwater that serves public and private drinking water wells within a four-mile radius. PCE was detected at concentrations of up to 200 parts per million (ppm) in the groundwater. The PCE-contaminated groundwater also affected surface water. In addition, following indoor air sampling of 300 residential and commercial properties in 2001, EPA had to install ventilation systems in the basements of nine homes and one ventilation system on a commercial property. This property was acquired by Summit Bank. Fleet Bank then took title to the property when it acquired Summit Bank. Fleet then merged with BOA. The Swan Cleaners/Sun Cleaners Area Ground Water Plume site suggests that banks should perform the kind of environmental due diligence that they customarily expect from their borrowers.

II. 2010 Lender Liability Cases

In ***Palmtree Acquisition Corp. v. Evers***,[34] PCE from a dry cleaner contaminated the soil and groundwater beneath the Livermore Arcade Shopping Center ("LASC") and Millers Outpost Shopping Center ("MOSC") in Livermore, California. The Grubb & Ellis Realty Income Trust, Liquidating Trust ("GERIT") owned and operated LASC from 1989 through 1996.

In February 1993, GERIT brought an action under CERCLA against the former owners of LASC, the current and former owners of MOSC as well as the operators of the dry cleaning businesses. In February 1994, the parties to the earlier action entered into a settlement agreement where the settling parties appointed Ellis Partners, Inc. ("EPI") as the Project Manager to oversee the remediation efforts. In April 1996, the San Francisco Water Quality Control Board ("RWQCB") issued an order establishing a Containment Zone. The order required further groundwater monitoring and set trigger levels of PCE for outside the Containment Zone, which could prompt further investigation and/or remediation. The RWQCB then issued a no further action ("NFA") letter to GERIT. Thereafter, GERIT sold LASC to the Anderson Marital Trust and Anderson Tax Deferral Trust and GERIT's assets were distributed in their entirety

However, the RWQCB reopened the matter in 2008 and the current landowner filed a contribution action against the former owners, among others. As co-trustee of GERIT, Ellis held legal title to LASC under California law. A third party complaint named Harry Ellis as a former owner of the site. Since Ellis died in 2009, the complaint was amended to add his estate.

The estate argued that Ellis fell within the fiduciary protections that were added to CERCLA in 1996. The third-party plaintiffs alleged that Ellis benefited from his position as co-trustee of GERIT by selecting EPI to serve as GERIT's Liquidating Agent and by maneuvering for EPI to serve as project manager for the PCE remediation efforts. The court granted Ellis' motion to dismiss, finding that the complaint did not state any actions taken by Ellis that were not pursuant to his responsibilities as co-trustee. The court said Ellis' dual role as co-trustee of and manager of the remediating firm did not necessarily remove Ellis from CERCLA's fiduciary exemption. Note that the third-party plaintiffs did not allege that Ellis was liable under CERCLA due to his management role with EPI.

The complaint also alleged that Ellis was liable under the negligence exception of the CERCLA fiduciary exemption. This section provides that a fiduciary may be personally liable if that person negligently causes or contributed to the release or threatened release of hazardous substances. However, the court said that the complaint did not allege any particular actions taken by Ellis that led to the release of PCE, and any failure by Ellis to prevent others' pollution was insufficient to qualify Ellis for the negligence exception. Because Ellis' involvement in the PCE contamination, investigation and remediation was limited to his role as co-trustee of GERIT, he was not personally liable for recovery costs under CERCLA. The court granted the motion to dismiss without prejudice and gave the third party plaintiffs thirty days to file an amended complaint pleading sufficient facts to hold Ellis personally liable.

In ***Harwood Investment Company v. Wells Fargo National Association, Inc.***,[35] the defendant bank extended a $16MM loan to Harwood Products, Inc., a lumber mill. The loan was guaranteed by the plaintiff and the promissory note was secured by the property and equipment owned by the lumber mill. After the bank asserted that it was in default of its loan in the amount of $2.6MM, Harwood Products, Inc. filed for bankrtupcy. In September 2008, the lumber mill defaulted on its loan and the bank retained an auctioneer to conduct a sale of the borrower's assets.

In December 2008, a contractor retained to provide security and dismantle equipment allegedly caused hydraulic fluid and other hazardous substances to be released. Later, the Mendoncino County Department of Environmental Health ("MCDEH") conducted an inspection and observed abandoned drums without secondary containment and wastewater overflowing from a dip tank, along with evidence of staining on floors and near floor drains. The MCDEH determined the conditions posed an imminent and substantial endangerment and notified the regional water quality control board.

In January 2009, a purchaser of certain equipment located in one of the buildings was using a blow torch to dismantle equipment when a spark ignited that engulfed the building. Water from the fire suppression system and from fire fighting actions of the local fire department caused the hazardous substances to flow into surface water and the storm water system containment system and to spread into the soil and groundwater. Following the fire, the regional water quality control board issued an abatement order requiring the borrower to implement remedial actions.

The bankruptcy case was then converted to a Chapter 7 liquidation and the bankruptcy court authorized the abandonment of the facility to Willits Financial Company, Inc. in April 2009. The plaintiffs then filed a contribution and cost recovery action, alleging the bank and its agents took possession of the lumber mill in September 2008 and were responsible for the releases of hazardous substances. The defendants filed a motion to dismiss and the parties reached a settlement.

In ***State of Ohio v. Estate of Roberts***,[36] Citizens National Bank of Norwalk ("Citizens") extended credit to Ultimate Industries, Inc. ("Ultimate") who manufactured artificial rocks and rock waterfalls at the property. The loan was secured by a mortgage, inventory and equipment.

Ultimate defaulted on its loan obligations in June 2004 and after the company ceased operations, Citizens took possession of the property in the fall of 2004. Approximately 54 drums of chemicals were present when Citizens assumed control of the site, with eight of these drums containing hazardous wastes. The bank sold some of the equipment but was only able to sell two of the drums. The bank commenced foreclosure proceedings in May 2005 and allegedly rejected an offer to purchase the entire building and its contents for $100,000 in late 2005. When one of the paint sprayer's that Citizen sold was removed, a hole was left in the roof were the vent line had been located. This allowed water to accumulate on the third floor and black mold soon began to grow. Except for putting antifreeze in the toilets, Citizens took no action to winterize or protect the building.

In May 2006, the property was sold at a sheriff's sale to Citizens for $40,000. However, before the sheriff was ordered to convey the deed to Citizens, Citizens moved to have the confirmation of sale vacated due to "newly discovered evidence." While Citizens' motion to vacate was pending, the Ohio Attorney General filed a complaint in October 2006 against Ultimate for injunctive relief and civil penalties, claiming that many of the drums at the site had become unusable in the intervening period.

In January 2007, the trial court granted Citizens' motion to vacate, finding that Citizens acted within a reasonable time of becoming aware of the newly discovered evidence, which by due diligence could not have been discovered. In July 2007, the state ordered Ultimate to properly dispose of the hazardous wastes at the site. Two weeks later, the owner of the company died and Ultimate was dissolved.

In January 2008, the state filed an amended complaint against the estate of the owner of the company. The estate, in turn, filed a third-party complaint against Citizens in April 2008. The estate ("appellant") asserted that Citizens committed waste for failing to take steps to adequately protect the real property after it took control of the property. The estate also asserted that it no longer owned or possessed the waste drums since Citizens assumed control of the site.

Citizens subsequently filed a motion for summary judgment arguing it had no obligation to comply with the Ohio EPA order. The trial court agreed, holding that while Citizens had had discretion under the financing statement or loan documents to perform any duty or covenant that appellants failed to perform, the bank was not obligated to do so. The court also noted that responsibility for environmental remediation generally follows ownership and Citizen did not have title to the property. As a result, the trial court dismissed the third-party complaint filed by appellant. A bench trial was then held to determine the amount of the civil penalty to be assessed against appellant.

The court of appeals reversed, finding numerous genuine questions of material facts about the bank's actions. The court said there was a material question if Citizens had possession of the entire inventory, not just the inventory it sold as it alleged. The court said there was also a material question if Citizens' disposition of the inventory in which it held a security interest contained viable, marketable, and usable chemicals at the time appellants defaulted on their agreement. Moreover, the court found genuine issues of material fact if Citizens breached its implied duty of good faith and dealing when it allowed the inventory to deteriorate into hazardous waste, thereby allegedly causing appellant's additional damages in excess of their mortgage obligation to Citizens

Turning to the secured creditor exemption, the court noted that the statute not only required Citizen to dispose of its collateral in a commercially reasonable manner but that "every aspect of the disposition of collateral, including the method, manner, time, place and other terms, must be commercially reasonable."[37] Since the bank's agent was at the property to sell the collateral, the court found genuine issues of material fact if the bank failed to properly dispose of the drums and allowed useful chemicals to deteriorate into hazardous wastes.

In ***Voelker v. Home Office Realty***,[38] home owners in Michigan claimed that banks involved in the FHA loan process failed to sample well water, despite knowledge that a local landfill might have affected the drinking water supply. The plaintiffs noted that the FHA Mortgagee Letter 95-34 (July 27, 1995) required Direct Endorsement Lenders to sample drinking water in accordance with local and state private well regulations as well as for for contaminants of local concern.

The loan originator retained a contractor to test the well for the usual potable water parameters. Years after buying the house, two of the plaintiffs developed cancer that they alleged was a result of exposure to contaminants in the potable water. The trial court dismissed the claims on the grounds that alleged lender was just a loan originator and that it had no obligation to test the well water. The appeals court affirmed.

This case illustrates why banks are reluctant to go beyond minimum environmental requirements. In this case, the plaintiff argued that the loan originator had an obligation to interpret the FHA letter to determine if additional parameters had to be tested as part of the water quality sampling. Fortunately for the loan originator, the count found it was not a "lender" for purposes of the FHA loan process and therefore had no obligation to determine what sampling was appropriate.

Presumably, even if the loan originator could have been deemed to be a lender, it could still have avoided liability by arguing that it relied on the expertise of the well tester to determine what parameters had to be analyzed. Of course, the FHA letter seemed to require more than what was required under state or local drinking water regulations if there were local conditions that warranted sampling additional chemicals of concern, and the well tester might not have known about this additional FHA requirement. By ruling that the loan originator was not an FHA "lender", the court did not have to address the merits of the claims.

In ***Ironwood Homes v. Bowen***,[39] purchasers of farm land subsequently discovered that the property had been used as a disposal site for tannery waste. Plaintiffs asserted a variety of federal and state law claims against a range of defendants, including two banks that had a history of involvement in the site.

One bank served as the trustee that managed the affairs of the tannery owner ("trustee bank"), while the other bank provided financing to the plaintiffs ("lender bank"). The lender bank reviewed an environmental report concerning the property, but misstated the conclusions contained in the report to the plaintiffs. In particular, the bank's employee incorrectly described the environmental risk associated with the property as "low" and also stated that the report had concluded that no further environmental investigation was warranted.

The court denied the motion to dismiss by bank on claims for fraudulent concealment and reckless misrepresentation, negligent misrepresentation, and nongratuitous negligent advice. The court also denied the lender's motion to dismiss that an indemnification in loan modification agreements released plaintiffs' claims against the bank, ruling that if plaintiffs agreed to the modifications because they had been unaware of the bank's knowledge about the true environmental condition of the property, the release might be considered unconscionable and therefore unenforceable.

The court also rejected a state contribution claim brought by the trustee bank against the lender bank, holding that the contribution claim was barred because the trustee bank failed to allege that the lender bank "in any way 'caused, contributed to, or exacerbated the release' of contaminants or 'hinder[ed] or relay[ed] entry to, investigation of, or removal or remedial action at' the contaminated property."[40]

State v. Howe Cleaners[41] involves a baker, a banker, and a defunct pizza-bread maker. The property had been used as a dry cleaner from 1974-1996. The property was then conveyed to purchaser who converted it to a bakery. When the bakery failed, Granite Savings Bank and Trust ("Granite") foreclosed and sold the property seven months later to a pizzeria. The sale was "as is" and before acquiring the property, the purchaser reviewed a Phase 1 prepared for Granite.

Sometime after taking title, an EPA inspector spoke with former employees of the dry cleaner and visited the property. When he raised some floorboards, he observed two tanks in the crawl space that had apparently been used to store PCE and that had leaked.

The state implemented response actions and sought cost recovery under the state Waste Management Act ("WMA"). The state argued that the successor to Granite, TD Bank North ("TD Bank"), was liable as a person who owned the site at the time of a release. TD Bank argued it could not be liable because the state did not have any evidence that there had been a release during its ownership. The state responded that it did not have to prove there was a new release but simply migration of an initial release.

The trial court found the potential for liability under the WMA. Because there was a triable issue of fact whether there was a release during the ownership of TD Bank, the court denied the TD Bank's motion for summary judgment. The TD Bank then sought to depose the state's expert on the timing of the release. After the state refused to make its expert available for an extended period of time, the court issued a sanction prohibiting the state from introducing evidence of the timing of the release which effectively resulted in judgment for TD Bank.

III. CONCLUSIONS

These cases illustrate the heightened risks that lenders face when foreclosing or taking control of the property of defaulted borrwers. The situations where financial institutions have become embroiled in environmental issues have one unifying theme: conditions at the property were allowed to deteriorate. Typical problems have included: roofs have developed leaks that allow water to enter the building; or plumbing and drums in unheated buildings have frozen and burst during the winter, and then leaked during the spring thaw. Unhealthy chemical vapors may build-up during hot summer months from open or leaking containers of chemicals, or deteriorating containers of incompatible chemicals are left behind within proximity, creating risks of explosion.

Clearly, lenders face their greatest risk of liability when in post-foreclosure activities. There are many unreported situations where lenders have been issued administrative orders by governmental agencies and have had to pay to perform a cleanup because of the actions they took following foreclosure. These situations have typically taken place when a borrower has gone out of business and the lender takes control of the facility in order to sell off the inventory, fixtures, machinery and equipment of the borrower subject to the lender's lien. The lender typically does not take title to the property because of fear that it will lose its exemption, but instead hires an auction to conduct the sale of the personal property. Usually, there are barrels or drums of hazardous waste strewn about the facility and the equipment that is being auctioned off may even contain hazardous wastes. In order to avoid any suggestion that the lender or the auction had any control over hazardous wastes, the auction will often rope off the area where the drums or barrels are found. In some cases, the bidders are actually allowed to cherry-pick barrels containing useful raw materials. After the auction is conducted, the drums and barrels are then left in the abandoned facility. At some point, government authorities find out that there are abandoned drums at the facility and order the lender to pay for the removal of the materials.

Lenders will often argue that the drums containing the wastes were not part of its collateral or that the lender never exercised control over the drums because neither it nor its auctioneer ever touched or moved them. However, the definition of "release" under CERCLA includes abandonment of drums. Thus, a lender who has taken control of a facility to conduct an auction and leaves behind drums or equipment containing hazardous wastes could be deemed to have caused a threatened release of hazardous substances. Thus, financial institutions should exercise extreme caution when conducting auctions and should consult with environmental counsel prior to conducting any auction at a manufacturing facility.

If the lender decides to have the hazardous wastes removed, it should try to have a representative of the borrower execute the waste manifests so that the lender would not be considered the generator of the waste. However, if no such representative is available, the lender or one of its agents would have to execute the waste manifests. Since the lender would be considered a generator of the waste under these circumstances, the lender should have its consultant select a reputable disposal or treatment facility. The financial institution could have its environmental consultant or attorney perform a regulatory review of the facility to minimize the possibility that the lender could incur liability for releases of hazardous substances at that treatment or disposal facility. It is important for purchasers to evaluate the environmental conditions of the collateral prior to purchasing the note or exercising control over the property.

These caveats also apply even when the lender does not foreclose on the real estate but just the inventory and equipment. Once a lender, through its agents, asserts control over a site, it will be an "operator" for purposes of CERCLA and state environmental laws even where the lender does not actually operate the business. Conducting auctions of personal property or authorizing repairs may infer control, and purchasers can face liability as "operators" if they do not qualify for the secured creditor exemption. Purchasers should also consult environmental counsel prior to taking any actions that would be suggestive of exercising control over a potentially contaminated property.

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1. 42 U.S.C. 9601.
2. 42 U.S.C. 9607(a)(1)-(4).
3. 42 U.S.C. 9601(20)(E)(i).
4. *U.S. v. Lamb, Kemp Indus. v. Safety Light Corp.*, 857 F. Supp. 373 (D.N.J. 1994).
5. *Stearns & Foster Bedding Co. v. Franklin Holding Corp.*, 947 F.Supp. 790, 802 (D.N.J. 1996); U.S. v. Wallace, 893 F.Supp. 627 (N.D. Tex. 1995).
6. 212 F.3d 144 (2000).
7. See notice of lodging of proposed consent decree in *United States v. The S.W. SHATTUCK CHEMICAL COMPANY, Inc.*, No. 01-2404, 67 FR 2243 (12/12/01). Shattuck was indirectly owned by Salomon Smith Barney Holdings, Inc. ("Solomon") which, in turn, was owned by CITIGROUP Inc. Solomon had guaranteed Shattuck's compliance with an order issued by EPA. Shattuck ended up agreeing to pay $7.2 million to the federal government and the State of Colorado.
8. *LaSalle Bank Nat'l Ass'n v. Lehman Bros. Holdings*, 237 F. Supp. 2d 618 (D. Md. 2002); see also *In re William Hurley*, 285 B.R. 871 (Bankr. D.N.J. 2002).
9. 42 U.S.C. 9601(20)(E)(ii).
10. *U.S. v. Capital Tax Corp.*, No. 04 C 4138, 2007 U.S. Dist. LEXIS 1184 (N.D. Ill. 2007), vacated, 545 F.3d 525 (7th Cir. 2008).
11. 15 U.S.C. 2601.
12. 42 U.S.C. 9607(b). To qualify for this defense, a defendant must establish the following four elements: The release was caused solely by the act or omission of a third party; whom the defendant had no direct or indirect contractual relationship; the defendant exercised due care with respect to the hazardous substances due care ("due care element"); and took precautions against the foreseeable acts or omissions of any such third parties ("precautionary element"). Id. at 9607(b)(3).
13. 42 U.S.C. 9601(35)(A). To establish the innocent landowner defense, a purchase must establish that it "did not know or had no reason to know" of contamination. To demonstrate this lack of knowledge, the purchaser must have engaged in an appropriate inquiry into the past use and ownership of the property. EPA has promulgated a rule for satisfying the "all appropriate inquires" requirement at 40 CFR 312. Performing a phase 1 environmental site investigation that complies with the ASTM E1527-05 standard practice for environmental site assessments satisfies the AAI requirements.
14. Because the innocent purchaser defense is technically a part of the third party defense, a landowner would have to satisfy the due care and precautionary elements of the third party defense as well.
15. 42 U.S.C. 9607(r).
16. 42 U.S.C. 9607(q).
17. 42 U.S.C. 6901.
18. 42 U.S.C. 6924(u) and (v).
19. 42 U.S.C. 6938(h).
20. 42 U.S.C. 6973.
21. 42 U.S.C. 6991(b)(h)(9).
22. 42 U.S.C. 6972.
23. 42 U.S.C. 6972(a)(1)(B).
24. 33 U.S.C. 1251 et seq.
25. SWPPPs must contain a site map depicting the topography before and after completion of the project, drain age patterns, existing and future buildings, lots, roadways and stormwater collection and discharge. The plan must

also identify the best management practices ("BMPs") to be used to control runoff and establish a monitoring plan.

[26] CWA fines can range as much as $37,500 per day per violation, depending on the severity of the violations and length of time the properties have been in noncompliance. In addition, the violations run with the land. These costs can quickly add up, especially for banks with numerous defaulted construction properties. For example, a Georgia-based lender was fined in excess of $4 million for inadequate erosion controls for a site that was valued at $1.97 million in 2006.

[27] 42 U.S.C. 7401 et seq.

[28] 40 CFR Part 61.

[29] 15 U.S.C. 2682-83.

[30] 40 CFR Part 745.

[31] For examples of common law liability, see *Carrion v. 605 Realty Assocs. Ltd. P'ship,* U.S. Dist. LEXIS 12985 (S.D.N.Y. July 9, 2004) and *Edwards v. First Nat'l Bank,* 122 Md. App. 96, 712 A.2d 33 (Md. Ct. Spec. App. 1998).

[32] *Hess v. Chase Manhattan Bank, USA, N.A.*, 220 S.W.3d 758 (Mo. 2007).

[33] *Hull v. Lewis, Case* No. A-005403-07T3, 2009 N.J. Super. Unpub. LEXIS 1412 (App. Div. June 11, 2009).

[34] 2010 U.S. Dist. LEXIS 105782 (N.D. Ca. 10/4/10).

[35] No. C-09-3410 EMC (N.D. Cal. 1/22/10).

[36] 935 N.E.2d 450 (Ohio App. 2010).

[37] *Id.* at 457.

[38] 2010 Mich. App. LEXIS 1719 (Ct. App. 9/16/10).

[39] *Ironwood Homes, Inc. v. Bowen,* 719 F. Supp. 2d 1277 (D. Or. 2010).

[40] *Id.* at 1294.

[41] 2010 VT 70 (Vt. Aug. 6, 2010).