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LENDER LIABILITY REVIEW

Some Relatively Recent Cases Have Involved Environmental Liabilities of Foreclosing Lenders under Federal and State Law and Recovery of Cleanup Costs under the Federal Resource Conservation and Recovery Act. The Author Reviews these Cases and Discusses Bank Use of Insurance to Cover Environmental Risks and Loans for Brownfield Sites.

By Larry Schnapf*

Since the enactment of the Asset Conservation, Lender Liability, and Deposit Insurance Protection Act of 1996 (the "Federal Lender Liability Amendments") and state lender liability laws, many financial institutions have become less concerned about potential environmental liability. Indeed, with Wall Street increasingly competing with traditional lenders for loans, many banks have relaxed their due diligence requirements. However, lenders are continuing to find themselves embroiled in disputes over responsibility for environmental contamination. This article will review some of the significant cases that were decided in 1998 as well as other regulatory developments.

OVERVIEW OF LENDER LIABILITY

The principal federal environmental laws of concern to financial institutions have been the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA")[1] and the Resource Conservation and Recovery Act ("RCRA").[2] Most states have enacted versions of these statutes.

CERCLA imposes strict and joint liability on four classes of potentially responsible parties ("PRPs") for the cleanup and reimbursement of costs associated with releases of hazardous substances. The four classes of PRPs include past and current owners of facilities and vessels (i.e., tanks, equipment, etc.), past and current operators of facilities and vessels, generators of hazardous substances, and transporters of hazardous substances. The definition of "owner or operator" does contain a secured creditor's exclusion, which states that any person who " holds indicia of ownership primarily to protect his security interest" in a vessel or facility will not be liable as an owner or operator if that person does not "participate in the management" of the facility or vessel. EPA issued a CERCLA Lender Liability Rule in 1992,[3] but the rule was vacated by a federal appellate court in 1994.[4]

1. 42 U.S.C. 9601 et seq.
2. 42 U.S.C. 6901 et seq.
3. 57 FR 18344 (April 29, 1992)
4. Kelley v. EPA, 15 F.3d 1100 (D.C. Cir. 1994)

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IN THIS ISSUE

- ***Lender Liability Review***

RCRA regulates the generation, storage, handling, transportation, and disposal of hazardous waste. Owners or operators of RCRA-regulated facilities must comply with certain operating standards and are also required to undertake corrective action to clean up contamination caused by hazardous or solid wastes. RCRA contains a secured creditor's exemption similar to the CERCLA provision except that 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: (i) the indicia of ownership is held primarily to protect a security interest; (ii) the lender does not participate in the management of the UST system; and (iii) the lender is not engaged in petroleum production, refining or marketing (42 U.S.C. 6991(b)(h)(9)). The EPA issued a RCRA Lender Liability Rule interpreting the scope of the RCRA secured creditor's exemption in 1995.[5]

The Lender Liability Amendments added new provisions to the CERCLA and RCRA secured creditor exemptions and codified the provisions of the two EPA lender liability rules. Those regulations essentially provided that a lender must exercise actual day-to-day control over a borrower's operation before it will be considered "participating in the management of a facility." Moreover, lenders were allowed to foreclose on property without becoming liable as an owner so long as they expeditiously took steps to sell the property and comply with environmental laws while they were in possession of the property.

LENDER COMMON LAW LIABILITY FOR PETROLEUM DISCHARGE

In past articles, we have reminded readers that the Federal Lender Liability Amendments do not provide relief from claims brought under state environmental and common laws. The lack of protection offered by these provisions was recently illustrated in a Maryland state court decision.

In *Edwards v. First National Bank of North East*,[6] plaintiffs,who were the owners of a gasoline station/mini-market, defaulted on their mortgage. The defendant bank foreclosed on the property, and after it acquired title performed a tightness test on three underground storage tanks ("USTs") that were located on the property. The USTs passed the tightness test and the bank/defendant then arranged with a local contractor to remove them. A representative of the Maryland Department of the Environment ("MDE") was present during the UST removal. Petroleum odors were detected during the tank removal and post-excavation samples confirmed the presence of concentrations of petroleum above the MDE cleanup levels. Presumably, the contamination was from older tanks that had been replaced. The MDE then arranged for the installation of three groundwater monitoring wells, which detected petroleum in the groundwater.

Meanwhile, the defaulted borrowers also operated a day care center from their home which was located near the former mini-market. Several weeks prior to the UST excavation the borrowers had installed a drinking water well on their property to comply with local health code requirements governing day care centers. One month after the well had been installed, the plaintiff/borrower began to smell gasoline in their house. When the odor intensified, they had the well water sampled,which confirmed the presence of petroleum in their drinking water. The plaintiff/borrowers then filed suit for injury to their real and personal property. They filed common law claims for negligence, trespass, nuisance and strict liability and also filed a claim under the state Water Pollution Control and Abatement Act (the "Act").

5. 60 FR 46698 (September 7, 1995)

6. 712 A.2d 33, 122 Md. App. 96 (Ct. Sp. App. June 24, 1998)

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The defendant bank argued that the secured creditor exemption excluded lenders from the definition of persons who could be responsible for a discharge. The exemption provided, in part, that a person who holds indicia of ownership primarily to protect its security interest and does not participate in the management of a facility will not be a person responsible for a discharge if it abandons a UST in accordance with the MDE requirements within six months of acquiring title through foreclosure or other means. The exemption also provided that a creditor who acquires title through foreclosure on a property that is subject to a corrective action plan approved by the MDE, or who extends credit to perform remedial actions pursuant to MDE requirements, would also not be considered a person responsible for the discharge. Moreover, a creditor who takes actions to stabilize, contain, or prevent a discharge in a manner that does not cause or contribute to a discharge also shall not be responsible for a discharge, provided that the lender: (i) furnished advance notice of the action to the MDE; (ii) would not be considered responsible for the discharge prior to the remedial action, and (iii) did not by its actions violate the statute. Finally, the secured creditor's exemption also limited a lender's liability to the costs to respond to the discharge caused by the lender.

Since the defendant bank had complied with the foregoing requirements by removing the USTs within 180 days of foreclosure, the bank argued it was immune from any environmental liability at the site. The trial court agreed and held that the secured creditor's exemption abrogated all common law claims arising out of petroleum contamination at the adjacent property that originated from the mini-market property.

However, a state appellate court reversed the dimissal. The appellate court held that the secured creditor's exemption did not confer a blanket immunity on the bank, but was limited to determining when the bank could be held statutorily liable as a "person responsible for the discharge." In so holding, the court relied on language elsewhere in the Act, which indicated that the statutory rights and remedies may not be construed to abridge or alter rights or remedies under existing common law or other statutes. In addition, the court said that the state constitution contained a presumption against statutory preemption of common law rights and that there was no express or implied legislative intent to abrogate or preempt common law claims.

The bank contended that such a narrow reading of the secured creditor's exemption would render it superfluous. However, the court responded that the exemption insulated lenders from claims for cleanup costs brought by the MDE. The case was remanded to the trial court for a hearing on the merits of the common law claims.

Commentary: Over two dozen states have enacted their own lender liability statutes or promulgated lender liability regulations that may differ from the federal law. While some state lender liability statutes expressly protect lenders against common law claims, others — as we have seen — do not confer such protection. Consequently, lenders need to familiarize themselves with the scope and requirements of state statutes before determining whether to foreclose on property.

Lenders also need to exercise extreme caution and perform detailed site inspections when foreclosing on assets of a defaulted borrower. There have been a number of unreported instances where lenders have been issued administrative orders by governmental agencies and have had to pay for a cleanup when lenders have taken control of a site after a borrower has gone out of business. Often, a bank will take control of the facility in order to sell off the borrower's inventory, fixtures, machinery, and equipment that are subject to the bank's lien. The bank typically does not take title to the property but simply hires an auctioneer to conduct the sale. There may be barrels or drums of hazardous waste strewn about the facility as well as USTs located at the site. In order to avoid any suggestion that the bank or the auctioneer had any control over hazardous wastes, the auctioneer 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 have ordered the lender to pay for the removal of the materials.

By taking control of the site, a lender may also be unwittingly asserting control over the USTs and exposing itself to a claim from the landlord. Such claims are most likely when there are environmental covenants imposing obligations on the borrower or where the borrower had the right to use or control the USTs under its lease.

As a result, financial institutions should consult with environmental counsel prior to taking possession of a former borrower's facility or conducting any auction at a manufacturing facility. It would be advisable for lenders to retain an environmental consultant or environmental attorney to inspect the facility prior to taking control in order to evaluate the possible environmental liabilities that might be associated with the auction. In addition,

the lender should have its counsel review both the lease and the state UST registrations to determine who is responsible for the USTs. If the USTs are registered in the name of the borrower, the lender should discuss the status of the USTs with the landlord. If the owner believes that the USTs enhance the marketability of the site, the lender may be in a good position to negotiate a satisfactory resolution to the UST issue prior to assuming control of the site for the purpose of conducting an auction of the former borrower's assets.

Another practice that can expose a lender to liability is the hiring of guards. Lenders frequently hire a guard to protect inventory or equipment until an auction can be conducted. The guard often is posted at the entrance to the plant and will not allow access to the property without approval of the lender. There have been occasions when the lender's guard denied access to a local government inspector who wanted to confirm that the abandonment of the facility did not pose a risk of danger or explosion. By exercising such control over a facility, a lender could be deemed to be an operator of the facility and be held responsible for remediating environmental problems at the site. To minimize this possibility, a lender should have its guard posted in or outside the building where the collateral is located instead of at the gate leading to the entire facility.

The lender may also want to have an environmental consultant present at the auction to make sure that hazardous materials remaining at the property are not disturbed or spilled. If any materials are inadvertently spilled, the consultant could take immediate steps to contain and cleanup the spill and document those actions.

BANK NOT LIABLE AS OWNER OR OPERATOR OF SUPERFUND SITE

The Federal Lender Liability Amendments insulated a lender from CERCLA liability in *United States v. Pesses*.[7] In that case, Dollar Savings Bank ("Dollar") in 1975 entered into a industrial loan financing arrangement with the Lawrence County Industrial Development Authority ("LCIDA"). Under this arrangement, the LCDIA acquired a site for development and entered into a 15 year lease-purchase agreement with Metcoa which had agreed to develop the site. Between December 1975 and November 1978, Dollar and two other banks made three loans to LCIDA totaling $916,000. The LCIDA distributed the proceeds of these loans to Metcoa, which used the funds to purchase machinery and equipment and to build a plant. LCIDA assigned its right to the rental payments to Dollar which Dollar applied to pay down the loan. In addition, Dollar took back chattel mortgages on the machinery and equipment and a mortgage on the property.

When Metcoa defaulted on its July 1983 rental payment, Dollar declared a default. Metcoa was forced into chapter 7 bankruptcy and the bankruptcy trustee assumed Metcoa's rights under the lease while title remained with LCIDA. Dollar attempted to find a new tenant to take over the property and listed the property with several real estate brokers. In November 1983, the bankruptcy trustee auctioned off Metcoa's inventory and equipment. Several parties inquired about the property, but it was not until October 1984 that Dollar was able to lease a portion of the property to a sailboat manufacturer who wanted to use the site as a storage facility. This leasing arrangement lasted until July, 1985 and resulted in only minimal rent payments.

In December 1984, a representative of the Nuclear Regulatory Commission ("NRC") inspected the site and discovered low-level radioactive materials. The NRC told Dollar it could not market the site without an NRC survey certifying that the site was clean. After contacting the state Department of Environmental Resources ("DER"), Dollar retained a consultant to determine the extent of contamination at the site. In October 1985, the consultant issued a report recommending that a comprehensive site investigation be performed to determine the cleanup costs. When Dollar realized that the cleanup costs exceeded the loan balance and the property value, the bank returned the keys to the facility to the bankruptcy trustee.

In 1986, EPA commenced a site investigation and removed over three thousand drums of hazardous materials. In 1990, the agency filed a cost recovery action against over two dozen parties who had sent waste to the site. These parties, in turn, filed contribution actions against other potentially responsible parties, including Dollar.

Dollar continued to try to lease the site but potential tenants lost interest when they learned about the contamination and the lawsuit. Dollar's efforts were also hindered because EPA would not grant permission to interested parties to inspect the site. In 1997, Dollar did find one party who offered to purchase its liens for the value of the tax liens on the property, but this prospective purchaser could not obtain financing.

Plaintiffs conceded that Dollar had not arranged for the disposal of hazardous substances at the Metcoa site, but alleged that Dollar was an owner or operator of the

7. 1998 U.S. Dist. Lexis 7902 (No.-90-0654, May 6, 1998).

site. Without much analysis, the court concluded that Dollar had not participated in the management of the facility while the borrower was in possession of the site and that Dollar's efforts to re-lease or sell the property fully satisfied the requirements of the Federal Lender Liability Amendments.

Commentary: In this case, Dollar made effective use of both the bankruptcy trustee and the industrial development authority to shield itself from liability. By having the LCIDA retain title to the land and the trustee assuming control over the property, Dollar was able to maintain a tenuous connection to the site while still playing an active role in trying to sell or re-lease the property. Moreover, the opinion reported that some drums were knocked over or had deteriorated following the bankruptcy trustee's sale of the inventory and equipment. Banks in the past have been found liable as operators of a facility under such circumstances. However, since the bankruptcy trustee was managing the site instead of an auctioneer hired by the bank, Dollar avoided liability in this case.

Another interesting aspect of the case is that the court retroactively applied the Federal Lender Liability Amendments to actions taken by the bank in the 1980s and early 1990s. At that time, there was no "bright-line" test for judging a bank's post-foreclosure actions. The court nevertheless concluded that no prospective bidder had made a bona fide offer for the property even though the standard for judging whether an offer was bona fide did not exist until EPA promulgated its lender liability rule.

LENDER BARRED FROM RECOVERY CLEANUP COSTS UNDER RCRA

The past few years have seen a dramatic increase in the number of RCRA private cost recovery actions. Landowners performing UST cleanups or remediating historical contamination have sought relief under section 7002(a)(1)(B) of the RCRA citizen suit provision. This section provides that any person may commence a civil action against "any person who has contributed to the past or present handling, storage, treatment, transportation, or disposal of any solid or hazardous waste which may present an imminent and substantial endangerment to health or the environment." Courts are given broad discretion to fashion any remedy that they deem appropriate.

The RCRA citizen suit provision offers several advantages over CERCLA private cost recovery or contribution actions. First, because CERCLA excludes petroleum from the definition of hazardous substances, property owners cannot bring CERCLA contribution actions to recovery cleanups of petroleum contamination. In contrast, RCRA not only covers petroleum products but also extends to a potentially broader range of substances than CERCLA because RCRA regulates solid wastes. Under RCRA, solid waste includes any "garbage, refuse and other discarded material, including solid, semi-solid or contained gaseous material resulting from industrial, commercial, mining, and agricultural operations, and from community activities." Courts have held that petroleum fuel leaking from an underground storage tank is a "discarded material resulting from commercial activity," and therefore qualifies as a solid waste.

Second, private parties seeking to recover response costs under CERCLA must demonstrate that their costs were "necessary" and that they complied with the National Contingency Plan ("NCP"). The NCP establishes complex procedures for investigating contamination, selecting remedies, and also requires that the public be given the opportunity to participate in the remedial selection process. RCRA does not contain any NCP requirements. Thus, costs that might be excluded under CERCLA might be recoverable under RCRA.

Finally, unlike CERCLA, plaintiffs may seek recovery of their attorneys fees under section 7002. It should be noted, though, that several courts have denied awards of attorneys fees where the plaintiff is a landowner of the contaminated property. In those cases, the courts suggested that where plaintiff is trying to clean up its own property, it is not acting primarily for the health of the community. Therefore, these courts reason, plaintiff should not be entitled to attorneys fees.

Most of the private 7002 actions have involved properties that were contaminated by leaking USTs. However, this section has also been used by developers of shopping centers against tenants (e.g., dry cleaning tenants who disposed of hazardous substances at the property) and municipalities that operated sewer systems which leaked hazardous substances into the environment.

The scope of relief that is available under section 7002 was limited by the United States Supreme Court in 1996. In *KFC Western Inc v. Meghrig*,[8] the Court ruled that private parties cannot recover cleanup costs under section 7002 that were incurred prior to the commencement of the litigation. However, the Court left unresolved the question of whether plaintiffs could seek recovery of their cleanup costs incurred after they commenced suit.

8. 516 U.S. 479 (1996).

It was exactly this issue that was before the court in *Avondale Federal Savings Bank v. Amoco Oil Co.*[9] In that case, the plaintiff bank acquired title to a former gasoline station when it merged with another bank. Plaintiff found a purchaser for the property in late 1995. Avondale performed an environmental audit that was required by the purchase agreement and discovered petroleum contamination from leaking USTs. Avondale then filed a section 7002 action in May 1996 against Amoco Oil Company, which had owned and operated the gasoline station from 1926-1970. Avondale sought an injunction requiring Amoco to remediate the contamination. To preserve its sale, Avondale went ahead and removed the USTs and contaminated soil. In November 1996, Avondale received a no-further-action letter from the state of Illinois.

After the closing, Avondale amended its complaint to add a claim for restitution to recover the value of the benefit it had conferred upon Amoco by performing the cleanup. Avondale still sought an injunction for any off-site contamination that might exist.

The federal district court granted Amoco's motion for summary judgement on both claims and the Seventh Circuit affirmed the lower court in a 2-1 decision. The court interpreted *Meghrig* as prohibiting recovery of any past cleanup costs regardless of whether they were incurred prior to the commencement of litigation or after the suit was filed. The court said that Avondale should have waited for the court to rule on its injunction. Moreover, the court noted that Avondale could still seek recovery of its cleanup costs under state law. The dissenting opinion vehemently disagreed that *Meghrig* prohibited recovery of cleanup costs after an RCRA citizen suit had been filed.

Commentary: This decision illustrates the importance of reviewing the historical information of all properties that may be acquired or leased. Even though a property may currently be used for a purpose that appears to present a low environmental risk, many sites have undergone substantial changes in usage. This is particularly true with fast food restaurants, where many of the sites were once used as gasoline stations because of their location. Since cleanup practices and standards were not as stringent in the past as they are today, it is important for purchasers acquiring properties by direct purchase or through a corporate transaction to fully investigate the history of the properties being acquired.

9. No. 98-2003 (7th Cir. March 11, 1999)

BANK WILL USE ENVIRONMENTAL INSURANCE TO REPLACE PHASE I REQUIREMENTS

For much of the 1990s, banks served as surrogate regulators by requiring prospective borrowers to perform environmental due diligence as a condition to their loans and also mandating that borrowers correct environmental problems identified during the diligence process. With the passage of the CERCLA lender liability amendments in 1996, many lenders have been relaxing their environmental due diligence requirements in an effort to increase profits in a highly competitive loan market and to expedite the time it takes to process loans. Indeed, First Union recently announced that it will no longer require borrowers to perform Phase I site assessments but instead allow them to purchase an environmental insurance policy. The policy reportedly covers the lender for losses arising when there is a default and the discovery of contamination. The policy will pay the lesser of the outstanding loan balance or the cleanup costs. In many instances, the policy premium will be less than the cost of a commodity-style Phase I environmental site assessment.

To reduce transaction costs, some unsophisticated borrowers or purchasers may be tempted to forego performing their own environmental due diligence if a lender does not require environmental investigations or simply requires purchasing an insurance policy. However, this can be a shortsighted approach for a number of reasons. First, the lender environmental insurance policy protects the bank and not the borrower from environmental hazards. Second, failure to perform due diligence will preclude the borrower or purchaser from asserting any innocent purchaser's defense that might be available under state or federal law. Third, a borrower or purchaser who does not perform due diligence will not understand the future environmental liabilities associated with a property or business and, thus, will not be able to effectively price the transaction or allocate the liability. Moreover, a borrower or purchaser failing to perform due diligence will not be able to take advantage of the substantial penalty reductions available under the EPA or state audit policies.

There are a number of new environmental insurance products offered by a handful of insurers that can serve as useful environmental risk management tools in corporate or real estate transactions, especially those with environmentally complex contamination or multiple sites. It is important to keep in mind that there can be considerable variation among the policies offered by the insurers and that the standard off-the-shelf forms may not reflect the actual policies that will be issued in some

transactions. Because each deal has different environmental issues and the complexity of environmental issues at sites can vary, the policies should be tailored to the particular needs of the transaction or parties. The terms of coverage and the language of the policy may have to be heavily negotiated either by endorsements or manuscripting of the actual policies. However, policy modifications can result in delays as well as changes in pricing and deductibles. These policies are highly specialized insurance products that require a fairly thorough understanding of environmental law.

Lenders who rely on environmental insurance policies in lieu of requiring borrowers to perform due diligence should consider providing borrowers with a written disclosure that the waiver of the environmental due diligence requirement or the purchase of an environmental insurance policy does not constitute a finding by the bank that there are no environmental concerns associated with the property. Otherwise, some unsophisticated borrowers who end up facing substantial cleanup costs may argue that they were led to believe by their bank that there were no serious environmental problems associated with the property. We previously reported on *Mattingly v. First Bank of Lincoln*, where the Montana Supreme Court reversed a summary judgement ruling in favor of a bank and allowed the borrower to proceed with negligent misrepresentation and constructive fraud claims against its former lender because there was a question of material fact whether the bank had created a false impression about the environmental conditions of the property.[10]

LENDERS AND BROWNFIELD SITES

During the past few years, approximately 40 states have established voluntary cleanup or brownfield programs ("VCPs") to encourage the reuse of abandoned, deteriorating and under-used industrial properties, which are known as Brownfields. While many of these Brownfield sites have been contaminated with hazardous substances from prior uses, the contamination is usually not serious enough to require a cleanup under CERCLA or to undergo RCRA corrective action. Nevertheless, the mere perception of contamination has been an obstacle to redevelopment of brownfields despite the fact that these sites have access to a skilled work force, mass transportation and other infrastructure features. Fear of liability, concerns with reduced collateral values and with the effect that a cleanup will have on the ability of borrowers to repay their loans have also made lenders reluctant to provide financing to redevelop these sites.

The VCPs vary from state-to-state, but they generally include liability protection to prospective purchasers and lenders, establish streamlined cleanup procedures, authorize the use of risk-based cleanup standards that take future land use into account and also provide for the issuance of a No Further Action (NFA") letter and Covenant Not To Sue letter after a cleanup has been satisfactorily completed.

Nearly all VCP programs permit risk-based cleanups which establish cleanup standards based on the use of the property. Under this approach, higher levels of residual contamination may be allowed to remain at a industrial site than would be permitted for a residential property. Under such circumstances, institutional controls that impose use restrictions on the property are usually required. Institutional controls can dramatically lower remediation costs. For example, instead of removing contaminated soil, a volunteer may be permitted to encapsulate the contaminated soil with an impermeable cap and then file deed restrictions preventing that portion of the property from being used. In addition, instead of remediating groundwater to drinking water standards, a volunteer may be required to file a deed restriction precluding water under the site from being used for drinking purposes.

Lenders who are contemplating taking 30 year mortgages on remediated sites may be concerned that the state standards may change in the future or that the institutional control may not work effectively (e.g. a construction project inadvertently compromises the integrity of the impervious cap). The state could then require a borrower to perform additional cleanup under the reopener clause in the VCP agreement, which can affect a borrower's ability to repay its loan.

Another problem with institutional controls is that many states have not established sufficient oversight controls for ensuring compliance with the institutional controls. Once a VCP agreement is signed, many states leave enforcement of the restrictions to local government which, in turn, often relies on the good faith of the borrower.

Lenders should be aware that institutional controls often require that the owner be responsible for post-remedial operation and maintenance activities (O & M) such as groundwater monitoring, which can last as long as 30 years. While they can result in an initial reduction

10. Schnapf, Lenders Continue to Face Liability for Underground Storage Tanks, 13 Rev. Banking & Financial Services 215 (1997).

in remediation costs, O & M costs often are severely underestimated. As a result, some lenders will not extend financing for sites where remedial actions involve the use of engineering or institutional controls. Instead, they are continuing to insist that the contamination be remediated using the traditional or residential cleanup standards as a condition of the loan.

It is extremely important for lenders to carefully scrutinize institutional controls that may have been implemented for a site to be developed or financed. These restrictions may be a particular concern where there is a soil treatment system installed to remediate contamination caused by volatile organic compounds since the restrictions may prevent excavation of soil which would preclude construction or other development activities. Unless the restrictions can be removed, the property may not be able to be developed in accordance with its highest and best use or even according to the project development plans. Removal of existing restrictions will require approval of the regulatory agency, the owner or PRP responsible for the remediation, and the local community. When a non-owner such as a former site operator or owner of an adjacent property is responsible for the remediation, the developer may have a difficult time obtaining the approval of the non-owner PRP since removal of the restrictions will likely result in a more costly cleanup for which the non-owner PRP will want to be reimbursed.

Lenders who finance brownfield redevelopments will usually impose a number of conditions on the financing, which restrict their usefulness. First, lenders usually require developers to have at least 25% equity in the project to make sure that the borrower has sufficient capital at risk. Because owners with low equity interests abandoned property during the last decline in the real estate market, many lenders will require owners to maintain sufficient equity to ensure an owner's commitment to the project. However, in today's hot real estate market, many owners have been able to obtain loans that exceed their original acquisition costs.

Second, the rule of thumb used by many banks is that the remediation costs cannot exceed 25% of the fair market value of the unimpaired property.

Third, the loan proceeds often cannot be used to finance the cleanup. Instead, the borrower is expected to use its own equity or find other sources to fund the site investigation and cleanup. Because of these requirements, usually only the smaller properties with rather limited contamination have been financed through traditional bank lending. In addition, the nature of the contamination can influence the availability of financing. For example, a site with soil that is contaminated with petroleum may be easier to finance than a site with groundwater contaminated with chlorinated solvents.

The expedited cleanup procedures and NFA Letters that are available under the VCPs can help lenders quantify the risks posed by a site. Many financial institutions require pre-approval of a remediation action plan ("RAP") and remediation schedule by the state environmental authority as a condition of the loan commitment. In some cases, banks may also require the developer to enter into a VCP agreement where the state will issue a NFA and covenant not to sue in favor of the borrower and the lender. If there is concern that EPA may be interested in the site, some lenders may also request that the borrower enter into a prospective purchaser agreement with the EPA, which can insulate the developer, lender and seller from future liability.

Many VCPs also offer grants and loans that may be used to defray cleanup costs. Borrowers can use these financial programs as well as the insurance products mentioned earlier to lower the risk ratio of the loan. ■

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