LENDERS CONTINUE TO FACE LIABILITY FOR UNDERGROUND STORAGE TANKS

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The presence of underground storage tanks ("USTs") has often proven to be an unexpected source of environmental liability for lenders. Even if a lender has conducted a Phase I site assessment before taking control of a site, it is often difficult to determine if there are old, unknown leaking USTs that may have contaminated the soil and groundwater beneath the property.

To alleviate the concern of lenders, the federal Environmental Protection Agency ("EPA") issued a regulation in 1995 interpreting the scope of the secured creditor's exemption under the federal Resource Conservation and Recovery Act ("RCRA").[1] These regulations were codified when Congress enacted the Asset Conservation, Lender Liability, and Deposit Insurance Protection Act of 1996 (the "Lender Liability Amendments").[2] Despite these administrative and legislative actions, lenders are continuing to find themselves embroiled in disputes over responsibility for contamination caused by USTs. This article will discuss the most recent lender liability case involving USTs.

1 42 US.C. 6901 et seq.
2 Pub L. 104-208, Subtitle E, 110 Stat. 3009 (Sept. 30, 1996) (codified at 42 U.S.C. 9601(20)(A))

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REGULATORY FRAMEWORK

RCRA regulates the generation, storage, handling, transportation, and disposal of hazardous waste. Owners or operators of RCRA-regulated facilities and USTs 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 that is limited to 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, and marketing.[3]

The RCRA Lender Liability Rule[4] provided detailed guidance on what kinds of actions constituted "partici-

3 42 US.C. 6991(b)(h)(9)
4 September 7, 1995, 60 FR 46698

pating in the management of a UST system," and described the circumstances under which a lender would be considered to have "indicia of ownership primarily to protect a security interest".[5] In summary, a lender must exercise day-to-day control over the USTs in order to be considered participating in the management of the USTs. The rule imposed additional requirements on lenders after foreclosure. In order for the lender to be deemed to have held "indicia of ownership primarily to protect a security interest," the lender must have attempted to sell the property in an expeditious manner. Moreover, if the lender displaced the borrower and there is no one else to assume responsibility for the USTs, the lender would be required to comply with the temporary closure requirements for USTs such as emptying the USTs and sealing off the piping. Lenders that allow the USTs to continue to store petroleum will be considered UST operators and lose their regulatory exemption from liability.

The RCRA Lender Liability Rule does not insulate lenders from liability under other provisions of RCRA such as the citizen suit provision of section 7002. This section allows suits to be brought against any person who has contributed to the past or present handling, storage, treatment, transportation, or disposal of any solid or hazardous waste that may present an imminent and substantial danger to health or the environment. Courts have broadly interpreted the phrase "contributed to." In fact, a state court in Mississippi relied on similar language appearing in the Mississippi superfund law to hold a bank liable for environmental conditions at its borrower's facility. The court said that by extending financing to a company the lender bank knew was mishandling hazardous materials on its property, the bank had contributed to the creation of the problem.[6]

The RCRA Lender Liability Rule also does not preclude lenders from being held liable under state common law and contract claims. Recently, in *Mattingly* v. *First Bank of Lincoln*,[7] a bank in Lincoln, Montana that did not take any actions that could be construed as asserting control over the USTs found itself in the center of a controversy involving a contaminated gasoline station. The bank was sued by its borrower under state tort and contract causes of actions.

5. For a more detailed description, readers should refer to the author's previous article discussing the RCRA Lender Liability Rule See *Lender Liability for Underground Storage Tanks*, Rev. of Bank. & Finan. Serv., Vol.11, No. 17 (Oct. 11, 1995)
6. *Citizens Bank and Trust Company vs MidSouth Rail Corp.*, No. 30, 011 (Ch. Div. Rankin Cty. Miss. Mar 18, 1994)
7. No 96-678, 1997 WL 668215 (Sup. Ct. Mont., Oct. 28, 1997)

MATTINGLY V. FIRST BANK OF LINCOLN

In July, 1983, a construction crew installing a new sewer line in the center of Lincoln, Montana discovered a pocket of gasoline floating on top of the groundwater. An investigation by the state Water Quality Bureau ("WQB") identified three gasoline stations as the source of the contamination. One of the gasoline stations responsible for the contamination was an Exxon station owned by August Habet. Another source was the Handi-Mart that was owned and operated by a director and active board member of the First Bank of Lincoln ("FBOL"). The WQB determined that the leading edge of the groundwater extended to the FBOL office site and obtained permission from the FBOL president to excavate a portion of the FBOL site to determine the extent of the zone of contamination.

Four years later, the plaintiff agreed to purchase the Exxon station for $79,000. Habet did not inform the plaintiff about the contamination and the plaintiff did not conduct any investigation. When the plaintiff applied for a loan from FBOL to finance the purchase of the station, FBOL did not require a formal real estate appraisal because of the large down payment. Instead, it hired a real estate inspector to make a visual inspection of the property "to obtain an impression" of the property's value. The inspector was relatively new to the area but had some general knowledge about the contamination.

When the FBOL loan committee met to act on the plaintiff's loan application, neither the FBOL president nor the director who knew about the contamination raised the contamination issue. Two months after FBOL approved the initial loan request of $56,000, the plaintiff applied for a second loan in the amount of $127,000 to remodel and expand the service station. However, FBOL denied this loan request and the plaintiff obtained an SBA-guaranteed loan of $105,000. The plaintiff used the proceeds of this loan to pay off the balance on his FBOL loan and to remodel the station.

The plaintiff learned about the contamination in July, 1991 when he tried to sell the property. The sale fell through when the purchaser became aware of the contamination. One year later, the state Department of Health and Environmental Services notified the plaintiff that he was potentially liable for remediating the groundwater contamination. The plaintiff then sued Habet, the real estate broker, and also FBOL on the grounds of constructive fraud, negligence, and negligent misrepresentation. The trial court found Habet liable to the plaintiff for $435,000, but granted summary judgment to FBOL. The plaintiff then appealed to the Montana Supreme Court, which reversed the lower court ruling.

On the negligent misrepresentation count, the Montana Supreme court held that the FBOL appraisal and approval of the loan constituted an affirmative representation that the property was worth at least the value of the loan. However, the court found that there was a material question of fact whether the plaintiff had relied on that representation.

On the question of constructive fraud, the court ruled that FBOL had peculiar knowledge of the contamination associated with the site that may have created a special duty to disclose that information to the plaintiff. The court also said that FBOL's failure to disclose the contamination to the plaintiff might not only constitute a breach of that special duty but may also have created a false impression about the site conditions at the property. Moreover, the court held there was a material question of fact whether FBOL had gained an advantage by failing to disclose the existence of the contamination. The court suggested that Habet had used a portion of the sale proceeds to pay off a mortgage that FBOL had taken on the property, i.e., that FBOL benefited from the sale. The court reasoned that had the plaintiff known about the site conditions, it might not have agreed to purchase the property and might have been saddled with a non-performing loan. In addition, the court noted that FBOL was able to collect interest on its loan to the plaintiff until the plaintiff paid off the loan with the proceeds of its SBA-guaranteed loan.

Finally, the court reinstated the plaintiff's claim for punitive damages. The court said it was possible that a jury could find that FBOL was guilty of actual fraud or actual malice by failing to disclose what it knew about the contamination.

ANALYSIS AND RECOMMENDATIONS

While the facts of *Mattingly* are somewhat unusual because of the manner in which the two members of the loan committee obtained information about the contaminated property, the case does provide an important lesson to lenders regarding environmental due diligence. Many lenders now routinely order environmental site assessments on property before approving a loan. This case shows how important it is for lenders to disclose what they know about the environmental conditions of a property not only to prospective borrowers but also to any other banks that may be contemplating purchasing all or part of a loan. Although many banks only want to review reports that are less than a year old, it is important that a lender planning to sell all or part of a loan review its files and provide the prospective purchaser with copies of all existing environmental reports in its possession since it is possible that there may be information contained in the older reports that was overlooked in the more recent report.

To minimize their potential liability for UST-related contamination, lenders should also review their foreclosure policies to make sure that they conform to the requirements of the RCRA Lender Liability Rule. There have been a number of unreported instances where lenders have been issued administrative orders by governmental agencies and have had to pay to perform a cleanup when lenders have taken control of a site after a borrower has gone out of business. A bank often takes control of the facility in order to sell off the inventory, fixtures, machinery, and equipment of the borrower, which 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 of the personal property. Usually, there are barrels or drums of hazardous waste strewn about the facility and there may be USTs located at the site as well. 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 left in the abandoned facility. In some cases, government authorities have learned 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, lenders may also unwittingly be asserting control over the USTs. Failure to properly close the USTs may not only cause a lender to forfeit its immunity from liability under the RCRA Lender Liability Rule but could also expose the lender to a claim from the landlord, especially where the borrower had the right to use or control the USTs under its lease. As a result, financial institutions should exercise extreme caution when conducting auctions and should consult with environmental counsel prior to conducting any auction at a manufacturing facility. It would also be advisable for lenders to retain an environmental consultant or environmental attorney to inspect the facility prior to taking control of the facility 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 existence of the USTs enhances 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. ■