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Financial Institutions and Hazardous Waste Litigation: Limiting the Exposure to Superfund Liability

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INTRODUCTION

In 1980, Congress passed the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA),[1] specifically aimed at silencing the "not me" responses elicited when response cost litigation is commenced. CERCLA, as amended by the Superfund Amendments and Reauthorization Act of 1986 (SARA),[2] provides that the parties responsible for a hazardous waste disposal facility may be held liable under CERCLA and SARA (Superfund) to the Environmental Protection Agency (EPA), a state agency, or to a private party, when response costs are incurred for the cleanup of the hazardous waste disposal facility. The recoverable costs include the actual costs incurred by the EPA, the state agency, or the private party, in cleaning up the site, damages for the destruction of or loss of natural resources, and health assessment costs.[3]

It may seem axiomatic to state that the responsible parties are liable for cleanup costs incurred until it is realized that the potential for liability continues even when the hazardous waste disposal facility has become

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1. Comprehensive Environmental Response, Compensation and Liability Act of 1980, Pub. L. No. 96-510, 94 Stat. 2767, *codified at* 26 U.S.C. §§ 4611-4682 (1982), and at 42 U.S.C. § 6911(a), §§ 9601-9657 (1982).

2. Superfund Amendments and Reauthorization Act of 1986, Pub. L. No. 99-499, 100 Stat. 1613, *codified at* 42 U.S.C.A. §§ 9601–9657 (West Supp. 1987).

3. 42 U.S.C.A. § 9607(a) (West Supp. 1987) sets forth the scope of liability under CERCLA and SARA.

> Notwithstanding any other provision or rule of law, and subject only to the defenses set forth in subsection (b) of this section—
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> (1) the owner and operator of a vessel or a facility,
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> (2) any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of,
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> (3) any person who by contract, agreement or otherwise arranged for disposal or treatment, or arranged with a transporter for transport for disposal or treatment, of hazardous substances owned or possessed by such persons, by any other party or entity, at any facility owned or operated by another party or entity and containing such hazardous substances, and
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> (4) any person who accepts or accepted any hazardous substances for transport to disposal or treatment facilities, incineration vessels or sites selected by such person, from which there is a release, or a threatened release which causes the incurrence of response costs, of a hazardous substance, shall be liable for—
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> (A) all costs of removal or remedial action incurred by the United States Gov-

inactive[4] and then subsequently changes ownership one or more times.[5] Thus, definition of responsible parties may include the new owner even though the new owner did not participate in the creation or maintenance of the contaminated site. Further, recent case law has set financial institutions in a somewhat tenuous position as they expose themselves to potential liability as responsible parties under Superfund in the event they foreclose on a secured interest in a hazardous waste disposal facility.[6]

In order to fully appreciate the impact of the imposition of Superfund liability upon a financial institution, it will be necessary to examine the specific liability[7] and definitional provisions[8] of Superfund, and the case

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ernment or a State or an Indian tribe not inconsistent with the national contingency plan;

(B) any other necessary costs of response incurred by any other person consistent with the national contingency plan;

(C) damages for injury to, destruction of, or loss of natural resources, including the reasonable costs of assessing such injury, destruction, or loss resulting from such release; and

(D) the costs of any health assessment or health effects study carried out under section 9604(i) of this title.

The amounts recoverable in an action under this section shall include interest on the amounts recoverable under subparagraphs (A) through (D). Such interest shall accrue from the later of (i) the date payment of a specified amount is demanded in writing, or (ii) the date of the expenditure concerned. The rate of interest on the outstanding unpaid balance of the amounts recoverable under this section shall be the same rate as specified for interest on investments of the Hazardous Substance Superfund established under subchapter A of chapter 98 of Title 26. For purposes of applying such amendments to interest under this subsection, the term "comparable maturity" shall be determined with reference to the date on which interest accruing under this subsection commences.

Id.

4. Inactive in the sense that the site is no longer being used as a dump site or treatment facility for hazardous materials, not that there is no longer any activity occurring at all, such as an actual release or leaching of chemicals into and through the soil or into and through water supplies.

5. Mott, *Liability for Cleanup of Inactive Hazardous Waste Disposal Sites*, 14 NAT. RESOURCES LAW. 379, 413 (1982).

> Allocation of liability among successive owners of a disposal site has been one of the most vexatious issues in case law to date. Each owner will have varying degrees of knowledge and participation in the disposal actions and often the most culpable party will have become insolvent. Accordingly, the principles for resolving the allocation of liability between prior and current owners are key questions in abatement litigation.

Since Superfund liability arises out of ownership status and applies despite subsequent transfers of title, the liability runs with the land unless the owner qualifies under the innocent landowner provision of 42 U.S.C.A. § 9601 (35)(A) (West Supp. 1987). See *infra* note 33 for the text of 42 U.S.C.A. § 9601 (35)(A) (West Supp. 1987).

6. *See* United States v. Maryland Bank & Trust Co., 632 F.Supp. 573 (D.Md. 1986). As pointed out in Comment, *Fear of Foreclosure: United States v. Maryland Bank & Trust Co.*, 16 ENVTL. L. REP. (ENVTL. L. INST.) 10165 (1986): "Liability for hazardous substances cleanups, like the flu, eventually seems to get around to everyone with any contact with the infected site and it is now beginning to make bankers sick." *Id. But see* United States v. Mirabile, No. 84-2280 (E.D. Pa. Sept. 4, 1985), 15 ENVTL. L. REP. (ENVTL. L. INST.) 20994 (1985).

7. *See supra* note 3.

8. 42 U.S.C.A. § 9601(20)(A), 9601(35) (West Supp. 1987).

law in which the liability provisions of Superfund have been interpreted, applied and enforced. Finally, recommendations will be made by which a financial institution may attempt to reduce its exposure to liability through preventive measures.

LIABILITY, COVERED PERSONS, AND SCOPE: 42 U.S.C.A. SECTION 9607(a) (WEST SUPP. 1987)

Under Superfund, responsible parties may be held liable for: (1) governmental response costs; (2) private party response costs consistent with the National Contingency Plan; (3) damages for injury to natural resources; and (4) health assessment costs.[9] The key to liability is in defining "responsible parties," since the present owner may have innocently purchased the contaminated site, and since the statutory scheme provides for strict liability for those who are found to be responsible parties.[10] While the statutory scheme of liability does not provide a system of allocation of liability when there are several defendants,[11] those examining the liability provisions in depth generally agree that apportionment of liability, rather than joint and several liability, should be applied to those situations in which there are multiple defendants found to be liable.[12]

Liability provisions with respect to responsible parties under Superfund apply to virtually any individual or corporation that holds any indicia of

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9. *See supra* note 3.

10. Grad, *A Legislative History of the Comprehensive Environmental Response, Compensation and Liability (Superfund) Act of 1980*, 8 COLUM. J. ENVTL. L. 1, 9 (1982). *See In re* T.P. Long Chemical, Inc., 45 B.R. 278 (Bkrtcy. 1985); United States v. Northeastern Pharmaceutical & Chemical Co., Inc., 579 F.Supp. 823 (W.D. Mo. 1984).

11. *Mott, supra* note 5, at 405. Although there is no express provision for joint and several liability in Superfund, reference to legislative history clearly shows that common law principles of joint and several liability are applicable. H.R. Rep. No. 253(i), 99th Cong., 2nd Sess., *reprinted in* 1986 U.S. CODE CONG. & AD. NEWS 2835, 2856.

12. Grad, *supra* note 10, at 5. *See* Superfund § 301(e) Study Group Report to Congress, Appendix C, August 1982, *Problems of Responsibility and Apportionment of Damages in Hazardous Waste Cases and Liability of a Current Landowner for Injuries Caused by Hazardous Conditions Created by a Previous Owner, reprinted in* 12 ENVTL. L. REP. (ENVTL. L. INST.) 30031 (1982) (hereinafter Report). *See also* Light, *Modest Proposal to Codify the Fair and Just View of the Justice Department on CERCLA*, 16 ENVTL. L. REP. (ENVTL. L. INST.) 10064 (1986).

> Finally, the United States has officially come around to the view that joint and several liability does *not* apply in some Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) § 107 cases, *even though the harm at the site is indivisible*. The government adopts this view in its recent brief in Mola Development Corp. v. United States (No. CV 82-0819-RMT (JRx), E.L.R. PEND. LIT. 65891 (C.D. Cal. brief filed Dec. 16, 1985)) in a December 1985 pleading styled, "Response to the Court's Order for Briefing on the United States Counterclaim."

Id. (emphasis added) (footnotes omitted).

ownership, unless exempted.[13] For example, Congress has specifically exempted from liability those holding "indicia of ownership primarily to protect [a] security interest."[14] Of vital interest to those holding indicia of ownership *via* a security interest is the liability which may be allocated to them, or imposed upon them, in the event that the primarily responsible party defaults on the secured obligation and the financial institution must act to protect its investment through the foreclosure process. The question then becomes: Is the foreclosing financial institution an owner of a contaminated site under Superfund liability provisions and thus a responsible party and liable for response costs? The answer to the question depends upon numerous variables which may trip up the unaware and naive, and thus expose the lender to Superfund liability.[15]

While courts generally give a broad interpretation to the liability provisions of Superfund,[16] courts are also cognizant of the exceptions and defenses.[17] The usefulness of the exemption and/or defenses by a financial institution, however, is dependent upon the financial institution maintaining the proper distance from the hazardous waste disposal facility.[18]

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13. CERCLA § 107(a) makes four categories of persons potentially liable for releases or threatened releases of hazardous substances from facilities: current owners or operators of facilities, those who owned or operated the facilities at the time of disposal, those who "arranged for disposal" of hazardous substances (generators), and those who accepted wastes for transport to a disposal facility "from which there is a release or threatened release which causes the incurrence of response costs, of a hazardous substance."

Reed, *CERCLA 1985: A Litigation Update*, 15 ENVTL. L. REP. (ENVTL. L. INST.) 10395, 10400 (1985). *See also* Comment, *supra* note 6, at 10165: "Three categories of landowners may be liable under CERCLA § 107(a): current owners, owners during dumping, and owners who abandon sites. Anyone with title to a CERCLA site has good reason to fear liability." *Id.*

14. 42 U.S.C. § 9601(20)(A) (1982). The statute provides a definition of "owner" and/or "operator" for the liability provisions of CERCLA.

> The term "owner or operator" means (i) in the case of a vessel, any person owning, operating, or chartering by demise, such vessel, (ii) in the case of an onshore facility or an offshore facility, any person owning or operating such facility, (iii) in the case of any facility, title or control of which was conveyed due to bankruptcy, foreclosure, tax delinquency, abandonment, or similar means to a unit of State or local government, any person who owned, operated or otherwise controlled activities at such facility immediately beforehand. Such term does not include a person, who, without participating in the management of the vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility. . . .

Id.

15. Knowledge of the existence of hazardous chemicals is sufficient to impose liability upon the subsequent purchaser as is the lack of diligent inquiry when purchasing. *See* H.R. Conf. Rep. No. 962, 99th Cong., 2d Sess., 132 CONG. REC. H9,084–85 (1986).

16. *In re* T.P. Long Chemical, Inc., 45 B.R. 278, 283 (Bkrtcy. 1985). "Courts have generally held, however, that the liability provisions under CERCLA should be given a broad construction." *Id.* (citing United States v. Northeastern Pharmaceutical & Chemical Co., Inc., 579 F.Supp. 823 (W.D. Mo. 1984); State *ex rel.* Brown v. Georgeoff, 562 F.Supp. 1300 (N.D. Ohio 1983); United States v. Reilly Tar & Chemical Corp., 546 F.Supp. 1100 (D. Minn. 1982)).

17. *See* In re T.P. Long Chemical, Inc., 45 B.R. 278 (Bkrtcy. 1985); United States v. Mirabile, No. 84-2280 (E.D. Pa. Sept. 4, 1985) 15 ENVTL. L. REP. (ENVTL. L. INST.) 20994 (1985).

18. *See* United States v. Maryland Bank & Trust Co., 632 F.Supp. 573 (D.Md. 1986).

The imposition of, or allocation of liability among successive landowners,[19] and any imposition of, or allocation of, liability that may be assessed to an "innocent" landowner *vis-a-vis* prior owners will become very important to the lender holding the security interest,[20] since cleanup costs are extremely high[21] and eventually the lender will wish to dispose of the security interest collateral.[22]

The liability provisions of Superfund may be enforced merely by virtue of ownership status; however, commentators contend that mere ownership alone should not be sufficient to establish Superfund liability,[23] but rather that traditional case law be followed.[24] Superfund provides a narrow escape from liability to the financial institution which makes loans to industrial concerns which have hazardous waste by-products. However,

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19. *See supra* note 5. Various factors will either increase or decrease the potential for liability.

20. *See* Mott, *supra* note 5, at 414. *See also* Reed, *supra* note 13, at 10401.

> CERCLA imposes a sort of absolute liability on owners. They are liable even if they had no involvement with disposal activities of a lessee or were not the proximate cause of releases resulting principally from the activities of a previous owner. Current owners who are not operators may be able to use the § 107(b) third party defense if the hazard was caused solely by a prior owner or operator with whom the current owner had no contractual connection and can seek indemnification or contribution.

Id. (footnotes omitted). An important question yet to be answered is how the courts will apply 42 U.S.C.A. § 9601 (35)(A) (West Supp. 1987) "contractual relations" to the foreclosing lender situation. *See intra* note 105.

21. *See* Sparrow, *Hazardous Waste Insurance Coverage: Unexpected Past, Uncertain Future*, 64 MICH B. J. 169, 171–72 (1985).

22. 42 U.S.C. § 9607(e)(1) (1982) provides:

> No indemnification, hold harmless, or similar agreement or conveyance shall be effective to transfer from the owner or operator of any vessel or facility or from any person who may be liable for a release or threat of release under this section, to any other person the liability imposed under this section. Nothing in this subsection shall bar any agreement to insure, hold harmless, or indemnify a party to such agreement for any liability under this section.

Id. See Mandan Corp. v. C.G.C. Music, Ltd., 600 F.Supp. 1049 (D. Ariz. 1984) (Seller may limit any liability it may have by a hold harmless clause or a release clause *vis-a-vis* the Buyer, but not any liability it may have *vis-a-vis* the Government under CERCLA). *See also* Reed, *supra* note 13, at 10401; and Comment, *supra* note 6, at 10166.

23. *See generally* Report, *supra* note 12.

24. A good example of traditional case law is State, Dep't of Envtl. Protection v. Exxon Corp., 151 N.J. Super. 464, 376 A.2d 1339 (N.J. Super. Ct. Ch. Div. 1977). The *Exxon* decision held that a current owner is not liable for a previous owner's spillage which polluted the groundwater. *See* Philadelphia Chewing Gum Corp. v. Commonwealth, 35 Pa. Commw. 443, 387 A.2d 142 (1978), *aff'd sub nom.*, Nat'l Wood Preservers, Inc. v. Commonwealth, 489 Pa. 221, 414 A.2d 37 (1980). *See also* Mott, *supra* note 5, at 414.

> Thus, the innocent purchaser of an inactive site, who unknowingly acquires buried drums, contaminated soil, or polluted groundwater, has been protected from the severe consequences of liability for previous owners' conduct. In fact, a vendor's failure to disclose these conditions may create a cause of action against the prior owner.

Id. (footnotes omitted). The traditional case law is discussed in depth in text accompanying notes 108 to 142.

SARA, 42 U.S.C.A. § 9601(35) (West Supp. 1987) removes liability from the landowner who can prove innocence with regard to hazardous substance releases. *See infra* text accompanying notes 26 to 43.

the narrow avenue available to financial institutions for escaping liability is wholly consistent with recent court decisions involving Superfund liability and common law liability of non-financial institutions.[25] Further, it does not preclude the careful financial institution from protecting itself from Superfund liability through negotiated indemnification clauses with its industrial customers.

The definitional scope of liability for a responsible party was further widened when Congress reauthorized CERCLA with SARA on July 31, 1986,[26] though, definitional adjustments were made to protect the truly innocent landowner.[27] The reauthorization which became law on October 17, 1986,[28] was a compromise combination of the Senate bill[29] and the House bill.[30] The Senate bill did not contain any provisions which would change CERCLA liability provisions;[31] however, the House amendment did allow the innocent landowner the opportunity to demonstrate his innocence in connection with a release or threatened release of hazardous substances.[32]

The ensuing compromise by the conference committee resulted in adoption of the House amendment, adding to the definitional section a subsection covering real estate transactions with innocent subsequent purchasers.[33] The new definition clarifies the intent of Superfund to impose

25. State of N.Y. v. Shore Realty Corp., 759 F.2d 1032 (2d Cir. 1985) (current owner held liable for activities of previous owner). United States v. Carolawn Co., No. 83-2162-0 (D.S.C. June 15, 1984), 14 ENVTL. L. REP. (ENVTL. L. INST.) 20696 (1984) (company held title for one hour); United States v. Argent Corp., No. CIV 83-0523 BB (D. N. Mex. May 4, 1984), 14 ENVTL. L. REP. (ENVTL. L. INST.) 20616 (1984) (lessor held liable for disposal activities of lessee).

26. Comment, CERCLA Reauthorization: The Wise Demise of § 114 (c) and Exxon v. Hunt, 16 ENVTL. L. REP. (ENVTL. L. INST.) 10286 n.1 (1986).

27. *See infra* notes 32 and 33.

28. Pub. L. No. 499, 100 Stat. 1613 (1986).

29. S. Res. 51, 99th Cong., 1st Sess. (1985). *See EPA Draft Side-By-Side Comparison of the Provisions of CERCLA, EPA Amendments, Senate, House Superfund Bills*, 16 ENV'T REP. (BNA) CURRENT DEVELOPMENTS, 1894 (1986) (hereinafter *Comparisons*).

30. H.R. Res. 2817, 99th Cong., 1st Sess. (1985). *See Comparisons, supra* note 29, at 1894. On Dec. 10, 1985, the House passed H.R. 2005 (formerly H.R. 2817). *See* 16 ENV'T REP. (BNA) 1587 (1985).

31. *Comparisons, supra* note 29, at 1984.

32. "§ 107(m) Removes liability from landowner who can prove innocence with regard to hazardous substance release." *Id.* at 1933.

> The purpose of the House amendment was to eliminate liability which might exist under section 107 for landowners who acquired title to real property after the time hazardous substances, pollutants or contaminants had come to be located thereon and who, although they exercise due care with respect to discovering such materials, were nonetheless ignorant of their presence.

H.R. Rep. No. 962, 99th Cong., 2nd Sess., 132 CONG. REC. H9084 (1986).

33. 42 U.S.C.A. § 9601(35)(A) (West Supp. 1987).

> The term "contractual relationships," for the purpose of section 9607(b)(3) includes, but is not limited to, land contracts, deeds or other instruments transferring title or possession, unless the real property on which the facility concerned is located was

liability upon parties responsible for the creation and maintenance of the hazardous waste site and not upon innocent subsequent purchasers who are least responsible for the site and who are least likely to be able to afford cleanup costs.[34]

Under the new definitional provision, the subsequent purchaser will not incur liability if he exercises the "requisite due care."[35] The "requisite due care" requirement has two prongs which must be satisfied in order to discharge potential liability. The first prong requires examination of the buyer's knowledge as to the existence of hazardous substances at the time of purchase.[36] The second prong requires examination of the actions taken once the buyer learns there are hazardous substances on or in the

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acquired by the defendant after the disposal or placement of the hazardous substance on, in, or at the facility, and one or more of the circumstances described in clause (i), (ii), or (iii) is also established by the defendant by a preponderance of the evidence:

(i) At the time the defendant acquired the facility the defendant did not know and had no reason to know that any hazardous substance which is the subject of the release or threatened release was disposed of on, in, or at the facility.

(ii) The defendant is a government entity which acquired the facility by escheat, or through any other involuntary transfer or acquisition, or through the exercise of eminent domain authority by purchase or condemnation.

(iii) The defendant acquired the facility by inheritance or bequest.

In addition to establishing the foregoing, the defendant must establish that he has satisfied the requirements of section 9607(b)(3)(a) and (b) of this title.

Id.

34. H.R. Rep. 962, 99th Cong., 2nd Sess., 132 CONG. REC. H9084-85 (1986).

This new definition of contractual relationships is intended to clarify and confirm that under limited circumstances landowners, who acquire property without knowing of any contamination at the site and without reason to know of any contamination (or as otherwise noted in the amendment) may have a defense to liability under section 107 and therefore should not be held liable for cleaning up the site if such persons satisfy the remaining requirements of section 107(b)(3). A person who acquires property through a land contract or deed or other instrument transferring title or possession that meets the requirements of this definition may assert that an act or omission of a third party should not be considered to have occurred in connection with a contractual relationship as identified in section 107(b) and therefore is not a bar to the defense.

In the limited circumstances identified in this definition, such landowners are entitled to the defense if they exercise the requisite due care upon learning of such release or threat of release. . . .

The Conferees recognized that the due care requirement embodied in section 107(b)(3) only requires such person to exercise that degree of due care which is reasonable under the circumstances. The requirement would include those steps necessary to protect the public from a health or environmental threat. Finally, the precautions against foreseeable acts of third parties requirement of section 107(b)(3)(b) does not prevent a subsequent purchaser after contamination has occurred from claiming the defense, but only comes into play after the landowner acquires the property. Foreseeability must be considered in light of the specific circumstances of each case. The provisions of section 101(35)(B) as to "reason to know" govern the purchaser's responsibility with regard to acts of third persons prior to the purchase.

Id.

35. *Id.*

36. *Id.*

land.[37] The innocence of the subsequent purchaser as to knowledge is measured by "good commercial or customary practices."[38] Once the prior lack of knowledge of the subsequent landowner is established under the "good commercial or customary practices" standard, the subsequent purchaser must demonstrate that, once knowledge was gained, he used due care towards the hazardous substances and acted to protect himself and others from the further foreseeable consequences of a release or threatened release.[39]

The amended definitions of Superfund liability set forth criteria for liability remarkably similar to the position set forth by the Restatement (Second) of Torts (Restatement [Second]).[40] The point of departure between

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37. *Id.*

38. 42 U.S.C.A. § 9601(35)(B) (West Supp. 1987).

> To establish that the defendant had no reason to know, as provided in clause (i) of subparagraph (A) of this paragraph, the defendant must have undertaken, at the time of acquisition, all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability. For purposes of the preceding sentence the court shall take into account any specialized knowledge or experience on the part of the defendant, the relationship of the purchase price to the value of the property if uncontaminated, commonly known or reasonably ascertainable information about the property, the obviousness of the presence or likely presence of contamination at the property, and the ability to detect such contamination by appropriate inspection.

Id.

39. 42 U.S.C. § 9607(b)(3)(a), (b) (1982):

> There shall be no liability . . .
>
> . . .
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> . . . if the defendant establishes by a preponderance of the evidence that (a) he exercised due care with respect to the hazardous substance concerned, taking into consideration the characteristics of such hazardous substance, in light of all relevant facts and circumstances, and (b) he took precautions against foreseeable acts or omissions of any such third party and the consequences that could foreseeably result from such acts or omissions. . . .

40. One who takes possession of land upon which there is an existing structure or other artificial condition unreasonably dangerous to persons or property outside of the land is subject to liability for physical harm caused to them by the condition after, but only after,

> (a) the possessor knows or should know of the condition, and
>
> (b) he knows or should know that it exists without the consent of those affected by it, and
>
> (c) he has failed, after a reasonable opportunity, to make it safe or otherwise to protect such persons against it.

RESTATEMENT (SECOND) OF TORTS § 366 (1977).

> A possessor of land is subject to liability for a nuisance caused while he is in possession by an abatable artificial condition on the land, if the nuisance is otherwise actionable, and
>
> (a) the possessor knows or should know of the condition and the nuisance or unreasonable risk of nuisance involved, and
>
> (b) he knows or should know that it exists without the consent of those affected by it, and

the two is in the action required once knowledge is gained. The Restatement (Second) requires the subsequently purchasing landowner to abate the condition within a reasonable period of time once he knows of the condition, "or otherwise to protect such persons against it."[41] On the other hand, Superfund liability provisions would require only taking precautions against foreseeable acts or omissions.[42] It seems that the intent was to spare the innocently purchasing landowner the high cost of abatement required at common law.

A general reading of the amended provisions does not preclude a financial institution from taking advantage of the liability exemption; however, the legislative history indicates that the commercial transaction should be

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(c) he has failed after a reasonable opportunity to take reasonable steps to abate the condition or to protect the affected persons against it.

RESTATEMENT (SECOND) OF TORTS § 839 (1977).

In a report to Congress the study group explained and analyzed the Restatement (Second) position:

> The SECOND RESTATEMENT OF TORTS, together with Prosser and other commentators, takes the view that a vendee becomes liable for a hazardous condition on his land only after he is given notice of the conditions, constructive or express, and has had a reasonable time to correct it. . . .
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> . . .
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> The SECOND RESTATEMENT thus imposes liability on the landowner only if he knows or should have known of the dangerous condition. In the case of latent defects, "the vendee or lessee may have enough in the way of information or warning to lead a reasonable man to investigate, so that he 'should know.'" In a hazardous waste case, this could occur when the title search prior to purchase disclosed that the land was at one time owned by a chemical company or similar industrial concern putting the new owner on notice that an investigation for latent hazards is necessary. The care the vendee should give the investigation should reflect the nature of the prior use. . . . Similarly, former ownership by a chemical company may well point to the need for intensive inspection of the land more than former ownership by a less hazardous enterprise.
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> The SECOND RESTATEMENT also draws a distinction between situations where the vendee may reasonably assume that persons affected have consented to be exposed to the danger, and situations where such consent could not, reasonably, have been given. Consent may not be assumed in the case of public nuisance. . . . Consent may be assumed in some private nuisance cases, but the condition . . . threatening bodily harm to persons outside of the land, . . . may yield the conclusion that . . . no reasonable person would give his consent to such an interference. It is enough that the landowner knows or should have known of the condition.
>
> The last prerequisite to liability under the SECOND RESTATEMENT's formulation is that the landowner have failed to abate the condition within a reasonable period of time. This "reasonable" period runs from the moment a request to abate has been made, or, in cases where no request is necessary, from the moment the owner knows or should know that the condition exists. . . . Even though repair of the condition may take some time, the possessor may be required in the interim to post a warning, or take such other steps as may be reasonable, for the protection of such persons, pending the repair or removal.

Report, *supra* note 12, at 3032–33 (footnotes omitted).

41. *Id.*

42. *See* 42 U.S.C.A. § 9607(b)(3) (1982); *supra* note 34.

examined more closely than the residential transaction and that the commercial entity should be held to a higher standard of due diligence and care than the residential consumer.[43]

LIABILITY OF FINANCIAL INSTITUTIONS UNDER CERCLA

A recent article[44] provided a brief outline of the risks inherent in the transacting of industrial loans by the unaware lender:

> Recent cases have exposed lenders to significant risks under CERCLA that their security interests may be seized to pay governmental cleanup costs. The cases compel commercial real estate lenders to evaluate carefully each proposed mortgage transaction or foreclosure and to seek additional contractual or financial protections. While not absolute, it is becoming increasingly clear that current interpretations of CERCLA impose significant risks that must be met.[45]

Three recent cases discuss the Superfund liability of a financial institution upon foreclosure of its security interest in the hazardous waste disposal facility; however, the cases do not do so at any great depth.[46] The cases set forth two separate tests for imposing liability upon a foreclosing financial institution. All of the cases suggest without discussion that third-party defenses may be available and may pose "a potential route of escape open to lenders."[47] Also of relevance are cases decided in state courts under so-called mini-Superfund statutes which discuss the response cost liability which may be imposed upon a subsequent owner.[48]

Financial institutions are usually the only "deep pocket" available when the party or parties primarily responsible become insolvent. While attain-

43. H.R. Rep. 962, 99th Cong., 2nd Sess., 132 CONG. REC. H9085 (1986): ("Those engaged in commercial transactions [of real estate] should, however, be held to a higher standard [of inquiry] than those who are engaged in private residential transactions.").

44. Fleischaker & Mitchell, *The Insecurities of Security Interests in Hazardous-Waste Cases*, 9 NAT'L L. J. 18, Sept. 15, 1986.

45. *Id.* at 20.

46. United States v. Maryland Bank & Trust, 632 F.Supp. 573 (D.Md. 1986); United States v. Mirabile, No. 84-2280 (E.D. Pa. Sept. 4, 1985), 15 ENVTL. L. REP. (ENVTL. L. INST.) 20994 (1985); *In re* T.P. Long Chemical, Inc., 45 B.R. 278 (N.D. Ohio 1985).

47. Fleischaker & Mitchell, *supra* note 44, at 20. The cases include Maryland Bank & Trust, 632 F.Supp. 573; Mirabile, 15 ENVTL. L. REP. 20992; Shore Realty Corp., 759 F.2d 1032 (2d Cir. 1985); United States v. Argent Corp., CIV 83-0523 BB (D. N. Mex., May 4, 1984).

48. *See* Philadelphia Chewing Gum Corp. v. Commonwealth, 387 A.2d 142 (Pa. Commw. Ct. 1978), *aff'd sub nom.*; Nat'l Wood Preservers, Inc. v. Commonwealth, 414 A.2d 37 (Pa. 1980). The United States Supreme Court in Exxon v. Hunt, 475 U.S. 355 (1985), held that CERCLA preempted state Superfund legislation. Congress responded by deleting § 114(c) (42 U.S.C. § 9614(c) (1982)).

> Although the Supreme Court interpreted the statute in the most logical fashion, the opinion produced a result at odds with CERCLA's deeper purpose of expediting cleanup actions. As it became clear that the extent of the hazardous waste cleanup problem in America was more widespread than CERCLA could effectively control by itself,

ing the desired outcome of cleaning up the contaminated site, the imposition of liability upon a foreclosing lender merely because the foreclosing lender is a "deep pocket" which is connected with the primarily responsible party ignores the basic goal of Superfund: that of imposing liability upon parties responsible for the hazard.[49] Further, imposing liability upon the financial institution as a landowner merely because of its status as landowner also side-steps the real issue of liability. Under both situations, the causation element normally required for tort liability is absent.[50]

Liability of a Financial Institution Upon Foreclosure of Its Security Interest in a Hazardous Waste Disposal Facility

United States v. Maryland Bank & Trust[51]

In the early 1970s, Maryland Bank and Trust loaned money to Hershel McLeod Sr. to operate a trash and garbage business on his farm.[52] Mr. McLeod operated the trash and garbage business until 1980, accepting hazardous chemical waste for disposal.[53] The bank was aware that the farm was being operated as a trash and garbage business.[54] In 1980, Mr. McLeod's son, Mark, purchased the business from his father with the proceeds of a loan from Maryland Bank and Trust,[55] and in 1981, the bank foreclosed on the loan to Mark McLeod for nonpayment.[56] The bank subsequently purchased the farm at the foreclosure sale for $381,500.[57]

> drafters of the reauthorization bill realized that state efforts would be necessary in addition to what they could provide through CERCLA. Even though it might sacrifice some measure of coordinated efficiency . . . , Congress is expected to remove the law's preemptive section.

Comment, *CERCLA Reauthorization: The Wise Demise of § 114(c) and Exxon v. Hunt*, 16 ENVTL. L. REP. (ENVTL. L. INST.) 10286, 10291 (Oct. 1982).

49. "The goal of assuring that those who caused chemical harm bear the cost of that harm is addressed in the reported legislation by the imposition of liability." S. Rep. No. 848, 96th Cong., 2nd Sess. 13 (1980).

50. *Id.* In Maryland Bank & Trust, 632 F.Supp. at 576 the court listed the elements of the cause of action under CERCLA:

> To establish liability under section 107(a) of the Act, the government must establish the following:
>
> 1) The site is a "facility";
>
> 2) A "release" or "threatened release" of any "hazardous substance" from the site has occurred;
>
> 3) The release or threatened release has caused the United States to incur "response costs"; and
>
> 4) The defendant is one of the persons designated as a party liable for costs.

Id. See, Shore Realty Corp., 759 F.2d at 1044 (causation does not matter).

51. 632 F. Supp. 573 (D.Md. 1986).

52. *Id.* at 575.

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.*

57. *Id.*

Instead of selling the business immediately, the bank held on to the farm for undisclosed reasons.[58] In late 1983, the EPA began cleaning up the farm, removing numerous drums of hazardous waste and contaminated soil.[59] When Maryland Bank and Trust refused to pay the cleanup bill, the EPA sued the bank, filing a motion for summary judgment on the basis of the undisputed facts.[60] The bank also filed a motion for summary judgment claiming the security interest exemption under 42 U.S.C.A. Section 9601 (20)(A).[61]

The United States District Court for the District of Maryland ruled against Maryland Bank and Trust and granted the EPA's motion for summary judgment as to the issue of liability under Section 9607(a)(1).[62] The court determined that the exemption allowed by subsection (20)(A) only applied when the security interest existed at the time cleanup measures began and that once the financial institution foreclosed on its security interest, and then subsequently purchased the security at the foreclosure sale, the financial institution was no longer protecting a security interest within the meaning of the exemption provided by subsection (20)(A) but was, in fact, protecting an investment.[63] Therefore, the court held that the bank was liable as an owner under the Superfund liability provisions for the cleanup of the contaminated site.

The court rejected the arguments put forth by Maryland Bank and Trust[64] holding that if the court allowed the exemption to Maryland Bank and Trust, the bank would be unjustly enriched. The court's rationale was that Maryland Bank and Trust's arguments would place cleanup responsibility on the taxpayers with the bank reaping the benefits.[65] "In

58. *Id.*
59. *Id.* at 576.
60. *Id.*
61. *Id.* at 582.
62. *Id.*
63. The court stated:

> The exemption of subsection (20)(A) covers only those persons who, at the time of the cleanup, hold indicia of ownership to protect a then-held security interest in the land. The verb tense of the exclusionary language is critical. The security interest must exist at the time of the cleanup. The mortgage held by M B & T (the security interest) terminated at the foreclosure sale of May 15, 1982, at which time it ripened into full title.

Id. at 579 (citing 55 AM. JUR.2d *Mortgages*, § 785 (1971)). The court suggests that the bank may only incur liability if it purchases the security at the foreclosure sale.

64. Defendant had raised three arguments: that § 107(a)(1) applies only to owners who are operators; that the § 101(20) security interest exemption remained in effect after foreclosure and insulated the bank from liability; and that the bank was protected by the third-party defense because it had no connection with McLeod's hazardous waste business. The court flatly rejected the first two arguments and reserved judgment on the third until after trial.

Comment, *supra* note 6, at 10167.

65. The interpretation of section 101(20)(A) urged upon the Court by M B & T runs counter to the policies underlying CERCLA. Under the scenario put forward by the

essence, the defendant's [Maryland Bank and Trust] position would convert CERCLA into an insurance scheme for financial institutions, protecting them against possible losses due to the security of loans with polluted properties."[66]

The court set out a definite rule by which financial institutions may gauge their potential liability in the event the lender is in the position to foreclose on its security interest. The rule seems to be that any exercise of financial control over any aspect of the business by the foreclosing lender will trigger Superfund liability. The court declined to give a broad interpretation to the liability exemptions[67] and disagreed with the holding in *United States v. Mirabile*,[68] a case in which the United States District Court for the Eastern District of Pennsylvania insulated a lender which foreclosed on a hazardous waste facility from Superfund liability.[69] In the event the foreclosing lender does purchase the site at the subsequent foreclosure sale, it should not retain the property for a period of three years; in other words, financial institutions should learn from the example set by Maryland Bank and Trust, which held onto the foreclosed property for four years, unless they are prepared to pay cleanup costs.[70]

United States v. Mirabile[71]

Unlike the decision in *United States v. Maryland Bank & Trust*, the decision issued by the United States District Court for the Eastern District of Pennsylvania exempted a financial institution which foreclosed on its security interest from Superfund liability. In *Mirabile*, the American Bank

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> bank, the federal government alone would shoulder the cost of cleaning up the site, while the former mortgagee-turned-owner, would benefit from the cleanup by the increased value of the now unpolluted land. At the foreclosure sale, the mortgagee could acquire the property cheaply. All other prospective purchasers would be faced with potential CERCLA liability, and would shy away from the sale. *Yet once the property has been cleared at the taxpayers' expense and becomes marketable, the mortgagee-turned-owner would be in a position to sell the site at a profit.*

Maryland Bank & Trust, 632 F.Supp. at 580 (emphasis added).

66. *Id.* The court then issued an admonition to financial institutions in general: "Financial institutions are in a position to investigate and discover potential problems in their secured properties. For many lending institutions, such research is routine. CERCLA will not absolve them from responsibility for their mistakes of judgment." *Id.* (footnote omitted).

67. *Id.*

68. No. 84-2280 (E.D. Pa. Sept. 4, 1985), 15 ENVTL. L. REP. (ENVTL. L. INST.) 20992 (1985).

69. *Id.*, at 20992–93.

70. Because M B & T has held the property for such an extended period of time, this Court need not consider the issue of whether a secured party which purchased the property at a foreclosure sale and then promptly resold it would be precluded from asserting the section 101(20)(A) exemption. The United States District Court for the Eastern District of Pennsylvania recently held that a former mortgagee that purchased the property at a foreclosure sale and assigned it four months later was exempt from liability.

Maryland Bank & Trust, 632 F.Supp at 579 n.5 (citation omitted).

71. 15 ENVTL. L. REP. (ENVTL. L. INST.) at 20992 (1985).

and Trust Company foreclosed on property containing hazardous waste.[72] The property in question, prior to 1976, had been owned by Arthur Mangels who operated a paint manufacturing business.[73] The business generated hazardous waste by-products which were stored on-site in drums.[74] In 1976, Turco Coatings, Inc., took over manufacturing operations at the site and continued to store the hazardous waste by-products in drums on-site.[75] Turco Coatings, Inc. ceased operations in December 1980, and the American Bank and Trust Company foreclosed the following August.[76] At the sheriff's sale, American Bank and Trust successfully bid on the property; however, the bank subsequently assigned the bid to the Mirabiles.[77]

The EPA commenced cleanup of the site and sued for the response costs, joining Mangels, Turco, American Bank and Trust Company and the Mirabiles. The American Bank and Trust Company argued that "a secured creditor's exercise of financial control over a debtor should not bring the creditor within the scope of CERCLA liability."[78] The court agreed with American Bank and Trust Company that the mere exercise of financial control over any aspect of the business was not sufficient to impose CERCLA liability;[79] however, the court did state that if the lender exercised any control over day-to-day operations, Superfund liability may attach.[80]

The two cases, *United States v. Maryland Bank & Trust* and *United States v. Mirabile,* on their faces, appear to take opposite positions, deciding the individual cases on separate policy guidelines.[81] One com-

72. *Id.*
73. *Id.*
74. *Id.* at 20993.
75. *Id.*
76. *Id.*
77. *Id.*
78. *Id.* at 20995.
79. [T]he exemption plainly suggests that provided a secured creditor does not become overly entangled in the affairs of the actual owner or operator of a facility, the creditor may not be held liable for cleanup costs. The difficulty arises, of course, in determining how far a secured creditor may go in protecting its financial interests before it can be said to have acted as an owner or operator within the meaning of the statute.

Id.

80. [I]n enacting CERCLA Congress manifested its intent to impose liability upon those who were responsible for and profited from improper disposal practices. Thus, it would appear that before a secured creditor such as ABT may be held liable, it must, at a minimum, participate in the day-to-day operational aspects of the site.

Id. at 20996.

81. The *Mirabile* court was primarily concerned with giving full effect to the security interest exemption. . . . The *Maryland Bank & Trust* court, on the other hand, principally wanted to avoid establishing a rule that would allow private parties to profit from government cleanup of CERCLA sites. . . . In many respects, then, *Mirabile* and *Maryland Bank & Trust* are almost like opposite sides of the coin.

Comment, *supra* note 6, at 10168.

mentator has suggested that one explanation for the difference between the two decisions is the title theories of the respective states.[82] Under Maryland law, the mortgagee holds legal title to the mortgaged property until the mortgage is paid in full.[83] Maryland is thus known as a title theory state.[84] On the other hand, Pennsylvania is classified as an intermediate theory state, under which the mortgagor holds legal title to the mortgaged property while the mortgage is in effect.[85] The mortgagee is entitled to possession only upon default.[86] Under this analysis, Maryland Bank and Trust was an "owner" while the American Bank and Trust was not since it did not hold legal title.

The same commentator suggested a second basis for reconciling the two decisions defining landowner for the purposes of liability.[87] The bank in *Mirabile* foreclosed on the property, successfully bid on the property at the subsequent foreclosure sale and then assigned the bid to the Mirabiles all before the Pennsylvania Department of Environmental Resources informed any party of the existence of toxic waste and before the EPA commenced cleanup actions.[88] Therefore, "the bank in *Mirabile* may not have been liable as an owner at all. There was no dumping at the Mirabile property while the bank held title after foreclosure; the bank did not abandon the site; and it was not the owner when the cleanup was performed."[89] However, neither of the two theories adequately explains the difference between the two decisions.

Overall, the only factor which may truly reconcile the two decisions is the length of the respective banks' ownership and the actions taken to protect the investment or to protect the security interest. Maryland Bank and Trust held title to the property for nearly four years;[90] in comparison, the American Bank and Trust Company assigned its high bid at the foreclosure sale only four months after the foreclosure sale.[91] It may

82. *Id.* ("As the *Maryland Bank & Trust* court suggested, duration of the bank's ownership is one basis for reconciling the two cases. Indeed, the bank in *Mirabile* may never have taken legal title. . . .").

83. Maryland Bank & Trust, 632 F.Supp. at 579.

84. G. PINDAR, AMERICAN REAL ESTATE LAW, § 20-13 n.2 (1976).

85. *Id.*

86. The right to possession is retained by the mortgagor until default, but after default possession automatically accrues to the mortgagee.

87. Comment, *supra* note 6, at 10166 defined the scope of owner liability as follows:

> The scope of landowner liability thus is . . . not all-inclusive. One who owned a CERCLA site before or after it was used for hazardous substance disposal, who sold the site before anyone incurred cleanup costs reimbursable under CERCLA, and who never operated the site, apparently is not liable.

Id.

88. United States v. Mirabile, 15 ENVTL. L. REP., at 20993. *See* notes 77 and 78, and accompanying text.

89. Comment, *supra* note 6, at 10168.

90. Maryland Bank & Trust, 632 F.Supp. at 579.

91. Mirabile, 15 ENVTL. L. REP. at 20993; *see* Maryland Bank & Trust, 632 F.Supp. at 579.

further be argued that Maryland Bank and Trust "participated in the management of [the] . . . facility"[92] thus meeting the test set forth in *Mirabile* of participation in the "day-to-day operational aspects of the site."[93] While no hard evidence is available from the cases, the mere fact that Maryland Bank and Trust held the site for nearly four years suggests just such a conclusion.

Since no adequate rationale exists for reconciling the two decisions, a foreclosing bank would be wise to follow in the footsteps of American Bank and Trust Company. Precedent demonstrates that a foreclosing lender may permissibly hold title for approximately four months but that holding title for just under four years is not permissible. The cases leave a wide void in which a foreclosing lender may be trapped.

In re T.P. Long Chemical, Inc.[94]

Although *In re T.P. Long Chemical, Inc.*, was clothed in bankruptcy proceedings rather than a Superfund action,[95] the court was faced with a claim made by the EPA for response costs against the estate, specifically against funds in which BancOhio held a perfected security interest.[96] BancOhio held a perfected security interest in the personal property of the debtor business, including a perfected security interest in drums containing sulfur monochloride buried at the site.[97] The EPA sought recovery from the funds subjected to BancOhio's security interest because the unencumbered assets of the estate were insufficient to pay the response costs incurred by the EPA.[98]

The court rejected the argument set forth by the EPA[99] finding that BancOhio was not liable as an owner or operator under Superfund[100] and

92. 42 U.S.C. § 9601(20)(A) (1982). For the text, *see supra* note 14.

93. Mirabile, 15 ENVTL. L. REP. at 20996.

94. *In re* T.P. Long Chemical, 45 B.R. 278 (Bkrtcy. 1985).

95. The T.P. Long Chemical Company, Inc. originally filed for reorganization under Chapter 11; however, the court ordered it converted to a Chapter 7 liquidation. In re T.P. Long Chemical, Inc., 45 B.R. at 280.

96. The court framed the issue as follows: "Is the EPA entitled to recover the cost of removing the hazardous material from the funds in which BancOhio has a security interest?" *Id.* at 282.

97. *Id.* at 281.

98. *Id.* at 287.

99. The EPA argues that the trustee's obligation to abate the hazard would have extended to BancOhio had it sought to sell its collateral pursuant to its security agreement. The EPA then argues that this liability cannot be avoided by transferring the ownership of the collateral.

Id. at 288. It might be argued that the security interest exemption was specifically inserted to facilitate the transfer of collateral even though the collateral may be a hazardous waste disposal facility.

100. The court must reject this argument. The court finds that even if BancOhio had repossessed its collateral pursuant to its security agreement it would not be an "owner or operator" as defined by CERCLA. . . . The only possible indicia of ownership that can be attributed to BancOhio is that which is primarily to protect its security interest. It is undisputed that BancOhio has not participated in the management of the Long facility. Thus, BancOhio cannot be held liable as an owner or operator under CERCLA.

Id. at 288–289.

that, even as a matter of equity, the EPA could not recover response costs from BancOhio.[101] The court in this instance, like the court in *Mirabile*, gave full effect to the security interest exemption, setting forth the criteria that the financial institution must participate in the management of the facility before a court would be able to impose liability under Superfund.[102]

Under the three cases discussing financial institution liability for Superfund response costs upon foreclosure of the interest in the hazardous waste disposal facility, it appears that the financial institution initially should carefully consider the alternatives to foreclosure. If it becomes evident that foreclosure is the only realistic alternative available, the lender should foreclose on the interest. In the foreclosure process, however, the lender should take particular care to not become involved in any day-to-day operations on the site. While these actions may not fully relieve the financial institution from Superfund liability,[103] it will certainly put the financial institution in a better position to avail itself to the *Mirabile* and *T.P. Long Chemical, Inc.* decisions. The financial institution may also attempt to utilize third-party defenses,[104] the success of which will depend upon the financial institution's knowledge of the use of the loan, the timing of the loan itself, and the interpretation placed upon the contractual relations[105] between the financial institution and the owners/operators of the now inactive hazardous waste disposal facility.[106]

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101. The court finds that, as a matter of equity, the EPA may not recoup its expenses from BancOhio. . . . It would be inequitable, however, to make BancOhio bear the risk of all damage caused by property in which it holds a security interest.

Id. at 289.

102. *Id.* at 288, 289.

103. *See* Maryland Bank & Trust, 632 F.Supp. 573 at note 6.

104. 42 U.S.C. § 9607(b)(3) (1982) provides:

> There shall be no liability under subsection (a) of this section for a person otherwise liable who can establish by a preponderance of the evidence that the release or threat of release of a hazardous substance and the damages resulting therefrom were caused solely by—
>
> . . .
>
> (3) an act or omission of a third person other than . . . one whose act or omission occurs in connection with a contractual relationship, existing directly or indirectly, with the defendant. . . .

Id.

105. CERCLA provides a third party defense to take into account acts or omissions by third parties. The defense does not apply when the acts are committed by an employee or agent of the defendant, or if there is a contractual relationship between the third party and the defendant. 42 U.S.C. § 9607(b)(a)(3) (1982). The definitional section states that the term "contractual relations" will include most methods of real estate transfers and only excludes transfer in which the disposal of the hazardous substance occurred prior to the purchase by the defendant and the defendant had no reason to suspect that hazardous materials were located on, in, or at the site. 42 U.S.C.A. § 9601 (35)(A) (West Supp. 1987). The defendant is then held to a "good commercial or customary practices" standard. *See supra* note 38 and accompanying text.

106. [I]f the bank's loans had nothing to do with the hazardous waste disposal and the bank did not know about and reasonably should not have known about the activity, it will likely be successful in its § 107(b)(3) defense. . . . If the bank knowingly loaned money for the hazardous waste disposal business, the bank clearly should

The Liability of a Financial Institution as an "Innocent" Subsequent Owner of an Inactive Hazardous Waste Disposal Facility

In a situation in which a financial institution forecloses on its security interest in the inactive hazardous waste disposal facility after the EPA has cleaned up the site and has been reimbursed for the cleanup by the responsible party or parties,[107] the question becomes what potential liability awaits the financial institution as a subsequent landowner. The question is not altogether easily answered.[108] Three cases which discuss subsequent ownership liability will be examined.[109] The cases demonstrate that the key to the imposition of liability upon a subsequent owner is the

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> be liable under the principle of "he who profited from the pollution should pay," which seems to underlie CERCLA. If the court denies the defense on the contractual relationship issue, simply because the bank loaned money . . . during the period in which hazardous wastes were being dumped . . . regardless of the bank's actual or constructive knowledge, the bank's security interest will have soured into a heavy liability without much culpability or profit on the part of the bank. However, CERCLA imposes this kind of retroactive liability on other categories of responsible parties who are no more closely connected with a particular site.

Comment, *supra* note 6 at 10168 (footnotes omitted). The author of the Comment also made the following observation:

> The court [in *United States v. Maryland Bank & Trust*] observed that it would not rule as a matter of law that McLeod Sr.'s disposal of hazardous waste was connected to the bank's contractual relationship with him without knowing whether there were loans outstanding to him during the 1972–73 period of toxics. It also discussed that the bank knew about McLeod's disposal activities as relating to the due care issue, not the contractual relationship issue. While it requires several speculative leaps of deduction, the inference might be drawn that the court would rule that the temporal overlap of the loans and the disposal would satisfy the contractual relationship test without actual knowledge on the part of the bank about the activities for which McLeod was using the money.

Id. at 10168 n.47.

107. This was one of the issues of a case filed in the District Court of Harris County, Houston, Tex., the 152nd Judicial District captioned Joseph Edward Powell v. Pulte Home Corporation, No. 84-75865.

108. [C]ourts are reluctant to impose liability even after a reasonable time on current, nonpolluting owners because of the great costs associated with abating the problems created by the leakage of chemicals from underground dumpsites. The prevailing approach now appears to be that courts will primarily consider factors other than ownership in determining who should bear liability for the contamination. In actions involving private litigants, this trend would allow a succeeding landowner to be relieved of liability if he or she did not know of the earlier waste disposal on the land. . . . However, sometimes a failure to take reasonable steps to abate the known nuisance may render an otherwise innocent purchaser liable for the nuisance.

Comment, *Changes in the Ownership of Hazardous Waste Disposal Sites: Original and Successor Liability*, 67 MARQ. L. REV. 691, 708 (1984) (hereinafter *Changes in Ownership*).

109. The three cases are: State of N.Y. v. Shore Realty Corp., 759 F.2d 1032 (2d Cir. 1985); Philadelphia Chewing Gum Corp. v. Commonwealth, 35 Pa. Commw. 443, 387 A.2d 142 (1978), *aff'd sub nom.*, Nat'l Wood Preservers, Inc. v. Commonwealth, 489 Pa. 221, 414 A.2d 37 (1980); State, Dept. of Envtl. Protection v. Exxon Corp., 151 N.J. Super, 464, 376 A.2d 1339 (N.J. Sup. Ct. Ch. Div. 1977).

degree of knowledge held by the subsequent landowner of past activities on the land tempered by any actions taken by the subsequent owner after knowledge was gained to abate the hazardous situation.[110] The case holdings were reflected in the Superfund liability provisions.[111]

State of New York v. Shore Realty Corporation

In February 1984, the State of New York brought suit under CERCLA against Shore Realty Corporation and Donald LeoGrande, its sole officer and stockholder, to clean up a hazardous waste disposal site.[112] The property had been purchased by Shore Realty Corporation for development.[113] The relevant facts are as follows:[114] On July 14, 1983, Shore Realty Corporation contractually agreed to purchase 3.2 acres of property located at One Shore Road, Shore Realty Corporation being formed solely to purchase the land. At the time of the purchase, LeoGrande was aware that the then current tenants were illegally operating a hazardous waste storage facility on the property. On October 13, 1983, Shore Realty Corporation took title to the property. From October 13, 1983, to January 5, 1984, nearly ninety thousand gallons of hazardous chemicals were added to the site. On January 5, 1984, the tenants who were operating the facility on the site were evicted. It was estimated that, as of January 5, 1984, seven hundred thousand gallons of hazardous chemicals were on the premises.

Shore Realty Corporation denied responsibility claiming that it was not covered by CERCLA since it "neither owned the site at the time of disposal nor caused the presence or the release of the hazardous waste at the facility."[115] The court rejected Shore Realty Corporation's argument and imposed CERCLA liability.[116] The basis of imposing liability on Shore

110. Shore Realty Corp., 759 F.2d at 1037. "It is generally held that the liability of the subsequent landowner is limited unless they had accepted or associated themselves with the creation of the maintenance of the harmful conditions on the property." Changes in Ownership, *supra* note 108, at 709.

111. *See* notes 35 to 42 and accompanying text.

112. *Shore Realty Corp.* 759 F.2d at 1037. While not a state court decision based upon a state mini-superfund statute, the case does demonstrate that knowledge of hazardous chemicals on site at the time of the purchase may trigger Superfund liability as an owner and responsible party.

113. *Id.* The case does not indicate what type of development was planned.

114. The facts of *Shore Realty Corp.* are set out in the case at 1037–1039.

115. *Id.* at 1043.

116. *Id.* at 1045.

> It is quite clear that if the current owner of a site could avoid liability merely by having purchased the site after chemical dumping had ceased, waste sites certainly would be sold, following the cessation of dumping, to new owners who could avoid the liability otherwise required by CERCLA. Congress had well in mind that persons who dump or store hazardous waste sometimes cannot be located or may be deceased or judgment-proof.

Id. (citation omitted).

Realty Corporation was the knowledge Shore Realty Corporation had of the presence of the hazardous substances,[117] knowledge which successfully blocked any third-party defenses.[118] The court held that the limitation of landowner liability "clearly does not extend to successor owners who knew about the condition of the land before purchasing it."[119]

Limited Liability

There are cases in state courts which show the concern for subsequent landowners by limiting the liability of successor landowners.[120] Both *Philadelphia Chewing Gum v. Commonwealth*[121] and *New Jersey Dep't of Environmental Protection v. Exxon Corp.*[122] were brought under state mini-Superfund statutes; however, their application to federal Superfund liability litigation was recognized in the Superfund Section 301(e) Study Group Report to Congress[123] and in SARA provisions. The cases generally follow the common law analysis which bases liability upon the level of knowledge possessed by the successor owner and the subsequent actions taken to abate the condition once knowledge is acquired.[124] Unlike the situation in *State of New York v. Shore Realty Corp.* in which the successor owner had knowledge of the hazardous waste on the land prior to purchase, the two cases illustrate a situation in which the subsequent landowner discovers the existence of hazardous substances after the purchase. It is a situation in which the subsequent purchasers truly are "innocent" subsequent landowners at the time of purchase and know nothing of the existence of hazardous waste even after diligent search.[125]

Philadelphia Chewing Gum Corp. v. Commonwealth.[126] The issue

117. *Id.* at 1048 n.23.

> While we need not reach the issue, Shore appears to have a contractual relationship with the previous owners that also blocks the defense. The purchase agreement includes a provision by which Shore assumed at least some of the environmental liability of the previous owners.

Id.

118. *Id.* at 1051.

> It is immaterial . . . that other parties placed the chemicals on this site; Shore purchased it with knowledge of its condition—indeed of the approximate cost of cleaning it up—and with an opportunity to clean up the site. LeoGrande knew that the hazardous waste was present without the consent of the State or its DEC, but failed to take reasonable steps to abate the condition.

Id.

119. *Id.* at 1050 n.25.

120. Philadelphia Chewing Gum Corp. v. Commonwealth, 35 Pa. Commw. 443, 387 A.2d 142 (1978), *aff'd sub nom.*, Nat'l Wood Preservers, Inc. v. Commonwealth, 439 Pa. 221, 414 A.2d 37 (1980), and State, Dep't of Envtl. Protection v. Exxon Corp., 151 N.J. Super. 464, 376 A.2d 1339 (N.J. Sup. Ct. Ch. Div. 1977).

121. Philadelphia Chewing Gum Corp., 387 A.2d 142.

122. State Dep't of Envtl. Protection, 376 A.2d 1339.

123. *See* Report, *supra* note 12.

124. *See supra* notes 35 to 42 and accompanying text.

125. *See supra* note 40.

126. 35 Pa. Commw. 443, 387 A.2d 142 (1978), *aff'd sub nom.*, Nat'l Wood Preservers, Inc. v. Commonwealth, 489 Pa. 221, 414 A.2d 37 (1980).

in *Philadelphia Chewing Gum* was whether a landowner was liable for the cleanup of a condition existing on his land which was caused by an adjacent landowner.[127] Pentachlorophenol mixed with oil was found in groundwater under, at, and near the area involved.[128] The area included two tracts of land separated by a road running southwest to northeast. Philadelphia Chewing Gum Corporation owned property on the southeast side of the road.[129] The property on the northeast side of the road was owned by Clifford and Virginia Rogers who had leased a majority of the property to National Wood Preservers, Inc., a wood preservative business.[130] The balance of the Rogers' property was leased to Shell Oil Company for a gasoline station.[131] The presence of chemicals in the groundwater originated on and in the property leased to National Wood Preservers, Inc. and Shell Oil Company and flowed through Philadelphia Chewing Gum Corporation's property and into a stream.[132]

The Pennsylvania Environmental Hearing Board found that none of the current occupiers, Philadelphia Chewing Gum Corporation, National Wood Preservers, Inc., or Shell Oil Company, contributed to the pollution of the groundwater,[133] but that the previous owner's activities caused the introduction of pentachlorophenol and oil into the groundwater.[134] Since the present occupiers of the land had no knowledge of the condition nor

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127. *Id.* 387 A.2d at 144.

> At the heart of these consolidated appeals is the following fundamental question: Under what circumstances may the Commonwealth order a landowner or an occupier of land to correct a condition existing on his land which is causing pollution of Commonwealth waters, where such polluting condition was created by the conduct of someone other than the owner or occupier?

Id.

128. *Id.* 387 A.2d at 145.

129. *Id.* 387 A.2d at 144.

130. *Id.*

131. *Id.* 387 A.2d at 144–45.

132. *Id.* "Pentachlorophenol mixed with oil flows, mostly on top of the water table, under the surface of the property of Rogers' and leased, in part to Shell and in part to Wood. This material then flows in a southwesterly direction under Eagle Road. . . . Pentachlorophenol mixed with oil flows, mostly on top of the water table, under the surface of the property of Gum. This material then infiltrates the storm sewer pipe which is maintained by the Township . . . and is discharged to Naylors Run at the terminus of this pipe."

Id.

133. *Id.*

> In its adjudication, EHB concluded that the 'condition' which is present in this case is 'the presence of pentachlorophenol mixed with oil' under the surface of appellants' land. EHB found as fact, however, the neither Wood, . . . nor Shell, nor Gum had 'discharged or permitted the discharge of industrial waste to the waters of the Commonwealth.' (quoting the Environmental Hearing Board).

Id.

134. *Id.* 387 A.2d at 146.

> Given the specific findings of fact that neither Wood, under Goldstein, nor Gum nor Shell has discharged any industrial waste into Commonwealth waters, we must conclude that the presence of pentachlorophenal under the land of these appellants is a direct result of Jacoby's activities prior to and including the year 1956.

Id.

had taken part in the creation of the present condition, the court, accepting the Environmental Hearing Board's findings, declined to impose liability. However, the court did outline the situations in which the "innocent" occupier could be ordered to take corrective measures.[135] The court stated that liability would be predicated upon the knowledge and positive association of the parties, beyond mere ownership or occupancy, to the condition of the land.[136] Mere ownership status was insufficient in and of itself to cause liability to attach.[137]

State, Dep't of Envtl. Protection v. Exxon Corp.[138] In *State, Dep't of Envtl. Protection v. Exxon Corp.*,[139] the New Jersey Department of Environmental Protection brought suit against Exxon Corporation and ICI America, Inc. under the New Jersey Spill Compensation and Control Act[140] for remedial action to cleanup the petroleum pollution and correct any further emanation of the petroleum pollution. Exxon Corporation owned a tract of land, approximately 320 acres, in Bayonne, New Jersey since 1898.[141] Exxon Corporation used the property for refining, storing and trans-shipping crude oil and other petroleum products.[142] During the time of Exxon Corporation's ownership, oil was spilled, permitted to leak, and was intentionally dumped at the site.[143]

Over a period of four years ending in 1969, Exxon Corporation sold approximately 35 acres of the site to ICI America, Inc.[144] The New Jersey

135. *Id.* 387 A.2d at 150.

> Where the polluting condition is created by the conduct of an individual other than the owner or occupier, the owner or occupier of the land on which the condition exists cannot be liable to take corrective measures . . . on the basis of the bare fact of ownership or occupancy. Such an owner or occupier can be ordered to take corrective measures, however, if he permitted or authorized the creation of the condition on his land. Such an owner or occupier can also be ordered to take corrective measures if he (1) knows or should have known of the existence of the condition on the land; and (2) associates himself in some positive respect, beyond mere ownership or occupancy, with the condition after its creation. The key to imposing liability . . . upon an owner or occupier for the correction of a condition which he did not create is that such an owner or occupier, after knowing of the condition, engages in some affirmative conduct indicating his adoption of the condition. Essentially, this theory of liability for owners or occupiers who do not create the condition is an application . . . of the common law liability of owners or occupiers who 'continue' or 'adopt' a nuisance not created by them.

Id.

136. *Id.* 387 A.2d at 150–51.

137. *Id.* 387 A.2d at 150.

138. 151 N.J. Super. 464, 376 A.2d 1339 (N.J. Sup. Ct. Ch. Div. 1977).

139. *See supra* note 24.

140. N.J. Stat. Ann. §§ 58:10-23.11 to 58:10-23.11z (West 1982 and Supp. 1985).

141. State, Dep't of Envtl. Protection v. Exxon Corp., at 469, 376 A.2d at 1341.

142. *Id.* at 469, 376 A.2d at 1342.

143. *Id.*

144. *Id.* at 469, 376 A.2d at 1342. Since acquiring the property, ICI has conducted a manufacturing operation on the site which does not involve the utilization, storage, handling or transfer of oil, and ICI has never engaged in any activity which added oil to the condition which existed at the time the ICI property was purchased from Exxon. *Id.*

Department of Environmental Protection obtained an agreement with Exxon Corporation for Exxon Corporation to cleanup the land which it owned.[145] The Department of Environmental Protection and ICI America, Inc. did not agree as to the liability of ICI America, Inc.; therefore, each filed motions for summary judgment as to ICI America, Inc.'s liability for response costs.[146]

The court declined to impose liability for response costs on ICI America, Inc. since the Department of Environmental Protection could not prove causation.[147] The court further held that liability could not be imposed based on a nuisance theory. The Department of Environmental Protection argued that "ICI is chargeable with maintaining a nuisance because after acquiring the subject property it learned of the existence of the nuisance and it has done nothing to remedy it."[148] The court rejected the argument based on the general rule that the creator of the nuisance (Exxon Corporation) remained liable for the nuisance even after alienating the property;[149] therefore, ICI America, Inc. could not be held liable for response costs merely because it happened to own a polluted site.[150]

LIMITING SUPERFUND LIABILITY

In light of the case law under Superfund and state mini-superfund provisions, it is clear that a foreclosing financial institution may be held liable for response costs and for the consequential damages to the environment. It is equally clear that the sophisticated lender will also take steps to limit its exposure to Superfund liability. Since there is only one sure way of preventing the imposition of Superfund liability, not wholly

145. *Id.* at 469, 376 A.2d at 1341 ("With regard to defendant Exxon, a stipulation of dismissal was previously filed with this court which requires that Exxon remedy the petroleum pollution problems which exist on its property. . . ."). The Government would not dismiss the charges against ICI America, Inc.

146. *Id.*

147. *Id.* at 477–478, 376 A.2d at 1346.

> Under the circumstances of this case it appears that causation cannot be shown between any act of ICI and the resultant harm. ICI acquired its property between 1965 and 1969. By then almost seven decades had gone by under Exxon's ownership in which the land was despoiled by spillage of oil by Exxon. These acts so contaminated the ground that some 7,000,000 gallons of oil lie under the surface of the 35 acres purchased by ICI. However, ICI had no control over the land while the oil was being deposited thereon by Exxon and thus could not have prevented it. Therefore, no causal relation can be found between ICI's acts and the oil originally deposited on the land by Exxon and now seeping into the waters of the State.

Id.

148. *Id.* at 484, 376 A.2d at 1349.

149. *Id.* at 484, 376 A.2d at 1349. The general rule only applies when the nuisance in question is a latent nuisance, i.e., the grantor must disclose any latent defect or dangers he knows or should know will not be discovered by the grantee. *See* United States v. Inmon, 205 F.2d 681 (5th Cir. 1953); Beall v. Lo-Vaca Gathering Co., 532 S.W.2d 362 (Tex. Civ. App. 1975). *See also* RESTATEMENT (SECOND) OF TORTS, §§ 352 and 353 (1977).

150. State, Dep't of Envtl. Protection v. Exxon Corp., 151 N.J. Super at 484, 376 A.2d at 1349.

acceptable,[151] future loan negotiations with specified industrial concerns will likely deal with provisions providing for indemnification, environmental risk assessments, and environmental audits, along with warranty representations.[152] All must be done without the lender becoming involved in the day-to-day operations of the industrial borrower.[153]

Under the provisions of Superfund, it is permissible for a lender to negotiate and secure an indemnification agreement, triggered by foreclosure and EPA cleanup, from the borrower.[154] The negotiated indemnification clause may be rendered useless to the lender, however, if the lender does not somehow insure compliance with the applicable environmental laws by requiring initial environmental assessment and periodic follow-up environmental audits as a part of the loan package. The initial assessment and subsequent audits may well become standard negotiated prerequisites to the disbursement of loan proceeds in light of the high standard of due diligence and care required in the commercial transaction.[155] The assessment does not come without a price tag, for the more exacting the initial assessment, the higher the initial cost. However, the cost of the initial assessment will be money well spent if the assessment demonstrates that the proposed site is already contaminated and in need of cleanup, for the lender may then decide not to risk exposure to Superfund liability.

While the initial cost may be high, the benefits to the lender and the borrower justify the costs. The lender benefits from the initial assessment by becoming fully aware of the condition of the property on which the loan is made. The lender may then decide either to forego the loan or proceed with the transaction. The follow-up audits will alert the lender to potential problems after the loan is made and better enable the lender to protect its security interest in the property. The borrower also benefits from the assessment and audits since the knowledge of potential problems

151. It seems that the only way a lender can truly insure insulation from Superfund liability is by declining to make loans to designated industrial concerns which create hazardous waste. The high risk of liability has already forced many smaller lenders to refuse to loan money to these industrial borrowers.

152. Fear of a hidden Superfund site or acquiring a business with hidden environmental problems has driven all but the most obtuse management to reflect upon what it should do to protect itself. It simply no longer makes good business sense to take a laissez faire approach to environmental problems. Responsible managers are demanding assurance on environmental risks. Many are requiring a system to detect environmental risks and verify compliance with applicable internal and external controls. The vehicle used to attain these goals is a rapidly growing discipline called environmental auditing.

Earl, *Environmental Auditing: What Your Client Doesn't Know Hurts the Most*, LX FLA. B. J. n.47 (Jan. 1986).

153. As discussed earlier, such involvement in the day-to-day operations of the borrower would expose the lender to liability under the more liberal *Mirabile* test.

154. 42 U.S.C. §9607(e) (1982). *See supra* notes 71 to 80 and accompanying text.

155. *See supra* note 42.

will allow the borrower to correct the problems before it reaches the critical stage in which the EPA and Superfund would intervene. Further, compliance with assessments and audits may target the industrial borrower as a "good environmental risk" making it easier to secure new loan benefits.

Initial Environmental Assessments

When an industrial concern goes to a lender to borrow money for activities connected with the business, the lender runs a risk of Superfund liability. The exposure to risk puts the lender in a position to require initial environmental assessment, with the loan itself being contingent upon the completion and analysis of the environmental assessment. The decision by the lender to require an environmental assessment to be performed by a qualified entity[156] is a wise one as it will provide information upon which the lender may assess initial potential for Superfund liability in the event the lender must foreclose upon its security interest. Two questions immediately present themselves: 1) When should the assessment take place; and 2) What information should be required in the assessment.

The timing of the assessment, for maximum benefit to the lender, should take place prior to the lender becoming obligated to disburse the loan. The lender could easily make loan disbursement contingent upon an analysis which demonstrates a lack of contamination at the site. Further, the specific mechanics of the assessment may dictate the timing for a particular transaction. There is also some question as to whether a lender would be adequately protecting itself under the due diligence standard if the assessment were to take place upon foreclosure instead of at the time the loan is initially made. Since the EPA would surely argue that the foreclosing lender is in the same shoes as the purchaser the lender is foreclosing on, the question becomes: Does the "foreclosure purchase" relate back to the making of the loan? The EPA would argue that the foreclosure is a purchase that does relate back under the contractual relations definition to the time of the initial loan.[157]

Should the lender wait to the time of foreclosure to make the environmental assessment, the lender would be faced with the decision of either foregoing foreclosure or of foreclosing and exposing itself to Superfund liability as the lender would be under the "good commercial or customary practice" standard.[158] Therefore, the lender would be wise to require the

156. The qualified entity generally will provide services in a wide enough range so that the assessment will be specifically tailored to the needs of the lender and the borrower.

157. *See supra* notes 35 to 39 and accompanying text.

158. *See* 42 U.S.C.A. § 9601(35) (West Supp. 1987).

environmental assessment up front and not make the assessment contingent upon foreclosure.

What then are the mechanics of the environmental assessment? The first step is one that is already required of most large loans made on real estate, a title search. The title search will provide a point of reference for further testing if the title search discloses that the land was once owned by an industrial concern which produced hazardous waste by-products. The second step involved, regardless of what the title search reveals, is an actual walk-through of the property by a qualified environmental risk assessor. The walk-through can also provide a reference point for specific testing of the site. The third step would then involve the testing of the site by whatever means determined by the walk-through to be necessary, that is, general hydrological and/or geological, or merely substance specific. The final step would be a written analysis submitted to the requisite parties. The initial assessment, while providing valuable decision information to the lender, may also provide the basis for the subsequent environmental audits.

Subsequent Environmental Audits

The EPA has recognized the value of the environmental audit as a tool to promote an increase in compliance with environmental laws and regulations.[159] The EPA has defined environmental auditing as "a systematic, documented, periodic, and objective review by regulated entities of facility operations and practices related to meeting environmental requirements."[160] A successful environmental audit program also requires the assurances of compliance on the part of the borrower to the lender. The assurance of compliance must be carried out without the lender becoming substantially involved in the day-to-day operations of the borrower.

A successful program will be tailored to the individual, specific needs

159. In developing compliance strategies under the environmental statutes, the United States Environmental Protection Agency (EPA) has found that traditional administrative and judicial enforcement efforts are not always sufficient to achieve a high level of compliance from all regulated entities, including industry, municipalities, and federally-owned facilities. This has become particularly apparent under the environmental programs that regulate hazardous wastes and toxic substances. To address this issue, EPA has explored the concept of environmental auditing as an innovative approach to promote increased compliance by the regulated community.

Danzig, Walker, & Price, *Environmental Auditing: Reaching the Bottom Line in Compliance*, NAT. ENVTL. ENFORCE. J. 3 (Jan. 1987).

160. U.S. EPA, Environmental Auditing Policy Statement, 51 FED. REG. 25004 (1986). Danzig, Walker & Price, *supra* note 159, at 3. "It [environmental auditing] does not replace environmental awareness or protection programs: It measures their effectiveness." Earl, *supra* note 152, at 47 (footnote omitted).

of the borrower.[161] Various industrial factors and the company's specific past history will also play a key role in the development of a successful audit.[162] Since the audits are specifically tailored, it is difficult to outline a general audit program; however, the most important element in the audit is the support of the company hierarchy.[163] Once the environmental audit is set up and operational, lenders will feel more comfortable in making loans to industrial borrowers who demonstrate a commitment to a successful environmental audit program since the lenders will have a history available to them regarding the particular borrower's past record.

CONCLUSION

Since the passage of Superfund in 1980, financial institutions have wrestled with the Superfund liability provisions and have generally won, keeping sufficient distance to avoid liability; however, recent court decisions and the Superfund amendments have left financial institutions in a state of fear and uncertainty as to their exposure to Superfund liability. The lenders must find a way to insulate themselves from Superfund liability. This path will lead the lender to negotiate for environmental assessments prior to the disbursement of funds for loans to the specific industrial customers. The path will also dictate that the lender require the implementation of an environmental audit program to continue compliance with environmental regulations. The lender that successfully negotiates these concessions from the industrial borrower will be in a far better position than the lender who does not properly weigh the risks involved. In Superfund liability, as in real life, the foolish and their money are soon parted. The lender who does not take steps to adequately assess Superfund risks prior to loan disbursement is extremely foolish and is likely to be forced to part with large amounts of money for the response costs.

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161. A successful auditing program must be tailored to the needs of a specific organization. What's appropriate for a phosphate company will not be appropriate for Mom and Pop Drum Recycling Company. The scope, goals, strategies, staffing, and procedures must be designed to meet specific needs.

The program chosen depends upon such factors as: (1) particular objectives; (2) available resources; (3) company structure and size; (4) environmental impacts; (5) past history and compliance; and (6) the desirability of confidentiality.

Earl, *supra* note 152, at 48 (footnotes omitted).

162. *Id.*

163. "The key component in any successful audit is generally recognized to be the support of top management. Only with that support can independence and follow-up be assured." *Id.*