

KENTUCKY BAR ASSOCIATION 2011 CONVENTION



PURSUING JUSTICE
IN THE 21ST CENTURY

ENVIRONMENTAL LAW FOR LENDING INSTITUTIONS AND REAL ESTATE TRANSACTIONS

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Kentucky Bar Association

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ENVIRONMENTAL LAW FOR LENDING INSTITUTIONS AND REAL ESTATE TRANSACTIONS:¹ INDUSTRIAL PROPERTY

Ronald R. Van Stockum, Jr.
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I. SELECTED FEDERAL LAW

A. Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA, also known as Superfund, Hazardous Substances), (42 U.S.C. §§9601 *et seq.*)

1. CERCLA liability generally.

a. Strict liability -- "liability...shall be construed to be the standard...under Section 311 of the Clean Water Act."
(42 U.S.C. §9601(32)).

b. Joint and several liability (Burlington Northern and Santa Fe Railway Co. v. U.S., 129 S.Ct. 1870 (2009); United States v. Chem-dyne Corp., 572 F.Supp. 802 (S.D. Ohio, 1983)).

c. Liable parties (42 U.S.C. §9607(a)).

i. Persons, including individuals (see CERCLA §101(21) definition).

ii. "Owner and operator" (United States v. Best Foods, 524 U.S. 51 (1998)).

iii. "Any person who **at the time of disposal of any hazardous substance owned or operated...**"

iv. "Any person who by contract, agreement, or otherwise **arranged for** disposal or treatment or...transport..."

v. "**Transport...**"

THIS IS AN ADVERTISEMENT

¹ This seminar material is for instructional purposes only. Application to specific legal or factual issues necessitates a detailed analysis beyond that provided herein. Only selected sections and paragraphs of cited regulations and statutes are provided. Additional statutes and regulations can be applicable.

- d. Defenses (42 U.S.C. §9607(b)).

“The damages resulting therefrom were caused solely by...”

 - i. An act of God...
 - ii. An act of war...
 - iii. An act or omission of a third party (restrictively allowed).
- e. Liability (42 U.S.C. §9607(a)).
 - i. "All costs of **removal** or **remedial action** incurred by the United States..."
 - ii. "Any other necessary costs of **response** incurred by any other person consistent with **National Contingency Plan**..."
 - iii. "Damages for injury to, destruction of, or loss of **natural resources**."
 - iv. "Costs of any **health assessment** or health effects study..."
- f. "Contractual Relationship" (42 U.S.C. §9601(35))
 - i. Related to 42 U.S.C. §9607(B)(3) (third party defenses).
 - ii. "...**did not know and had no reason to know**..."
 - iii. "**Reason To Know**" and "**All Appropriate Inquiry**" defined.
 - iv. "Standards and Practices"

2. CERCLA Lender Liability

- a. Asset Conservation, Lender Liability and Deposit Insurance Protection Act (1996), P.L. 104-208.

b. "Owner or Operator" (42 U.S.C. §9601(20)).

"(20) (A) The term "**owner or operator**" means...

(E) EXCLUSION OF LENDERS NOT PARTICIPANTS IN MANAGEMENT. –

(i) INDICIA OF OWNERSHIP TO PROTECT SECURITY.

"...Such term **does not include** a person, who, **without participating in the management** of a vessel or facility, **holds indicia of ownership primarily to protect his security interest in the vessel or facility...**

(ii) FORECLOSURE. – The term "owner or operator" does not include a person that is a lender that **did not participate in management** of a vessel or facility prior to foreclosure, notwithstanding that the person –

(I) **forecloses** on the vessel or facility; and

(II) after foreclosure, sells, re-leases (in the case of a lease finance transaction), or **liquidates** the vessel or facility, maintains business activities, winds up operations, undertakes a response action...

(F) PARTICIPATION IN MANAGEMENT. – For purposes of subparagraph (E) –

(i) the term "**participate in management**" –

(I) means **actually participating in the management or operational affairs** of a vessel or facility; and

(II) **does not include merely having the capacity to influence**, or

the unexercised right to control, vessel or facility operations;

(ii) a person that is a lender and that holds **indicia of ownership primarily to protect a security interest** in a vessel or facility **shall be considered to participate in management only if**, while the borrower is still in possession of the vessel or facility encumbered by the security interest, the person –

(I) **exercises decisionmaking** control over the environmental compliance related to the vessel or facility, such that the person has undertaken responsibility for the hazardous substance handling or disposal practices related to the vessel or facility; or

(II) **exercises control** at a level comparable to that of a manager of the vessel or facility, such that the person has assumed or manifested responsibility –

(aa) for the **overall management** of the vessel or facility encompassing day-to-day decision-making with respect to environmental compliance; or

(bb) over all or substantially all of the **operational functions** (as distinguished from financial or administrative functions) of the vessel or facility other than the function of environmental compliance;

(iii) the term “participate in management” **does not include performing an act or failing to act prior** to the time at which a security interest is created in a vessel or facility; and

(iv) the term “participate in management” **does not include** –

(I) holding a **security interest or abandoning** or releasing a security interest;

(II) including in the terms of an extension of credit, or in a contract or security agreement relating to the extension, a covenant, warranty, or other term or **condition that relates to environmental compliance**;

(III) **monitoring or enforcing** the terms and conditions of the extension of credit or security interest;

(IV) monitoring or undertaking one or more **inspections** of the vessel or facility;

(V) **requiring a response action** or other lawful means of addressing the release or threatened release of a hazardous substance in connection with the vessel or facility prior to, during, or on the expiration of the term of the extension of credit;

(VI) **providing financial or other advice** or counseling in an effort to mitigate, prevent, or cure default or diminution in the value of the vessel or facility;

(VII) **restructuring, renegotiating, or otherwise agreeing to alter the terms** and conditions of the extension of credit or security interest, exercising forbearance;

(VIII) **exercising other remedies** that may be available under applicable law for the breach of a term or condition of the extension of credit or security agreement; or

(IX) **conducting a response action** under section 9607(d) of this title or under the direction of an on-scene coordinator appointed under the National Contingency Plan, if the actions do not rise to the level of participating in management (within the meaning of clauses (i) and (ii))." (Emphasis added).

c. Liability of fiduciaries (42 U.S.C. §9607(n)).

“(1) In general – The liability of a fiduciary under any provision of this chapter for the release or threatened release of a hazardous substance at, from, or in connection with a vessel or facility held in a fiduciary capacity **shall not exceed the assets held in the fiduciary capacity.**

(2) Exclusion – Paragraph (1) **does not apply** to the extent that a person is liable under this chapter independently of the person’s ownership of a vessel or facility as a fiduciary or actions taken in a fiduciary capacity.

(3) Limitation – Paragraphs (1) and (4) do not limit the liability pertaining to a release or threatened release of a hazardous substance **if negligence of a fiduciary causes or contributes to the release or threatened release.**

(4) Safe harbor – A fiduciary shall not be liable in its personal capacity under this chapter for –...

(5) Definitions – As used in this chapter:

(A) Fiduciary

The term **“fiduciary”** – (i) means a person acting for the benefit of another party as a bona fide – (I) **trustee**; (II) **executor**; (III) **administrator**; (IV) **custodian**; (V) **guardian of estates or guardian ad litem**; (VI) **receiver**; (VII) **conservator**; (VIII) **committee of estates of incapacitated persons**; (IX) **personal representative**; (X) **trustee (including a successor to a trustee) under an indenture agreement, trust agreement, lease or similar financing agreement,...**

(8) Limitation – This subsection does not preclude a claim under this chapter against –

(A) the assets of the estate or trust administered by the fiduciary; or

(B) a nonemployee agent or independent contractor retained by a fiduciary..." (Emphasis added).

3. Innocent landowners, bona fide prospective purchaser, and all appropriate inquiry.
 - a. Innocent landowners (42 U.S.C. §9601(35) and 42 U.S.C. §9607(B)(3)).
 - b. Bona fide prospective purchaser (42 U.S.C. §9601(40) and 42 U.S.C. §9607(R)).

"(B) Inquiries --

(i) In General - The person made all appropriate inquiries into the previous ownership and uses of the facility in accordance with generally accepted good commercial and customary standards and practices in accordance with clauses (ii) and (iii).

(ii) Standards and Practices -- The standards and practices referred to in clauses (ii) and (iv) of paragraph (35)(B) shall be considered to satisfy the requirements of this subparagraph.

(iii) Residential Use -- In the case of property in residential or other similar use at the time of purchase by a non-governmental or noncommercial entity, a facility inspection and title search that reveal no basis for further investigation shall be considered to satisfy the requirements of this subparagraph...

(D) Care -- The person exercises appropriate care with respect to hazardous substances found at the facility by taking reasonable steps to --

(i) stop any continuing release;

(ii) prevent any threatened future release; and

(iii) prevent or limit human, environmental, or natural resource exposure to any previously released hazardous substance."

- c. Prospective purchaser and windfall lien (42 U.S.C. §9607(R)).

"(1) Limitation on Liability
Notwithstanding subsection (a)(1) of this section, a **bona fide prospective purchaser** whose potential liability for a release or threatened release is based solely on the purchaser's being considered to be an owner or operator of a facility shall not be liable as long as the bona fide prospective purchaser does **not impede the performance of a response action** or natural resource restoration..."

- d. All appropriate inquiry (42 U.S.C. § 9601(35)(B)).

"(B) **Reason to Know** --

(i) **All Appropriate Inquiries** -- To establish that the defendant had no reason to know of the matter described in subparagraph A(i), the defendant must demonstrate to a court that --

(I) on or before the date on which the defendant acquired the facility, the defendant carried out all appropriate inquiries, as provided in clauses (ii) and (iv), into the previous ownership and uses of the facility in accordance with generally accepted good commercial and customary standards and practices; and

(II) the defendant took reasonable steps to --

(aa) stop any continuing release;

(bb) prevent any threatened future release; and

(cc) prevent or limit any human, environmental, or natural resource exposure to any previously released hazardous substance."

- e. "Innocent landowners, standards for conducting all appropriate inquiry" (40 CFR §312).
 - f. Contiguous property owners (42 U.S.C. §9607(q)).
4. Additional CERCLA sections.
- a. Contribution (42 U.S.C. §9613(f)).
 - b. Cleanup standards; applicable or relevant and appropriate requirements (ARARs) (42 U.S.C. §9621(d)(2)(A)).
 - c. Citizen suits (42 U.S.C. §9659).
 - d. Natural resource liability (42 U.S.C. §9607(f)).
 - e. Liability of fiduciaries (42 U.S.C. §9607(n)).
 - f. De micromis exemption (42 U.S.C. §9607(o)).
 - g. Municipal solid waste exemption (42 U.S.C. §9607(p)).
 - h. Definition of "facility" (42 U.S.C. §9601(9)).

"The term **"facility"** means (A) any building, structure, installation, equipment, pipe or pipeline (including any pipe into a sewer or publicly owned treatment works), well, pit, pond, lagoon, impoundment, ditch, landfill, storage container, motor vehicle, rolling stock, or aircraft, or (B) any site or area where a hazardous substance has been deposited, stored, disposed of, or placed, or otherwise come to be located; but **does not include any consumer product in consumer use ..."**
 - i. "Brownfield site" (42 U.S.C. §9601(39)).

- B. Resource Conservation and Recovery Act (RCRA, Hazardous Waste) (42 U.S.C. §§6901 *et seq.*)
1. The Resource Conservation and Recovery Act of 1976; Pub. L. No. 94-550, 90 Stat. 2796 (1976), amended Pub. L. No. 96-484, 94 Stat. 2334 (1980).
 2. First regulations promulgated May 19, 1980, (40 CFR Part 260 *et seq.*).
 3. Hazardous waste defined (40 CFR Part 261):
 - a. 40 CFR §261.3.
 - i. A **solid waste**...
 - ii. Which is also described...
 - a) By the **four characteristics** (see 40 CFR §261.20-261.24 and below); or
 - b) By the **four lists** (see 40 CFR §261.30-261.33 and below); or
 - c) Is a **mixture** of the above (see 40 CFR §261.3(a)(2)(iv)).
 - b. Section 261.4 exclusions.
 - c. Lists of hazardous waste.
 - i. Hazardous wastes from non-specific and specific sources, 40 CFR 261.31 and 32. – **F-List** (non-specific source waste); **K-List** (source-specific waste).
 - ii. Discarded commercial chemical products, 40 CFR § 261.33 – (**P-List**) and (**U-List**).
 - iii. Characteristic Wastes, 40 CFR §§261.21-261.24 – **Ignitability** (D001), **Relativity** (D003), **Corrosivity** (D002), **Toxicity** (D004-D043).
 - d. Selected rules and policies.

- i. Mixture rule (40 CFR §261.3(a)(2)(iv)).
 - ii. Contained in policy (63 Fed. Reg. 28617 (May 26, 1998), codified in 40 CFR Parts 148, 261, 266, 268, and 271).
 - iii. Derived from rule (40 CFR §261.3(c)(2)(i)).
 - iv. Universal waste (40 CFR Part 273, including batteries, pesticides, mercury containing equipment, and lamp bulbs).
4. Corrective action.
- a. Hazardous waste and constituent releases.
 - b. Solid waste management units (SWMUs).
 - c. Section 3004 (u)-(v) of the Act.
 - d. 42 U.S.C. §§6924(u)-(v).
 - e. Federal Register corrective action discussions.
 - 1. Corrective Action for Solid Waste Management Units, Advanced Notice for Proposed Rule-Making (61 Fed. Reg. 19432 (May 1, 1996) codified in .40 CFR Chapter 1).
 - 2. Requirements for Management of Hazardous Contaminated Media (HWIR – Media), 63 Fed. Reg. 65874 (December 1, 1998), codified in 40 CFR §§260, 261, 264, 265, 268,270 and 271).
 - 3. Hazardous Remediation Waste Management Requirements (HWIR – Media) 63 Fed. Reg. 66101 (November 30, 1998), codified in 40 CFR §§260, 261, 262, 264, 268, 269 and 271).
 - f. 3,747 facilities nationally.

II. KENTUCKY PROGRAMS

A. Uncontrolled Sites; Lender Liability

1. KRS 224.01-400, "Reportable quantities and release notification requirements for hazardous substances, pollutants, or contaminants – Variation of requirements by administrative regulations – Emergency plan – Powers of cabinet – **Remedial action to restore environment** – Lien of cabinet for costs of cleanup – **Liability of financial institution acquiring property or serving as fiduciary;**" (Emphasis added).

(1). "As used in this section:...

h) "**Financial institution**" means, for purposes of subsections (26) and (27) of this section, the following...

i) "**Fiduciary**" means, for purposes of subsections (26) and (27) of this section, a fiduciary as defined by KRS Chapter 386..."

"(18) Any person **possessing or controlling a hazardous substance, pollutant, or contaminant** which is released to the environment, or any person who caused a release to the environment of a hazardous substance, pollutant, or contaminant, **shall characterize** the extent of the release as necessary to determine the effect of the release on the environment, and shall take actions necessary to correct the effect of the release on the environment. Any person required to take action under this subsection **shall have the following options:**

(a) Demonstrating that **no action is necessary to protect human health, safety, and the environment;**

(b) **Managing the release** in a manner that controls and minimizes the harmful effects of the release and protects human health, safety, and the environment, provided that the management may include any existing or proposed engineering or institutional con-

trols and the maintenance of those controls;

(c) **Restoring the environment** through the removal of the hazardous substance, pollutant, or contaminant; or... (Emphasis added).

(26) In addition to the defenses and limitations provided in subsection (25) of this section, a **financial institution** that acquired a site by **foreclosure**, by receiving an assignment, by deed in lieu of foreclosure, or by otherwise becoming the owner as a result of the enforcement of a mortgage, lien, or other security interest held by the financial institution, **shall not be liable** under this section with respect to the site, if:...

(27) In addition to the defenses and limitations provided in subsection (25) of this section, a **financial institution serving as a fiduciary** with respect to an estate or trust, the assets of which contain a site, **shall not be liable** under this section with respect to the site if..."

2. KRS 224.01-405, "Corrective action for release of petroleum or petroleum product from a source other than a petroleum storage tank."
- B. Brownfields, Remediation, and The Voluntary Environmental Remediation Program (VERP)
1. KRS 224.01-530, "Standards for Remediation."
 - a. "The numerical values contained in the document titled "**Region 9 Preliminary Remediation Goals**," published by the United States Environmental Protection Agency's Region 9, are hereby established as screening levels and shall be used by the cabinet in conformance **with the guidance** set out in the Region 9 Preliminary Remediation Goals. It is **not the intent of this section to establish these levels as the clean-up standards** for individual contaminants that may be present at any site..." (See "b" immediately below).

- b. 2011 Kentucky Legislature Senate Bill 70 (Leeper) replaces Region 9 Preliminary Remediation Goals, referenced in KRS 224.01-530, with the Region 3 Regional Screening Level (RSL) Table used in conformance with the “Risk-Based Concentration Table User’s Guide.”
 - 2. KRS 224.01-510 to 224.01-532, “Voluntary Environmental Remediation Program (VERP).”
 - 3. KRS 224.01-410, Methamphetamine Contamination.
 - 4. KRS 224.01-040, “Evidentiary Privilege for Environmental Audit Reports – Exceptions – Restriction on Civil Penalties.”
 - 5. KRS 224.01-450, “Legislative Intent Regarding Issuance of [No Further Remediation] Letter.”
 - 6. KRS 224.01-465, “Effect of Letter – Limitations – Contents – Application – Voidable Circumstances – Recording.”
 - 7. KRS 224.01-514, “Voluntary Environmental Remediation Program – Application for Entry.”
 - 8. KRS 224.01-518, Voluntary Remediation Agreed Order.”
 - 9. KRS 224.60-137, "Standards for Corrective Action for Release from Petroleum Storage Tanks."
 - 10. KRS 224.80-110, "Environmental Covenants and Correction Action Plans..."
 - 11. 401 KAR 100:030, "Remediation Requirements."
 - 12. 401 KAR 30:031, Environmental Performance Standards.
- C. Remediation Mechanisms
- 1. KRS 224.01-400(18).
 - a. “Demonstrating that no further action is necessary...”
 - b. “Manage the release...”
 - c. “Restoring the environment through the removal...”

2. VERP (including Covenant Not to Sue, KRS 224.01-526).
3. Manage In Place With Environmental Covenants (KRS 224.80-100 through 228.80-210).
4. Notice of Completion Letter (Standard closure letter issued pursuant to KRS 224.01-400 and 401 KAR 100:030).
5. No Further Remediation Letter to a Public Entity (KRS 224.01-450 through 224.01-465).
6. CERCLA Bonafide Prospective Purchaser (applicable through KRS 224.01-400(25)).

KRS 224.01-400 (25)

"Defenses to liability, limitations to liability, and rights to contribution shall be determined in accordance with Sections 101(35), 101(40), 107(a) to (d), 107(q) and (r), and 113(f) of the Comprehensive Environmental Response Compensation and Liability Act, as amended, and the Federal Clean Water Act, as amended."

D. Underground Storage Tanks (UST)

1. Petroleum Storage Tank Environmental Assurance Fund (PSTEAF).
 - a. KRS 224.60-130 "Petroleum Storage Tank Environmental Assurance Fund..."
 - i. Financial Responsibility Account (FRA).
 - ii. Petroleum Storage Tank Account (PSTA).
 - iii. Small Owners' Tank Removal Account (SOTRA).
 - b. "The account shall receive four tenths of 1 cent (\$0.004) from the one and four tenths cent (\$0.014) paid on each gallon of gasoline and special fuels received in this state pursuant to KRS 224.60-146." (KRS 224.60-130(1)(c)).
 - c. Registration extended to July 15, 2013.

- d. Payment from PSTA extended to July 15, 2016.
 - e. SOTRA participation extended to July 15, 2013.
2. UST data.
- a. Since 1985, in Kentucky:
 - i. 49,229 registered USTs.
 - ii. 37,780 permanently closed USTs.
 - iii. 12,390 No Further Action letters.
 - b. Currently in Kentucky:
 - i. 139 sites in closure.
 - ii. 1,460 site investigations.
 - iii. 377 in corrective action.
 - iv. 3,846 UST sites with 11,623 active USTs.
 - c. Nationally, 68 percent of underground storage tanks are in compliance; in Kentucky, the rate is 46 percent.
3. KRS 224.60-137 "Standards for Corrective Action For Release From Petroleum Storage Tank."

III. PARTIAL CONTRACTUAL ISSUE CHECKLIST

- A. Environmental Representations
- B. Environmental Warranties
- C. Environmental Releases
- D. Environmental Waivers
- E. Environmental Indemnities
- F. Environmental Covenants
- G. Environmental Disclosures

- H. Environmental Investigations
- I. Superfund and RCRA Liability
- J. State Law Liabilities
- K. Common Law and Statutory Liabilities
- L. Due Diligence, Reason To Know, and All Appropriate Inquiry
- M. Environment Consultant Contract Language
- N. Audit Privileges
- O. Confidentiality Issues
- P. Environmental Audits; Screening, Phase 1 and Phase 2 (intrusive sampling)
- Q. Environmental Reports and Reporting Requirements
- R. Definitions, including waste, hazardous waste, hazardous substances, pollutants and contaminants
- S. Caveat Emptor, "As Is" Issues
- T. Asset Acquisition Liabilities
- U. Allocation of Liabilities and Risk
- V. Escrow for Environmental Cleanup
- W. Limit on Damages
- X. Lender Liability Considerations
- Y. Corporate Formalities
- Z. Property Contract History
- AA. Third Party Issues and Claims
- BB. Environmental Insurance, Past, Current, Future
- CC. Insurance Subrogation

- DD. Choice of Law Issues
- EE. Duties to Disclose, Fraudulent Non-Disclosure
- FF. Negligent, Intentional or Fraudulent Misrepresentation
- GG. Merger Provisions
- HH. Litigation, Existing, and Threatened
- II. Right to Perform Periodic Inspections (Leases, Lenders)
- JJ. Right to Inspect and Sample Property, Effective of Restriction
- KK. Transfer of Environmental Permits
- LL. Opinion of Counsel
- MM. Assignment
- NN. Claim Time Limits
- OO. Lease Liabilities
- PP. Citizen Suit Issues

IV. SELECTED CASE LAW

A. CERCLA Liability Case Law

1. City of Gary, Indiana v. Shafer, 683 F.Supp.2d 836, (N.D. Ind. 2010). Scrap yard. Liability for movement of contaminated soil under CERCLA.
2. Scarlett & Associates, Inc. v. Briarcliff Center Partners, LLC, 2009 WL 3151089 (N.D. Ga. 2009). Strip Mall. Management company not an "owner" for purposes of CERCLA liability.
3. Cal. Dept. of Toxic Substances Control v. Hearthside Residential Corp., 613 F.3d 910 (9th Cir. 2010). The current owner for CERCLA liability purposes is the owner at the time of cleanup.

4. U.S. v. Saporito, 684 F.Supp.2d 1043, (N.D. Ill. 2010). Lessor of plating line is owner under CERCLA and not entitled to security interest exemption.
5. New York v. Shore Realty, 759 F.2d 1032, (2d Cir. 1985). Liability of current owner not owning property at time of release.
6. Redwing Carriers, Inc. v. Saraland Apartments, 94 F.3d 1489, (11 Cir. 1996). Apartment complex limited partners not liable under CERCLA based on Alabama law.
7. Uniroyal Chemical Co. v. Deltech Corp., 160 F.3d 238, (5th Cir. 1998). Court finds that "disposal requirement" is not a condition of CERCLA liability for current owners. The court further reviewed the "consumer product in consumer use" exclusion in 42 U.S.C. §9601(9) (definition of facility).
8. Sierra Club, Inc. et al. v. Tyson Foods, Inc., 299 F.Supp.2d 693, (W.D. Ky. 1993). Court explored definition of "person in charge" and "facility" for reporting purposes.
9. Commander Oil Corp. v. Barlo Equipment Corp., 215 F.3d 321, (2d Cir. 2000). Parent company liability under CERCLA.
10. In re: Bergsoe Metal Corp., 910 F.2d 668, (9th Cir. 1990). Parent company liability under CERCLA.
11. United States v. Capital Tax Corp., 545 F.3d 525, (7th Cir. 2008). Owner liability of trust beneficiary holding title.
12. Dayton Independent School Dist. v. U.S. Mineral Products Co., 906 F.2d 1059, (5th Cir. 1990). Asbestos in buildings.
13. Anheuser-Busch, Inc. v. Ford Motor Co., 1997 WL 594498, (W.D. Ky. 1997). Liability for spreading contamination. Liability for failure to disclose known conditions at transfer.
14. U.S. v. CDMG Realty Co., 96 F.3d 706, (2d Cir. 1996). Passive migration insufficient to create liability.
15. Bob's Beverage, Inc. v. Acme, Inc., 264 F. 3d 692, (6th Cir. 2001). Passive migration insufficient to create liability.
16. McDonald v. Sun Oil Co., 548 F.3d 774, (9th Cir. 2008). Discovery Rule, CERCLA § 309.

17. U.S. v. Best Foods, 524 U.S. 51 (1998). Parent company and "operator" liability.
18. U.S. v. Township of Brighton, 153 F.3d 307, (6th Cir. 1998). Failure to act does not constitute "operator" liability.
19. U.S. v. Northeastern Pharmaceutical Chemical Co., 810 F.2d 726, (8th Cir. 1986). Corporate management liability.
20. Burlington Northern & Santa Fe Railway Co. v. United States, 129 S.Ct. 1870 (2009). Owner, arranger liability, consumer product exemption. Allocation of liability in CERCLA cases.
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15. Canadyne-Georgia Corp. v. Bank of America, 174 F.Supp. 2d 1360 (M.D. Ga. 2001). Fiduciary liability issues.

V. MISCELLANEOUS

American Society for Testing and Materials (ASTM) Standards

- A. ASTM Standard E-1528-06: “Standard Practice for Limited Environmental Due Diligence: **Transaction Screen Process.**”
- B. ASTM Standard E-2247-08: “Phase 1 Environmental Process for **Forest and or Rural Property**” (see also 73 F.R. 78,651, December 23, 2009).
- C. ASTM Standard E-1527-05: “Standard Practice for Environmental Site Assessments: **Phase 1 Environmental Site Assessment.**”
- D. ASTM E-1903-97: “Standard Guide for Environmental Site Assessments: **Phase II Environmental Site Assessment Process.**”
- E. ASTM Standard E-2600-08: “Standard Practice for the Assessment of **Vapor Intrusion** into Structures on Property Involved in Real Estate Transactions.”
- F. ASTM D-5746-98: “Standard Classification of Environmental Condition of Property Area Types for **Defense Base Closure** and Realignment Facilities.”
- G. ASTM D-6008-96: “Standard Practice for Conducting **Environmental Baseline Surveys.**”
- H. ASTM E-1984-03: “Standard Guide for Process of **Sustainable Brownfields** Redevelopment.”
- I. ASTM 2018-08: “Standard Guide for Property Condition Assessments: **Baseline Property Condition Assessment** Process.”
- J. ASTM E-2091-05: “Standard Guide for Use of Activity and Use Limitations, Including **Institutional and Engineering Controls.**”
- K. ASTM 2308-05: “Standard Guide for Limited **Asbestos** Screens of Buildings.”
- L. ASTM 2418-06: “Standard Guide for Readily Observable **Mold** and Conditions Conducive to Mold in Commercial Buildings: Baseline Survey Process.”

ENVIRONMENTAL LAW FOR LENDING INSTITUTIONS AND REAL ESTATE TRANSACTIONS -- COMMERCIAL PROPERTY ISSUES

Jennifer J. Cave

I. CERCLA

A. Overview

The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), commonly known as Superfund, was enacted by Congress on December 11, 1980. Under CERCLA, the U.S. Environmental Protection Agency (“EPA”) can require liable parties to conduct cleanups or EPA can conduct a cleanup and subsequently seek cleanup costs from liable parties. This law created a tax on the chemical and petroleum industries and provided broad federal authority to respond directly to releases or threatened releases of hazardous substances that may endanger public health or the environment.

1. Persons liable under CERCLA.

CERCLA imposes liability based not upon a violation of a law, but rather on a person’s relationship to a site from which there has been a release or threat of a release of a “hazardous substance.” Those liable under CERCLA (and referred to as potentially responsible parties or PRPs) include the current owners and operators of a contaminated site and those who owned it or operated it at the time of disposal, transporters who selected the disposal or treatment site, and those who arranged for disposal or treatment of waste at the site. 42 U.S.C. §9607(a). Damages recoverable under CERCLA include costs of investigating and remediating hazardous substances disposed of at contaminated sites and associated natural resource damages.

2. Defenses to CERCLA liability.

Section 107(b) (42 U.S.C. §9607(b)) lists the defenses to CERCLA’s joint and several liability that may be asserted by PRPs. The burden of proof for these defenses is upon the PRP. The defenses available under CERCLA are:

- a. Act of God;
- b. Act of war; and

c. Act of a third party.

The third-party defense is limited to situations in which the PRP had no contractual or other relationship with the third party. The PRP also must prove that it exercised due care with respect to the hazardous substance, and took precautions against foreseeable acts or omissions of the third party. The third-party defense has generally been unavailable to purchasers or occupiers of property or anyone in the chain of title because of the requirement that the person asserting the defense cannot be in contractual relationship with the third party (usually a prior landowner or tenant) who caused the release. CERCLA defines a “contractual relationship” to include land contracts, deeds or other instruments transferring title or possession.

B. Superfund Amendments and Reauthorization Act (SARA)

In 1986, Congress enacted the Superfund Amendments and Reauthorization Act (SARA). SARA modified the third party defense by creating the innocent landowner defense. This defense affords protection to three types of acquirers of property: (1) innocent purchasers; (2) government entities acquiring a facility by involuntary transfer, condemnation or eminent domain; and (3) those acquiring a facility by inheritance. The innocent purchaser defense was the first CERCLA defense to focus on parties to a real estate transaction.

- Innocent purchasers

The PRP must prove that it acquired the property after disposal of the hazardous substances and that, at the time of acquisition, it did not know and had no reason to know that any hazardous substances were disposed of at the facility. The standard for determining whether the PRP had “reason to know” is whether the PRP made “all appropriate inquiries” (“AAI”). Even if the proscribed contractual relationship is present, the PRP nonetheless can take advantage of the third party defense if it proves that it satisfied the requirements for establishing that it was an innocent landowner. 42 U.S.C. §9601(35(A)).

C. Small Business Liability Relief and Brownfields Revitalization Act

In 2002, Congress passed the “Small Business Liability Relief and Brownfields Revitalization Act,” also referred to as the “Brownfields Amendments.” The Brownfields Amendments clarified that a “contractual relationship” included land contracts, deeds, easements, leases or other instruments transferring title or possession, and, by amending the definition of contractual relationship, added to CERCLA two new, transaction-related defenses – the *bona fide* prospective purchaser defense and the contiguous landowner defense. The Brownfields Amendments partially amended the innocent purchaser doctrine by elaborating on the AAI requirement.

1. *Bona fide* prospective purchasers.

This defense, which can be found at Section 107(r) of CERCLA (42 U.S.C. §9607(r)), provides protection from CERCLA liability and limits EPA’s recourse for unrecovered response costs to a lien on the property for the lesser of the unrecovered response costs or increase in fair market value attributable to EPA’s response action. To meet the statutory requirements for the defense, a person must meet the requirements set forth in Sections 101(40) and 107(r) of CERCLA. A *bona fide* prospective purchaser must have bought property after January 11, 2002, may purchase property with knowledge of contamination after performing AAI provided the property owner meets or complies with all of the other statutory requirements set forth in Section 101(40) of CERCLA. These requirements are lengthy and include the following: (1) only acquire the property after all disposal of hazardous wastes at the property ceased; (2) provide all legally required notices with respect to the discovery or release of any hazardous substances at the property; (3) exercise appropriate care by taking reasonable steps to stop continuing releases; (4) prevent any threat of future releases; (5) prevent or limit human, environmental, or natural resource exposure to any previously released hazardous substance; (6) provide full cooperation, assistance, and access to persons that are authorized to conduct response actions; (7) comply with land use restrictions; (8) not impede the effectiveness or integrity or any institutional controls; (9) comply with CERCLA requests for information or administrative subpoena; and (10) not be potentially liable or affiliated with any person who is potentially liable for response costs for addressing releases at the properties.

2. Contiguous landowners.

This defense, which can be found in Section 107(q) of CERCLA (42 U.S.C. §9607(q)) excludes from the definition of owner or operator a person who owns property that is contiguous to or otherwise similarly situated with respect to and that is or may be contaminated by a release or threatened release of a hazardous substance from property owned by someone else. To qualify as a contiguous property owner, a landowner must have no knowledge or reason to know of contamination at the time of acquisition, have conducted AAI, and meet all the criteria set forth in CERCLA Section 107(q). The contiguous property owner liability protection protects parties that are essentially victims of pollution incidents caused by their neighbor's actions.

3. Innocent landowners.

The Brownfields Amendments also clarified the Innocent Landowner Defense. To qualify as an innocent landowner, a person must conduct all appropriate inquiries and meet all the statutory requirements, which include having no knowledge or reason to know that any hazardous substance, which is the subject of a release or threatened release, was disposed of on, in, or at the facility, provide full cooperation, assistance, and access to persons authorized to conduct response actions, comply with land use restrictions and not impede the effectiveness or integrity of institutional controls, take reasonable steps to stop continuing releases, prevent threatened releases, and prevent exposure to previously released substances.

D. What Is "All Appropriate Inquiries?"

"All appropriate inquiries" ("AAI") is the process of evaluating a property's environmental conditions and assessing potential liability for any contamination. Congress included in the Brownfields Amendments a list of criteria that EPA must include in new regulations establishing standards and practices for conducting AAI. EPA issued standards and practices for conducting AAI on November 1, 2005. 70 Federal Register 66070. The rule became effective on November 1, 2006, and is located in 40 CFR 312 "Innocent Landowners Standards for Conducting All Appropriate Inquiries." The AAI requirements are applicable to any party who may potentially claim protection from CERCLA liability as an innocent landowner, a *bona fide* prospective purchaser, or a contiguous property owner.

1. Timing.

The AAI investigation must be conducted within one (1) year of the property acquisition. If the AAI is more than one year old, updated interviews, updated records searches, and a new visual inspection must be performed and a new declaration from an environmental professional must be provided within 180 days of and prior to the acquisition of the property.

2. Environmental professional.

The AAI must be conducted by an environmental professional. An environmental professional is someone who possesses sufficient, specific education training and experience necessary to exercise professional judgment to develop opinions and conclusions regarding conditions indicative of releases or threatened releases of hazardous substances on, at, in, or to a property sufficient to meet the objective and performance factors of the rule. To qualify as an environmental professional, the inspector must have a state or tribal issued certification or license and three (3) years of relevant full-time work experience, or a baccalaureate degree or higher in science or engineering and five (5) years of relevant full-time work experience, or ten (10) years of relevant full-time work experience.

3. Scope of inquiries.

The inquiries conducted by the environmental professional for the AAI must include interviews, collection and review of historical information, and clean-up liens, government records, visual inspections, an inquiry into the purchase price, commonly known information, and degree of obviousness. The environmental professional must then render an opinion on the degree of obviousness on the presence or likely presence of hazardous substances. The AAI rule requires that the environmental professional also provide in the written report an opinion regarding additional appropriate investigations that may be necessary. The AAI rule also requires the environmental professional to identify data gaps that remain after the conduct of all required activities identify the sources of information consulted to address such data gaps and comment upon the significance of such data gaps with regard to his or her ability to identify conditions indicative of releases or threatened releases of hazardous substances on, at, in, or to the property.

4. Petroleum exclusion.

Note that the AAI rule does not require the consideration of releases or threatened releases of petroleum and petroleum products in the scope of environmental site assessments because petroleum is not “a hazardous substance” under CERCLA. As such, the scope of the investigation used in the environmental professional retainer agreement should include the identification of potential petroleum releases at the discretion of the prospective property owner and/or the environmental professional.

5. ASTM standards.

EPA now recognizes both ASTM International E1527-05 “Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process” and ASTM E2247-08 “Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process for Forest Land and Rural Property” as compliant with the AAI Rule. Either of these ASTM International Phase I standards may be used to satisfy the statutory requirements for conducting AAI under CERCLA. As a result, parties must comply with either the AAI final rule or follow the standards set forth in ASTM E1527-05 or ASTM E2247-08 to attain protection from liability under CERCLA as an innocent landowner, a contiguous property owner, or a *bona fide* prospective purchaser.

- ASTM Standard E1528-06 “Standard Practice for a Limited Environmental Due Diligence: Transaction Screen Process”

Should not be used if a person is seeking liability protection under CERCLA. This standard was developed to define good commercial and customary practice for conducting transaction screens for parcels of commercial real estate where the user wishes to conduct a limited environmental due diligence that is less than a Phase I Environmental Site Assessment. If the driving force behind the due diligence is a desire to qualify for one of the landowner liability protection defenses under CERCLA, ASTM E1528-06 should not be utilized.

E. Are Lenders Liable for Contamination under CERCLA?

Banks that hold mortgages on property as secured lenders are exempt from CERCLA liability, if certain criteria are met.

1. Secured creditor exemption.

CERCLA Section 101(20) (42 U.S.C. §9601(20)) contains a secured creditor exemption that eliminates owner/operator liability for lenders who hold ownership in a CERCLA facility primarily to protect their security interest in that facility, provided they do not “participate in the management of the facility.”

a. Participation in management.

Generally, “participation in the management” may apply if a bank exercises decision-making control over a property’s environmental compliance, or exercises control at a level similar to that enjoyed by a manager of the facility or property. “Participation in management” does not include actions such as property inspections, requiring a response action to be taken to address contamination, providing financial advice, or renegotiating or restructuring the terms of the security interest.

b. Effect of foreclosure.

In addition, the secured creditor exemption provides that simply foreclosing on a property does not result in liability for a bank, provided the bank takes “reasonable steps” to divest itself of the property “at the earliest practicable, commercially reasonable time, on commercially reasonable terms.” Generally, a bank may maintain business activities and close down operations at a property, so long as the property is listed for sale shortly after the foreclosure date, or at the earliest practicable, commercially reasonable time.

2. How does AAI apply to lenders?

The AAI rule primarily applies to borrowers who want to claim protection from CERCLA liability as innocent land-owners, bona fide prospective purchasers or contiguous property owners. The rule does not change the CERCLA

liability exemption for banks that hold mortgages on property as secured lenders. The secured lender exemption is not conditioned upon a bank or lender undertaking AAI prior to issuing a mortgage or prior to the property being purchased by the borrower. Although banks and lenders are afforded protection from CERCLA liability through the secured creditor exemption, banks may choose to further protect themselves from loss (due to decreases in the value of the property or collateral) by requiring that borrowers qualify for liability protections. Banks therefore may want to encourage their borrowers to comply with the provisions established for *bona fide* prospective purchasers and ensure that borrowers properly conduct AAI prior to acquiring a property. It is important to note that it is still possible for a bank or lender to be liable for contamination on or at a property, if it is found to be acting as either an owner or operator of a contaminated property. Also, even if a financial institution qualifies for the secured creditor exemption from CERCLA liability, it is still possible that a particular state may have stricter laws governing lender liability for contaminated properties.

II. KENTUCKY

A. Overview

Releases in Kentucky are subject to remediation requirements under both federal and state programs. At the federal level, CERCLA is the general legal authority addressing remediation of such releases. Under state law, KRS 224.01-400 is the primary remediation statute. (Releases of petroleum or petroleum products from sources other than underground storage tanks (USTs) are governed by KRS 224.01-405.) Unlike CERCLA, under Kentucky's statute, liability is only imposed on persons "possessing or controlling a hazardous substance, pollutant, or contaminant which is released to the environment, or any person who caused a release to the environment of a hazardous substance, pollutant or contaminant." KRS 224.01-400 does not specifically identify off-site generators as PRPs. KRS 224.01-400 requires that all PRPs characterize releases as necessary to determine the effect on the environment and remediate the release as necessary to correct the effect of the release on the environment. If the release is less than the reportable quantity, the PRP can generally characterize and remediate the release without supervision from the Division of Waste Management. KRS 224.01-400 has no explicit counterpart to the cost recovery provision in CERCLA Section 107. KRS 224.01-400(25) does provide for defenses to liability, limitations to

liability, and rights to contribution to be determined in accordance with CERCLA Sections 107(a) through (d) and 113(f).

B. Voluntary Cleanup Program

Kentucky's Voluntary Cleanup Program supports the redevelopment of brownfields. The Kentucky Voluntary Cleanup Program provides four tracks for those who volunteer to remediate releases of hazardous substances on their property. The tracks vary in eligibility, complexity, and liability protection.

1. Self-certified.

The Self-Certified cleanup track, which provides no liability protection, is available for minor releases or releases authorized by permit. Eligible sites include those with minor releases or releases authorized by permit. (KRS 224.01-400(19)).

2. Notice of completion.

The Notice of Completion track is available to any party, and results in a Notice of Completion letter (KRS 224.01-400, KRS 224.01-405).

3. No further remediation.

The No Further Remediation Cleanup track is available only to public entities, and results in a No Further Remediation Letter (KRS 224.01-450, KRS 224.01-455, KRS 224.01-460, KRS 224.01-465).

4. Voluntary environmental remediation program.

A Voluntary Environmental Remediation Program (VERP) cleanup is available to most parties, with some statutory restrictions. This track is the most complex and culminates in a Covenant Not to Sue. The 2001 Kentucky General Assembly enacted the Voluntary Environmental Remediation Act ("VERA") to encourage volunteers to clean up contaminated properties or brownfields through increased liability protection for participants. Within this act, the VERP was established. VERP is a formalized, voluntary cleanup program by which an applicant can enter into an Agreed Order with the Energy and Environment Cabinet to obtain a covenant not to sue upon completion of an approved corrective action plan. VERP establishes clear procedures and pro-

vides time frames for cabinet review of documents. (See KRS 224.01-510 to 224.01-532).

a. Ineligible sites.

Ineligible sites include licensed radioactive materials facilities, National Priorities List (“NPL”) sites, Resource Conservation and Recovery Act (“RCRA”) sites, sites subject to enforcement actions, and sites presenting an environmental emergency.

b. Program requirements.

Participation in the VERP requires completion of an application, filing, fee, characterization plan, and public notice requirements and entry into Voluntary Remediation Agreed Order. Additional requirements exist for sites seeking covenant not to sue liability protection.

c. Covenant not to sue.

The covenant not to sue covers releases identified in the corrective action plan and provides protection against further remediation requirements and for future civil and administrative enforcement.

C. Brownfield Redevelopment Program

The Kentucky Brownfield Program seeks to help redevelop and revitalize properties that are abandoned or underutilized due to real or perceived contamination. There are an estimated 8,000 brownfields across the state. They include sites such as old gas stations, mine-scarred lands, abandoned factories, old schools and hospitals and meth labs. The Kentucky Brownfield Program offers free Phase I and II environmental assessments to local governments, nonprofits and quasi-governmental agencies. EPA grants are available for cleanup and assessment, and there are tax incentives for private entities undertaking a brownfield cleanup project.

D. Underground Storage Tank Program

All UST systems located in Kentucky (including large fueling stations, small country stores, and commercial and industrial properties) must be registered with the Division of Waste Management's UST Branch unless the tank system is exempt from UST regulations. UST systems (including the tanks and associated piping) are required to have leak detection, spill and overfill prevention, corrosion protection, and financial responsibility. USTs that do not meet these minimum requirements must be permanently closed. Only contractors certified through the Kentucky State Fire Marshal's Office can perform installation, repairs or closures of UST systems.

1. Common contamination from UST systems.

Releases from UST systems may result due to a number of reasons. Most commonly, the UST system develops a small leak and the release is fairly constant over an extended period of time. Releases may also result from a catastrophic failure of the UST system. If contamination above allowable levels is found then it must be defined and the soil and groundwater must be remediated. Regardless of the cause, the effects of a release can be very damaging to soil and groundwater. Groundwater contamination can be especially difficult to remediate. Often, the cleanup and remediation process can take several years and several hundred thousand dollars to complete.

2. Petroleum Storage Tank Environmental Assistance Fund.

On Dec. 22, 1988, the U.S. Congress passed legislation that required owners or operators of USTs to demonstrate their capability to pay for remediation costs and third-party damages in the event of a release into the environment. Rules governing the requirements are contained in 40 CFR Subpart H. In response, the 1990 Kentucky General Assembly created the Petroleum Storage Tank Environmental Assurance Fund ("PSTEAF") to assist owners and operators of USTs in meeting the federal financial responsibility requirement and to provide reimbursement of eligible costs of corrective action due to a release from a UST system. All reimbursements for UST-related activities come from the PSTEAF. Monies for the PSTEAF come from an assurance fee of \$0.014 assessed on each gallon of gasoline and special fuels imported to Kentucky. Owners and operators of UST systems can seek reimbursement for costs asso-

ciated with removal and/or remediation in the event of a release. Reimbursement for removal costs comes from the Small Owner Tank Removal Account (“SOTRA”). Reimbursement for remediation costs comes from the Financial Responsibility Account (“FRA”) and the Petroleum Storage Tank Account (“PSTA”). Reimbursements from the FRA and PSTA are determined by a ranking system. Owners and operators must have all required work performed by UST program certified contractors and laboratories to be eligible for reimbursement from the PSTEAF.

III. FEDERAL AND STATE ENVIRONMENTAL AUDIT POLICIES

A. EPA’s Audit Policy

The EPA Audit Policy, formerly titled “Incentives for Self Policing: Discovery, Disclosure, Correction, and Prevention of Violations,” safeguards human health and the environment by providing several major incentives for regulated entities to voluntarily come into compliance with federal environmental laws and regulations. To take advantage of these incentives, regulated entities must voluntarily discover, promptly disclose to EPA, and expeditiously correct recurrence of future environmental violations. Disclosures are often preceded by consultation between EPA and the regulated entity so that they can discuss mutually acceptable disclosure details, compliance, and audit schedules. As an incentive for disclosure, EPA may provide significant civil penalty reductions if all of the applicable conditions under the Audit Policy are met.

1. Use of EPA Audit Policy for penalty amnesty.

Many regulated facilities have taken advantage of EPA’s Audit Policy to reduce and in some cases eliminate penalties for violations of federal environmental laws. New facility owners, however, have remained reticent about calling EPA’s attention to their newly-acquired facilities fearing post-acquisition penalties for environmental problems caused by the previous owner. Under EPA’s Audit Policy, an entity only has twenty-one days from the time it discovers a violation has or may have occurred to disclose the violation in writing to EPA. Under the Policy, discovery is defined to be when any officer, director, employee, or agent of the facility has an objectively reasonable basis for believing that a violation has, or may have, occurred.

2. EPA Audit Policy upon property acquisition.

To motivate new owners to use EPA's Audit Policy, EPA published a new guidance document entitled "Interim Approach to Applying the Audit Policy to New Owners" on August 1, 2008 (2008 Guidance) (73 Federal Register 44991). The 2008 Guidance offers incentives tailored specifically to new owners in order to make a "clean start" at their newly-acquired facilities by addressing pre-acquisition environmental violations using post-acquisition audits and disclosures. Penalty mitigation is now available to eligible new owners who, within nine months of acquiring the new facility, disclose the violations to or enter into an audit agreement with EPA and who meet all of the conditions set forth in the audit policy as modified by the 2008 Guidance. In order to be eligible for the incentives, the new owner must not have been responsible for environmental compliance with the facility prior to the acquisition, and must not have caused or been able to prevent the violation. The violations must have originated with the previous owner. Finally, the new owner and the previous owner must not have shared a common corporate parent prior to the acquisition.

- Penalty amnesty provisions

The 2008 Guidance eliminates both gravity-based and economic benefit penalties assessed to new owners for pre-acquisition violations. Post-acquisition economic benefit penalties associated with delayed capital expenditures or with unfair competitive advantage are also eliminated, provided that the new owner corrects the violations within sixty days following discovery or within a reasonable time period approved by EPA. The new owner will, however, still be subject to penalties in the amount of any savings on operation and maintenance costs realized by the new owner as a result of delayed compliance.

- i. 100 percent penalty mitigation.

In order to be eligible for 100 percent mitigation of gravity-based penalties, a new owner's one-time, pre-closing due diligence is sufficient to constitute the required systematic audit or compliance management system, which ordinarily must be a recurring event. Most new owners should be able to meet this require-

ment as well as the remaining eight conditions set forth in the Audit Policy to be eligible for the absolute mitigation of gravity-based penalties. If they meet these requirements, new owners will also be eligible to receive EPA's agreement not to pursue criminal prosecution, as well as its agreement not to request further audits.

ii. Seventy-five percent penalty mitigation .

If the pre-acquisition due diligence requirement is not met, the new owner can still qualify for the reduction of gravity-based penalties up to 75 percent, EPA's agreement not to pursue criminal prosecution, and/or its agreement not to require further audits if they meet the remaining conditions of the Audit Policy.

B. Kentucky's Environmental Audit Privilege Statute

In 1994, the Kentucky General Assembly passed a statute creating a limited privilege for environmental audits. The statute also includes provisions providing limited relief from civil penalties for violations discovered during such audits and voluntarily disclosed where the requirements of the statute are met.

1. Key provisions and limitations associated with Kentucky's environmental audit privilege statute.

a. Environmental audit.

Kentucky's environmental audit privilege statute defines an "environment audit" for purposes of the privilege and the amnesty provisions as a: voluntary, internal and comprehensive evaluation of one of more facilities or an activity at one or more facilities regulated under KRS Chapter 224 or federal, regional or local counterparts, or of management systems related to that facility or activity where the evaluation is designed to identify and prevent non-compliance and to improve compliance with statutory and regulatory requirements. KRS 224.01-040(1)(a). An environmental audit may be conducted by the owner or operator, by the owner or operator's employees, or by independent contractors.

b. Environmental audit report.

The privilege extends to “environmental audit reports,” which are defined under the statute to mean a set of documents, each labeled “environmental audit report: privileged document” and prepared as a result of an environmental audit. The environmental audit report may include field notes and records of observations, findings, suggestions, conclusions, drafts, memoranda, drawings, photographs, computer generated or electronically recorded information, maps, charts, graphs and surveys provided the supporting information is collected or developed for the primarily purpose of and in the course of an environmental audit. The statute provides that the audit report, when completed, has three components:

- i. An audit report prepared by an auditor which shall include the scope and date of the audit and the information gained in the audit together with exhibits and appendices including conclusions and recommendations;
- ii. Memoranda and documents analyzing part or all of the audit report and discussing implementation issues; and
- iii. An audit implementation plan that addresses corrected past non-compliance, improving current compliance, and preventing future non-compliance.

2. Civil penalty amnesty protections provided by the statute.

KRS 224.01-040 provides for limited amnesty from civil penalties for violations of KRS Chapter 224 that are voluntarily disclosed and corrected within sixty days of having voluntarily discovered the fact of the violation. KRS 224.01-040(8). Specifically, the statute provides that the Cabinet shall not seek a civil penalty against a facility for a violation of KRS Chapter 224 or the administrative regulations implementing Chapter 224 if:

a. Voluntary disclosure.

The owner or operator made a “voluntary disclosure to the Cabinet of the voluntary discovery of the violation;”

b. Correct violation.

The owner or operator has corrected the violation within sixty (60) days of voluntary discovery (unless the Cabinet demands a shorter period in order to protect human health or the environment or approves a longer period);

c. Prevent recurrence.

The owner or operator has agreed in writing to take steps to prevent a recurrence of the violation;

d. Not repeat violation.

The specific violation or a closely related violation has not occurred within the past three years and is not part of a pattern of violations of federal, state or local law occurring within the past five years;

e. Not subject to prior penalty litigation.

Is not an act or omission for which the facility has received penalty mitigation from a federal, state or local agency; and

f. No economic advantage.

Did not result in significant economic benefit which gives the violator a clear advantage over competitors. Further, the violation must not be one that resulted in serious actual harm or presented an imminent and substantial endangerment to human health or the environment or violated the terms of a judicial or administrative order. Finally, the owner or operator of the facility must cooperate as requested by the Cabinet and provide information as necessary to determine whether the penalty amnesty afforded by the section should be applied.

IV. HOW TO KEEP THE DEAL ALIVE

A. Insurance

An existing Commercial General Liability (“CGL”) policy cannot be relied upon, in most instances, for any pollution-related coverage. Most, if not all, Insurance Services Office (“ISO”) CGL policy forms contain the absolute pollution exclusion (“APE”). The APE is a long and comprehensive exclusion and has resulted in many pollution-related claims being denied. Fortunately, the insurance industry has developed a number of specialty products to cover pollution-related claims. When faced with the potential for acquiring environmental risk or for looking for a way to minimize potential exposure, environmental insurance can be a cost-effective option to transfer certain risks. Every environmental insurance policy must be negotiated with a specialized understanding of the environmental issues present at each particular site to ensure that the policy is appropriately tailored to a particular conveyance.

1. Pollution legal liability.

Pollution Legal Liability (“PLL”) policies generally protect the insured against on-site clean up costs of unknown, preexisting pollution and current pollution from ongoing operations and third-party claims arising from pollution conditions (*e.g.*, bodily injury and property damage).

2. Cleanup cost cap.

Cleanup Cost Cap (“CCC”) policies, in contrast, are designed to limit the cost of remediating known contamination by covering costs that exceed the original cost estimate based on the approved remediation plan or cover new or additional contamination found after the clean-up work begins. This coverage is often purchased in addition to a PLL policy.

3. Contractors’ professional liability.

Contractors’ Professional Liability (“CPL”) policies are written to cover third party claims for bodily injury, property damage or clean up costs that result from a pollution condition associated with environmental work performed by contractors, consultants, or architects. These policies include coverage for claims related to pollution conditions caused by the negligent acts, errors, or emissions of the contractor.

4. Lenders pollution liability.

Finally, Lenders Pollution Liability (“LPL”) policies are designed to protect lenders from environmental risks associated with real estate being held as collateral for a loan. Generally, coverage is limited the lesser of the outstanding balance of the loan or the cost of cleaning up the contamination.

B. Other Risk Management Tools

In dealing with the sale of the contaminated or potentially contaminated parcel of land, the interests of buyers and sellers usually are not aligned. For example, the seller hopes for a quick sale of his property at the maximum price while getting relief from future liability. The buyer would like to quickly purchase the property, limit liability and maximize the resale value. There are a number of risk management tools available which can address environmental risks and property transactions.

1. Indemnification.

Indemnifications are agreements that provide for one party to bear the cost, either directly or by reimbursement, for damages or losses incurred by a second party. Generally, environmental indemnifications must be drafted with care and specificity in order to be upheld and enforceable in court actions. Indemnification agreements do not prevent government agencies from asserting direct liability claims for remediation costs or environmental enforcement actions against the indemnified parties. Indemnification agreements may be supported by financial mechanisms such as escrow funds, hold-backs, letters of credit, bonds, or environmental insurance policies.

a. Sample language.

“Seller agrees to indemnify, protect, defend (with counsel reasonably acceptable to Purchaser) and hold harmless Purchaser from and against any and all losses, damages, liabilities, costs, expenses, and demands (including attorneys, consulting, and expert fees) suffered or incurred by Purchaser, as a result of: (1) any and all violations of environmental laws or releases of hazardous materials in connection with the performance of the remediation work (excluding, however, violations, releases, or events to the extent

caused by the negligence of Purchaser or Purchaser's contractor or agents)....”

b. Other key issues.

Other key issues to evaluate include type of cost covered (e.g., actual, incidental consequential, discretionary, defense), caps on amount of the indemnification, deductibles (only amounts above deductible could be claims), on-site vs. off-site liabilities, time limits for indemnification, predecessor operations, and posturing arrangements.

2. Representation and warranty.

Representations and warranties consist of statements of fact and promises that a seller makes to a buyer. Typically, they are provided by a seller who will disclose environmental risks associated with acquisition of the property. When used along with indemnification, representations and warranties also may allocate risk for environmental conditions and liabilities among parties to a contract. The goal of these terms is adequate disclosure of material risks and issues.

a. Sample language.

“Except as described in Schedule (X), there are no present or (to the knowledge of the seller) past actions, activities, circumstances, conditions, or incidents, including without limitation any release of hazardous materials, that could form the basis for assertion of any environmental liability against seller, buyer, the business, or any property used therein against any predecessor.”

b. Other key issues.

Key issues to analyze include the duration (whether and how long R&W survive closing), the scope of due inquiry (extent of seller's obligation to collect information), predecessor operations (whether R&W cover predecessor and other third-party operations on seller's property) and scope of issues covered (whether seller's R&W's cover all environmental liabilities or only liabilities arising from violations or arising from on-site conditions.).

3. Assumption, retention, and release.

With these provisions, the buyer accepts or the seller attains responsibility for known or unknown environmental conditions and releases the other party from liability for current and future claims arising from the specified condition. The purpose of such provisions is to allow the buyer and seller to allocate risk or liability for certain condition.

- Sample Language

“Purchaser hereby releases Seller from any and all liability to remediate or respond to any release of a regulated substance arising from (listed conditions or including unknowns)” Note that under this language, however, the seller would not be protected against third party claims for known or unknown conditions without a separate indemnification by the buyer for such claims.

4. Covenants.

Covenants are promises or agreements by seller or buyer to do, or refrain from doing, an act. Covenants allocate responsibility for tasks, particularly elements of the cleanup, transferring of permits, continue operation of assets, and compliance with environmental laws or to not take any action such as disposal of hazardous substances after a specified date (often closing).

a. Sample language.

“Seller shall, at its sole cost and expense, take or cause to be taken all actions necessary to ... ensure that as of the closing date, the Site, all activities and operations thereon, and all alterations and improvements thereto, comply with all applicable environmental laws, and with any and all agreements with governmental agencies, court orders, and administrative orders regarding environmental conditions.”

b. Other key issues.

Key issues to analyze include limitations on liability or conditions for action, scope and duration of the obligation, and thresholds for action may need to be specified.

5. Included or excluded liabilities.

Included or excluded liabilities provisions identify and allocate between seller and buyer particular risks associated with the business and some or all of the assets and liabilities and specifies whether they are included in or excluded from the risks allocated in the transaction. Included or excluded liabilities will not affect governmental agencies' ability or inclination to assert claims against indemnified party, particularly under CERCLA or similar state statutes.

6. "As is" sale.

An "As Is" sale involves an express statement that seller makes no representations or warranties about the condition of the property. "As is" sales are intended to preclude buyer from recovering damages from seller for known or unknown conditions at time of sale. To assist enforceability, specific environmental conditions, including latent defects should be disclosed to buyer, and indemnification should expressly state that the property transfer includes all risks associated with listed federal and state environmental laws.

a. Sample language.

"Purchaser acknowledges to and agrees with seller that purchaser is purchasing the property in an 'as-is' condition and specifically and expressly without any warranties, representations or guarantees, either express or implied, of any kind, nature, or type whatsoever from or on behalf of seller except as otherwise expressly set forth in this agreement."

b. Other key issues.

"As is" provisions may not preclude a CERCLA contribution action against seller and do not operate against third parties, including government, claims.

7. Post-signing and pre-closing conditions.

Post-signing and pre-closing conditions are requirements that some act be performed by a party to an agreement before closing the transaction. Clauses establish certain conditions that must be met, typically by the seller, prior to closing and may allow a party to "back out" of the deal or

adjust the purchase price or other terms if the conditions are not met. Clauses may provide buyer with opportunity to perform environmental audit or investigation.

a. Sample language.

“Purchaser’s obligation to close hereunder shall be subject to Purchaser, at Purchaser’s sole cost and expense, inspecting or causing an inspection to be made by qualified professionals on Purchaser’s behalf of the Property and other assets described herein, including at Purchaser’s option, environment inspections or tests for hydrocarbons or for any toxic hazardous substances.”

b. Other key issues.

Other key issues to evaluate include mechanisms for providing assurance to seller performing remedial work that transaction will be completed (*e.g.*, escrow); cost sharing provisions for investigatory and remedial work; extent of remedial work including whether approvals needed from regulators and site access for remedial work.

ENVIRONMENTAL LAW FOR LENDING INSTITUTIONS AND REAL ESTATE TRANSACTIONS*

Cathy Franck
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I. RESIDENTIAL REAL ESTATE

Most all real estate contracts, whether a standardized form used by the local real estate board members or an attorney-drafted individualized contract, provide the buyer with an opportunity to do a home inspection if they so choose. And, most buyers choose to perform an inspection on the property prior to closing.

During the inspection timeframe, a standard clause allows the buyer to inspect the property for any purpose, and it is during this time that most environmental hazards are discovered. In Kentucky, the home inspection definition statute does not specifically include or exclude environmental issues. See KRS 198B.700(5)-(6) (effective 7/15/2010). In addition, a Realtor representing the buyer might notice then point out environmental hazards, or the buyer might notice some hazards on their own as well. The appraiser might also find environmental hazards he or she considers worth noting while performing the appraisal, especially if the lender has particular guidelines for the appraiser.

Furthermore, within the contract and/or on the Lead Paint Disclosure, which becomes an addendum to the Residential Sales Contract, the buyer has an opportunity to note whether or not he/she intends to test for lead paint hazards in the housing.

A. Lead Paint

Residential real estate sales and lease contracts contain a "Lead Paint Disclosure" addendum. This addendum is required by 42 U.S.C. 4852d and provides a "Lead Warning Statement," then requests lead paint disclosure information from the seller, and the buyer's acknowledgement that he/she has received a copy of the

* *Note: If you are working on an environmental issue related to lending institutions and real estate transactions, this document is only a very basic guide and does not include all rules, regulations, laws, and guidelines. All of the rules, regulations, laws and guidelines included in this overview are often updated, with some lender guidelines subject to change daily and without notice. Each transaction and every lender's guidelines are different and transactions are approached on a case-by-case basis. Also note, this information addresses the most common real estate transactions, does not address jumbo loans, and it is recommended that you speak directly with the lender regarding any guidelines if you are researching a particular transaction.*

form. The buyer must next initial that he/she has received the pamphlet entitled “Protect Your Family from Lead in Your Home” and jointly created by the EPA, the U.S. Consumer Product Safety Commission, and the U.S. Department of Housing and Urban Development (HUD) [per section 406 of the Toxic Substances Control Act (TSCA), 15 U.S.C. 2686(a)]. The buyer must also initial that she/he has either (a) received a ten-day opportunity to conduct a lead paint test; or (b) waived the opportunity to conduct a lead paint test.

Penalties for violations are found in 42 U.S.C. 4852d(b) and include:

1. Monetary penalty, subject to civil money penalties in accordance with provisions of 42 U.S.C. 3545. May collect three times actual damages, plus court costs, expert witness fees, and reasonable attorney’s fees.
2. Action by Secretary of EPA – “The Secretary is authorized to take such lawful action as may be necessary to enjoin any violation of this section.”
3. Civil liability – Anyone knowingly violating this section shall be liable to purchaser or lessee in an amount equal to three times the amount of damages.
4. Costs – Prevailing plaintiff may recover court costs, reasonable attorney fees and expert witness fees.
5. Prohibited act – Refusal or failure to comply with section requiring the Lead Paint Disclosure is prohibited by section 409 of the TSCA [15 U.S.C. 2689]. Enforcement under TSCA [15 U.S.C. 2601 *et seq.*] for each applicable violation under section 16 of that Act [15 U.S.C. 2615] shall not exceed \$10,000.
6. Violations of the Lead Paint Disclosure requirement shall not affect the validity or enforceability of any sale or contract for the purchase and sale or lease of any interest in residential real property or any loan, loan agreement, or lien made or arising in connection with a mortgage loan, nor shall anything in this section create a defect in title. [42 U.S.C. 4852d(c)].

The Lead Renovation, Repair and Painting Program is a new EPA rule that regulates the creation of lead hazards during painting,

repair, and renovation activities. Lead contractors who disturb more than six square feet of lead paint inside or twenty square feet outside pre-1978 built housing and child-occupied facilities (e.g. daycare, schools) must be certified by the EPA for lead paint abatement. Violators may be fined up to \$37,500/day/occurrence. This rule was promulgated April 22, 2010, but due to backlogging in the certification process, overall compliance enforcement did not begin until December 2010.

B. Seller Disclosure of Property Condition Report – Other Disclosed Hazards

The seller is also required (by KRS 324.360 and 201 KAR 11:350) to provide the buyer with a “Seller Disclosure of Property Condition” form. On this form, the seller is required to “Report all known conditions affecting the property,” as well as provide responses to specific indications regarding whether or not a specific environmental hazard is present.

Other *environmental-related disclosures* the seller makes to the buyer in a residential sales contract in Kentucky include the following, and are found on the Seller Disclosure of Property Condition Report:

1. Disclosure regarding leaky basements.
2. Disclosure regarding leaky roofs.
3. Disclosure regarding:
 - a. Soil stability problems.
 - b. Drainage, flooding, or grading problem.
 - c. Whether property is in a flood plain zone.
 - d. Whether water features are on or adjoining property.
4. Disclosure regarding:
 - a. Ureaformaldehyde, asbestos materials, or lead based paint in or on this home.
 - b. Results from any testing for radon gas.
 - c. Underground storage tanks, old septic tanks.

- d. Any environmental hazards known to seller.
- e. Whether the house has ever had pets living in it.
- f. Whether the property is in an historic district.
- g. Mold or fungi in the property.

The Seller Disclosure of Property Condition form is not required for:

- Court supervised foreclosures
- Real estate sold at auction
- Residential sales of new construction if a home warranty is offered

Instructions to the seller when completing the form include: (1) complete all numbered items; (2) Report all known conditions affecting the property.

Currently, there is no legislation that prohibits a buyer from purchasing a property that houses any of the above-mentioned environmentally related features. Yet, some guidelines and protocols are in place, should perhaps a buyer or appraiser find some of the features considered as hazardous, subject to the terms of the contract and professional appraisal and lender guidelines.

C. Formaldehyde/Ureaformaldehyde

The Formaldehyde Standards for Composite Wood Products Act was signed into law by the President on July 7, 2010. This legislation adds a Title VI to the TSCA and establishes limits for formaldehyde emissions from composite wood products: particle-board, medium-density fiberboard, and hardwood plywood. These national emission standards mirror standards previously established by California's Air Resources Board for such products within that state. Congress has directed the EPA to promulgate final regulations implementing this Act by January 1, 2013.

Sources of formaldehyde include the wood products identified above, wood paneling, furniture made with these wood products, urea-formaldehyde foam insulation (UFFI), combustions sources, environmental tobacco smoke, some textiles including durable press drapes, and glue.

Formaldehyde emissions generally decrease with age. During the 1970s, UFFI was installed in many homes to conserve energy; yet,

these homes were found to have higher indoor concentrations of formaldehyde soon after the installation. According to the EPA, studies show the UFFI emissions decrease with time and those homes are unlikely to have high levels of formaldehyde today. www.epa.gov/iaq/formalde.html

D. Asbestos

Asbestos becomes an issue when a homebuyer wants it removed, or if an appraiser notes that its existence causes the property value to not meet the contract price, or if it is torn or cracked and fibers are disturbed. During the removal process, air quality can be affected by asbestos fibers. Asbestos workers must be certified according to the Kentucky Asbestos Accreditation Program. 401 KAR 58:040.

E. Radon

The Indoor Radon Abatement Act of 1988 was signed into law October 28, 1988. It authorized funds for radon programs, surveys, studies, and public information dissemination. The EPA and the U.S. Surgeon General recommend you test your home for radon, prior to even being involved in a real estate sale transaction.

In January, 2005, the Surgeon General issued a health advisory:

Indoor radon gas is the second-leading cause of lung cancer in the United States and breathing it over prolonged periods can present a significant health risk to families all over the country. It is important to know that this threat is completely preventable. Radon can be detected with a simple test and fixed through well-established venting techniques.

EPA recommends that a homeowner mitigate radon levels if the air testing results are at a 4.0 pico Curies per Liter (pCi/L) or higher. Because there are no known safe levels of exposure to radon, EPA now also recommends that people *consider* mitigating radon when test results are above 2.0 pCi/L, as well.

Kentucky just signed into law in March 2011 an act that establishes a certification program for “radon measurement contractors, mitigation contractors, and radon laboratories.” See HB 247.

F. Underground Storage Tanks (USTs)

Upon finding underground residential heating oil storage tanks that are empty, most homebuyers ask that the tank be filled with either sand or water and capped. Upon finding such tanks that still contain oil, most homebuyers request the tank and any contaminated soil be removed. USTs on farms are treated as commercial tanks and are regulated by the state Division of Waste Management Underground Storage Tank Branch. See 401 KAR 42:005-340 for Regulations dated September 13, 2006 – present. <http://waste.ky.gov/UST/Forms/Pages/default.aspx> also includes prior regulations, and proposed administrative regulations.

G. Historic Preservation

Although at first glance more related to the visual environment than ecology, properties in a historic preservation district or listed on the National Register of Historic Places are subject to certain remodeling and demolition requirements, and owners must obtain appropriate approval prior to making cosmetic or certain externally apparent structural changes.

H. Mold or Fungi

There are no federal standards for permissible mold exposure limits, nor does the CDC recommend routine sampling for molds. Kentucky has no established regulations or laws regarding mold contamination itself. However, the Kentucky Cabinet for Health and Family Services (CHFS) does state that all mold contamination should be removed from the home, as “[a]ny mold has the potential to cause negative health effects if left unchecked.” (See <http://chfs.ky.gov/dph/info/phps/mold.htm>.)

I. Methamphetamine (Meth) Labs

As of 2008, people who are considering renting or buying a residence in Kentucky must now be given notice by the owner if the property has been contaminated by a meth lab and not properly cleaned up. KRS 224.01-410(10). Failure to give such notice is a Class D Felony, and could result in a fine up to \$25,000 and/or imprisonment from one to five years. Kentucky’s meth lab cleanup law is codified at KRS 224.01-410.

Kentucky State Police or the local city or county law enforcement agency notifies the local health department the day they become aware of a property contaminated by a meth lab. Then CHFS or

their staff in the local health department posts a Notice of Meth Lab Contamination on each exterior door that goes directly into the residence. This posting remains until the property is decontaminated by a certified contractor in accordance with law. Contractors must be certified by the Environmental and Public Protection Cabinet (EPPC).

Guidance and enforcement of practices by certified contractors is provided by the Kentucky Office of Occupational Safety and Health Administration (KyOSH). These contractors fall under the scope of 29 CFR 1926.50-1926.65 Hazardous Waste and Emergency Response Operations (HAZWOPER) as adopted by KyOSH under 803 KAR 2:403, and must complete a minimum of forty hours of HAZWOPER safety training and field experience.

J. Carbon Footprint/Energy Efficiency

Kentucky adopted the 2009 International Energy Conservation Code (IECC) effective March 6, 2011, and mandatory June 1, 2011. New standards affecting residential new construction include: Glazing U-factors go to 0.35; flooring R-factor go to R-15/19; attic hatches are to be weather-stripped and air sealed. See the 2009 IECC and Kentucky Building Code.

II. APPRAISER ENVIRONMENTAL HAZARD REQUIREMENTS

In addition to a home inspection and an environmental hazard disclosure between the Seller and the Buyer, there is also another level of disclosure taking place in residential real estate transactions that are being financed by a lender.

Each government-sponsored enterprise (GSE), agency, or department backing the funds for the mortgage loan has a set of guidelines it follows when making a loan on a property. The funding for a conventional, conforming loan will ultimately be backed by either the Federal National Mortgage Association – FNMA (Fannie Mae) or the Federal Home Loan Mortgage Corporation – FHLMC (Freddie Mac) – both GSEs; funding for a Rural Housing Service (RHS) loan is backed by the USDA; funding for a Veterans' Administration (VA) is guaranteed by the VA, and a Federal Housing Administration (FHA) loan is backed by Housing and Urban Development (HUD). Each of these entities has its own guidelines regarding environmental hazards.

Lenders rely on appraisers to determine whether or not environmental hazards exist. The most common hazard found and reported by appraisers is chipping lead paint. The remediation a HUD appraiser will

require is that the chipping paint be scraped, the area repainted, and the chips removed from the property.

A. Conventional Loans Backed by GSEs

Traditionally the GSEs, Fannie Mae and Freddie Mac, were allowed to buy only conforming loans. [However, in 2006, Fannie Mae did purchase subprime and Alt-A loans as investments, and Freddie Mac in 1995 began receiving affordable housing credit for buying subprime securities. In 2007, Freddie Mac announced it would buy a subprime adjustable rate mortgage only if the buyer/borrower would qualify for the payment at the cap rate of the loan.]

Today, appraisers use the Fannie Mae and Freddie Mac guidelines for conforming loans, as those are the loans they are buying at this time.

The GSEs appraisers must follow the Uniform Standards of Professional Appraisal Practice (USPAP) that are in place as of the date the appraisal date.

The USPAP Handbook requires appraisers to look for and note the following:

1. The existence of hazardous waste sites on or near the property;
2. The proximity of a property to an airport; and
3. Whether the property is in a Special Flood Hazard Area that is identified on the Federal Emergency Management Agency's (FEMA) Flood Insurance Rate Maps.

Traditionally, the appraisal guidelines for conventional loans have been less stringent than HUD/FHA, VA, or USDA/RHS backed/funded loans when looking at the repair/remedy items noted by the appraiser in the appraisal. The list of repair/remedy items for conventional loans have been fewer to non-existent when compared to the loan types that follow.

B. FHA / HUD Guidelines

The basic overlying guideline the HUD appraisers follow is: The site must be "safe for occupants."

The property must be free of those foreseeable hazards and adverse conditions that may:

1. Affect the health and safety of the occupants;
2. Affect the structural soundness of the improvements; and
3. Impair the customary use and enjoyment of the property.

See the HUD website at <http://www.hud.gov/offices/hsg/sfh/ref/sfh1-18b.cfm>. (Note, in some other states, HUD appraisers look for proximity to lava zones and avalanche hazards.)

As mentioned above, if a HUD appraiser sees flaking paint, they will require it to be scraped and painted and the chips properly disposed of (all by an EPA certified lead paint contractor). Any time you access federal funds, the property is closely scrutinized with respect to compliance with federal environmental (including historic preservation) laws and regulations.

Also, at the FHA underwriter's discretion, an NPMA-33 (Wood Destroying Insect Inspection Report) Form may be required at closing, showing there are no active wood destroying insects in the buildings. This is more often required for FHA loan closings than for conventional closings.

If the transaction involves a condominium residence, the condominium project itself must be FHA-approved.

C. VA Appraisal Guidelines

VA appraisals must conform to the USPAP guidelines, and meet the additional requirements VA considers as supplementary to the USPAP.

Environmental Hazards that will not allow a VA loan to be underwritten include:

1. Property that is located in a Special Flood Hazard Area is not eligible for a VA loan; nor is property in an area subject to regular flooding regardless of whether in a Special Flood Hazard Area or not.
2. Airport Noise Zone 3, whether proposed, or under construction.

3. An easement involving liquid petroleum, high voltage electricity, or high-pressure gas, if any part of the residence is located within the easement.
4. A new/proposed/or under construction in an area susceptible to soil instability, if the builder cannot provide evidence that either that site is not affected by the soil instability, or the problem has been adequately addressed in the engineering design.
5. If a condominium, must be a VA-approved condominium project.

VA loans are to be appraised by VA appraisal requirements and conditions and in some instances, under HUD requirements and conditions.

Also, VA will allow veterans to use their Loan Guaranty benefit to buy a farm on which there is a farm residence.

D. USDA/RHS Appraisal Guidelines

USDA/RHS will guarantee or write directly single-family home loans to qualified rural residents unable to secure a conventional (conforming) loan. These appraisers will also have a list of items to note.

III. HUD HOUSING PROJECT REQUIREMENTS – FARMS OR LAND TRACTS BEING DEVELOPED

C.F.R. Title 24 – HOUSING AND URBAN DEVELOPMENT

PART 50 – PROTECTION AND ENHANCEMENT OF ENVIRONMENTAL QUALITY – Table of Contents

Subpart A – General: Federal Laws and Authorities

Section 50.4 Related Federal laws and authorities.

HUD and/or applicants must comply, where applicable, with all environmental requirements, guidelines and statutory obligations under the following authorities and HUD standards:

- a. Historic properties.
 1. The National Historic Preservation Act of 1966 (16 U.S.C. 470 *et seq.*), as amended.
 2. Executive Order 11593, Protection and Enhancement of the Cultural Environment, May 13, 1971 (3 CFR 1971-1975 Comp., p. 559).
 3. The Archaeological and Historic Preservation Act of 1974, which amends the Reservoir Salvage Act of 1960 (16 U.S.C. 469 *et seq.*).
 4. Procedures for the Protection of Historic and Cultural Properties (Advisory Council on Historic Preservation – 36 CFR, part 800).
- b. Flood insurance, floodplain management and wetland protection. (1) Flood Disaster Protection Act of 1973 (42 U.S.C. 4001-4128) and the National Flood Insurance Reform Act of 1994 (Pub.L. 103-325, 108 Stat. 2160). (2) HUD Procedure for the Implementation of Executive Order 11988 (3 CFR, 1977 Comp., p. 117) – 24 CFR part 55, Floodplain Management. (3) Executive Order 11990 (Protection of Wetlands), (3 CFR, 1977 Comp., p.121).
- c. Coastal areas protection and management. (1) The Coastal Barrier Resources Act, as amended by the Coastal Barrier Improvement Act of 1990 (16 U.S.C. 3501 *et seq.*). (2) The Coastal Zone Management Act of 1972 (16 U.S.C. 1451 *et seq.*), as amended.
- d. Sole source aquifers. The Safe Drinking Water Act of 1974 (42 U.S.C. 201, 300 *et seq.*, and 21 U.S.C. 349, as amended. (See 40 CFR part 149).
- e. Endangered species. The Endangered Species Act of 1973 (16 U.S.C. 1531 *et seq.*), as amended. (See 50 CFR part 402).
- f. Wild and scenic rivers. The Wild and Scenic Rivers Act (16 U.S.C. 1271 *et seq.*), as amended.
- g. Water quality. The Federal Water Pollution Control Act, as amended by the Federal Water Pollution Control Act Amendments of 1972 (33 U.S.C. 1251 *et seq.*), and later enactments.
- h. Air quality. The Clean Air Act (42 U.S.C. 7401 *et seq.*), as amended. See 40 CFR parts 6, 51, and 93).

- i. Solid waste management.
 - 1. The Solid Waste Disposal Act, as amended by the Resource Conservation and Recovery Act of 1976 (42 U.S.C. 6901 *et seq.*), and later enactments.
 - 2. The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (42 U.S.C. 9601 *et seq.*), as amended.
- j. Farmlands protection. The Farmland Protection Policy Act of 1981 (7 U.S.C. 4201 *et seq.*), as amended.
- k. HUD environmental standards. Applicable criteria and standards specified in HUD environmental regulations (24 CFR part 51).
- l. Environmental justice. Executive Order 12898 – Federal Actions to Address Environmental Justice in Minority Populations and Low-Income Populations (3 CFR, 1994 Comp., p. 859).

IV. FARM PROPERTIES

Depending on what type of loan you are obtaining, a farm property mortgage could be treated either as a conventional loan associated with a residential purchase (by apportioning off a five acre tract in order to obtain the conventional residential loan) or based on the guidelines of an independent bank that writes the loan, or based on guidelines of a Farm Credit System entity such as a Farm Credit Services cooperative, or similar to a commercial property (for example when obtaining a mortgage through Farm Service Agency (FSA)).

A. Conventional Loans

Guidelines differ, depending whether the farm is being sold with a residence or not. The state required “Seller Disclosure of Property Condition Report” required (by 324.360 and KAR 201 11:350) does not apply to vacant land.

Loans for land of more than five acres do not meet the conventional loan guidelines, but if the Buyer wants to obtain a conventional loan, he or she may do so by surveying off a five acre tract that includes the residence, and obtaining a conventional loan on just that portion of the property.

B. Farm Credit Services (FCS)

Guidelines will also differ if the borrower chooses a lender backed by an entity other than Fannie Mae and Freddie Mac. A mortgage through Farm Credit Services (FCS) cooperative will require an environmental disclosure to be completed by the seller only for farm/commercial mortgage loans greater than \$500,000, home loans greater than \$500,000 and acreage greater than forty acres. Some Farm Credit System loans may ultimately be purchased by Farmer Mac (the Federal Agricultural Mortgage Corporation) which is a publicly traded corporation that purchases loans from agricultural lenders and pools them for resale.

With FCS mortgages, the appraiser will also be required to complete a separate appraiser's Environmental Inspection Report ONLY when concerns exist or are identified from the inspection.

The main impetus for the FCS having environmental concerns is that in the event the lender must take back the property as in a foreclosure situation or a deed in lieu of foreclosure situation, the lender, depending upon the state, could have liability for damages and clean-up costs under CERCLA. Then, even if the lender avoids liability, the value of the collateral is reduced if contamination exists, which reduces the monetary return to the lender.

C. Farm Service Agency (FSA)

FSA provides loans that are USDA funded. FSA/USDA loans are available for those who do not qualify for conventional loans; however, there is still a qualification process that must be met. The applicant must show that he/she has been farming as an occupation for three of the past ten years. These loans are designed for people who will be farming to produce food.

FSA has very extensive forms to be completed regarding environmental assessment of a farm property. The lender first makes an initial review of the property and makes note of such things as the following, to name a few of the guidelines:

1. Whether the property has ever been used for industrial production such as a machine shop.
2. Whether such use has occurred on adjoining properties.
3. Whether the property has ever been used as a base location for aerial crop spraying or dusting service.

4. Whether gasoline, solvents, pesticides or other chemicals were ever commercially on the property.
5. Whether the property has ever been used as a junkyard or landfill or drum burial location.
6. Whether there are any Comprehensive Environmental Response, Compensation, and Liability Information System (CERCLIS) sites located within a half-mile of the property.

If the lender finds any issues during the initial review, he/she will recommend a Class II environmental assessment for the property.

Loan applicants who plan to construct, purchase, enlarge and/or refinance Animal Feed Operations (AFOs) or Confined Animal Feeding Operations (CAFOs) must submit a Comprehensive Nutrient Management Plan (CNMP). Also, all owners and operators of CAFOs shall be jointly and severally liable for complying with the KPDES permit, including permits for new/expanded waste management facilities, setback requirements based on number of animal units, waste management plans, neighborhood notification, and a certified livestock manager.

In addition, loan applicants must certify they have developed a Water Quality plan for all farmland owned and are in compliance with its provisions.

Some, but not all-inclusive, of the other environmental issues noted during the Agency official's initial assessment of making the loan determination are:

7. Wetlands (Executive Order 11990, Protection of Wetlands; Section 363 of the Consolidated Farm and Rural Development Act (CONACT) the Clean Water Act; and the Food Security Act.
8. Floodplains and Riparian Areas (Executive Order 11988) Note, Kentucky has more miles of streams and rivers per acre than any state other than Alaska, which makes us most susceptible to the need to protect our water resources from runoff and flood hazards. This ability to have the opportunity of the vistas of our visible water resources (as opposed to some states where the water resources are not so visible) also makes us more aware of the need to protect those resources.

9. Water quality (Safe Water Drinking Act, Federal Water Pollution Control Act / Clean Water Act of 1977, NPDES, KPDES).
 - a. Well testing.
 - b. Abandoned wells.
 - c. Sewer requirements.
 - d. Mines and minerals.
 - e. AFOs/CAFOs.
10. Endangered and threatened species.
11. Wilderness.
12. Wild and scenic rivers.
13. Natural landmarks.
14. Historic and archaeological properties.
15. Outdoor air quality.
16. Noise.
17. Environmental justice.
18. Hazardous waste.
19. Lead paint and radon.

Every farm is different, and whether or not Environmental Assessments are required will depend upon the land, the land type, and the operation on the property.

FSA's approach to environmental testing is based mainly upon regulations.

D. Hazards Particular to Farms

1. Underground or aboveground storage tanks containing herbicides, fungicides, pesticides, gasoline, oil.
2. Chemical or waste holding ponds/lagoons.
3. Confined animal feed operation waste and pipelines to transport such waste, or any of the above.

4. Weeds on some farms are now tending to become resistant to commonly-used herbicides, as certain crops have been genetically engineered with the insertion of a gene with foreign cellular makeup (another gene is inserted for the EPSPS enzyme) to resist a given herbicide; yet, through some means the herbicide-resistant quality is transferring to the weeds.

Have not located studies that determine whether the cause is through root discharge/uptake in the soil, plant foliar exposure to the pollen from herbicide-resistant plants, some level of cross-pollination, or just resistance due to weed's generations of exposure to the herbicide. This could become an environmental issue, with some monoculture crop farm purchasers who might intend to continue the same synthetic chemical regime.

5. Natural landmarks, wetlands, historical, archeological sites.
6. Protection of wells and springhouses as water supplies.

V. PRECAUTIONARY APPROACH VS. CAVEAT EMPTOR

At one time the application of lead paint, asbestos, and ureaformaldehyde were considered acceptable practices.

However, once our government was made aware of the hazards associated with these practices and was petitioned regarding these hazards, then rules, regulations, laws and guidelines were implemented, in order to protect "the people."

Many countries throughout the world – in order to protect the environment which ultimately protects "the people" – implement what is called "the Precautionary Principle" when new products are introduced. The Precautionary Principle is actually a basic tenet enveloping political policy, scientific research, and materials production that states:

Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation.

See Report of the United Nations Conference on Environment and Development, Annex I, Principle 15, June, 1992.

The United States, with regard to many discoveries, has allowed the scientific community (e.g., Research & Development) which made the discovery to determine whether a new product or technology should undergo years of studies as under the Precautionary Principle approach, or is safe for widespread use. This country's government has also allowed the industry which creates a new product to provide the research and test results to our government, and this information determines whether a new product or technology is considered safe for the marketplace or not.

With many new products and technologies, our government proceeds along the lines that the product is "Generally Recognized as Safe" (GRAS), unless challenged through petition otherwise.

Ultimately, if and when these products are found to be destructive to the environment, hence destructive to life including humanity, the burden of cleanup is passed on to the landowner in a property transfer, or in some instances this liability is shared by all in the chain of title.

One wonders what new products or technologies our society is currently introducing or has been using for years, that are yet to be considered by our government as hazardous. Yet once these new products or technologies are considered as such, they would become another obstacle to overcome in the health of our environment or in a real estate transfer.

What if the Precautionary Principle is a more logical approach than the GRAS approach? Obviously, competing interests and varying viewpoints exist. Yet it is the actions and motivations of the prevailing interests only, by which our society is most often judged.

