Developments in Federal
and State Law

ENVIRONMENTAL
LAW IN
NEW YORK

ARNOLD & PORTER

MATTHEW
BENDER

Volume 9, No. 1

January 1998

Assessing Environmental Liability of Lenders and Fiduciaries Under the Asset Conservation Act

by Maureen F. Leary

I. Introduction

With little fanfare, the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA),[1] was amended in 1996 to provide greater protection to lenders and fiduciaries who take title to property contaminated with hazardous substances. Only the banking industry, which had long sought liability protection, seemed to be paying attention when the amendments were passed. All lenders and fiduciaries should know the full parameters of the protections afforded by the amendments, however, and fully understand what activities are not protected from liability.

The amendments, known as the Asset Conservation, Lender Liability and Deposit Insurance Protection Act of 1996 (the "Asset Conservation Act" or the "ACA"), statutorily define and clarify the narrow circumstances in which lenders and fiduciaries can be found liable under CERCLA.[2] The ACA changes little in either CERCLA's liability scheme or in case law that has developed in the area of lender liability.[3] Lenders and fiduciaries may still be held liable under CERCLA's broad reach depending on the degree of control they exercised over a party responsible for contamination of property, including control of the acts of disposal that resulted in contamination. The "capacity to control" test is no longer viable, however.

This article will analyze the main aspects of this relatively new legislation, and discuss the protection from liability intended by Congress to be afforded. This article also will focus on where future litigation may arise in construing the ACA's terms, and will attempt to provide suggestions for counseling

(continued on page 8)

IN THIS ISSUE

LEGAL DEVELOPMENTS
- Agency Practice . . . 2
- Air Quality . . . 2
- Hazardous Subsatnces . . . 3
- Historic Preservation . . . 3
- Insurance . . . 3
- Land Use . . . 3
- Lead . . . 4
- SEQRA/NEPA . . . 4
- Solid Waste . . . 5
- Water . . . 5
- Wetlands . . . 6
- Wildlife . . . 6

NATIONAL DEVELOPMENTS . . . 6
NEW YORK NEWSNOTES . . . 7
UPCOMING EVENTS . . . 8
WORTH READING . . . 8

decreasing contamination in the creeks and wetlands is due to natural processes and previous cleanup work at the site, and that excavation of the contaminated sediments would cause "severe distress to over two acres of productive and diverse habitats." If the contamination does not continue to decrease as expected, EPA will reevaluate the situation. EPA Region 2 Press Release (Oct. 9, 1997).

EPA Selects Long-Term Remedy for Contamination at Sidney Superfund Site

The U.S. EPA has selected a long-term remedy to control the sources of contamination at the inactive Richardson Hill Road Landfill Superfund Site in Sidney. The cleanup action plan, estimated to cost $13.9 million, includes the excavation of contaminated soils and sediments near the landfill to obtain safe levels. The most contaminated material will be disposed off-site, and moderately contaminated material will be placed in a new, on-site disposal cell. The lesser contaminated material will be placed under a proper landfill cap with a leachate collection system. In addition, EPA will address contaminated groundwater through the construction of a system that extracts and treats the water, and long-term monitoring of groundwater, surface water, fish and sediment are also incorporated into the plan. EPA Region 2 Press Release (Oct. 1, 1997).

UPCOMING EVENTS

April 28-29, 1998

"Corporate Environmental, Health, and Safety Excellence: Bringing Sustainable Development Down to Earth," sponsored by Arthur D. Little, New York City. Information: (212) 339-0345.

May 14-15, 1998

"Hazardous Substances and Male Reproductive Health," jointly sponsored by the Mount Sinai School of Medicine, the National Institute of Environmental Health Sciences/ Superfund Research Program and the New York City Academy of Medicine, New York City. Information: (212) 241-4785.

WORTH READING

Daniel M. Abuhoff & Stuart Hammer, "Due Diligence: Phase I Seen Not Sufficient Alone," *New York Law Journal*, Oct. 30, 1997, at S4:1.

Stanley S. Arkin, "The Criminal Reach of Environmental Statutes," *New York Law Journal, &Eit;Oct. 8, 1997, at 3:1.*

Mark A. Chertok & Michael S. Bogm, "Passive Disposal: New Protection Now Available," *New York Law Journal*, Oct. 30, 1997, at S2:3.

David J. Feedman & Gregory R. Belcamino, "Funding Procedures for Brownfields: Bond Act Offers an Opportunity for Revitalization," *New York Law Journal*, Oct. 30, 1997, at S3:1.

Michael B. Gerrard and Monica Jahan Bose, "New Restrictions on Citizen Suits," *New York Law Journal*, Nov. 28, 1997, at 3.

Steven L. Gordon & Matthew Morreale, "Recycling Reprieve?" *New York Law Journal*, Oct. 30, 1997, at S5:1.

Susan Millington Campell & Carol E. Remy, "Disclosure Requirements and Securities Laws," *New York Law Journal, Oct. 30, 1997, at S4:3.*

Alan Kaminsky, "Litigating Infant Lead Poisoning Cases," *New York Law Journal*, Sept. 30, 1997, at 1:1.

Assessing Environmental Liability of Lenders and Fiduciaries Under the Asset Conservation Act

(continued from page 1)

clients who are acting in either a lending or fiduciary role.

A. Retroactive and Prospective Applicability

The ACA's applicability is both retroactive and prospective. The ACA's protections expressly apply to all pending and future CERCLA claims against lenders and fiduciaries as of the ACA's effective date, September 30, 1996.[4] This includes claims which have not been *finally* adjudicated prior to the ACA's effective date. In other words, protection is intended to be afforded to lender and fiduciary defendants in cases on appeal when the ACA was enacted.

B. CERCLA Liability Narrowed

The ACA does not eliminate CERCLA liability for lenders and fiduciaries, but significantly narrows it.[5] Secured lenders who have not "participated in the management" of contaminated property are excluded from CERCLA's "owner/operator" definition.[6] Such secured lenders are therefore no longer within the class of persons that may be held liable under CERCLA Section 107(a), 42 U.S.C. § 9607(a).

Fiduciaries also are excepted from the liability scheme in CERCLA Section 107(a) and can be held liable only to the extent of the assets held. This is consistent with the traditional concepts of fiduciary liability before CERCLA was passed. Historically, the liability of a fiduciary was limited to the assets held.[7] Under the ACA, personal liability for response costs and cleanup beyond the assets held can be imposed on a fiduciary only under certain enumerated circumstances. One of these circumstances is when the fiduciary relationship is formed with the purpose of avoiding liability.

C. Liability under State Superfund Unaffected

Although the ACA provides liability protection under

CERCLA, the potential liability for lenders and fiduciaries under State law remains unaffected. Lenders and fiduciaries may still be held liable as "owners" of property under the State Superfund law, ECL Article 27, title 13.[8] ECL Article 27, title 13 gives the New York State Department of Environmental Conservation (DEC) cause of action for remediation but does not provide any private cause of action. As a practical matter, DEC generally has not sought relief against lenders or fiduciaries under ECL Article 27, title 13. Cases in which a polluting party does not sign an administrative consent order with DEC are then referred to the Attorney General.[9] Actions for cost recovery and remediation are then brought by the Attorney General on DEC's behalf pursuant to CERCLA § 107(a) and the common law of public nuisance.[10]

D. Legislative Intent

The ACA is consistent with EPA's 1992 lender liability regulations which were invalidated in *Kelley v. United States Environmental Protection Agency.*[11] In *Kelley*, the D.C. Circuit held that EPA lacks the statutory authority to establish rules of liability under CERCLA or to exempt particular classes of parties from its reach.

The legislative history of the ACA reflects an intent to overturn the *Kelley* decision and provides an interesting confrontation between the judicial and legislative branches.[12] Congress made clear that it intended not only to protect lenders and fiduciaries, but to give EPA the authority to promulgate regulations that further address liability under CERCLA.[13]

> Mr. Lautenberg: . . . My understanding is that our intention [in passing the ACA] was to substantially endorse . . ., and to validate EPA's prior exercise of rulemaking authority for lenders and fiduciaries. . . . [W]e believe and it is our intent that EPA has the authority to clarify and refine the liability rules applying to lenders and fiduciaries. . . . The *Kelley* decision struck down EPA's original lender liability rule, but this legislation recognizes EPA's authority to promulgate rules in this area. This is consistent with our general intent that EPA should use its expertise to issue authoritative interpretations of CERCLA, whether by guidance or regulation. . . .[14]

It appears that in passing the ACA, Congress intended to overrule *Kelley* and reinforce EPA's fairly broad rulemaking authority.[15]

Congress viewed the CERCLA case law addressing lender liability as a root cause for some of the financial difficulties small businesses and potential homeowners were facing.[16] Indeed, the House Report noted that as a result of cases such as *United States v. Maryland Bank & Trust Co.*[17] and *Guidice v. BFG Electroplating and Mfg. Co.*[18] the majority of banks, approximately 88%, had actually changed their lending practices out of fear that they may be held liable under CERCLA. Congress was convinced that the nation's economic development was being adversely impacted by CERCLA's broad liability scheme.

Other statistics in the House Report stated that 62.5% of banks had rejected loan applications because of the possibility of environmental liability, and 45% had discontinued financing certain loans altogether (e.g. loans to service stations, chemical businesses and RCRA facilities).[19] Congress intended the ACA to remedy what was perceived to be the sometimes inequitable construction of CERCLA's liability provision, Section 107(a), and to reduce CERCLA's adverse impact on economic development.[20]

II. LENDER LIABILITY UNDER THE ACA

A. Definition of Lender

A lender is defined broadly under the ACA to include not only federal and State financial institutions, such as insured depository banks, credit unions and leasing/trust companies that are affiliated with banks, but any person that:

(a) makes a bona fide extension of credit to, or takes or acquires a security interest from, a non-affiliated person;

(b) insures a loan to, or guarantees against default on a loan by, a non-affiliated person; or

(c) provides title insurance and acquires a contaminated facility as a result of an assignment or conveyance in the course of underwriting and settling a claim.[21]

The watch word in these provisions is the term "non-affiliated." The term is not defined in the ACA but the Bankruptcy Code's definition of "affiliate" is instructive.[22] An "affiliate" is defined to include

- an entity that directly or indirectly owns, controls, or holds power to vote 20% or more of the outstanding securities of the debtor;
- an entity of which the debtor owns 20% or more of the outstanding securities;
- a person whose business or property is operated by the debtor under a lease or operating agreement; or
- an entity that operates the business or property of the debtor under a lease or operating agreement.

An affiliate is not, however, an entity that holds the debtor's securities in (1) a fiduciary capacity without discretion to vote, or (2) solely to secure a debt without exercising power to vote.

The term "non-affiliated" in this provision of ACA may be judicially construed more broadly than the Bankruptcy Code's definition. Depending on the facts of a particular case, a lender's familial relationship or substantial business relationship with the borrower could be construed to fall outside the meaning of "non-affiliated" and therefore outside the meaning of the term "lender" under the ACA. This would open lenders to potential CERCLA liability.

B. Exemptions From Liability

Before passage of the ACA, CERCLA's definition of "owner/operator" already excluded persons who held indicia of ownership in a facility primarily to protect a security interest but without participating in management.[23] The ACA repeats this exclusion (although perhaps less clearly):

> The term "owner or operator" does not include a person that is a lender that, without participating in the management of a vessel or facility, holds indicia of ownership.[24]

The ACA also exempts from liability a lender who, without participating in the management of a facility *prior* to foreclosure, actually forecloses and thereafter:

(a) sells, leases (in lease/financial transactions), or liquidates the facility;

(b) maintains business activities;

(c) winds up operations at the facility; or

(d) undertakes a response action or takes other measures to preserve, protect or prepare the facility for sale or disposition.

This exemption from liability applies only to a lender who seeks to sell, lease or otherwise divest itself of the facility "at the earliest practicable, commercially reasonable time, on commercially reasonable terms, taking into account market conditions and legal and regulatory requirements."[25] Thus, a lender is still protected if he briefly operates a facility as a part of foreclosure.

C. "Participation in Management" Defined

The ACA defines the term "participation in management" to mean a lender who actually participates in the management or operational affairs of a facility. A lender holding indicia of ownership will be considered to "participate in management" if, during the borrower's ownership, the lender:

(a) exercises decision-making control over environmental compliance related to the facility by taking responsibility for hazardous substance handling or disposal practices; or

(b) exercises management control of the facility by

  (i) taking responsibility for overall management encompassing day-to-day decision making on environmental compliance; or

  (ii) taking responsibility for substantially all of the *operational functions*, as distinguished from the financial or administrative functions, other then the function of environmental compliance.[26]

The term "operational function" as used in this last section refers, for example, to the job responsibilities of a facility or plant manager, an operations manager, a chief operating officer or a chief executive officer.[27]

"Participation in management" does not include a broad array of other listed activities as long as they "do not rise to the level of participating in management."[28] These protected activities include:

(a) having the capacity to influence management of a facility;

(b) having the unexercised right to control facility operations;

(c) performing an act or failing to act prior to the time when a security interest in the facility is created;

(d) holding, abandoning or releasing a security interest;

(e) including a condition relating to environmental compliance in a contract or security agreement;

(f) monitoring or enforcing the terms and conditions of a credit agreement;

(g) monitoring or inspecting a facility;

(h) requiring a response action or other lawful measures to address contamination;

(i) providing financial or other advice in an effort to mitigate, prevent or cure default on the loan or the diminution in a facility's value;

(j) restructuring, renegotiating or altering the terms and conditions of a loan or security interest;

(k) exercising other remedies available under applicable law for breach of the loan agreement; or

(l) conducting a response action under CERCLA Section 107(a).

These provisions define what does not constitute "control" of a facility. They appear to have been enacted specifically to erode the "capacity to control" test for lender liability set forth in *United States v. Fleet Factors Corp.*[29] In *Fleet Factors*, the court stated that "a secured creditor will be liable if its involvement with the management of the facility is *sufficiently broad* to support the inference that it could affect hazardous waste disposal decisions *if it so chose*."[30] The *Fleet Factors* court then remanded the case for further fact-finding on whether the secured creditor exercised sufficient control to be held liable for contamination at the facility in which it held a security interest.

The *Fleet Factors* decision caused considerable discomfort in financial lending circles. (Some would argue that this is an understatement.) Nevertheless, *Fleet Factors* led to the extensive lobbying effort by financial institutions that ultimately resulted in passage of the ACA.[31]

D. Other Financial Transactions Protected

The ACA protects the extension of credit in lease-finance transactions. The party extending credit is protected from liability as long as the lessor to whom credit is extended did not "select" the leased facility that is contaminated, nor control its daily operations.[32] The ACA also protects lease-finance transactions made in conformance with federal or State banking regulations.[33]

III. Fiduciary Liability Under the ACA

A. General Protection of Fiduciaries

CERCLA changed the well-settled rule that absent fraud or breach of contract[34] a fiduciary's liability did not extend beyond the value of the assets held. CERCLA imposed personal liability on all owners and operators.[35] This necessarily included fiduciaries holding title to, or operating, a contaminated facility. The ACA expressly states that a fiduciary's liability under CERCLA "shall not exceed the assets held in the fiduciary capacity."[36] Fiduciary liability therefore is not personal.

Prior to the ACA, CERCLA's provisions already protected heirs taking ownership of contaminated property.[37] A party taking ownership of contaminated property in a fiduciary capacity, rather than as an heir, was not expressly protected, however, because the fiduciary did not acquire the property by "inheritance or bequest."[38] Moreover, the fiduciary holding contaminated property in trust is often a member of a bank's trust department or is an attorney, both of whom could be considered sufficiently sophisticated to perform due diligence and make a conscious decision to avoid CERCLA's liability reach by refusing to hold the contaminated property in trust.

Now, the ACA protects fiduciaries as long as they are not negligent and do not cause or contribute to the release of hazardous substances. The ACA also protects fiduciaries as long as the fiduciary relationship is not set up primarily to avoid liability.[39]

B. Definitions

The ACA defines the term "fiduciary" broadly to include a person acting for the benefit of another as a bona fide: a) trustee; b) executor; c) administrator; d) custodian; e) guardian of an estate or guardian ad litem; f) receiver; g) conservator; h) committee; i) personal representative; or j) trustee of an estate of an incapacitated person (including a successor trustee) under an indenture agreement, trust agreement, lease or similar financing agreement for debt securities or other forms of indebtedness for which the trustee is not the lender.

The term "fiduciary capacity" as used in the ACA is defined to mean the capacity of a person in holding title to a facility, or otherwise having control of, or an interest in, a facility pursuant to the exercise of fiduciary responsibilities.[41] The ACA's definition of the term "fiduciary" is quite similar to the definition of that term under New York's General Business Law.[40]

C. EPA Rulemaking Authority

The ACA also gives EPA the express authority to promulgate regulations to give protection to other fiduciary representatives serving to capacities similar to those noted above.[42]

D. Exclusions

The ACA's definition of the term "fiduciary" expressly excludes: a) a fiduciary for a trust or estate organized for the "primary purpose" of carrying on a business for profit; and b) a fiduciary relationship created or established for the "objective purpose" of avoiding CERCLA liability.[43]

The ACA also does not protect against claims asserted against a non-employee agent or independent contractor hired by a fiduciary, such as an accountant, lawyer or other professional.[44]

These provisions are the most likely to involve litigation in the future. It may be difficult to prove that a fiduciary relationship was created for the "primary purpose" of avoiding liability. The attorney-client privilege may prevent discovery of the real purpose for the formation of a fiduciary relationship. The burden of proof may be construed to be on the party asserting that the fiduciary is not protected from CERCLA liability.

The discovery of facts relevant to the formation and purpose of the fiduciary relationship is critical to preventing unscrupulous parties from using the new protections afforded by the ACA to undermine CERCLA's liability scheme. EPA's existing authority and its new authority under the ACA to promulgate regulations protecting fiduciaries that are determined to be acting purely for the benefit of another may provide a solution.[45] EPA may be authorized to promulgate regulations that would protect fiduciaries who have required specific provisions in trust agreements designed to foster disclosure of the facts and circumstances surrounding the purpose of the fiduciary relationship. EPA also may be authorized to promulgate regulations requiring disclosure to State and federal governmental entities of the formation of a trust that holds contaminated property as an asset and information related to the trust's creation. Failure to file the required disclosure would make the trust voidable. These types of regulatory proposals may conflict with state trust laws, however, and may require formal legislation.

These regulatory proposals do not necessarily solve the problem for private plaintiffs claiming entitlement to contribution under CERCLA Section 113. Contribution plaintiffs may only have the option of showing by inference that the purpose of a fiduciary relationship was to avoid CERCLA liability.[46]

E. Safe Harbor Activities

The ACA outlines "safe harbor activities" that a fiduciary may undertake or decline to undertake without incurring personal liability when managing property. These include a) undertaking a response action pursuant to CERCLA; b) addressing by other lawful means the release of hazardous substances at a facility; c) terminating a fiduciary relationship; d) providing for environmental compliance in the fiduciary agreement by way of a covenant, warranty or other term or condition; e) monitoring or inspecting contaminated property; f) providing financial or other advice to parties to the fiduciary relationship; g) altering the terms and conditions of the fiduciary relationship; h) administering trust property that was contaminated before the fiduciary relationship began; and i) declining to take any of the foregoing actions.[47]

The ACA also does not affect the rights, immunities or defenses otherwise available to a fiduciary under CERCLA or any other applicable law.[48] A fiduciary can assert innocent landowner or statute of limitations defenses, for example.

F. Limitations

The ACA provides that a fiduciary will be personally liable, that is, liable *beyond* the value of the assets held, in certain specific circumstances. These include: a) when the fiduciary has CERCLA liability independent of his fiduciary ownership interest in contaminated trust property; b) when the fiduciary has CERCLA liability independent of his actions taken in a fiduciary capacity; and c) when the fiduciary's negligence causes or contributes to the release of hazardous substances at a facility.[49]

The concept of negligence set forth in this last section forseeably may include situations where a fiduciary fails or refuses to maintain trust property (*e.g.*, as repairing a roof) and a release of hazardous substances occurs (*e.g.*, from deteriorating and leaking drums). Under those circumstances, liability may be imposed for negligent acts or omissions that result in "passive contamination."[50] In addition, Although the ACA protects lenders and fiduciaries from liability under the Resource Conservation and Recovery Act (RCRA) for underground storage tanks,[51] RCRA Section 7002 appears to continue to provide an avenue of liability for lenders and fiduciaries who foreclose and then "contribute" to the contamination at a facility.[52]

The ACA's concept of fiduciary negligence, which considers fault or causation to determine liability, is contrary to the otherwise strict liability language of CERCLA Section 107(a). Nevertheless, Congress sought to protect the initially non-polluting fiduciary up to the point where his acts or omissions actually result in the release of hazardous substances. This is not only consistent with CERCLA's liability scheme but is equitable and places some responsibility on the fiduciary to manage and operate property held in trust in compliance with state and federal law.[53]

G. No Protection for Persons Having Both Fiduciary and Beneficiary Roles

The ACA provides that a fiduciary is not afforded protection from personal liability if he acts in a non-fiduciary capacity, including acting as a beneficiary under a trust, and (i) in that capacity he benefits directly or indirectly from the trust; or (ii) he is a beneficiary and a fiduciary with respect to the same fiduciary estate *and* receives benefits that exceed the reasonable compensation otherwise permitted under applicable law.[54]

The first fiduciary/beneficiary provision applies when an individual who is both a fiduciary and a beneficiary of a trust or a manager, director, officer or shareholder of trust property, compensates himself for both roles with trust assets. This provision bars the ACA's protection when a trust compensates the fiduciary, who is also acting in an second capacity, with trust assets. The rationale for this is clear. The "clean" assets which compensated the fiduciary beneficiary then are not available to fund remediation of a contaminated asset.

The second provision bars any protection from liability when a fiduciary who is also a beneficiary receives compensation for the performance of fiduciary duties that exceeds "reasonable" compensation.[55]

H. Pre-ACA Case law On Fiduciary Liability

There have been few published cases dealing with the question of when a fiduciary can be held personally liable under CERCLA.[56] In cases where courts found the fiduciary liable, some level of control and the exercise of affirmative measures that caused the contamination were evident.[57]

In *City of Phoenix v. Garbage Services, Inc.*,[58] a bank fiduciary was held personally liable beyond the trust assets it held. The bank, as executor of a decedent's estate and as trustee for a testamentary trust, exercised the decedent's option to buy a landfill. The bank then leased the property to a hazardous waste disposal company. With the knowledge of the bank, the property was then used for the disposal of wastes and became contaminated.

The court held that the bank did not need to participate in the day-to-day operation of the landfill property in order to have exercised the required level of control over the trust property in order to be found liable beyond the trust assets.[59] The *City of Phoenix* court set forth the "control test" for fiduciaries:

(a) If a trustee holds title to property previously contaminated, the trustee's liability is limited to the trust assets and he will not be held personally liable.

(b) If a trustee does not have the power to control use of the trust property during the time the contamination occurs or did not knowingly allow property to be used for the disposal of hazardous substances, the trustee's liability is limited to the trust assets and he will not be held personally liable.

(c) If a trustee has the power to control the use of trust property and knowingly allows the property to be used for the disposal of hazardous substances, the trustee will be held personally liable.

IV. RECENT CASES CONSTRUING THE ACA

In the short time since the ACA became effective, there have been few cases construing its terms. In a case "not recommended for full-text publication," the Sixth Circuit in *Kelley v. Tiscornia*[60] affirmed the district court's application of EPA's lender liability regulations and a parallel provision of Michigan's Superfund law in entering summary judgment in favor of a bank.[61] EPA's regulations later were invalidated by the D.C. Circuit in *Kelley v. USEPA* and the plaintiff in *Tiscornia* moved for reconsideration. The district court refused to reconsider its prior ruling and continued to hold that the bank's activities related to two facilities were protected despite proof that the bank had some involvement in the management of the business that owned the contaminated property. The State of Michigan appealed the district court's ruling. The ACA was passed while the case was on appeal.

The Sixth Circuit agreed with the district court's decision insofar as it found that the bank had not participated in the management of the polluting company because it had not exercised decision-making control over the company's environmental compliance or its day to day operation.[62] The Sixth Circuit found that the bank was exempted from CERCLA liability and upheld the district court's application of the EPA regulations because the ACA had effectively codified them.

Interestingly, the Sixth Circuit made a distinction between the bank's lack of control over environmental decision-making and the bank's participation in and control over the financial and administrative aspects of the business.[63] The Court found that the bank's participation in only the financial and administrative aspects of the business had not "crossed the murky line from the ability to influence operational decisions to actually making operational decisions."[64]

In another unpublished case decided under the ACA by the Pennsylvania district court, a bank foreclosed and took title to the assets of a chemical manufacturing facility.[65] The assets included hazardous substances that had contaminated the plaintiff's property. The plaintiff alleged that the bank's activities with the facility/borrower involved more than mere foreclosure and constituted "active management" and operation of the facility. On the bank's motion to dismiss pursuant to the ACA and a parallel Pennsylvania law, the district court refused to dismiss the plaintiff's claims against the bank, finding that the complaint sufficiently alleged that the bank "operated" the site.

V. ADVISING THE LENDING OR FIDUCIARY CLIENT

Obviously, a lender or fiduciary taking title to contaminated property wants to avoid litigating the issue of whether he will be protected under the ACA or be potentially liable under CERCLA Section 107(a) as an "owner/operator."[66] How can lenders and fiduciaries avoid litigation? One answer is the exercise of due diligence in assessing property that ultimately may be foreclosed upon and owned by the lender, or that may be held in trust by the fiduciary. This should be done *prior* to entering into the lending or fiduciary relationship. Sometimes this is simply not feasible, however, particularly for fiduciaries. The steps necessary to exercise due diligence are beyond the scope of this article but are covered in depth elsewhere.[67] Nevertheless, there are still some contractual and common sense precautions to be taken when entering into a lending or fiduciary role. Legal advice should always begin with the caveat that lenders and fiduciaries must assume they are *not* protected from liability by the ACA and must exercise caution in contractually structuring their role if it includes dealing with contaminated property or a potentially responsible party.

Before entering into a lending or fiduciary relationship, lenders and fiduciaries should require the same documents that a purchaser would request in a due diligence search. Specific information about assets to be held and managed can be gleaned by interviewing a company's environmental safety manager and/or environmental consultant. This will provide the lender/fiduciary or with specific details on the nature of the assets held and will allow a reasoned determination to be made regarding whether to enter into the fiduciary relationship. Although the fiduciary may avoid the risk of litigating CERCLA/ACA liability issues in pursuing this course, it may also operate to simply kill the deal.

In addition to requesting information from the company, regulatory documents may be requested from federal, State and local environmental regulatory authorities. These may include a) permits and pending permit applications; b) enforcement documents, notices of violations, administrative orders or other documents related to administrative and/or judicial proceedings; c) SARA Title III and State hazardous substance reporting and spill notifications, and emergency response plans which will indicate the type and amount of hazardous substances on site; d) State or federally funded site investigations and/or assessments; e) multi-media inspection reports; and f) underground storage tank registrations and inspection reports.

When entering into an agreement, lenders and fiduciaries should seek the advice of an attorney familiar with the intricacies of CERCLA's and RCRA's liability schemes, the specific protections afforded in the ACA amendments. The attorney should also be familiar with the contractual provisions in financial agreements that afford lenders and fiduciaries the greatest indemnification and other protections allowable under State banking, estate, trust or other laws. Fiduciary agreements also should have specific contractual provisions giving the fiduciary the widest latitude to remediate property with estate assets, and protecting the discretion of the fiduciary from the objections of beneficiaries who may not want property remediated with those assets at the beneficiaries' expense.

A foreclosing lender should make efforts to quickly wind down the operations of a contaminated facility in order to avoid falling within the definition of "operator." A fiduciary appointed as an executor to a decedent's estate also should have all property in the estate liquidated and distributed quickly in order to avoid the possibility of being characterized as an "operator" or as one who negligently allowed contamination to occur. When liquidation of property is not a preferable option, specific measures to contain or clean up the contamination should be taken with regulatory oversight. Finding a "volunteer" under New York's voluntary cleanup program may be an alternative for both lenders and fiduciaries to explore.

Loan documents and any deed conveying property to a trust should contain environmental warranty provisions related to the previous uses of the property. If possible, these agreements should warrant that the trust property has not been used in a way that resulted in the release of hazardous substances.

Finally, a fiduciary agreement should contain a provision completely indemnifying the fiduciary, including indemnification for personal liability to the full extent of the trust assets, for all costs damages, penalties, and attorneys fees that may arise from the administration of trust property.

VI. CONCLUSION

While the ACA clearly provides protection for lenders, trustees and other fiduciaries, it is no panacea and careful client counseling regarding its provisions is essential. It is a complicated amendment to an already complex law. To a surprising degree, the rules regarding "control" of a contaminated facility, rather than *Fleet Factors'* "capacity to control," continue to apply. The good news is that parties who, under traditional concepts of equity, have an arm's length lending or fiduciary relationship to the real polluter and are otherwise "innocent," will be protected from CERCLA liability as long as involvement in managing the operational aspects of a facility is avoided.

Future judicial interpretation of the ACA will be instructive but may further complicate CERCLA, an unpopular environmental statute. Despite its many faults, CERCLA has a remedial purpose worth fostering. The ACA amendments have brought some equity into the liability equation. A parallel state law providing the protections to lenders and fiduciaries may be warranted.[68] Although DEC occasionally has given full releases to banks as a part of voluntary cleanup agreements, this type of state legislation protecting lenders and fiduciaries from liability under ECL § 27-1313(3) may help to foster real estate transactions under New York's voluntary cleanup initiative.[69] Many properties in this State are in that nebulous area between the defaulting borrower and the non-foreclosing lender. In an effort to avoid CERCLA liability, lenders have often refused to foreclose on these contaminated properties. This has effectively kept properties from the possibility of a voluntary cleanup and their return to profitable use. Moreover, these properties have been kept off the tax rolls to the detriment of the municipality in which they are located.

The ACA's purpose of facilitating transactions by lenders and fiduciaries toward future use of contaminated properties may be thwarted in New York if liability protection is not afforded under state law. New York's economic future could benefit from such legislation.

Maureen F. Leary has been an Assistant Attorney General in the Environmental Protection Bureau of the New York State Department of Law since 1987. She is primarily responsible for litigating CERCLA cases on behalf of the New York State Departments of Environmental Conservation and Health. Prior to joining the Attorney General's Office, she was with Wilson, Elser, Moskowitz, Edelman & Dicker as a member of the joint-defense trial team in CERCLA and toxic tort cases. The views expressed in this article are not necessarily the views of the Attorney General's office or of any agency of the State of New York.

[1] 42 U.S.C. § 9601 *et seq.*

[2] The Asset Conservation Act amendments are found in CERCLA Sections 101(20)(A) to (G) (lender liability) and 107(n) (fiduciary liability), 42 U.S.C. § 9601(20)(A) to (G) and § 9607(n).

[3] *See United States v. Fleet Factors Corp,* 901 F.2d 1550 (11th Cir. 1990), *cert. denied,* 498 U.S. 1046 (1991).

[4] *See* Pub. L. No. 104-208, § 2502 (1996).

[5] Protection is also afforded lenders and fiduciaries for underground storage tanks covered by the Resource Conservation and Recovery Act, 42 U.S.C. § 6901 *et seq. See,* Fox and Zabel "Environmental Fiduciary Liability: The Mist Clears," Trusts and Estates, January, 1997; *see also* Witkin and Desiderio, "Safe Harbors for Lenders under EPA's New UST Rule," 10 Prob and Prop 33 (May/June 1996). Underground storage tanks covered by RCRA are a major concern of lenders and fiduciaries holding title to commercial real property that is otherwise not known to be contaminated. These tanks often present a hidden liability for lenders and fiduciaries.

[6] 42 U.S.C. § 9601(20)(A) and (E).

[7] *See generally,* Scott on Trusts, §§ 261-265 (4th Ed. 1991).

[8] ECL § 27-1313 sets forth the statutory framework of the hazardous waste remedial program for which the New York State Department of Environmental Conservation (DEC) is responsible. ECL§ 27-1313(3)(a) states that when the Commissioner finds that hazardous substances pose a "significant threat" to the environment, he may order the "owner of the site and/or any person responsible for the disposal of hazardous wastes at such site" to develop and implement a remedial program subject to DEC's approval. There is no liability protection for acquiring ownership of the site as a lender or fiduciary.

[9] ECL § 71-2705.

[10] 42 U.S.C. § 9607(a); *State of New York v. Shore Realty Co.* 759 F.2d 1032 (2nd Circuit 1985).

[11] 15 F.3d 1100 (D.C. Cir. 1993), *amended on petition for rehearing,* 25 F.3d 1088 (D.C. Cir. 1994), *cert. denied,* 513 U.S. 1110 (1995)

[12] *See* 142 Cong. Rec. 512292 (1996).

[13] *See* 142 Cong. Rec. 512292 (1996).

[14] 42 Cong. Rec. 12292-93 (1996).

[15] 142 Cong. Rec. 512292 (1996). *But see* the colloquy between Senators Smith and D'Amato:

Mr. Smith:... Title V of this bill gives EPA limited and specific rulemaking authority on two narrow issues. The first one is the recognition of additional fiduciary capacities under new section 107(n)(5)(a)(i)(XI) of CERCLA....

Mr. D'Amato: The Senator is correct.

Mr. Smith: It is my understanding that in granting EPA the authority to issue rules on these two narrow issues, title V *does not in any way disturb the central holding in the Kelley case,* namely that absent a specific delegation,... CERCLA, today, or as amended by this act, does not authorize EPA to issue rules defining the scope of CERCLA liability. I would like to confirm that my interpretation is the correct one, in order to avoid possible confusion and uncertainty in the future.

Mr. D'Amato: That is correct.

142 Cong. Rec. 511896 (1996) (emphasis supplied).

[16] *See* H.R. Report 104-185, Title V (1995 WL 747809)

[17] 632 F. Supp. 573 (D. Md. 1986)

[18] 732 F. Supp. 556 (W.D. Pa. 1989).

[19] *See* H.R. Report 104-185, Title V (1995 WL 747809).

[20] 42 U.S.C. § 9607(a).

[21] 42 U.S.C. § 9601(20)(G)(iv).

[22] *See* 11 U.S.C. § 101(2).

[23] See, 42 U.S.C. § 9601(20)(A).

[24] 42 U.S.C. § 9601(20)(E)(i).

[25] 42 U.S.C. § 9601(20)(E)(ii).

[26] 42 U.S.C. § 9601(20)(F).

[27] 42 U.S.C. § 9601(G)(v).

[28] 42 U.S.C. § 9601(20)(F)(iii).

[29] 901 F.2d 1550, 1558 (11th Cir. 1990) *cert denied*, 498 U.S. 1046 (1991).

[30] 901 F.2d at 1558. (emphasis added.)

[31] *See* House Report 104-882, 104th Congress, 2nd Session 1995.

[32] 42 U.S.C. § 9601(20)(G).

[33] 42 U.S.C. § 9601(20)(G).

[34] *See* Bogert, "Trusts" §§ 125 and 129 (6th Ed. 1987).

[35] *See State of New York v. Shore Realty*, 759 F.2d 1032, 1042 (2d Cir. 1985).

[36] 42 U.S.C. § 9607(n)(1) states: "The liability of a fiduciary under any provision of this chapter [CERCLA] 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."

[37] 42 U.S.C. § 9601(35)(iii); *United States v. Pacific Hide & Fur Depot, Inc.*, 716 F.Supp. 1341 (D.C. Idaho 1989) (finding heirs to PCB contaminated property to be "innocent landowners"). CERCLA Section 107(b)(3) provides a defense to liability for the acts or omissions of a third party as long as there is no "contractual relationship" with the third party. A party is deemed not to have a "contractual relationship" with the polluting party if contaminated property is acquired "by inheritance or bequest." 42 U.S.C. § 9601(35)(iii).

[38] Acquiring property by "inheritance or bequest" is excluded from the definition of "contractual relationship" in CERCLA Section 101[35], 42 U.S.C. § 9601(35). Hence, acquisition by heirs is directly protected by the "innocent purchaser" defense in § 107(b)(3), 42 U.S.C. § 9607(b)(3). A trustee acquiring property by trust agreement does involve a contractual relationship between the responsible party and the trustee. Thus, the innocent third party defense in CERCLA Section 107(b)(3) previously was unavailable to trustees acquiring contaminated property as a part of a trust agreement. 42 U.S.C. § 9601(35). The ACA changed that.

[39] 42 U.S.C. § 9607(n)(3) and (7).

[40] 42 U.S.C. § 9607(n)(5)(B).

[41] *See* GBL § 359-i.

[42] *See* 42 U.S.C. § 9607(n)(5)(A)(i).

[43] *See* 42 U.S.C. § 9607(n)(5)(A)(ii).

[44] 42 U.S.C. § 9607(n)(8) addresses "non-employee" agents of the fiduciary.

[45] 42 U.S.C. § 9607(n)(5)(A)(i)(XI).

[46] For a discussion of when intent can be inferred from facts and circumstances, *see Beck v. Manufacturer's Hanover Trust Co.*, 820 F.2d 46, 50 (2d Cir. 1987), *cert. denied*, 484 U.S. 1005(1988) and *Quintel Corp. v. Citibank Corp.*, 606 F. Supp. 898, 909910 (S.D.N.Y. 1985). *See also United States v. Carolina Transformer*, 978 F.2d 832, 841 (4th Cir. 1992) (record as a whole leaves unmistakable inference that transaction was undertaken by successor corporation to avoid environmental liability).

[47] *See* 42 U.S.C. § 9607(n)(4).

[48] *See* 42 U.S.C. § 9607(n)(6).

[49] *See* 42 U.S.C. § 9607(n)(2) and (3).

[50] CERCLA liability can be imposed on owners who do not actively pollute but instead fail to take sufficent measures to prevent passive contamination." *See Nurad, Inc. v. Hooper & Sons Co.*, 966 F.2d 837 (4th Cir. 1992); *State of New York v. Shore Realty*, 759 F.2d 1032, 1045 (2d Cir. 1985); *State v. Almy Brothers*, 866 F. Supp. 668, 676-77 (N.D.N.Y. 1994); *but see ABB Industrial Systems, Inc. v. Prime Technology, Inc*, 120 F.3d 351 (2d Cir. 1997); *United States v. CDMG Realty Co.*, 96 F.3d 706 (3d Cir. 1996) (passive migration of contamination is not "disposal" for purposes of imposing CERCLA liability).

[51] 42 U.S.C. § 6991b(n).

[52] 42 U.S.C. § 6972(e).

[53] A fiduciary's responsibilities in this regard are analogous to those of an bankruptcy trustee and/or debtor in possession under 11 U.S.C § 959(b) which provides that both "shall manage and operate property... according to the requirements of the valid laws of the State in which such property is situated..."

[54] *See* 42 U.S.C. § 9607(n)(7)(B).

[55] 42 U.S.C. § 9607(n)(7).

[56] *See Lone Star Industries, Inc., v. Horman Family Trust*, 960 F.2d 917, 921 (10th Cir. 1992); *Quadion Corp. v. Mache*, 738 F. Supp. 270, 275 (N.D. Ill. 1990).

[57] *See City of Phoenix v. Garbage Services*, 827 F. Supp. 600 (D. Ariz. 1993).

[58] *See City of Phoenix v. Garbage Services*, 827 F. Supp. 600 (D.Ariz. 1993).

[59] *City of Phoenix v. Garbage Services, Inc*, 827 F. Supp. at 607

[60] *Kelley v. Tiscornia*, 104 F.3d 361 (6th Cir. 1996).

[61] *Kelley v. Tiscornia*, 810 F. Supp. 901 (W.D.Mich. 1993).

[62] *Kelley v. Tiscornia*, 104 F.3d at 362.

[63] *Kelley v. Tiscornia*, 104 F.3d at 362.

[64] *Kelley v. Tiscornia*, 104 F.3d at 362.

[65] *F.P. Woll & Company v. Fifth and Mitchell Street Corp.*, 1997 WL 535936 (E.D. Pa. 1997).

[66] 42 U.S.C. § 9607(a).

[67] *See* "Environmental Due Diligence in Real Estate and Commercial Transactions," New York State Bar Association (May 1997).

[68] In April 1997, a bill (S. 5007) was introduced in the New York Senate that would have provided protections to lenders under State law.

[69] For a discussion of DEC's voluntary cleanup initiative and the statutorily authorized brownfield program, *see* Markell, "Some Observations About the 1996 New York State Environmental Bond Act and a Closer Look at Title 5 and its Approach to the 'Brownfields' Dilemma," 60 Albany L. Rev. 1217 (1997). To a degree, lenders are already protected from liability under the 1996 Clean Water/Clean Air Bond Act provisions related to brownfields development *See* ECL § 56-0509(1)(a)(ii).