

## Foreclosures Can Pose Hidden Enviro Risks For Banks

By Jesse Greenspan

*Law360, New York (March 25, 2010)* -- As banks foreclose in record numbers on unfinished construction projects, they could find themselves liable for stormwater and other environmental violations not covered by their secured creditor exemptions.

No major Clean Water Act lawsuits have yet been filed against banks in the U.S. with respect to stormwater violations, but state regulators may have issued notices of violation or unilateral administrative orders, according to David Roth, a partner in the environmental and toxic tort practice group at Bradley Arant Boult Cummings LLP.

At the very least, many regulators are aware of this issue and are addressing it, said Roth, who has spoken to state officials in 46 states about the matter.

"For the most part, I think these things get resolved before they go much further than the state coming in and saying, 'You've got to clean this thing up,'" Roth said.

But, he added, when a suit does get filed it will be a worst-case scenario where a bank forecloses on a property and then doesn't do anything to meet its stormwater obligations.

"I doubt that the state regulators will want to play as nice then," Roth said.

When a bank forecloses on an unfinished construction site, it has to apply for a stormwater permit or renew an existing permit, and then comply with the requirements of that permit, according to Larry Schnapf, an environmental lawyer with his own practice who also teaches at New York Law School.

And if a developer had to do wetlands mitigation as part of a project, then the bank may have those obligations as well, Schnapf added.

"If they don't, they're going to find themselves to be the deep pocket," he said.

The secured creditor exemption that banks have under the Comprehensive Environmental Response, Compensation and Liability Act and the Resource Conservation and Recovery Act do not create protections for violations of other environmental statutes.

"For so long banks were brought up thinking about environmental liability in terms of CERCLA," Roth said. "That was the 800-pound gorilla in the room, and I think a lot of people don't realize that that nice convenient exemption doesn't apply to the Clean Water Act and the Clean Air Act."

Schnapf noted that, with respect to their secured creditor exemption, banks had gotten “a little cavalier in their thinking.”

At this point, the U.S. Environmental Protection Agency has not stepped in to offer guidance, but certain states have begun to act by contacting banks directly over potential for compliance problems.

In June, for example, North Carolina officials sent a letter to presidents and chief operating officers of banking institutions that conduct business in the state, alerting them that they may acquire sites where necessary erosion control measures were never installed or were installed but not maintained.

“An unfortunate aspect of the current economic slowdown is that banks are increasingly taking control of commercial real estate projects of all kinds, many of which are partially completed,” the letter said.

“Failure by a bank in possession of partially developed real estate to comply with applicable law can have serious consequences in terms of potential legal and regulatory liability and reputation risk,” it added. “It is in the interest of all stakeholders .... that the lenders take possession, secure the property, deal promptly with environmental issues and dispose of the property in the way that gives the optimum recovery.”

The letter then encouraged banks to contact state officials and work with them to bring their foreclosed sites into compliance.

“If remedial measures are necessary ... those steps will be reflected in an administrative consent order,” the letter said.

Meanwhile, Georgia has a revised general stormwater permit that specifically addresses foreclosing lenders, and Minnesota has a fact sheet that provides guidance to banks and other property owners not familiar with the construction stormwater permitting program.

Other states don't have formal policies, but they agree that a foreclosing bank is subject to certain environmental requirements, according to Roth.

“A good many [regulators] are aware of the issue, and they were pretty consistent,” Roth said. “They generally encourage the banks to come in and see them, before you go too far down the road.”

In addition to government enforcement actions under the Clean Water Act, there is also the possibility of citizen suits, experts said.

“The concern there is that, in a lot of these instances, ... when you have the stormwater pushing sediment off the site it's either going onto someone's property or into a nearby creek,” Roth said.

But at this point, Roth said, he is not aware of any pending citizen suits against banks over stormwater issues.

In order to prevent litigation, Schnapf recommended that banks determine their environmental compliance liabilities before they take title to a property.

He pointed out that banks can face fines of a few hundred dollars to tens of thousands of dollars per day, depending on the severity of the violations.

“Banks have to think very carefully about what activities they undertake and what activities they decline to undertake,” said David J. Freeman, chair of the New York environmental practice group at Paul Hastings Janofsky & Walker LLP.

“Their goal has to be to divest the property and recoup their funds,” added Jesse Hiney, an associate at Paul Hastings.

States can also bring Clean Air Act enforcement actions at sites where the banks fail to minimize dust, experts said.

“That happens less,” Schnapf said. “I think it's more in the dry states or states where there are droughts.”

California has issued an advisory to banks reminding them to properly dispose of chemicals at abandoned sites, according to Schnapf, adding that there also can be asbestos issues.

And certain localities have passed ordinances that require banks to maintain abandoned homes, and they have issued fines for such infractions as dirty pools.

“[But] for the most part, the most common issue — and I suspect it's happening all over the country — is the stormwater issue,” Roth said.

“My advice is: Understand the environmental conditions of the site before you foreclose,” he added.