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Technical Brief for Commercial Real Estate Lenders

Dry Cleaner Liable Under CERCLA and Headed to Trial on RCRA

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EDR Insight often receives questions from risk managers at financial institutions looking for examples of cases in which property contamination impacted a lender. For today's Technical Brief, EDR Insight is honored to have Bill Wagner summarize a recent case in Illinois involving a lender that foreclosed on a residential property that was contaminated by a neighboring dry cleaner. In the following piece, Bill highlights what the bank might have done differently to reduce its environmental exposure and how other financial institutions can avoid similar actions

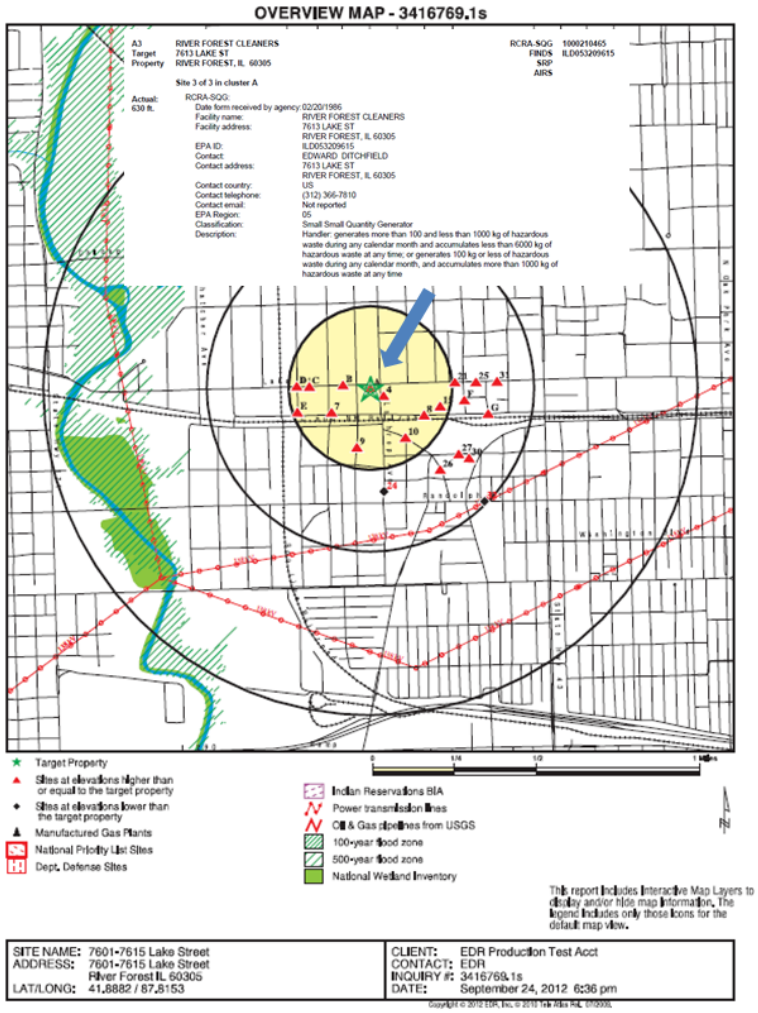
Bill Wagner is a seasoned trial lawyer who concentrates his practice on environmental law, complex litigation, and white collar criminal defense. He represents clients in matters involving environmental contamination, class action personal injury and toxic tort claims, remediation cost recovery claims, and federal and state enforcement actions. Bill has been honored by inclusion in Best Lawyers in America, has been regularly recognized as an Indiana Super Lawyer, has been named a Fellow of Litigation Counsel of America, The Trial Lawyer Honorary Society, and Life Fellow of the Indiana Bar Foundation, and has received the highest professional rating (AV) from Martindale Hubbell.

A federal district court recently entered summary judgment against a dry cleaner on a property owner's CERCLA[1] claim for past response costs and declaratory judgment claim regarding future response costs, and allowed the property owner's RCRA[2] claims to proceed to trial in Forest Park National Bank & Trust v. Ditchfield, 2012 WL 3028342, Case No. 10-C-3166 (N.D.Ill.July 24, 2012).

In 2009, a bank foreclosed on residential property that shared a boundary with a dry cleaning business that had operated for 35 years and had substantial tetrachloroethylene, also known as perchloroethylene or perc, soil contamination. Had the bank performed due diligence and searched Illinois EPA's online database before foreclosing on the property, it would have discovered that the dry cleaner voluntarily entered into EPA's Site Remediation Program 5 years earlier, in 2004. Instead, after foreclosing on the property, the bank hired an environmental consultant to conduct an environmental assessment of the eastern portion of the residential property closest to the dry cleaner.

The bank's consultant discovered elevated perc levels, as high as 33 parts per million (ppm) in soil and 0.26 ppm in groundwater, and concluded that the onsite contamination resulted from releases from the dry cleaner. A follow-up investigation at the dry cleaner found perc contamination up to 14,000 ppm in the soil beneath the business. The dry cleaner's consultant determined that the perc contamination in soil was about the size of a football field – 270 feet long, 90 feet wide, and 10 feet deep, with the most concentrated point having a perc concentration of 360 ppm and being 30 feet long, 20 feet wide, and 2 feet deep. The dry cleaner's consultant's figures indicated that the western edge of the contamination may have crept over the dry cleaner's western property line and onto the residential property.

Despite the dry cleaner's efforts to keep the matter within EPA's Site Remediation Program, USEPA became involved when a teacher at St. Luke's church and school, located across the street from the dry cleaner, emailed her concerns to USEPA. USEPA conducted indoor air testing at St. Luke's and a nearby children's gymnasium. The Agency for Toxic Substances and Disease Registry (ATSDR) became involved and recommended follow-up testing. Eventually, ATSDR recommended that the dry cleaner install a vapor mitigation system at the nearby children's gymnasium because its indoor air perc concentrations exceeded the long-term screening limit of 0.60 ppb established by OSWER's Draft Guidance for Evaluating the Vapor Intrusion to Indoor Air Pathway from



Source: EDR Radius Map Report

1 The Comprehensive Environmental Response, Compensation, and Liability Act.

2 The Resource Conservation and Recovery Act.

Groundwater and Soils (Nov. 2002).

The bank was not so fortunate. Sub-slab sampling at the bank's property only showed a residential long-term screening level exceedance for methylene chloride (another solvent used in dry cleaning) in the subsurface vapor of the building at 212 parts per billion. ATSDR concluded that since the residential property was vacant, there was no completed exposure pathway. However, ATSDR also concluded that the residential property should not be occupied until there is further site characterization to evaluate exposure from potential vapor intrusion. The court noted the "Catch 22" presented by the parties. On the one hand, the house could not be occupied until further indoor air sampling was performed, but further indoor air sampling could not be performed until the house was occupied or getting ready to be occupied (because of the need for the house to be at the proper temperature with the air conditioning or furnace running as if the house was occupied).

The owner of the dry cleaner and USEPA entered into a settlement agreement pursuant to § 122 of CERCLA. Under their agreement, the owner of the dry cleaner was required to perform remedial measures at the site and pay almost $40,000 of the nearly $150,000 USEPA incurred in past response costs. The "site" was defined in a way so as to not include the bank's residential property.

Having been left out of the administrative resolution, the bank filed a complaint against the dry cleaner and its owners in federal court, asserting claims under RCRA, CERCLA, and state law. One of the most interesting parts of the court's decision concerns the bank's claims asserted under RCRA 7002(a)(1)(B), 42 U.S.C. § 6972(a)(1)(B). Under that section, a person may file a citizen suit

> *"against any person … including any past or present generator, past or present transporter, or past or present owner or operator of a treatment, storage, or disposal facility, who has contributed or who is contributing to the past or present handling, storage, treatment, transportation, or disposal of any solid or hazardous waste which may present an imminent and substantial endangerment to health or the environment."*

The court noted that this subsection was added to RCRA by Congress in 1984 to create a basis for citizen suits against RCRA past violators where the violations were so egregious that their effects continued to pose a serious threat to human and environmental health. Under RCRA, a court may enter an order imposing injunctive relief, but may not award money damages, except that it can award to the prevailing party or substantially prevailing party costs of litigation, including reasonable attorney and expert witness fees.[3] Here, the bank hired an expert who concluded that the perc contamination at the residential property presented an imminent and substantial threat to both human health and the environment. The parties moved for summary judgment on the RCRA and CERCLA claims, which the court addressed in its 43-page order.

The dry cleaner raised numerous defenses, i.e.,

- it argued (unsuccessfully) that the bank lacked standing to assert its RCRA claims, which the court denied because the contamination amounted to a trespass onto the property sufficient to support standing.
- it argued (successfully) that RCRA 7002(a)(1)(A) claims, asserted under 42 U.S.C. § 6972(a)(1)(A), precluded claims for "wholly past" violations, which the court granted to the extent the claim was based on the "physical presence of contamination" in the environment because the evidence showed that the past owners "indisputably terminated the violating conduct" that caused the past releases years ago even though the past conduct resulted in the continued presence of perc at the site. (The court did not acknowledge the vast majority of cases that have found "ongoing violations" when contamination improperly discharged to the environment is capable of remediation and is not remediated. Courts have reasoned that if citizen-suits were barred merely because any illegal disposal was completed before it might reasonably be discovered, violators would have a powerful incentive to conceal their activities from public and private scrutiny, which would lead to serious problems in the public and private enforcement of environmental laws.)
- it argued (unsuccessfully) that RCRA 7002(a)(1)(A) claims for ongoing violations of Illinois regulations relating to the storage and disposal of hazardous waste, which required the dry cleaner, in part, to maintain records for the removal of drums of waste, submit annual hazardous waste reports to IEPA, draft and maintain a written closure plan, and operate the dry cleaner in a manner to minimize unplanned releases of hazardous waste, required judgment in its favor. Because the defendants countered with evidence that they have been in compliance with applicable regulations since 2002, the court held that the bank's claims survived summary judgment "only insofar as it is based on Defendants' alleged violations of Illinois regulations requiring them to properly label drums, maintain hazardous waste manifests, submit annual reports, and develop a written closure plan."
- it argued (unsuccessfully) that the CERCLA § 122 settlement acted as a jurisdictional bar under CERCLA § 113(h) to prevent the court from entertaining the bank's claims, which the court rejected because "There is no evidence that this litigation is delaying or will delay the completion of the ongoing cleanup action. To the contrary, the evidence suggests the [bank's] suit seeks to jump-start a nonexistent cleanup action."
- it argued (unsuccessfully) that the citizen suit provisions of RCRA 7002(a)(1)(B), 42 U.S.C. § 6972(a)(1)(B), provided no relief because the bank had no evidence that the dry cleaner "contributed to" any contamination at the residential property, which the court rejected as "border[ing] on the frivolous."
- it argued (unsuccessfully) that there was no evidence to support the RCRA 7002(a)(1)(B) claim of an "imminent and substantial" endangerment to health or the environment, which the court rejected finding that the issue had to be resolved at trial because "imminence does not require an existing harm, only an ongoing threat of future harm with the key words on RCRA 7002(a)(1)(B) being "may" and "endangerment" as RCRA 7002(a)(1)(B) creates liability where a defendant "contributed to" the handling of a hazardous waste "which may present an imminent and substantial endangerment."
- it argued (unsuccessfully), possibly because of the short shrift given the argument, that the bank's CERCLA claims would not allow the bank to recover its almost $5,700 in investigation costs. The court also held for the bank on its CERCLA claim for future response costs. The defendants could have argued that the bank failed to comply with requirements of the National Contingency Plan.
- In addition to the legal nuances under RCRA and CERCLA, the opinion is worth reading because of the detailed explanation of how transfer unit

3 RCRA § 7002(e), 42 U.S.C. § 6972(e).

dry cleaning machines worked compared to modern dry-to-dry machines and how past efforts used to capture and reuse spent perc and capture perc vapors operated.[4]

Implications for Lender Due Diligence

The facts showed that the bank did not do any environmental due diligence before either taking on the loan in 2007 or foreclosing in 2009. That isn't to say, however, that the bank did not know about the nearby contamination at the dry cleaning business. The bank's vice president testified at his deposition that the bank simply did not order Phase I's for residential properties, even though in this case, the bank knew that the residential property was next to commercial property (the long-standing dry cleaning business) and the commercial property was in Illinois EPA's Site Remediation Program. One could conclude from the deposition testimony that the bank had a lackadaisical attitude toward environmental due diligence. The bank's vice president testified as follows:

> ***"We had no knowledge that the ... property was contaminated, and it was security for a loan.... We never intended on owning [it]. It was just security, collateral, and it was a residential piece. So ... the environmental concern really didn't factor in."***
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> ***~ (Forest Park National Bank & Trust v. Ditchfield, Case No. 10-C-3166 (N.D. Ill), Docket Entry 105-3, Deposition Transcript of Forest Park National Bank & Trust by John A. Vainis, dated May 9, 2011, p. 89.)***

Had the bank performed environmental due diligence before making the loan, it would have discovered that in May 2006, Illinois EPA rejected the environmental consultant's characterization of the contamination at the site as inadequate. Had the bank performed environmental due diligent before foreclosing, it would have discovered that as of 2009, Illinois EPA had still not approved the site characterization. It appears that the bank was instead focused on other numbers. At foreclosure, the property had been appraised at $429,000, while the bank was owed approximately $405,000. After deciding to foreclose, the bank found itself having to also decide what to do with the contaminated property. By not doing due diligence on the front end or prior to foreclosure, the bank essentially bought itself a lawsuit, incurring tens (if not hundreds) of thousands of dollars in legal and consultant fees and expenses.

The good news for the bank, though, is that it should be able to recover its costs under the Resource Conservation and Recovery Act ("RCRA") claim. RCRA is a strict liability statute that generally imposes joint and several liability on responsible parties. And, RCRA provides injunctive relief to order a cleanup and damages to pay for the attorneys and consultant fees and expenses. Alternatively, if Illinois had more favorable treatment of the "pollution exclusion," the bank might have been able to pursue an insurance claim (as an additional insured) against the mortgagee's insurance policy to pay for the cleanup and investigation costs.

NOTE TO READERS: EDR Insight wishes to thank William Wagner for contributing to this Technical Brief.

4 The court noted that testing at a nearby restaurant "demonstrates that it is possible for indoor air samples to register threatening exceedances even where sub-slab samples do not." There was no discussion whether indoor background sources of contamination were properly considered and excluded from the analysis.

Questions or comments?

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