THE IMPACT OF TOXIC LIABILITY ON AGRICULTURAL LENDING: A WORKING SYMPOSIUM

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A WORKING SYMPOSIUM

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Preface

This volume contains the proceedings of the symposium entitled "The Impact of Toxic Liability on Agricultural Lending" held on July 26, 1990 in Fresno, California. The symposium was sponsored by University of California Cooperative Extension and the UC Agricultural Issues Center. It was attended by agricultural lenders, farmers, consultants and researchers.

The purpose of the symposium was to bring together members of the agribusiness community to exchange information about potential liability with respect to toxic cleanup of agricultural properties. These proceedings include information presented at the symposium through the formal presentations and the question and answer periods.

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University of California

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THE LEGAL PERSPECTIVE

Steve Bloom – Attorney, Frandzel and Share

Legislation and litigation case studies concerning hazardous waste and the corresponding responsibility for clean up undoubtedly will impact agricultural lending well into the 1990s and beyond. Creditors feared the specter of lender liability during the 1980s, even up here in the agricultural community, but that pales in comparison to the potential devastation of environmental liabilities in the 1990s. The impact will be found in the cost of lending, the cost of monitoring loans that are made, the cost of diminished or lost collateral, and—possibly most devastating—the cost of clean up. Based on current trends, it is clear that the government is looking at lenders as the environmental police of the 1990s. Without your badge, your nightstick, and your gun, you may well be helpless against the toxic polluters on the one hand and the government on the other.

To give you an idea of what you may be facing in the future, a recent study by the EPA concluded that pesticides, drinking water contamination, and indoor pollution posed the greatest environmental risks to human health and that fertilizer and pesticide runoff from agricultural lands could have serious ecological implications for our future.

In California alone, we are using over 500 billion pounds of pesticides a year. We don't know where all those pesticides are going, but I can tell you that some are going into the water and some into the air. This poses a great problem for us in the future.

To date most of the toxic cleanup efforts have focused on the hazardous waste sites. You see in the newspapers almost daily some hazardous waste facility that is being cleaned up. However, in the future the focus may well move to the agricultural sector and to pesticides and toxic pollution on agricultural lands.

In fact, here in Fresno during the early part of this year, the city commenced an action against several large companies as a result of pesticides that the city claims got into its drinking water. The contamination has forced Fresno to close several of its drinking water wells and the city claims that it will be required to ultimately modify its water system. The action seeks $650 million in damages, a combination of punitive and compensatory damages. I dare say that most of your customers, be they in the agricultural sector or the business sector, would not be able to respond to that large a damage claim and instead, would head to the bankruptcy court.

Over the past 20 years there has been a proliferation, an alphabet soup, of environmental legislation. This includes The National Environmental Protection Act, The Clean Air Act, The Clean Water Act, The Federal Insecticide, Fungicide, and Rodenticide Act, and The Resource Conservation and Recovery Act. However, the statute that we are going to focus on today is called The Comprehensive Environmental Response Compensation on Liability Act of 1980 (CERCLA) as amended by The Superfund Amendments and Reauthorization Act of 1986. It is this statute and its statutory scheme that poses the greatest risk to agricultural lenders during the 1990s.

CERCLA covers in a comprehensive fashion the use and disposal of hazardous materials in business, agriculture, and other operations. It is designed to identify and
remedy hazardous waste problems through a combination of federal funds and cost recovery actions. It is the cost recovery action that you as an agricultural lender or you as a farmer or you as a business man would be concerned about.

The statutory scheme covers disasters such as the spill at the Love Canal, where there is immediate harm to the environment. Funds were used to assist in the cleanup of that problem, but the statutory scheme also covers long-term situations where the environment has been ravaged by years of neglect, improper dumping, and improper emissions. I would suggest that in the agricultural area, with the use of pesticides, fertilizers, and other chemicals, there has been a large dose of improper dumping and improper emissions and neglect. It is not necessarily deliberate, and may have occurred through a lack of knowledge, but the statute doesn't care. CERCLA makes liability absolute if you are violating certain ecological and environmental standards.

There is a need to raise revenue in order to put into place these long-term remedial programs. When CERCLA was first passed in 1980 it allocated only approximately $1 1/2 billion to clean up and most of that money was probably spent by the federal bureaucrats back in Washington. The 1986 amendment increased the allocation to $8 1/2 billion. Yet billions and billions of pounds of waste are generated on an annual basis; in California alone 500 billion pounds of pesticides are used annually. To the extent that damage is being done to the environment, the allocation is not nearly enough to accomplish the cleanup. It is estimated that the ultimate cost will be in excess of $100 billion.

One example is that of a Chevron refinery where cleanup is now under way. The cost to Chevron is estimated to be $1 billion spread out over 20 years. While it may be a cost of doing business for Chevron, for most other people it would be a road map to the insolvency courts. Most people (and banks) simply cannot afford this type of cleanup. Because of the costs associated with the cleanup and the lack of actual public funding, the government is looking for deep pockets to help pay for the cleanup recovery actions. CERCLA offers them the weapon to achieve this result, because its liability is far reaching.

CERCLA could be economically devastating to any individual, entity or corporation identified as a "potentially responsible party" or a PRP. This is because liability is apportioned without fault and on a joint and several basis. The government does not have to prove you were negligent in your conduct, nor does the government have to prove that you engaged in any intentional wrong doing. All the government has to prove is that the land you own or operate is contaminated or that the crops you produce have exceeded certain specified levels of safety, and you may be designated a PRP.

**Who Is Responsible**

The following are PRPs: 1) present owners and operators of property where an emission or discharge occurs; 2) prior owners or operators of a property when a discharge occurred; 3) one who arranges for the disposal of hazardous materials; and 4) one who actually disposes (the transporter) of hazardous materials. An agricultural lender, or any lender, could fall into any of the first three categories.

A lender can become an owner of property simply by purchasing the property, acquiring the property through foreclosure, accepting a deed in lieu of foreclosure, or from some other mechanism whereby the lender acquires title. Lenders can also become an operator of the property. Most lenders will say, "We don't operate property, we simply loan money. We allow the farmers, the business people, to do their business and we monitor what they are doing."

However, think about the situations where credit is going south and you have to make some decisions as to how to handle that. You get involved in personnel decisions, what bills to pay, what bills not to pay, who to hire, who not to hire, should a consultant be brought in, and so forth.
Those situations will move you beyond the scope of a lender and put you into the realm of an operator—with all of the corresponding liability that goes along with it.

Also, a lender can have liability as one who gets involved in arranging for the disposal of toxic materials. In this instance, we have seen situations where a lender has come on to the property because it has been abandoned. They look at the farm equipment or the accounts receivable or whatever else is going on and they take control of the property. In the course of doing their business they notice that there are drums, perhaps storing pesticides or other chemicals, and they realize that that this poses a liability and they decide to get that drum off the property. They then hire a company to remove the drums. In the course of disposal, if the drums are opened or spilled by the person who transports and removes the waste, the one who is involved in arranging for disposal will be a PRP and have liability.

Lenders (and owners) are not without hope because there are certain exceptions that have been carved out in CERCLA that would allow liability to be avoided. (Ultimately, though, these exceptions are few and far between.) First, if the emission or discharge is as a result of an act of God there is no liability. If the emission or discharge is a result of an act of war, you have no liability. Another exception is the "third party defense." You may be able to use the "third party defense" if all of the following factors hold: 1) a third party causes damage to your property, 2) you did not cause or contribute to the damage done to the property, 3) you do not have a contractual relationship with that third party, and 4) the damage could not have been foreseeable. Most lenders would not be able to use the "third party defense" against acts by the borrower because the loan relationship with the borrower is contractual.

**Two Exceptions**

The most relevant exceptions built into the Superfund law are the "innocent landowner defense" and the "secured party exemption." In order to use the "innocent landowner defense", a lender (or owner) must be able to demonstrate that he did not cause or contribute to environmental discharge or environmental damage and that he had no knowledge of the problem at the time he acquired the interest in the property. Also, the lender (or owner) must be able to demonstrate that in exercising appropriate inquiry he had no reason to know of the problem. It's the latter factor that is the catch because in determining the standard of appropriate inquiry the government will not only look to the specific lender, but also at all the other lenders who are similarly situated. That would be at the very least the California lending market and it may well be the nationwide lending market.

The government will take into account a number of different factors including the following:

1. The lender's knowledge or experience in the area. An agricultural lender is going to be deemed to have knowledge of good agricultural lending practices.

2. The price of the property compared to the market value. If the lender acquires property for $100 that generally sells for $1,000 or $100,000,000, the government is going to raise its eyebrows and assume that the lender knew something was up when he acquired the property.

3. Information about the property that can be obtained through a reasonable effort. In other words, the lender should be able to find out about prior uses of the property and prior owners of the property and the likelihood that there would be environmental problems on the property when he acquired it. For example, was this property a gas station, an auto repair shop, a paint manufacturing site, or something of that nature before you acquired it?

The government will also take into account the lender's ability to identify environmental problems when he inspects the property. If you are out on agricultural farmland and see mostly beautiful, lush green areas but also brown dirt where nothing will grow in some areas, you can assume that there is a sub-surface problem or that the
farmer has a bad watering system. In most instances, there is a problem underneath the surface—something has gotten in there that is killing off the greenery. The government will take that into account in determining whether or not the lender made an appropriate inquiry before acquiring the property. The end result is that in most instances agricultural lenders will not be able to avail themselves of the innocent landowner defense.

The final and main hope is that the lender will not have liability for cleaning up the collateral property if the lender only holds a security interest in it and does not become an owner or operator. Whether or not a creditor has become an owner or operator is the subject of litigation with a number of contradictory results.

Let’s assume for the sake of argument that you have been able to satisfy the government that you should not be liable—you are not a PRP. Does that mean that the property that you now hold as security is home free, that you are safe, and that you don’t have to worry about its value? The answer is no; because even if you are not directly liable, once cleanup has been concluded the government may be entitled to place a lien on the property for the cost of clean up.

In certain states, including New Jersey and Connecticut, they have what is called a super priority lien which means this lien jumps ahead of all others. We don’t have that in California and it is not contained in the CERCLA statutes but it’s certainly something that has been talked about in the legislature over the past few years. It’s possible that it will come up in the near future.

Moreover, in a bankruptcy context, which the EPA sometimes likes, you may find the lien of your properly perfected security interest second to the cost of cleanup through what is known as administrative priority lien. If the government spends money to clean up the property and its cleanup enhances the value of the property, the courts have in certain circumstances allowed the government to be given a lien that goes ahead of whatever liens exist on the personal or the real property. Therefore, in some instances you will find that your first lien has become a second lien and you are behind a forced loan that far outweighs the collateral value.

Richard Hart – Attorney, Frandzel and Share

Lenders, be it in the agricultural area or otherwise, are once again the designated policeman for government policy. You have adapted your credit criteria and your credit policies to take these new risks into consideration. There are great risks involved.

Over the past few years, lenders have developed policies and procedures aimed at minimizing the risk of environmental cleanup liability in their loans. These have been developed with an eye toward protecting the "secured party exemption" under CERCLA. That exemption says that as long as you are acting only as a secured party in the protection of your collateral, you will not be deemed a potentially responsible party under CERCLA. The "innocent landowner defense" has been minimized by people working in the area as being very difficult to achieve. But at least lending policies and procedures have been developed with the idea that if there is in fact an "innocent landowner defense" standard it will be met.

Over the past few years, lenders have developed environmental policies and procedures to meet the "secured party exemption" and the "innocent landowner defense. Lenders have developed questionnaires to examine borrowers, previous owners of property and that sort of thing—building a file to establish these defenses as they go along. They have also developed the alternative that in certain cases abandonment of the property may be a possibility when faced with an excessive threat of cleanup costs. We have also developed policies to avoid becoming what would be deemed to be an operator as a potentially responsible party in a cleanup action. In some cases we have even avoided taking a deed of trust on real property where
it really wasn't necessary to the credit, simply to attempt to avoid those kinds of problems. Very recently, however, two cases have come up which, if they become the law in the United States, will really call into question the comfort level that we are achieving with respect to protection against environmental liability.

The first of these is a federal court case out of the Western District of Pennsylvania called Guidice vs. BFG Electroplating and Manufacturing Company. This particular case involved an action by 28 individuals against various defendants including a bank who financed an electroplating company. The bank had been financing the electroplating company for a number of years. The company went out of business. The bank ultimately foreclosed on its mortgage and became the owner of the manufacturing site of the electroplating business. The bank held that property in Other Real Estate Owned (OREO) for eight months and then got rid of it. Two and a half years later an environmental problem was discovered. Everybody had gone away — there was no deep pocket left except the bank. The result was that these 28 individuals ended up filing a law suit claiming that their health had been impaired by the wastes that were on the property.

The bank tried to get out on a motion for summary judgment but was denied, with the court holding that the bank had become an owner of the property because they held it during the eight month period. The court relied upon an original case called United States vs. Maryland Bank and Trust. It really is not the same because in Maryland Bank and Trust, the bank was, in fact, the titled owner of the property at the time the problem was discovered and investigated and remedial action commenced. It had owned the property for four years. Clearly (at least if the bank could not avail itself of the secured party exemption) it was a potentially responsible party as a current owner or operator of the property.

By the same test, the bank in Guidice would possibly have been a potentially responsible party if it was the owner or operator of the property at the time the contamination occurred. But at that time, the lending bank was nothing more than a secured lender. They owned the property only after the contamination ceased. So it's really difficult to fit Guidice into one of the potentially responsible party patterns that we have been trying to protect. What it may mean is that any owner or operator of a piece of property at any time after the contamination occurred, whether they contributed to it or not, may also be a potentially responsible party under CERCLA.

The Fleet Factors Case

The second case, which is even more amazing, has finally reached the Federal Appellate Court in the 11th District. In United States versus Fleet Factors Corporation, Fleet Factors is a lender that had been lending to a textile printing company secured by all of the receivables and inventory of the textile printing company. They also held a deed of trust on the contaminated site.

Several years ago, the textile printing company went into bankruptcy. Fleet Factors put in a receiver to liquidate the business on the premises and over time liquidated the inventory, collected the receivables and so forth. In the course of doing so, unfortunately, they got a little heavy with the removal of some equipment and did in fact create some asbestos problems. The real problem here is that there were a number of drums of waste material left on the premises when Fleet Factors finally moved out and abandoned the property.

The EPA came in, cleaned up the site, and then went after Fleet Factors for the cost of the cleanup, arguing that the company was either an owner or operator of the business. The court held that Fleet Factors was an operator of the business and in so holding greatly expanded the definition of an operator and "potentially responsible party".

It might be well to read something from the opinion itself just to show how far this court has gone to find this deep pocket lender liable for the cleanup costs. The court
referred to a case called U.S. vs. Mirabile which set up a definition for an "operator" which said, "the participation which is critical (to being an operator and therefore a PRP) is participation in operational production or waste disposal activities of the borrower. Merely financial ability to control waste disposal practices is not sufficient for the imposition of liability." That was the rule prior to Fleet Factors.

The court in Fleet Factors said,

Under the standard we adopt today, a secured creditor may incur liability as an owner or operator without being an operator, by participating in the financial management of a facility to a degree indicating a capacity to influence the corporation's treatment of hazardous waste. It is not necessary for the secured creditor actually to involve itself in the day to day operations of the facility in order to become liable. Nor is it necessary for the secured creditor to participate in management decisions relating to hazardous waste. Rather, 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 if it so chose.

What does that mean? For example, if a lender collects a payment from the borrower and as a result of that payment the borrower is financially unable to haul off the hazardous waste to the dump, is that a degree of control which makes the lender an operator? Under the Fleet Factors case it is very unclear at this point whether the secured party exemption as an operator still exists.

The court went on to say, interestingly enough,

This ruling should encourage potential creditors to investigate thoroughly the waste treatment systems and policies of potential debtors. If the treatment systems seem inadequate the risk of CERCLA liability will be weighed into the terms of the loan agreement. Creditors, therefore, will incur no greater risk than they bargained for, and debtors, aware that inadequate hazardous waste treatment will have a significant adverse impact on their loan terms, will have powerful incentive to improve their handling of hazardous waste. Similarly, creditors' awareness that they are potentially liable under CERCLA will encourage them to monitor the hazardous waste treatment systems and policies of their debtors and insist upon compliance with acceptable treatment standards as a prerequisite to continued and future financial support.

This court seems to say two things. The first is that anything more than a very passive involvement in the operations and day to day business of the borrower will jeopardize the secured creditor exemption. In an agricultural context, of course, that is really not the conventional way of doing things. Agricultural lenders have traditionally set up a budget on crop loans, allocated loan funds as budgeted and kept a very tight rein over the activities of the agriculturalists. I think that is a prudent and businesslike way of doing things. What this court is saying is that, at least in an industrial context, you are damned if you do and damned if you don't. If you maintain your prudent business controls you are jeopardizing the secured party exemption and if you don't exercise those controls, you are jeopardizing your credit—which may make some other regulatory agency very unhappy.

Second, in Fleet Factors the court implied that there may be a duty on the part of the lender to monitor the compliance of their borrower to environmental laws and regulations. The court didn't come right out
and say so but that seems to be an implication. How you monitor compliance without, at the same time, jeopardizing the secured party exemption by becoming an operator the court didn't say.

Those are the new things that are out there and you have to factor them in to your environmental policies and procedures and requirements. The net result is going to be to increase the cost of borrowing and the risk faced by lenders. I'm not saying that we should abandon the procedures that we have worked so hard to get installed; but, I think we ought to take another look at them in connection with these cases. We are just not as confident that we have done the degree of homework that we need to.

**Additional Comments**

**Steve Bloom** – Let me just add one thing in respect to Fleet Factors. Even Congress was concerned about what the Court of Appeals did in that case. At the end of June legislation was introduced by Senator Garn of Utah to drastically limit the broad impact of the ruling in that case. I think there were hearings scheduled for some time in July. Obviously, the legislation has an uncertain future. Other legislation has floated around Congress trying to give lenders an additional level of protection. You should be aware that there are people in Congress who actually care about what happens to lenders and are trying to make the environment a little bit better for them.

**Richard Hart** – There are some other legislative things going on. One is legislation at the federal level in recognition of the secured party exemption which, although it was slowed down by Fleet Factors, is apparently alive and well. More than half of the house has now endorsed the La Falce amendment which might take care of that problem federally. There are also things going on in California the preservation of the anti-deficiency laws in connection with real property.

One other point that Fleet Factors, although they had a deed of trust to real property as part of their security, never exercised their rights under that deed of trust and in effect abandoned the premises. That raises two questions in my mind. First of all, is the option of abandonment still a viable option after Fleet Factors? And second, do you have to have a security interest in the real property in order to become an operator?

Let's suppose you make a crop loan to a borrower, you hold absolutely no interest in his real property, and a contamination problem is discovered: the EPA or somebody pays the cost of cleaning up the property and starts looking for people to contribute. They find the bank that financed this particular landowner either unsecured (well, unsecured would be pretty hard to get to) or let's say secured by all of the personal property assets of that borrower and exercising the kind of control over those assets that might bring them within the non-exemption category carved out by Fleet Factors. Could a court find, in spite of the lack of real property collateral, that the lender is a potentially responsible party and therefore liable for the costs of the cleanup? It's a possibility.

**Question and Answer Period**

**Q.** Even in light of Fleet Factors, is there anything in underwriting documentation that a bank can do to protect itself?

**A.** Yes, there are lots of things that can be done in the underwriting aspect. One is to keep doing what you are doing now. That is, require documentation before you get into the loan establishing policies and procedures. You can revise your environmental assessment policies. You can put indemnification language in or strengthen your indemnification language. But I think basically you have to take a harder look before you get involved with this credit. I don't know what you do with a credit relationship that is ongoing over time but at least you can strengthen these things. I am not saying that the things that you have been doing in the programs you have developed in this area are bad. We can't give you a real
strong comfort level that they are going to do you any good, but you have to keep doing them.

If you are trying to comply with what the court says in Fleet Factors, you are almost left with: I will make you a loan, you will sign a promissory note, and you will pay it back. If you put in normal representations and warranties and covenants and agreements and indemnities, perhaps you have moved into the area where you have the ability to influence. But practically speaking, you cannot eliminate that type of documentation because there is a risk to you if the loan goes into default. You need the ability to control and to monitor and to recover on a credit.

The real protections to a lender will be not in the underwriting documentation but in the underwriting review—assessing the credit risk, doing the environmental audit, doing the risk assessment, learning about the property, learning about the borrower, and fashioning the credit. That is the level where you have the best ability to control your liability to environmental laws.

Specifically, if you recognize that the secured party exemption may not be there, and if you recognize that there may be a duty or something close to a duty to monitor the compliance effort, then you can structure your loan documentation to include things like a right of access to the property, a right of inspection, a reporting system in which the borrower reports to the lender periodically the scope of the borrower's compliance. You can monitor any complaint or action against the borrower. So at least you build into your loan documentation the ability to do what you have to do and the systems necessary to accomplish that.

A. No. The request for rehearing was denied on June 28th. The lender has filed for review of this case in the United States Supreme Court (September 21, 1990).

Q. If a licensed disposal service is used, does your liability continue for the life of the toxic waste? Is the waste still yours?

A. The waste is still yours. The waste is always yours. I don't know what the life of the toxic waste is but I believe your liability goes on forever on toxic materials. If the waste is disposed to a licensed regular disposal site and something happens over there and they can identify that waste as yours, you are still liable for it. But once it gets to the dump site the liability becomes proportional.

Q. Is there a court case that limits the liability of a lender who forecloses and then immediately sells the property?

A. Yes, that was the Mirabile case. In that instance a peculiarity of the state law was involved. There was a lender who held a security interest in certain real property. They foreclosed within two or three months, not having actually acquired the title or taken the final steps to acquire the title. They transferred their successful bid to a third party and during the subsequent law suit the court concluded that the lender did not have liability as an owner because its foreclosure process was merely a continuation of the security interest that it held and was not actually a true ownership. Based on what has happened with Fleet Factors and another case that goes in a different direction, the likelihood of that court holding withstand scrutiny throughout the United States is probably not too substantial. There will have to be, I think, help from the legislature in order to protect lenders.

There was some very emotional testimony before the House of
Representatives on the La Falce amendment. The speaker was the president of a bank in Idaho who had liquidated a post and pole manufacturing business. As part of the liquidation process they held a deed of trust on the property. They originally took a deed in lieu on the property but never recorded it and when the contamination was discovered, the bank released or reconveyed the deed in lieu. The EPA is trying to hold them responsible even though that deed of trust was never recorded. In that particular situation it was approximately a $60,000 ongoing line of credit relationship between the bank and the borrower. The cleanup bill on the site was something like $800,000 which was as much as the capital of the bank.

Q. What defense is available for a bank if it purchases some property, complies with the due diligence, and then later find some sort of off-site source for contamination?

A. If there is an off-site source of contamination such as from a neighbor or something else in the vicinity you may be able to avail yourself of the third party defense because you are not in a contractual relationship with the person who is causing the off-site problem. You have now solved the problem that most lenders have when they are dealing with their customers and then you look to the other two factors—whether or not it was foreseeable that this would occur and whether or not you caused or contributed to any aspect of that problem. I think a really interesting part of that is the groundwater problem coming from adjacent property. The source point of that groundwater problem is the one that is going to have to pay the cost of cleaning it up. But suppose there is nobody there and you still have to clean up your property. How do you protect the property from future problems?

Q. Do you foresee an adverse situation in that the borrower may create an environmental problem to eliminate the lien interest or diminish the lien interest of the lender?

A. That's the shiny carrot theory—the guy who calls up his banker while the banker is on his way down to the foreclosure sale and says, "Oh, Charlie why don't you stop by the house and see this glowing, seven foot long carrot in my back yard?" Can they either stall a foreclosure or work out some kind of a compromise based upon a claim that there is a problem with the underlying property? I guess, yes. It's almost akin to a murder/suicide because the borrower is the one who also has liability for what he does. He has to have made a conscious decision that he would rather destroy his land than allow the lender to recover on the loan. Some borrowers probably think in those terms but most do not want to go quite that far.

Suppose a borrower were to create a problem out of spite and then he was going to go through a bankruptcy, an individual going through a chapter 7, a corporate reorganization or something. It is possible that if the lender subsequently foreclosed and acquired the property that the lender would have liability for it. But you have to assume that at that point the borrower will be out of business. I think what might be relevant is that a modification of the California One Form of Action Rule is now making its way through the state legislature. There would be in effect a waiver of the One Form of Action Rule under certain circumstances in that case.

Q. Can you foreclose on only part of the property?

A. I don't think you can because you are going to have some illegal lot splits going on and you cannot as a lender pick and choose if you have a whole parcel of property. You can't pick and
choose within a specific piece of property but when you have multiple parcels involved there should be no reason why you cannot foreclose on the clean parcels and not foreclose on the dirty parcels. Yes, abandon the dirty parcel. You could try to reconvey the dirty parcel back to the borrower but you may not be able to reconvey the real property under existing California law.

Q. What if you have a deed of trust on a property, and you find out it is contaminated and you decide not to foreclose? Isn't it true that the borrower doesn't have to accept a reconveyance?

A. Until you foreclose on that property, you would not necessarily be the owner. You might become an operator for some other reasons, but the situation we were talking about here is a deed of trust situation where you don't want to foreclose, so what you try to do is to reconvey it back to the borrower. You are right that the borrower does not have to accept the reconveyance but you are not obligated to complete the foreclosure. I have seen situations where the property was abandoned by everybody and basically the state got stuck with it through a tax lien sale. So you should be okay as long as you don't make a conscious decision to complete the foreclosure on the dirty property.
LEGISLATIVE UPDATE

Maurine Padden - California Bankers Association, Sacramento

At the top of our legislative program for the last two years—and certainly a vehicle that is moving this year—is Senate Bill 1843, authored by Senator Art Torres out of Los Angeles, a Democrat who is Chairman of the Senate Toxic Committee. We drafted the legislation to address the unique problems of lenders related to the One Form of Action Rule in California\(^1\) which applies to both commercial and residential property. California is only one of about four states in the country that faces the lender with a very unusual Hobson’s Choice\(^2\) when a borrower defaults on a loan for which the collateral includes toxic contaminated property.

The bill does three things. First, it clarifies existing law, permitting the lender to enter and inspect the property for purposes of investigating suspected contamination or conducting an environmental audit—without violating the One Form of Action Rule. Permission has to be given by the landowner, but reasonable notice has to be given to the landowner by the bank. There are other special provisions in the bill to ensure that we are not going to violate anybody’s rights. In fact, the counsel that we are giving now is that even if the bill passes in its present form, if there is any kind of objection by the landowner, you should try and get a court order to enter the property. But we do have the inspection right in the bill.

Second, it clarifies existing law to permit the lender to enforce equitable remedies such as asking the court to appoint a receiver or requesting that the court issue an injunction to prohibit contamination, whether there is threatened contamination or continuing contamination—again, without violating the One Form of Action Rule.

Finally, and most controversially, SB 1843 would allow enforcement of environmental warranties, representations, and indemnifications\(^3\) that may be given by the borrower at the time the loan is made as to the condition of the property and the use of the property. This particular provision originally was going to be clarified to say that the lender could enforce those warranties without violating the One Form of Action Rule. However, because there was continuing negotiation at this point, in its present form the provision does not allow the lender to avoid the One Form of Action Rule and sue directly. The lender is only permitted to enforce those environmental warranties and representations to the extent that he is found liable for the cleanup costs or for liability he may incur as a result of claims of third parties who were injured by the contamination.

The Assembly Subcommittee on the Administration of Justice will hear SB 1843 on August 7, 1990 and the full committee, which is the Assembly Judiciary Committee, will hear the bill on August 8, 1990. This is the final policy committee hearing on the bill.

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1 The One Form of Action Rule is California Civil Code Section 726 and California Code of Civil Procedure 580 A, B and D. It is also referred to as the Single Action Rule. It requires a lender with a security interest in real property to look to the property first for recovery of the debt.

2 An apparent freedom of choice with no real alternative.

3 Contractual agreements, statements made during the loan process or other promises that are written or oral.
before it goes to the Assembly floor. At this point, we have not had any kind of significant opposition that has not been dealt with a compromise reached. The bill passed out of the Senate 38 to nothing and we expect to have it passed by the Assembly and on the Governor's desk by the end of August. 4

On the federal front, we have legislation that we are actively co-sponsoring. The Garn and LaFalce bills deal with the "secured creditor exemption" present in CERCLA. This exemption has been significantly eroded due to the court cases mentioned by Dick Hart (Legislative Update), U.S. versus Fleet Factors Corporation, in particular.

The LaFalce bill currently has 260 co-sponsors in the House and it is expected to be set for its first hearing later this year. The Congressman from the East Coast feels that we have to significantly add to the definition of a secured lender in order to protect lenders when they are not trying to exercise any control over the property, but for whatever reasons, the courts are finding them liable. We expect that bill to move by the end of this year.

It is significant that the whole issue of funding for CERCLA and the Environmental Protection Agency as the enforcement agency for CERCLA is coming up next year in Congress. The California Bankers Association in conjunction with the American Bankers Association is trying to push the LaFalce bill this year so that it does not become a bargaining chip when the very controversial issue of refunding the CERCLA law comes up next year. We anticipate that the bill will move due to the number of co-sponsors that we have. Almost the entire California delegation has signed on in support.

These are the legislative approaches that California Bankers Association is working on, in recognition of the fact that we are increasingly finding our members on the hook when they are not exercising either management or control over property used as collateral on a loan. They are only protecting their security interest in the property and yet they are found liable as operators.

Question and Answer Period

Q. Has legislation been introduced in other states or in California to provide some sort of statutory protection for court appointed receivers who are operating the property?

A. To my knowledge there is no state legislation on that particular issue. I assume that is going to be a very hot issue that should be addressed but at this point it is not. In fact, the only statutory protection we are seeing in California is the desire to exclude or exculpate state and local agencies from liability for properties that they may be dealing with. We've got about 10 bills winding through the legislative process right now on that—but certainly not on the receiver issue.

Q. Would SB 1843 affect existing loans or only those created after passage of the bill?

A. That is a key issue that is being addressed as we speak. Originally, as drafted, the intent was to apply SB 1843 to existing loans. Therefore, the environmental warranties and representations that the borrower may have made at a time before the loan was

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4 The vote on the Assembly floor, on September 28, 1990, was 39 to 29 defeating the bill. The California Farm Bureau, California Building Industry Association, The California Association of Realtors, California Commercial Council (Irvine, Inc. and Lincoln Properties, Inc.), California Housing Council and California Timber Association opposed the bill. Support came from California Bankers Association (Sponsor), Association of Life Insurance Companies, California League of Savings Institutions, and Western Farm Credit Bank. California Manufacturer's Association, Western Growers' Association and California Agriculture Council did not take a position. California Chamber of Commerce, California Department of Health Services and California Trial Lawyers Association removed their opposition.
entered into would be enforceable. If this bill in its present form is passed and signed by the Governor, it would allow the lender to enforce those warranties and representations that are given in loans today. I cannot say whether or not the bill will have retrospective application or only prospective application once it is in its final form and on the Governor's desk to be signed. It is one item that is definitely on the table for negotiation. This is my gut feeling that the bill will only have prospective application. Therefore, it will only apply to loans that are entered into after the operative date of the statute.
AGRICULTURAL LENDER RESPONSES TO POTENTIAL TOXIC LIABILITY

Moderator – Mike Fitch, Wells Fargo, San Francisco

We have heard the legal perspective. We have heard what the California Bankers Association is doing. There has been some allusion to what the American Bankers Association is doing. Now, I think it’s important that we talk about what individual banks and lenders are doing.

Our first panelist will discuss what bankers and lenders can do collectively. He serves as secretary of Security Pacific Bank’s Agricultural Committee. He’s responsible for monitoring government activities and economic trends that impact the bank’s ag loan portfolio. Most important for this particular presentation, he is a member of the American Bankers Association Agricultural Division’s Executive Committee—a key legislative and regulatory committee at the national level. He is also an ex officio member of the California Bankers Association Ag Lending Committee.

Vernon Crowder – Security Pacific Bank, Fresno

Dick Hart, Steve Bloom, and Maurine Padden covered a lot of the subject matter that Mike asked me to discuss—the new proposed legislation and even the court ruling on Fleet Factors. But I would like to continue talking about those and maybe give you a different perspective. I am a firm believer that reason will ultimately prevail. What you heard today is that everything is in chaos and you’ve got to be scared the sky’s going to fall in. You could walk away saying, "How can I lend to anybody, given these potential risks?" I hope to assure you that we still do have to do business. There are ways to minimize your risk. I believe that with conferences like this and also the information in hand, maybe we can convince our politicians and in some cases our judges that appropriate changes are needed so we can keep on doing business.

Legislative Action

In that process, Art Torres’ bill has been working through—a second attempt to do this at the state level. When this bill went through we found that a great many of the people out there, the builders, the realtors, and people who are basically involved in borrowing, really do appreciate the importance of the Single Action Rule. They understand that it delineates their borrowing bases and strengthens their case with particular lenders. They see this bill as a potential threat to the Single Action Rule—and it clearly is.

One of the ways the Single Action Rule has benefitted us is that it has probably made us all better lenders. When you realize what your limitations are you do a better job in your research and your inquiries and making sure that you have crossed all your t’s and dotted your i’s.

Not only are the borrowers concerned about their borrowing base and how they might best work off competitive rates. The environmentalists are also asking: If lenders are exempt or have other recourse, then what is their incentive to make sure they are not funding hazardous waste sites or inappropriate business practices? They are looking at it from the angle of not wanting to encourage another S&L bailout. S & Ls is the popular word to alarm politicians now. The environmentalists’ point is don’t exempt
lenders because they will just lend on environmentally poorly managed property. This is the real fight that the ABA and CBA are dealing with. From the politicians' point of view, with the fiscal concerns in trying to balance the budget, there is a real question on the federal level of who is going to pay for all this.

Superfund funding will be coming up for review next year. Some money has been spent already, though obviously not as much as many people would expect. A lot of things that have happened over many decades that are going to cost a lot of money to clean up. The government is concerned that they don't have the money to do it. Frankly, they are looking to the rest of us, including the people who were involved in making that waste, to pay for it.

That's the government's perspective. Then, of course, we have our perspective of trying to continue doing business. Is it really fair to hold us responsible for something like, for example, the Fleet Factors case?

On a positive note, they have been granted a rehearing. The American Bankers Association has filed a friend of the court brief in the Fleet Factors case. It's unreasonable to expect all lenders, or anybody involved with a company, to be a policeman and intervene to stop how that company is doing business, in order to avoid potential liability. We are optimistic that the Fleet Factors ruling will be eventually overturned.

With respect to the La Falce and Garn bills, I'm not so optimistic that there will be change this year. Although the La Falce Bill has more than 250 co-sponsors, the information I get from the advocates back at the Hill is that many of those co-sponsors have signed on because they recognize the problem and they feel something needs to be done. But just because they co-sponsor a bill does not mean that they are supporting it as it is written. That bill has to go through the Dingell Committee, the Energy and Commerce Committee, and that's going to be one tough battle.

The La Falce Bill makes a change essentially in CERCLA, the Superfund. The Garn Bill, on the other hand, addresses the issues from the perspective of banking regulations because Garn is on the banking committee and that is the path he could take. The general feeling is that that probably won't be the proper vehicle. It will be something more like the La Falce Bill that does make the fundamental change in CERCLA or restores what we originally thought our exemption was in CERCLA.

The problem with CERCLA is that the "secured lender exemption" exempts lenders assuming they made proper inquiries or what we call at our bank, due diligence. As I understand it, and I am not an attorney, the courts have basically said that if a lender finds himself with a loan that is in trouble for environmental reasons then his due diligence was obviously inadequate. I certainly know some credit administrators who have 20/20 hindsight and I guess the courts share that. The thing that the courts are sorting out is how do you define adequate due diligence? This might be a two or three year process. I am not as hopeful as Maurine was that we can get this resolved before we get into the funding issue next year.

The American Bankers Association has come up with reference manuals. The most recent one is called "Agricultural Lenders' Guide to Environmental Liability". It was developed in large part because of the work of the Agricultural Executive Board for Ag Bankers at ABA. I think it is not only helpful to bankers but also to realtors and lawyers, to get a perspective of what bankers are facing. There is a series of articles from different experts, including lawyers and environmental engineers. I think the book will go a long way towards getting the banking community understanding this issue and then talking to their politicians.

We heard during the legal portion of the presentations this morning that the greatest protection we can have (not withstanding all the collective things we can do in the legislative, regulatory process) is through our own prudent loan policies and procedures. Now, we have a chance to talk to someone
who is directly involved in that process with Bank of America. He is the Manager of the Environmental Services Department of the bank. He is responsible for development and implementation of the bank's hazardous waste and toxic substance policy. Let me point out that this responsibility transcends agriculture. He is also responsible for the technical management of any environmental consultants that the bank might retain. And finally, he does hold a certificate as a Registered Environmental Assessor in the state of California.

Evan Henry – Bank of America, Los Angeles

I agree with Vern that the sky is not falling. I think the rafters may be straining a little bit but it certainly is not falling. What I consider the lender perspective is that environmental risk is part of overall credit risk. This is just another factor that goes into the ability of the borrower to repay a loan—like valuation of a piece of property. It's been thrust on the lenders as a result of various court cases and the federal Superfund legislation. I want to stress that I don't think this is the central issue in lending. It is an important issue but you shouldn't consider this the thing that is going to drive lenders out of the lending business.

There are two basic areas of risks due to environmental factors for a lender. One is the impact on the borrower's ability to repay a loan and the second one is the CERCLA liability. Under CERCLA, if you own or operate the property then you can end up having to clean up your borrower's problem.

When we talk about the impact on the borrower's ability to repay, environmental factors are generally a drain on the bottom line, his profit. There are not a lot of positive, tangible impacts. It ends up just as money out the door. It may be appropriate because the past practices were allowing him to get away cheaply and now he's paying for it.

For example, if the borrower has contaminated the soil with his underground storage tank or he has a small land fill out in back where he has dumped his 55 gallon drum containers of pesticides for five or ten years, then he may have cleanup liability under current regulations. If for some reason there is a third party liability because of the illegal or improper disposal of pesticides and he's affected a water supply, he now has to pay damages. If he's paying off cleanup costs then he may not want to pay back the bank.

I don't know whether or not it's hit in the agricultural community but it has in the industrial and commercial community. In Los Angeles County, the District Attorney's office is prosecuting environmental crimes very heavily and they have got a pretty good case load. They brag that they have a 98 percent conviction rate that sends the CEOs or managers of companies that were charged with the crimes to jail. They don't just get fines and a slap on the hand, they are actually sending them to jail. Obviously, a borrower faced with an environmental noncompliance is going to fix the noncompliance rather than pay back the bank, if it comes down to a choice.

The bank may have liability for cleanup as the owner/operator following foreclosure under Superfund law. You end up having to expend however many dollars it takes for the cleanup of the underground storage tank where the gasoline is in the groundwater table, etc.

A second aspect of liability which you may encounter, particularly in the area of portfolios, is what I call the marketability cleanup. The property may not be subject to a specific environmental problem that has to be cleaned up according to regulatory agencies, but you may have to remove that hazardous waste in order to limit your future liability and to find a buyer who is willing to take that property. The issue of asbestos is critical here. There is no statutory requirement to remove asbestos from a building on a piece of property. You could theoretically seal up the windows and doors and leave that building there forever and no one would tell you have to remove it— even if it's flaking off the ceilings and the walls and would cause a real problem to
anybody who would occupy that building. Obviously, if you seal up a building it’s not very saleable so you may have to remove the asbestos in order to get a buyer. Alternatively, if you know exactly what it would cost to remove, you may have to mark down the purchase price of that property when you go to sell it.

Data Acquisition

My job at Bank of America is primarily in the prevention end. A lot of my work has to do with how to assess the environmental risk. The first thing you need is data. How do you get that data and once you have it, who does the assessment?

There are a variety of data acquisition mechanisms whether you are talking about commercial or industrial lending, residential lending or agricultural lending. For commercial real estate lending, we are focusing on what is called Phase I Environmental Site Assessment (ESA). However, that is not necessarily used across the board in the ag lending community.

As part of an ESA you can have questionnaires filled out voluntarily by the borrower. This is one way that Bank of America gets information. There may also be appraisal inspections. Our appraisers fill out a small check list but it’s not their primary responsibility. In some banks there is much more responsibility on the part of the agricultural appraisers. There can be outside third party consultant inspections or the third party environmental consultants can do a full Phase I.

Problems may be identified during the Phase I that need additional investigation. For example, if you know there is an underground storage tank or there is a large area of stains from a diesel spill on the property or you want to find out whether or not a landfill is leaking, you may have to do borings. You may have to test for asbestos in the refrigeration building. There are a variety of physical tests. I’m not going to touch on exactly which ones are appropriate under which circumstances at this point, but I hope that over time there will be some conformity in the industry.

On a separate note I do want to mention that in May I hosted an informal luncheon of about 30 lending institutions talking with people in those banks who were responsible for this environmental risk assessment on their lending practices. We’ve developed a steering committee and hopefully over the course of the next year we will be figuring out the format for an informal organization that will primarily serve for information transfer.

The bankers I have talked to do not want to make environmental risk assessment a competitive tool: "You require an environmental study but he doesn’t, so I am going to go with him." We want to try and provide some conformity in the industry. This would also help in establishing the appropriate level of due diligence to have protection under the various laws and regulations.

Who assesses for the bank? Again, it runs the gambit. I think appraisers are responsible in many cases. Also the actual loan officers may end up being very educated on short term notice. Outside environmental consultants can be hired for your review. Legal counsel, inside or outside the bank, often gets involved. I think you will see a trend towards more and more lending institutions either designating a person within the bank who has some kind of environmental expertise as responsible for environmental risk assessment, or hiring someone with more formalized environmental background from the consulting industry or from the regulatory industry.

Most of the major banks in California are moving in the direction of hiring environmental staffs. Banks which actually have environmental staffs now include Security Pacific, Bank of America, Union Bank, and Home Savings and Home Federal on the S&L end. But there are many other banks that have people who are designated as responsible for this environmental risk assessment.
Ag Loan Considerations

I want to point out some things in terms of agricultural lending as compared to some of the risk assessments we do for commercial clients and real estate developers. One, you always have to consider that the application of agricultural chemicals, pesticides, herbicides, etc. is legal in most cases if it is done appropriately. There is no requirement for the testing and clean up of residuals on crop lands. In contrast, if you were developing a piece of ground for residential use, due diligence may require that pesticide sampling and analysis be done in order to make sure that there would be no long-term impact on residences—kids playing in the backyard, etc.

In regard to ag properties in general, we are not pursuing residues from a risk perspective at present. However, heavily utilized areas such as barns or crop dusting strips, where there may be a higher concentrated use of fuels or ag chemicals, may require testing.

Lenders cannot act as pesticide use police. We just can't go out there and monitor everything that everybody is doing and make sure they are doing everything right. You have to decide your own level of comfort from the beginning as to the risk and reward in doing ag lending.

The focus of these environmental risk assessments is on loans secured by ag real estate. I know a lot of people do crop loans and other loans not secured by real estate. There is a different level of due diligence for each one. There are also loans to some of the ag support functions such as food processing that we do not consider to be agricultural. They are more industrial. They may actually use different types of chemicals and whatever, so we try to separate them out from crop loans or livestock related loans. In addition, an ag chemical supplier would also be considered a commercial loan as distinct from an ag type loan.

In Bank of America the ag environmental risk assessment was previously tied into our overall policy on hazardous waste and toxic substances risk assessment as part of the commercial banking unit. We are now trying to develop what we call a subpolicy that is geared for the critical issues on ag lending. Some of our due diligence procedures may be a little bit different for ag loans than other loans. We are trying to make sure that we do conform to some of the secondary market requirements and we are considering the American Bankers Association attitudes on it in developing that policy.

Rory Robertson – Prudential Life Insurance, Sacramento

I have been asked to speak to you today about the procedures that Prudential's loan originators follow in order to manage our hazardous waste risk. I would like to preface this discussion by pointing out that our procedures were developed with the recognition that we do exist in a competitive market. Therefore, it is imperative that these procedures not be perceived by prospective borrowers as too expensive, time consuming, or otherwise onerous. With that in mind, before we make any type of real estate loan, foreclose on property, purchase property for our own account, or accept a deed in lieu of foreclosure, we will undertake an environmental audit that can incorporate as many as three different phases.

At the very least, all of these investments will go through a Phase 1 evaluation. The purpose of the Phase 1 evaluation is to document basic site information and to detect obvious misuse or potential contamination of the property. This evaluation is done by a person in my capacity, the investment manager, along with some help from the applicant or the property owner—and therefore it is inexpensive. We don't charge for our time to do this Phase 1 evaluation and it doesn't really take very much time.

The First Stage

A Phase 1 evaluation involves two different steps. The first is a physical inspection of the property with particular attention paid to those areas where, from our
experience, problems are likely to occur. There are seven areas that we particularly look for as we walk around a ranch or farm property. The first is crop dusting air strips. We are particularly concerned when they are used to load chemicals for a number of surrounding properties and not just the property we are looking at. Chemical spills in mixing areas are the second common problem area.

We also look for fuel storage tanks. Often people are more concerned with the under ground ones, whereas in my experience, major problems can also occur with above ground tanks. Usually you can actually see if they are leaking. We had one situation where a nice, big 10,000 gallon tank was solid as a rock except that the pump attached to it leaked like a sieve. We had a fairly major problem as a result of that, which was finally worked out.

Burn areas or landfills and electrical transformers, particularly those that might have PCBs in them, are also concerns. Oil and gas wells, which are fairly common in the southern part of the Valley, can be a concern. Lastly, midnight dumping areas, which is where people come on to a property and leave things without your knowledge, can also be a significant problem.

Many of our procedures were developed from a case a couple of years ago where we had taken a property back through foreclosure and found out afterwards that someone was burning electrical wire on the property, to salvage the metal. This caused an environmental problem that we had to clean up. The property happened to be located out on one of the islands in the Delta so it was close to surface water. It turned out to be a major problem—but we did develop these procedures largely as a result of that incident.

The second step, after the walk-through on the property, is an environmental questionnaire that we have developed with the help of a consulting company. This is a 16-page document with about 50 questions. It sounds worse than it is. Usually it takes about a half an hour.

The first category of questions concerns to the background and history of the property. For example: Were there any past uses of the property which could have caused environmental problems, such as mining operations, military bases, or oil and gas operations? I will point out that some of these, like military bases, might sound a little far-fetched, but actually I've run into almost all of these situations. I was involved in a property down in Arizona that was General Patton's desert training area during World War II. At the time we didn't think about all the junk around there. I think if we were looking at it today we might have treated it a little bit differently.

Another question would be: Has the property ever been tested for soil or groundwater contamination? An obvious question and many times people, especially property buyers, have already gone through some of these steps so it will save us some work.

The second category of questions concern regulatory compliance. The first would be: Do you have all the required permits to operate the property? The second would be: How is your hazardous waste disposed of? In this area, again, we are looking for answers that might raise a red flag. If the borrower is burying his pesticide containers, that's generally not the answer we would like to hear.

The third category of questions concern water quality. For example: Are there any evaporation or impoundment ponds located on the property? The second question might be: Have there been any problems with contaminated groundwater on this or any neighboring farms?

The fourth category of questions has to do with agricultural chemicals. We will go into quite a bit of detail about what chemicals are used and have been used in the past, how they are stored, and how they are disposed of. Again, we like to see fairly clean operations. We're obviously paying attention to the answers to these questions to see if
these properties have been managed the way we would like.

The fifth category of questions has to do with hazardous waste. Has the property ever been used as a landfill or dump? Have there ever been any spills of chemicals, fuel, or hazardous waste on the property? Do crop dusters land on the property?

The last category of questions has to do with storage tanks. Do they exist? Are they above or below ground? Are they registered? Have they been tested? Incidentally, if there are below ground tanks then we will require that they have been tested and that there is an existing record of the test. If not, we will make sure that a test is done before the loan is made.

In most cases, once we walk through the property, take a look around, go over the questionnaire and review the answers, that is as far as it goes. The Phase 1 is all you need.

The Next Stages

If, however, some of these red flags that we have talked about result in concerns, then we will proceed to a Phase 2. This is where the costs start to add up because generally it is conducted by a consulting firm. A Phase 2 involves a detailed historical search and site reconnaissance. Consultants will review historical data on the property, for example the chain of title, to see if somebody owned it who might have used it for a nonagricultural use. They will look at old aerial photos to see if there was any mining activity or the property was ever used as a dump. They look at U.S. Geological Service maps that might show if there was a mine located on the property. They interview neighbors and review permits that are on file. They also will do a more thorough site investigation. Obviously on some of these properties, you are looking at hundreds if not thousands of acres, and you cannot cover the whole property. You only look at areas where you suspect that there might be problems.

The consulting firm will then generate a recommendation as to whether or not further study is needed. If not, obviously you can go ahead and proceed with the loan. If they feel that there is a need for a Phase 3 evaluation and the borrower wants to pay for it and the lender is still interested in making the loan, then you can go ahead with the Phase 3.

The Phase 3 assessment is primarily a sampling and analytical task to confirm or refute any potential concerns identified in the Phase 2 assessment. This is where the consulting firm will go out, take the soil samples, check for hydrocarbons, and do all the various necessary tests.

Those are the due diligence considerations that we go through before making a loan to be sure that we are reasonably well covered. We don't often go past Phase 1.

Loan Provisos

Other than that, we have language in our loan conditions that is intended to help protect us. There are basically two areas. First, the borrower must sign an indemnity which will provide for personal recourse against him in the event of an environmental problem. Second, we ask that the applicant agree that we can periodically request reports certifying that the property is not being used for activities involving the use, generation, treatment, or disposal of hazardous materials. Further, that if they are found, he will have to clean them up and he will have to follow all the regulations in doing so.

We have had these procedures in place for about two years. I feel they have been effective in helping us detect potential problems. A number of loans have been applied for where we saw problems and we resolved them to everyone's satisfaction before the loan was made. In a couple of cases, we have turned down business because of problems that we didn't think could be resolved, but I don't think that we have yet lost business because of the procedures that I have described. As a result, I believe this procedure is protecting
our interests while not scaring away any business.

I am an agricultural economist by education and one of the old questions that you hear in school is, "What is the point of minimum cost production for a business?" Of course, the point of minimum costs is not to produce anything at all. That is not a very satisfactory solution for most businesses. I think we face the same thing here as agricultural lenders. The point of minimum risk is probably not to loan any money and not to buy any property, and that is not a feasible solution either. So we have tried to come up with a method here that allows us to stay in business.

Susan A. Olson, Western Farm Credit Bank, Sacramento

I would like to talk about our attempts to limit our liability on acquired properties. The first rule that we like to follow is don't acquire the property. That is said a bit facetiously, but I'm trying to emphasize the large extent of the liability that is posed when you acquire property.

The liability is threefold. The first is CERCLA liability. The major concern is that it is joint and several and that it is unending. The second is that if problems on the property are discovered after you have acquired them you are going to have a problem with disclosure. In other words you are going to have a marketability problem. The third concern which has not been mentioned, is that once you acquire the property as an owner you are responsible for complying with the myriad of environmental regulations that are out there. You have to start asking the questions: Do you have underground storage tanks? If so, have they been abandoned, and if so, have they been abandoned properly? If not, do they need to be permitted and if they have been permitted, are the permits current? Does the nature of the operation involve the use of chemicals? If so, are you using such things as restricted pesticides, and are they being properly handled? Do you store chemicals? If so, do you come within the Community Right to Know laws so that you have inventory problems and notice requirements? Do you have a lease situation so that you fall within the California requirements of giving notice to your tenant or vice versa? Is the tenant giving you notice of any hazardous waste problems? Do you have any Proposition 65 concerns?

Those are the three reasons why the first rule of thumb is not to acquire the property. The reality is, of course, that there are good reasons for acquiring properties. Then what steps do we take to try and minimize our risks?

Environmental Risk Procedures

Ideally, preforeclosure you have established the nature of any problems and their extent. If we have the cooperation of our borrower, we ask them to complete a Hazardous Waste Statement. This is an unfortunate name. Our environmental committee may have had attorneys and representatives from the credit department and the appraisal department and the acquired property department but we forgot the marketing department! So we are in the process of renaming our statement to be completed by borrowers from Hazardous Waste Statement to something less ominous like the Environmental Condition Statement.

If we have the cooperation of the borrower we have him complete this statement. If we do not have the cooperation of the borrower then we have the appraiser do a site inspection and fill out a form called the Hazardous Waste Supplemental Statement. If we are unable to complete this process preforeclosure, then we start this process once we have acquired the property. We have the appraiser do an on-site inspection again using that second form.

Based on that report, a ranking is done of high, medium or low risk. The significance of the ranking is twofold. First, it will aid us in determining what real estate sales contract we are going to use. We have three different contracts depending on the nature of the property; high, medium and low risk real estate contracts. Second, a determination is made as to whether or not to
hire an environmental consultant to do a Phase 1 and/or a Phase 2 audit.

We now have an employee at the bank who is going through the University of California's program at Davis to be our environmental consultant. That individual is assisting in making that determination of what level of risk exists on acquired properties.

The kinds of conditions that we feel justify a professional site assessment include such things as underground storage tanks, aboveground leaking storage tanks, dumps which contain hazardous waste materials such as pesticide containers or oil drums, irrigation ponds that discharge into known waterways or endanger underground water, holding ponds containing pesticide or other chemical residue, evaporation ponds receiving waste water from drain systems, drums or containers that are unmarked or unlabeled and contain unknown substances, and any that are leaking extremely hazardous materials such as PCBs or restricted use pesticides. If PCBs or asbestos or extremely hazardous materials were used on the property, or the operation poses significant liability such as a pesticide application business, then a professional site assessment may be required. Farms with extensively developed shops and storage areas, as in commercial industrial property, may also trigger an audit.

If we find any of these kinds of conditions then our procedures involve hiring a qualified outside consultant to either obtain a Phase 1 or Phase 2 audit. (We use prequalified consultants who have executed a master service agreement with the bank.) We have to decide whether to risk indefinite exposure for cleanup costs or to cut off such exposure by cleaning up the property prior to the sale. There are no hard and fast rules on this. It has to be done on a case by case basis.

With regard to the sales contracts, if we do elect to take the risk and not clean up the property then the sales contracts include full disclosure of the problem. We use three different real estate sales contracts. All three have "as is" paragraphs and full disclosure requirements. Based on recent cases in California, we are in the process of revising those contracts to eliminate the "as is". If a medium risk property is determined to exist, then the contract that we use includes a limited indemnification from the buyer. If a high risk contract is deemed necessary then it contains a full disclosure, including any audits that were obtained. The contract includes full indemnification of the buyer's use and seller's use if the property is cleaned up.

In order to minimize risks the most important thing is to know the condition of the property prior to acquisition. The second thing is hire knowledgeable consultants. Make sure your property managers and your environmental consultants are knowledgeable.

Two Examples

I would like to end by giving you a couple of war stories that will probably be illuminating. The first one involves a very large piece of property in a very remote area. It contained a leaking fuel tank. There were levels of selenium and DDT in the water but there was no drinking water or ground water concerns and no danger to the surrounding community. The levels of DDT and selenium were acceptable for agricultural purposes. However, if this were close to an urbanized area it would not have been acceptable for residential purpose.

As a general rule we attempt to clean up what we have a legal duty to do. However, if we don't have a legal duty then what we are doing is disclosing. In this particular case, it was probably over-disclosure on our part because it is probably going to be a hundred years before this area is ever developed for residential purposes. However, we did disclose the levels and we had the buyers indemnify us with no requirement that anyone clean it up. The county is aware of the site litigation plan and agrees with what has to be cleaned up for residential use but is not requiring any cleanup now. This property is worth millions of dollars and the estimated cost of
cleanup is $110,000. We have reduced the sales price by the $110,000. The buyers agreed to handle the cleanup and to indemnify the bank.

A second example happened back in 1987. We had a piece of property that was going into foreclosure. It was 160 acres which was predominantly a farm. It had an air strip and an ag chemical spray operation. The preforeclosure action included completion of the appraiser’s Hazardous Waste Supplement Statement. The astute appraiser noted that there was a 10’ x 20’ unlined pit which caught rinse water from pesticide containers, the plane’s holding tanks, and the plane. The soil was sandy loam and the groundwater table was at 50 feet. It turns out that this property was on the state Department of Health Services’ expenditure plan for the Hazardous Substance Cleanup Bond Act of 1984. So the state was aware of this one.

The indebtedness to the bank was $600,000 without taking into consideration the environmental concerns. The fair market value of the property was $600,000. We had a Phase 1 and Phase 2 audit conducted and the estimated cleanup cost was $500,000,000 if there was no groundwater contamination. We did consider taking the deed in lieu of foreclosure. However, we were faced with the question that was asked earlier: Can you convey part of the property and just retain and foreclose on the remaining clean property? We thought there was a big question mark and still do; but the reality was that this air strip was literally on the property line. There were two 80-acre parcels and the airstrip was right down the middle so there was probably going to be very difficult parcel split if we elected to go that route.

I attended a seminar where this question was raised. The response was that if you have to comply with the Subdivision Map Act, the county is probably going to require you to clean it up before they will grant a subdivision.

We did not go the parcel split route. The adjacent landowner wanted that property. We sold the property for less than $.50 on the dollar of our note. The neighbor purchased our note and apparently reconveyed the 80 acres of it which included the problem property and retained 80. So we never acquired the property and we took a hit on it. But there is no doubt in our mind or the bank regulator’s mind that this was the way to go on this particular piece of property.

Further Examples

I think these two examples are the easy ones. I want to give you two more. In the first, you’ve got a large piece of property and minimal cleanup costs. In the second, you’ve got a smaller piece of property but the fair market value is probably going to be exceeded by the costs of the cleanup. The first example is probably more typical of what you are going to run into, and it is more difficult.

The appraiser’s supplemental statement was completed prior to acquisition and noted that there were eight shut-in oil wells. There was a steam cleaning area with unknown contamination. There was a fuel storage area that had significant oil spills. There was an air strip with a chemical area which was not properly maintained, meaning that there was a sump which had been plugged up. A site investigation revealed cleanup costs of approximately $150,000 to $400,000 just for the oil cleanup operation. The fair market value was approximately $4,500,000 so the bank elected to foreclose.

What we have found out since the foreclosure is that the eight shut-in oil wells are leased to seven different oil companies, four of which no longer exist. We are currently in the process of assessing the liability of those three oil companies that are still in existence.

What we are learning (and we are not experts in this field) is that there is apparently a difference between shut-in wells and abandoned wells. If these wells are abandoned, the cost for abandonment will be between $8,000 and $12,000. Also, oil companies typically feel that leases are subject to oil field standards which apparently are very lax. Not only do we have a problem
with four of these oil well companies that are out of business but with those that are still in existence; we apparently are going to have an up-hill fight to find them liable. We have now requested a Phase 2 audit and are asking the environmental consultant to advise us concerning what should be cleaned up and what should be disclosed.

From the information that we had going in to the foreclosure, theoretically there is a lot of equity here. We'll see. Our recommendation is don't acquire these properties until you can quantify the extent of the liability.

The last example is not an acquired piece of property. It was in foreclosure. We had a receiver appointed and the receiver found that there was some contamination on that property. One of the duties of the receiver was to sell that property. The receiver stopped and demanded indemnification as soon as he found out that there was a problem on that property. We did not feel that it was proper for us to give the indemnification because the receiver was court appointed.

It took eight months before the property was sold. We never were able to resolve what the indemnification language should be. I bring that to your attention because I don't think it is going to be an isolated instance.

**Moderator - Mike Fitch**

Before we entertain your questions, I would like to outline what I have heard here. That will help us better direct our questions to the individual panelists. What we heard when Vern started out is that it is important that we view this whole thing as not a "sky is falling" situation. Indeed, ultimately reason will prevail and what we need to do as an industry is seek out solutions rather than just rolling over and saying, "This is just hopeless and we are helpless." Based upon my experience with the American Bankers Association in the mid 80s during the so-called farm credit crisis, I think it is essential that as an industry we come together and not "knee-jerk" this. Otherwise I am fearful we will be inundated with other counter-productive legislation which will restrict the availability of reasonably priced credit to agriculture.

Second, Evan indicated that environmental risk is just one risk in lending and certainly shouldn't supersede our whole risk management approach. It should be just one consideration, albeit a very important one. I also hope that you took note of the fact that he is highly involved in an informal organization for information transfer as it relates to environmental risk assessment.

Then, Rory gave us some very practical illustrations of the way Prudential is approaching this thing, indicating that they indeed have a pretty exhaustive questionnaire, (16 pages) that he is firmly convinced is needed. The implementation of that questionnaire is not as onerous as people would immediately assume. He indicated that Prudential has turned down business because of this concern but has not lost customers because they have required this type of a checklist.

Then finally, Susan gave us some real world examples of the practical aspects of what we confront. In the process she emphasized the extent of this liability when we acquire property. She also indicated it is important to have some preventive actions and to know what the problems are ahead of time, rather than waiting until it's too late and then acquiring property.

**Question and Answer Period**

**Q.** How long is your environmental checklist and what has been the borrower reaction to these types of questionnaires?

**A.** Vern Crowder - Our list isn't nearly as long as Prudential's. Of course, we are not a long-term solely real estate lender like an insurance company. But doing working capital loans, we do look toward the equity in the real estate as a potential secondary source of repayment. Our check list is primarily filled out by our appraisers when we go
out and do our original appraisal or validation of the budget from the borrower for their working capital line. We are basically asking the growers if they are in compliance. The reaction we have gotten from some of our customers has been, "I'm surprised that you haven't been doing this before."

**Evan Henry** – Bank of America has two questionnaires, one for loans secured by agricultural real estate and the other more for the working capital loans (the ones that are not secured by real estate). The former is eight pages and the later is abbreviated down to four pages. We ask many of the same types of questions, perhaps providing a little more leeway for the borrower to answer them. We have column answers: yes, no, do not know, and not applicable and then if yes or if no please describe type of things or please attach copies of reports, etc.

I don't know of any negative reaction to filling out the questionnaires. In some ways the effectiveness of our questionnaire is diluted in the situation where a borrower just goes ahead and says, "Do not know."

**Susan Olson** – We are in the process of revising our form; however, I don't we think it's going to be all that much longer. To the best of my knowledge when we started using this form about three or four years ago there may have been a little bit of reluctance by the borrowers to complete it. But now three years down the road I am not aware that there is any further hesitation by borrowers. I think they see the need for it.

**Mike Fitch** – I'm on the board of our subsidiary, Wells Fargo Ag Credit, that lends outside of California. I remember specifically at a board meeting questioning our president as he outlined a four-page environmental checklist that he is using and saying, "Larry, competitively can you really afford to confront a borrower with that?" He said, "Mike, competitively, I cannot afford not to confront them." We are dedicated to making sure that we are covering the bases.

**Q.** Is it the appraiser's responsibility to decide whether or not there is an environmental problem on a property?

**A.** **Evan Henry** – Appraisals are done on our residential real estate or our commercial industrial real estate. Recognizing that ag was a little bit different, we have told our appraisers to go out there with this one-page checklist and if anything comes up yes on the checklist it's going to be referred to an environmental consultant or be reviewed in-house. But it was not left up to the appraiser's own experience or judgment to say, "This is or is not a problem." They were merely there to make the observation. So from our standpoint if an appraiser saw spills on the ground regardless of the size it would end up being a yes on the checklist, clarified on the cover sheet, and then given to the account officer. It would then be in the account officer's bailiwick to determine in consultation with our internal environmental unit, my unit, whether or not that was considered a problem. That is where we perhaps differ from other lending institutions in that we have environmental expertise to make that judgement as opposed to having an appraiser who may or may not be comfortable with making judgements on those types of observations.

**Mike Fitch** – Evan, did I understand that essentially what you would do is take the determination away from the appraiser if he made a casual indication, you would then send out an environmental consultant to verify that? How would you respond?

**Evan Henry** – We do not say that appraisers should have to make a judgement but we place a very high value on their ability to make very clear...
and concise observations. We would have to rely on what the appraiser has actually seen because we don't think that it is economical to have additional investigation done unless the appraiser describes it as being a significant problem.

I do want to say that our whole system is geared towards the premise that it is the borrower's responsibility to illustrate to us that their site is in fact credit worthy and that they do not have significant problems. We will put the responsibility on the borrower to hire the consultant to illustrate to us that in fact those spills, minor or major, are not a problem. This is regardless of whether or not it is the appraiser, the bank officer, or my department that asks the question.

Rory Robertson - At Prudential our organization is a little bit different in that as the loan originator I also do the appraisal. But it doesn’t change the question at all. What you should keep in mind, however, is that I’m basically paid to make loans and I need to get the money out. If I look at a minor problem of a small amount of oil on the ground and I don’t feel that it is going to threaten the borrower’s ability to pay us back, I might make a notation of it on our questionnaire but we are going to go ahead and make the loan unless there are other, major problems.

Susan A. Olson - We follow Bank of America in that the appraiser’s responsibility is nothing more than to report what they have found. We view them as being the eyes and ears of the loan officer and the environmental in-house consultant. The only other recommendation we make to our appraisers is that they take pictures if there is any uncertainty as to the seriousness of what they are observing. So an appraiser is not asked to make any judgement calls.

Q. Do you ask additional questions of dairy operations with respect to runoff?

A. Vern Crowder - He must know that we have a large dairy portfolio. Since we all know that dairies have to do something with their excess water from washing and so forth, how do we inspect or determine if there is a problem? It is my understanding that all the regulations dealing with dairy runoff as a result of Proposition 65 haven’t been perfectly formulated yet. This is an area of concern to us and we are watching the regulations as they are being implemented. But right now all we do is ask that the dairy operator be properly permitted and that he comply with the known regulations as they currently exist. If he’s got waste water permits and a permit to operate in that county and he’s complying with all the current regulations that is all we can do. We are concerned in the long term about the dairies in particular dairy-intensive counties. Chlorine, for example, is one of the compounds for which the scientists and regulators are trying to determine the risk benefit ratio. That is going to come up in the future, but right now we just look for proper permits.

Q. In each of your institutions, who pays for the consultant investigations including Phase 1, 2, and 3?

A. Susan A. Olson - Theoretically, it’s going to be the borrower but undoubtedly we are advancing the monies for the report. If you are in a preforeclosure mode I think that it goes without saying that that is how it is going to be handled. It is just going to be added to the loan inquiry, whether or not it is recoverable.

Evan Henry - At Bank of America we have a very clear demarcation between lending and preforeclosure. In lending it is the borrower’s responsibility to hire the environmental consultant. We don’t want to be in the position where we have to inspect or develop data that would allow us to make representations or warranties or
know something about the property that could come back as a liability some time in the future. It is the borrower’s responsibility to know everything and anything about his site and tell us. In the preforeclosure situation we are, in essence, going to become the buyer of the property. And in that case the bank expends the monies.

Rory Robertson — In general, I would say it is the responsibility of the borrower. However, like almost everything else that we do, it is negotiable. If you are looking at a big loan and you see a problem that you think needs to be looked at and the borrower says, "I'm not going to pay for it," then you really want the business you might go ahead and pay for it. It's a business decision. But in general we feel it is the responsibility of the borrower.

Vern Crowder — We have standard language in our environmental representations and warranty language. That standard language calls for the borrower paying everything. I would like to make the point that the value of the representations and warranties in your loan documents are only as good as the amount of resources your borrower has. That is something you have to keep in mind.

Q. How many of you or your banks have actually been involved in litigation regarding contaminated properties and what's happened in that litigation?

A. Susan A. Olson — I am not aware that we have actually had any litigation per se over environmental problems, nor that we have actually had any environmental losses.

Evan Henry — I am not familiar with some of the cases but I will say that Bank of America has its share of environmental litigation going on both in the ag end of things as well as non-ag. One thing that may be looming on the horizon is that a purchaser of a piece of property is trying to sue over nondisclosure at the time subsequent to us owning the property and having done a cleanup. I don't think he has a very good case but it is something that is a concern in terms of foreclosing on property, owning or operating it, cleaning it up, having all the appropriate signoffs and still being faced with potential future liability, rightfully or wrongfully just by virtue of having been in the chain of title.

Q. Mike Fitch — Evan let me ask you, are you aware of any third party type suits? It seems to me not long ago I read about a suit against a property owner and in turn a lender because of a contamination problem. The adjoining property owner felt that his property had been devalued as a result of the contamination and he was suing as a third property. Have you ever heard of anything like that?

A. Evan Henry — I haven't heard specifically about that but I would say it is well within the realm of possibility.

Rory Robertson — I don't know of any litigation off the top of my head.

Vern Crowder — I am not aware of any involving agricultural properties, it is very possible. We have had some cases where growers have had minor cleanup problems and, of course, any loss to them has been a loss to us. But we have never actually been in litigation.

Mike Fitch — Vern, I am going to ask you to begin answering this one, then I will ask each of the panelists to react as well because I think it is extremely important as an industry that we are together in this assessment. Actually, there are two questions. I am going to read both because they have a little different slant, but the same fundamental thrust.

Q.1 What may be the long-term impacts on farmers and agriculture in general in
terms of, first, increased costs due to reduced availability of chemicals, pesticides, and fertilizers, and, second, decreased ability to obtain loans?

Q.2 Has the toxic liability issue already raised interest rates that are charged to ag borrowers and, again, will it reduce the size of the bank's portfolio?

Vern Crowder – On the first one I will just talk about chemical availability and the impact on farmers in the long term. Obviously this comes close to home not only with Proposition 65 in the past, but with The Environmental Protection Initiative coming up and the industry's response to that, The Careful Initiative. I am firmly convinced that agriculture, as well as some other industries, has not been listening to the public. The public, be it right or wrong, is very concerned about its health and well-being. All of us have taken science classes and know that there is always risk in life. But what farmers have been saying to much of the public is that there is no risk, no more risk than driving on the freeway. Don't worry about it.

The public feels like they are being told they are stupid. When somebody feels like that they stop listening to you and they go to the voting polls and vote against you because they are getting older and they are concerned. I think there has been a communication gap. Many of you were involved years ago in trying to resolve that communication gap but unfortunately I don't think the industry realized the urgency of the problem back then. Now they realize how urgent it is and we need to increase communication and let the public know what we are doing to help them.

The bottom line is that there are chemicals that are being lost and there are going to be more chemicals lost. They are not only going to increase the cost of production because you have to seek alternatives but they are going to make it more difficult for some producers to be competitive with other producers in other parts of the world or other states where they have other alternatives. I don't mean just chemicals. They may not even be using chemicals at all, but they have cheap labor or other substitutes. I understood from a friend of mine that went to China that the Chinese pick the bugs off the cotton by hand.

The second question as I understood it is what has that done to availability of credit and the cost. First, I will not tell you that credit hasn't been available. In terms of availability, what I do know is that the overall perceived risk of agricultural lending is high and it is becoming higher because of issues such as this. Now that hasn't kept us all from lending but what it has done is gotten us all chasing the same premium credit.

If you happen to either be an operator with tight margins or you happen to have property that is in question, then, yes, availability of credit is a problem. There have been deals that we have not done because there has been a question—availability has been a problem on those deals.

In terms of the overall costs, this is a hard thing to compare because all of us in this industry are very liquid and there are about 15,000 lenders in the country chasing the same 3,000 growers for their business. We are all beating up each other in rates right now. Therefore, there has been no increased costs if you look at just the nominal rate. But I know that the lawyers that we consult with don't come cheap. We have also hired environmental consultants. Our appraisers are doing more work. That all takes time and money. Somehow we are going to get that back. It has to increase the cost of lending and I guess what I could say is while our loans are cheap now, maybe they could have
been cheaper if we didn't have to look at these additional costs.

**Mike Fitch** – Vern has underscored the communication gap between agriculture and the public as it relates to the environment. I would venture to say that perhaps the ag lending community suffers from the same communication gap versus agriculture and government with respect to cost and availability of credit. They have not done a good job of explaining that lending is a risky business.

**Susan A. Olson** – I want to add some thoughts from a consultant of ours who uses the mining industry as an analogy to agriculture. Apparently the mining industry didn’t see the heavy regulations that were coming. Our consultant says that the same thing is going to happen to agriculture in the 90s. Either you can get on this bandwagon and help form the regulation and the laws or, just as happened with the mining industry, you are going to be very surprised at the heavy regulation that comes down. If you recall, in the 1985 Farm Credit Bill the environmentalists were successful in getting some laws passed in this area. The concern is that the next farm bill is even going to have heavier regulation. I know that we are trying to monitor very heavily what is happening back in Washington and also here in California. I think we are all aware of the Big Green Initiative so I think it goes without saying that we are just seeing the beginning of agriculture being regulated.

**Mike Fitch** – I agree with you, Susan. I would encourage those of you who are members of the Society of Farm Managers and Rural Appraisers and the realty associations to challenge your leadership to be sure that they are communicating with the California Bankers Association and the American Bankers Association on this issue. Because, clearly, if we find ourselves in a reactive mode, we have two strikes against us.

**Q.** Do lenders or insurance companies have a “red flag list” of ag chemicals which may have been used on a particular property? In other words, typically how far back does the site history research go in identifying specific chemicals?

**A. Evan Henry** – We don’t have a specific list where we say we are going to take a hard look at anything on the A, B and C list for EPA. I think that if you are looking at the environmental clean up liability side of things, the ones that we are particularly concerned about would be the historic use of the DDT related pesticides—the ones that were in large scale use in the past and are now outlawed but are very persistent in the environment. When you are doing soil sampling it often ends up being the organochlorine and organophosphorus pesticides and herbicides that are of concern. But I won’t restrict it to that.

A lot of it has to do with what crops were known to be traditionally grown and the related chemicals that were in use historically. For instance, whenever we see an orange grove bulldozed in Orange County (almost all of them have been bulldozed into houses), the biggest concern is over DDT because there are very commonly high levels of DDT remaining in the soils on those types of properties. It would be different for a rice crop or maybe different for even a livestock and dairy facility.

**Mike Fitch** – To your knowledge, Susan, do you have a specific list of chemicals that you send your people after?

**Susan A. Olson** – No we don’t.

**Rory Robertson** – No, we don’t have a list either. The questionnaire does deal with historical use of chemicals and we sometimes go over
that a little bit lightly because it is not known if the chemicals listed were standard for the crops at that time. But we don't have any red flags. We might look for chemicals that would be atypical for a given crop.

Vern Crowder — We depend upon the current regulations and look at those lists and try to keep up with those changes. The only thing we look toward is regulations.

Q. Mike Fitch — I do think we need to hear from each of the panelists a little bit more about the use of consultants or Registered Environmental Assessors. I see three or four questions related to that issue. How do you hold those consultants accountable and what happens if they do a poor job? I would like each of you to respond to that if you can with any practical experience you or any of your people have had and particularly if you can help the audience to be aware of special qualifications that they ought to focus on. What type of agreement should they have with the consultant?

A. Evan Henry — From my perspective, the consultant that you hire should have a keen awareness of the subject matter both from education and actual experience. Many of the issues you are dealing with in terms of environmental contamination have to do with subsurface problems. Probably the person who is most keyed into that is someone with a geology or hydrogeology background. Don't let that be limiting because there are a lot of good civil engineers out there. But on the first cut, when you are looking at the potential for chemicals to seep into the ground and get into the ground water and cause problems, I think that hydrology is a discipline that is probably at the center of the bell curve.

Unfortunately, the environmental consulting industry covers a very, very wide range of professions from geographers to toxicologists to engineers to marine biologists. They have started their own environmental assessment companies to do these real estate site assessments, whether it's on ag property or industrial property, because they have gotten fed up with their bosses. I recently heard that there are more than 1,000 environmental consultants registered in the state of California. I think that there are some very good ones out there and there are a whole lot of very bad ones.

One of the things that I do in preparing a list of approved consultants for Bank of America borrowers to use, as well as hiring consultants for myself, is to look at three environmental site assessment reports that have been generated for previous projects. Some consultants will scream confidentiality and then you just say, "Well fine, there are 999 more who will provide it to me." The purpose of looking at those reports is so you can see what their work product is. If it looks like it is comprehensive, it has good graphics, it illustrates to you that they have reasonable command of the subject matter and they can write it up and present it in a format that is readable to the lay person, that is very valuable. What you want is environmental information that can be very technical distilled down so you can make a business decision. If it is a bunch of gobbledy gook that doesn't provide you with an interpretation and assessment opinion then you are basically paying for a technician, not a consultant.

Mike Fitch — Susan, would you address the issue of what recourse you might have if that consultant does a poor job?

Susan A. Olson — I would reiterate all the points that Evan has made and I would add that if you are using large environmental consulting firms then be sure that you are hiring the consultant and not the firm. It's the quality of the consultant's work that is going to be determinative because your recourse
may be minimal. That is why it is critical that you hire someone who is good.

We have a master services agreement. Unfortunately I didn't draft it and so I'm not overly familiar with it, but I believe that we are requiring bonds. Environmental consultants may try and negotiate out some of the language that is to our benefit. One thing that you have to be aware of is that many of them will try to limit their liability to negligent acts only, and you have to decide whether or not that's enough.

**Rory Robertson** – I don't really have much to add in this area. Prudential does have a list of consultants which have been approved by our engineering department.

**Vernon Crowder** – We do have a list of approved consultants in our ag credit manual and our real estate lending manual. Most of the firms that are represented at this symposium are probably on it. If an account officer decides he needs some consultant work then he has to use somebody on that list. Until they are put on that list they are not available.

**Member of Audience** – As an environmental consulting firm, how do we convey to the lenders a feeling of confidence that we are the kind of group that can help them and not make a mountain out of a mole hill? Yes, there is definitely a key individual that makes it happen in a company. That's the thing to focus on. A way to quantitatively tell who's good and who's not is to look at letters of recommendations. We commonly ask our people we have worked with if they were satisfied with us. In many cases they write letters and the project manager's name is usually placed at the head, plus the date. You notice the date of some of these letters of recommendation, you might find that they are 10 and 15 years old and that person's long gone and they really don't represent the company any longer. Looking at several of the 10 or 20 letters of recommendation provided can probably get you a pretty good feel of where the person is coming from.

**Mike Fitch** – I very much appreciate that input. I would ask you, if you would, to not only show appreciation to the panelists, but also again to the Agricultural Issues Center and Cooperative Extension for creating this type of information exchange. I hope it will continue.
Environmental Audits: What they are, when needed, how to select

Beth Gurney – Levine-Fricke, Emeryville

I am going to talk about four categories of potential impacts of hazardous materials on properties: 1) cost or decreased value of the property, 2) impacts related to time, 3) changes in development plans or use of the property, and 4) uncertainty.

One of the major impacts on real estate is costs related to investigation and cleanup of problems found on the site. They include: 1) the investigation to find out whether or not there is a problem and how substantial it is, 2) a risk assessment to determine how significant the risks are to human health or the environment, (That's getting down to the nitty gritty of figuring out exactly what is needed to clean up the problem), 3) designing plans and specifications for remedial action if necessary, and 4) regulatory agency review. This latter one is becoming an ever increasing element in cost and in time for investigation and cleanup of sites. Regulatory agencies in California in particular are now charging fees for reviewing work plans at basically every stage of the investigation and cleanup process. The requirements are becoming much more formal and require a lot more work on the part of consultants and their clients to document what is going on and exactly how they are going to clean it up.

The cleanup itself obviously is a major portion of the costs associated with hazardous substances on a property. Confirmatory testing and monitoring is another element, because once the cleanup is done you need to document that it was done in accordance with standards that were approved by regulatory agencies.

Finally, particularly with sites that are near residential developments or neighbors that are interested in what's going on on the property, there may be a need for a community relations program to educate the people who might be affected by the contamination on the site or any cleanup activities as to what the impacts might be and what's being done about them.

These are some of the elements of cost. They primarily affect three parties: the owner, the lender and a potential buyer of the property. The impacts on an owner of the property are fairly obvious. For one thing the owner is generally the responsible party or at least one of the major responsible parties, for cleanup. He doesn't pay the cleanup cost or take the initiative to clean up a problem once it is identified on the site, a regulatory agency will likely come in and either issue orders to do the cleanup or do it themselves. That cost will eventually be charged back to the owner, with some additional fines.

The owner also experiences reduced market value of the property if there is contamination on it. If potential buyers are looking at that property and another down the street that is not affected, or not known to be affected, then they are not going to want to pay as much for the contaminated property as the one down the street. This is particularly relevant for residential developments and sensitive uses. It may not be quite as much of a factor for industrial or commercial development. Finally, the ultimate impact is if an owner is forced into bankruptcy because of not being able to pay for all the costs associated with investigation and cleanup.
The impacts on lenders arise primarily when the owner isn’t financially able to pay for the cost of cleanup, there is no willing buyer around to accept that liability and responsibility and pay for the cleanup and there are no other potentially responsible parties to pass the cost to. Then a lender faces the choice of foreclosing on the property and accepting that responsibility for cleanup or walking away from the property and losing the investment and the collateral. Neither of these are very savory options.

Finally, the impact on the buyers can be interesting depending upon how savvy they are and what they know about the site. If a buyer is aware of a potential problem on a site and there is some information about what the costs might be to clean up the site but there is some uncertainty about that cost, a buyer may be able to negotiate a substantial reduction in the purchase price of a property and take control of the cleanup. If he is lucky and savvy, he may be able to actually achieve cleanup at a cost that is lower than the price reduction that they get on the property. Some folks are actually looking for these types of properties to take on—but this is not for the uninitiated. Of course, if a buyer isn’t aware of these problems and purchases the property, then he is in the same boat as the former owner. He becomes a responsible party.

**Impacts on Schedules**

The second impact that I want to touch on is time. Contamination on a property can disrupt schedules for real estate transactions and development, which have very tight deadlines and very severe consequences if those deadlines aren’t met. Investigations can typically take from one to six months or more. A fair amount of time is spent in just finding out how big the problem is and what it is.

Regulatory review time also can be substantial, and regulatory agencies are getting more restrictive in their requirements of what needs to be documented. Regulatory agencies are overloaded in California as well as other states. They are focusing on the priority sites. It can take several months for a review of a cleanup plan, for review of a risk assessment or for some initial documentation just to tell the agency what you think the problem is and what you want to do about it. For example, you need some kind of variance or permit if part of your cleanup plan includes treating the hazardous wastes or disposing of them on site by leaving them in some kind of containment. This is becoming a more viable option as land disposal restrictions increase. But it can take a year or more to obtain the variances or permits from the Department of Health Services in California.

The cleanup itself can take a fairly long period of time depending upon the nature of the contamination. Typically, if you have affected soil it can take weeks to months to cleanup. If you have affected ground water it can take decades. The amount of time that it actually takes depends a lot on what concentrations are there and what use is intended for the property afterwards.

This isn’t to say that everything has to grind to a halt as soon as you find a problem on a site. You can have cleanup occurring concurrently with the site development. For example, if you have enough space on the site you can put a ground water extraction and treatment system over in a corner and it can co-exist with other types of use.

**Impacts on Use**

A third possible effect of finding hazardous substances on a property is changes in development plans or property use. Finding environmental contamination on a site can have serious, but usually minor, impacts on the use of a property. It can either restrict or preclude certain types of uses. One question is how much money it is feasible to spend on achieving cleanup levels that would be required for the more sensitive uses, things like residential development, schools or hospitals. In general, if you are planning one of those more sensitive uses, the cleanup standards are going to be considerably more stringent than if you are planning industrial or commercial use or something else that is less sensitive.
Technically, under existing state law, if you have a property that is a hazardous waste site or has had hazardous waste disposed of on it, or if you are within 2,000 feet of a site that has had hazardous waste disposed of on it, you are supposed to go through a lengthy process with the state Department of Health Services in which they determine if you are actually one of those sites. Then you have to clean up the site in accordance with their requirements before you can develop the site for more sensitive uses. This doesn’t apply if you are planning development for commercial R&D or less sensitive uses; but even in those cases the state can advise local governments not to issue permits for development until the site has been cleaned up to their satisfaction. This can obviously put some restrictions on the property. This law hasn’t been enforced to date to my knowledge. No sites have actually been designated as border zone or hazardous waste sites under this law but it is on the books.

Also, if your cleanup plan calls for some kind of disposal or containment of hazardous waste on site then you will have a deed restriction entered on the property that will limit what can be built or excavated on that part of the property.

Another impact on property use that the presence of contaminants can have is changes in plans for the use of on-site soil. You may have been planning to use some soil on the site for landscaping or for filling particular areas, but because of the contamination that may not be possible. You may also need to change intended uses of the site. For example, I am working on a case now in which the developer of the property was planning to put residential developments smack in the middle of where we found high concentrations of lead in the soil. They have a 60 acre site and the contamination only affects 20 acres of it. What they are considering now is moving that residential development to another portion of the site and putting a less sensitive use on that 20 acres. Also, if you are planning to have some subgrade structures on a property, you might need to be flexible and move things around a bit.

**Increased Uncertainty**

The fourth impact that hazardous materials or contaminants can have on property is uncertainty. Regulatory standards for environmental cleanup are quite nebulous. Often they don’t exist. Consultants have to use very vague guidelines which can change depending on which regulator or which agency you talk to. Regulatory standards also can change with time. Something that was okay today according to one regulator in the Department of Health Services may not be okay in the future. These are the conditions that we have to put up with and you just have to try to get as much definition and documentation as you can on what you are doing and why.

The other aspect of this uncertainty is that it’s very difficult to get regulatory agencies to give you a blanket signoff that you have done everything you are supposed to do and that they are not going to bother you any more on this property. The most you can expect is a letter or statement to the effect that you’ve met the requirements that existed at the time of the clean up, and that no further action is required at this time. But the agency always reserves the right to take further action in the future if new information is unearthed that shows it was actually more of a problem than was originally thought. You are never completely off the hook. Documentation of rationale and so forth can help in these circumstances.

Now that I have discussed some of the impacts that contaminants can have on the property, I’m going to shift gears and talk a little bit about some suggestions for minimizing these impacts. As I mentioned, time and costs involving regulatory agencies are really increasing. One possibility is to get regulatory agency input early. What are the agencies likely to require and how are they likely to view the cleanup options that you are considering for the site? However, unless you are obligated to notify the agency under existing laws regarding contamination on the property, you may not want to get regulatory involvement early. You may not want them to know all the specifics about the site until
you have figured out who is going to be responsible.

If it's a real estate transaction, who is going to be responsible for paying the costs of cleanup and who is going to be responsible for liability on the site? Sometimes it is helpful to get that worked out before you get the regulatory agencies involved; but it's not always possible if you have concentrations of substances on the site that require notification.

We have also found that it is helpful to work with a consultant who knows the agencies involved and who knows the local regulators. That person can either have a feel through his or her own experience of how the agencies will likely respond to the problem or can contact people who will give a good picture of how the agencies will likely respond. As I said earlier, often the picture can vary depending on who you talk to; you might get an answer that you like better from one person than from another even when they are in the same agency. It's helpful to have people who really know who is the right person to contact in an agency in order to get the information you need.

Another way to minimize some of the impacts on properties is to develop a cleanup strategy that is best suited to the project needs. Usually there are several cleanup options with tradeoffs involved. You need to identify what the priorities are for the project and find the the package that has the best set of tradeoffs for you. Usually you would consider minimizing costs. Is that really the essential element? Is time an essential element—do you really need to get things moving? Do you really need to have residential or some other sensitive use on the site? Is there risk of liability—is this going to be an investment property with no liability or is a very minimal liability acceptable on the site? These things need be factored in as you are developing and working with your consultant. Your consultant can play a key role in helping you to determine what the implications or various options might be and to develop a strategy to best meet your needs.

Another suggestion is to keep development plans flexible. If you are dealing with properties that are going to be developed or redeveloped and have contamination problems, then there are advantages to being able to shift things around or alter uses. Some flexibility in your development plans could save you a lot of headaches and the time and cost of having to redesign everything in the future.

Another suggestion is to negotiate cost and liability as part of the deal. An environmental consultant can play an important role in negotiations over real estate transactions. We generally get involved with the lenders and the lawyers in advising the principal in the deal as to what the potential cleanup costs are likely to be, what the timing of expenditures is likely to be, and what impacts on use might be. It's helpful to have those things worked out so that all of the parties understand their responsibilities up front.

The final point that I would like to emphasize is that you need to allow enough time to gather data on the property that will give you a clear picture of what the risks are and enable you to decide whether the risks are within acceptable range. You need to gather enough data and the right data. That's very important.

**A Phased Approach**

Consultants can spend a great deal of money investigating a site and poking a lot of holes and looking for everything under the sun and still miss very large problems. It's always possible to miss problems no matter how diligently you do an environmental investigation; but it's helpful to use a phased approach in which you start out with screening that does not involve sampling but gives you some basic information about what the problems might be on the property and where to look. Then you take the next step, collecting and analyzing samples from the areas that might have the highest risks and then perhaps some random samples in other parts of the site.
This kind of progressive approach allows you to focus in on the possible problems and to minimize some of the costs. The time might be a little bit longer and costs up front might be a little bit more, but in the long run you are going to save some potential costs, time and liability. I want to emphasize that you should give your environmental consultant the time to use the phased approach because we have found it to be very effective and in the long run it saves a lot of headaches.

Finally, I want to leave you with the thought that there are many ways to find environmental problems on a property and an environmental investigation is only one of them. Actually, development of a property is one of the best ways to find a problem if you haven’t done any environmental investigation previously. If there is something there, you have a good shot at finding it when you are digging and driving piles. But that is not the time you want to discover that you have an underground tank, a waste pit or a septic tank in which somebody disposed of solvents—because it’s going to cost a lot more money and a lot more time and aggravation than if you had figured it out a month ahead of time and taken steps to address the problem.

Rene Atwater, SEACOR, San Francisco

I want to talk about environmental site assessments to discover any potential for environmental impairment to your property. Assessments have a phased approach. I often get a phone call from a panicky lender or potential buyer saying, "I don’t have time for a three week turnaround on your Phase 1. I just want to drill some borings in the ground." That might be okay if you knew what you were looking for or where you were going to place the borings, but generally that is not the case. Most people have some idea that there has been an underground storage tank or they have an idea of the past use of the property, but they don’t really have a clear picture of what we should look for. So we usually do a Phase 1. After going through the records in a Phase 1 then hopefully we will be able to narrow the scope of what we are looking for in the Phase 2 investigation.

The Phase I may not require the expensive borings that someone might have anticipated. It generally includes some sort of field analysis, taking samples of either soil or ground water or both and possibly some remediation depending on the results of those samples.

In this preliminary assessment we are looking at the historical use of the property. We look at site plans. Generally, we look at a lot of in-house records of our own investigations in the area. For agricultural land, aerial photographs play a big role. Aerial photographs may be taken periodically of crop usage on the property. We also use agency records. We look to the Department of Health Services, the Regional Water Quality Control Board, and the city and county fire departments. If you were to make some preliminary calls on your own, those would be three good places to start inquiries. These agencies may have collected information on impacts in and around your site or on past usage of your site.

Subsurface and regional data can also be collected at the agency level and from our own consultation files of jobs that we have done in the past. Often we can determine what the subsurface conditions are from a geotechnical report done on the building—for example, the depth of the ground water.

Generally we inspect the site around the facility as well as the facility itself. We also do an agency review of the facilities around the site. Often, at least in a commercial and industrial area, it’s the off-site impact that causes the biggest havoc with trying to make the loans. When you are talking about agricultural land, more than likely it’s surrounded by other agricultural land. But wouldn’t it be nice to know before you got into the loan if the leaking underground storage tank was really the problem of the guy next door? The preliminary investigation is to determine whether this property appears to be completely free of significant contamination or if it could have specific problems that warrant a Phase 2
investigation. There also may be some known problems, and you may be interested in estimating the cost of remediation or clean up.

**The Next Step**

For the detailed investigation, Phase 2, we take samples of soil and/or groundwater and submit them to a lab to test for contaminants; then we outline some of your options. We define the extent of the contamination and the potential for risk. We try to determine whether there is an impact to public health and the degree of cleanup that could be required.

The degree of cleanup is usually defined by the lead agency. If it's groundwater it is probably the Regional Water Quality Control Board. If it has been determined that there is a risk to public health, it's probably the California Department of Health Services. They will decide what the cleanup stand

The product that you get at the end of this investigation is hopefully a report that you can read. (Many times it's not.) But the extent of the problem has been defined as well as the range of risks, both to public health and to you as a lender or property owner going into the deal. The report should also alert you to future contingent liability associated with making a loan on this piece of property and to general cleanup requirements. You should be able to focus on the range of costs involved in getting rid of the problem and recommendations for the future maintenance and usage of the property. You may have some idea now that you can't use it for a more sensitive purpose such as residential.

I have a situation now — a big development in the Richmond area. As we all know Richmond was heavily used in a refinery capacity. The development that investigated was originally to be for overnight guests at a recreation facility. Now they have had to cut back and use this facility for an administrative building where there would never be overnight guests. Thus, there would be less chance of children or adults coming into contact with contaminants in the soil.

**What to Look For**

From an old aerial photograph you can see where streams were flowing. This can paint a picture of past activity for you. Often those streams or waterways have been rerouted. It helps to know where they used to be because those are lower lying areas. If you were able to discover from your historical review of the files that there had been a spill then you could determine where the spill would flow on the property.

In another example, I was doing a site walk and there was a culvert with an oily sheen on the water. Or there was something flowing out of the end of a pipe and whatever it was killed off the vegetation. Dead vegetation can also be an indication of a past spill or a contaminant in the soil that is not allowing the grass to grow back. It is certainly worth noting if you or your appraisers are doing a site walk.

Some of the sites with the highest possibility for contamination are former industrial or manufacturing properties. Railroad yards or railroad tracks that might run behind your property are other red flags. The reason to be concerned about this is because of metals that could contaminate the soils in that area. Oil field or refinery areas and landfill sites are also potential problems.

Surface impoundments—by that we mean any pits, ponds, or lagoons that might be on the property—may not be there any longer but could be indicated by a historical aerial photograph. If you have an underground storage tank that is over 20 years old, it's worth taking a look at. The thing to do is to have underground storage tanks periodically tested to make sure that they are tight and are not leaking. That's usually required in California, in most cities and counties at least, on an annual basis and sometimes more frequently. The concern with older electrical transformers is oils containing PCBs. In most areas PG&E will come out and test your transformer for free
and let you know whether or not it has PCBs in it.

Beth Gurney

Agricultural property has not typically been thought of as high risk in the past. But we are doing quite a bit of agricultural land assessment these days as more of it is redeveloped for residential use. That is a sensitive use so there is more concern. What we are finding is that agricultural properties can have some significant environmental problems related particularly to pesticide use and disposal. Often the farmers are used to handling these chemicals and they are not aware of what some of the problems might be. They may be applying them properly but storing them in a way that allows them to drip onto the soil. Sheds and barns are often where we find some concerns.

Also, the history of the use of some of these pesticides is important. DDT was used until 1978, when it was banned. We are finding residual concentrations of DDT on a lot of properties even though the farmers swear they have never used DDT—or it was used eons ago.

As one example, we investigated a nursery in the Santa Clara Valley that looked like a clean site. There was one little shed on the property where the nursery operator stored containers of pesticides. We looked under the shed floor and noticed something had leaked on to the ground. Beneath the slat floor it was just dirt. The owner swore he never used any DDT and it had never been used on the site to his knowledge. But we did some testing both in the field area and beneath that shed and found fairly high concentrations of DDT that were above the hazardous waste limit used by the Department of Health Services.

The owner wasn’t using DDT on the property and he probably hadn’t used it for some time. However, the half life of DDT is so long that it can persist in soil for 10 to 15 years or more. It can be there even if there is no record of it having been used.

Rene Atwater

What we look for mostly on ag properties is where the operators have stored their chemicals, how they handle them and how they rinse out their containers. Sometimes the tracking process isn’t easy because there has been no stringent requirement in the past for keeping records on chemicals. It’s sometimes very hard to determine what has gone on in the past, even though you may have inherited the property.

The operation of small underground storage tanks on agricultural land is not regulated under current underground storage tank laws. Although a permit was required to install the tank, often there is no record of underground tanks of less than 1,100 gallons. A problem that we often encounter is a tank that was abandoned without a closure permit and forgotten. There may be no records of this tank but it very well may be leaking.

There is no standardization in environmental site assessments. (An attempt at standardization is House Rule 2787—that is Senator Weldon’s Bill. It is now hung up in the Committee for Commerce and Energy. It is an attempt to standardize the Phase 1 product.) We are operating as consultants at our client’s direction on a site specific basis. As lenders you should know that investigations are limited to exactly what the client hires us to do. If they do not hire us to investigate storage tanks, then that is not going to be in the Phase 1 report regardless of whether we suggest that they actually investigate the underground storage tanks. So a limitation is that right now an ESA is not a standardized product. That is something you should be aware of.

To evaluate the degree of cleanup required, we would like to match the cleanup standards and the criteria with the planned use of the property. That can be a determining factor when suggesting a cleanup level to a regulatory agency. Identifying alternative use scenarios also is important. A property might not be appropriate for residential use but could be appropriate for many other types of usage.
The costs of ESAs are very difficult to determine. Consultant costs to review a preliminary assessment that someone else has done can be around $3,000. The minimum on a startup for a Phase I is about $6,000 (I have been visiting with my counterparts about this.) It certainly is site specific. It depends on how much acreage we are talking about and how involved the investigation needs to be.

Detailed investigations run the gambit. Probably the cheapest detailed investigation including taking samples of any kind would run in the $10,000 range. Drilling costs run from $5,000 to $100,000. I have not seen many lab fees for less than about $5,000 unless you are just testing a couple of things from a surface soil sample. Remediation costs are also a very broad range.

Possible cleanup costs can range from $150 to $350 per cubic yard for soil removal. This also depends on the contaminant. Gasoline can run anywhere from $50,000 to $5,000,000 and solvents from $400,000 to $40,000,000 or more. Solvents are probably one of the worst and metals certainly are another concern. It really is site specific and you will know a lot more at the end of the Phase I study.

Michael Mooradian, Georesearch, Fresno

The three phase investigative methodology commonly used in the consulting industry is designed to provide a client with the most cost-efficient and thorough approach to property investigation for potential environmental contamination. The phases can simply be termed like this:

Phase I is the Preliminary Site Assessment.

Phase II is the Site Characterization.

Phase III is the Remediation.

The Phase I investigation provides the lender an indication of the environmental conditions of the property and the consultant with clues on the types of problems that may be present. These clues can range from underground tanks and surface impoundments to a small spill on the property. The Phase I assessment establishes a baseline for the consultant to begin a Phase II study.

It is the environmental consultant's responsibility to note any kind of contamination on the property as well as note how extensive it appears. The consultant's obligation is to provide the client with information about site conditions, compliance requirements, and recommendations.

When the Phase I assessment is completed and there is an indication of a potential problem, typically the client (who may be the owner of the property or occasionally the buyer or the lender) wants more information on what type of problem is present. The goals of the Phase II investigation are to determine if there is a problem, and to characterize the problem. This information is needed to formulate a cost to remediate the problem.

When soil staining is identified during a Phase I assessment, the first step of a Phase II would include a minimum amount of sampling in the center of the spill area to determine the vertical extent of contamination. In some cases a large area saturated with an oily substance may be identified during the Phase I. On agricultural property, drilling may be required to collect soil samples at depth. At least three or four borings are drilled as part of these investigations. The collected soil is typically tested by a laboratory for various pesticides as well as hydrocarbons and other fuel related compounds.

A Phase II assessment may range from a technician in the field collecting surface samples at specified locations to an intensive drilling program to determine the extent of either soil or ground-water contamination. One of the things to note is that most Phase II assessments, especially as they relate to agriculture, generally concern themselves with soil contamination. However, once a Phase II investigation is
started, the scope of work often is expanded beyond the unsaturated soil to include the ground water. Production wells are typically investigated for proximity to waste sites or pesticides storage areas. Irrigation and domestic wells are sampled as part of a Phase II investigation to determine the general quality of ground water as well as to identify potential sources of contamination. This type of testing is common on agricultural facilities and properties but is not typically conducted on commercial property in major metropolitan areas. Water samples are generally tested for organic compounds and pesticides including DBCP, EDB, and other contaminants that are prevalent in agricultural areas.

The chemical analyses of soil samples provide data only about the location where the samples were collected. If there is a 1,500 acre piece of property of which 20 acres is questionable and the client mandates that the investigation cost must not exceed a couple of thousand dollars, the budget may only allow drilling and sampling three test holes to characterize the property. As a result, the interpretation of the data is very limited because the amount of gaps in the available data is extremely large.

On the other extreme, a zealous client with a very small piece of property may be very interested in the environment and mandates that test holes be drilled every five to ten feet across the property. In this case, the client has embarked on a very expensive Phase II investigation that probably could have been completed quicker and less expensively.

During drilling, an instrument called a split-spoon sampler is used to retrieve soil samples. These are collected at discrete depths, allowing the consultant to determine the vertical extent of contamination. Although in many cases the consultant is very concerned about the lateral extent, the depth of contamination has a direct relationship with the cost of mitigation because the deeper the contamination, the more difficult the remediation program. Where ground-water contamination is a concern, field instrumentation is used to periodically measure the depth of ground water. By measuring the depth to the water table and referencing it to an established datum such as sea level, the consultant can calculate the direction of ground-water flow. This information gives us an indication which direction contamination may migrate. Other parameters often measured in these wells include pH, temperature, oxygen, and salinity. These field measurements give the consultant real time information on the quality of ground water.

After all the field data are collected, the consultant attempts to formulate a very comprehensive report that will delineate the type of contamination as well as the extent in depth if there is contamination present. From this information, the consultant can begin to formulate a program for cleanup and the costs to implement such a program.

Phase II investigative costs can vary considerably based on the size of a property, on the purpose of the investigation, and on the available budget. A client needs a consultant experienced in environmental assessments and with the geographical area that is being investigated. The client must be specific at the onset as to the purpose of the investigation. If the purpose is not clearly established by the client, the consulting firm typically establishes the purpose based on available technical factors. If, for example, a client informs the consulting firm that a property is valued at $1,000,000, and that carrying costs during escrow are $10,000 a day, a good consultant will design the Phase II investigation on both technical and economic criteria.

Probably the most common method of cleanup, especially here in the San Joaquin Valley, has been to excavate the contaminated material and move it somewhere. That procedure is not only a very costly alternative but it also does not relieve the owner of the property from liability. As technology has progressed over the past five to ten years, a number of other options are now available to remediate contaminated properties. As a consultant, it is our responsibility to assess each one of these various options. They are assessed not only on a technical and cost basis, but also on quantifiable costs such as
how the system will interfere with future operations slated for the property. Some of these treatment systems can be installed and operated while the property changes hands and/or while facilities on the property continue to operate; but there are some remediation methods that require the property to lay fallow.

Often the remediation costs given to a client by a consulting firm are only the construction costs of that system: the operation and maintenance costs may not be included in the original budget. These costs are often not included because typically it is too early in the program to determine operational costs. These construction costs refer to systems that operate to clean up either contaminated soil or ground water on the property as opposed to systems used in removing it for disposal.

Obviously, a lot of the contamination problems are associated with leaking underground fuel tanks. The following discussions are case studies of investigations and cleanups that may aid you in understanding the complexity of environmental problems. During one project, a client decided he wanted an underground fuel tank removed without an assessment or investigation because he wanted to rapidly complete the project to facilitate the sale of the property. Unfortunately, when the tank was removed, ground water was discovered at a depth of about fifteen feet and there was approximately three feet of diesel fuel floating on top of it. The client had to regroup to decide on the consequences, including cost, funding, and responsibility. The 90-day escrow in this case actually fell through. Sometimes escrows can be extended for as much time as one year.

In another project, a treatment system was installed along the central coast adjacent to agricultural land. In this case the contamination was gasoline. Gasoline is volatile; it evaporates very easily. The remediation treatment system used the following process. Contaminated ground water is pumped out of the ground to the top of a large tower called an air stripper and allowed to trickle down the tower which is packed with various materials. As water percolates through the column, it encounters a much larger surface area. At the bottom is a large fan that blows the air up through the tower at a specific temperature that facilitates the gasoline contamination to volatilize or evaporate. The volatilized gas is then transferred down along the outside of the stripper. In some areas, the contaminated vapor can be off-gassed directly to the atmosphere, but in most areas the gas is required to be treated. At this site, the gas is treated through two large vessels of activated carbon. The gas then is discharged as clean air into the atmosphere. The entire system including the construction of the wells was about $150,000. This cost does not include the investigation or assessment of any of the previous work which probably totaled about $250,000. Operational costs associated with this system are on the magnitude of $20,000 per month. We expect the system to operate for two years. A large portion of the operation and maintenance costs are due to regulatory requirements of reporting and making sure that no contamination is going in the atmosphere, and other parameters that are not directly related with operating the system.

Another example of on-site cleanup is where there is only contaminated soil. At one location contaminated soil was no longer allowed to be aerated by the local Air Pollution Control District. In Fresno, in some cases, you can still take soil contaminated with gasoline and spread it out on the ground and allow the contamination to volatilize naturally. That type of cleanup was not allowable for this project. Approximately 800 yards of contaminated soil were excavated. A series of pipes were installed within the stockpiled soil. The spoils pile was then covered with a heavy plastic. A vacuum was drawn through the pile. The extracted gas was then put through carbon to remove the contamination and vented to the atmosphere. This type of system works fairly quickly. In this case, the spoil pile was cleaned in less than two months. Construction costs were minimal, on the order of less than $20,000. Operational costs are generally around $10,000 including the lease for the equipment.
In another case, the client did not want to excavate and remove the soil. The ground water was very shallow. In most cases a ground-water problem requires the installation of a system much like the one in the first example. In this case, because we found the extent of the contamination and the ground water had a high salinity, the agency allowed us to excavate the contaminated soil in the unsaturated zone, leave the excavation open, and actually extract the free floating fuel from the water table exposed in the excavation until there was no longer free floating fuel. The agency did not have us respond to the dissolved component of contamination. It doesn’t happen very often but because of the circumstances in this case, this procedure was acceptable. Wherever possible, we try to minimize the amount of treatment while still protecting the environment. In this case, all of the recovered fuel was taken to a recycler.

Earlier, I mentioned that the regulatory agencies do not often get involved with a Phase I Assessment. They typically do not. If you find a problem in your Phase II Assessment, you may be obligated to report the contamination to the agency. It is the client’s responsibility and obligation to report conditions — not the consultant’s. Although you may expect delays and some increase in up front costs when a regulatory agency is involved, it may be more beneficial in the long term to report the problem to ensure the site is cleaned up to agency’s specifications.

One of the most important things to note with environmental studies is that the amount of time and money that is spent up front in the initial phases of an investigation is more than recovered during the cleanup. It’s like anything else — you get what you pay for. By obtaining complete and accurate information up front, your costs on the cleanup end can be greatly reduced.

Question and Answer Period

Q. Are there any rules of thumb a lender or anyone can use to be sure they are hiring a reliable environmental consultant?

A. Rene Atwater. One of the things to look for is a registration. A state registration in California holds some weight—a registered geologist, a registered engineer, a registered assessor. Another need is a good understanding on the part of the consultant about what the client’s needs are. It comes down to a personal relationship between the consultant and yourself, getting them to understand not only why you are getting the product but what you want out of it.

Also worth looking at is certainly the errors and emissions insurance in the liability policies. Those things are hard to read and understand. Lawyers play a big role in interpreting them and trying to get something that is reasonable for the product.

Michael Mooradian – Look for somebody who has a background in the area you are working in—for example, a registered assessor or geologist. Find out their experience. Take a look at the previous work they have done. More importantly, it depends upon the site that you are looking at. How much experience do they have not only in their technical field but in the locality they will be looking at? We look at a lot of different types of properties—agriculture, commercial properties, residential, and heavy industrial. If you can find somebody who has a specialty in your area and he knows what to look for when he is out there, this can often expedite your assessment.

Rene Atwater. – As with any contractor or any service that you utilize, it is helpful to check references. A consulting firm’s work will speak for itself. Ask them for some references on jobs that sound similar to yours. Talk with those references and find out how they worked with the consulting firm, what problems they had with them, what worked well. Consulting firms are, I hate to say this, like breakfast cereals. Some of them might suit your
tastes and some of them might not. They have different styles of operating. They focus on different things. Some are very conservative, some are less conservative and you want to get a flavor of that. Find people who have had direct experience with them.

Q. What kind of time frames are we talking about here from the day somebody contacted you to the day Phase 1 would be completed; and if there was something beyond that, in Phase 2?

A. Rene Atwater. — For Phase 1 what I am quoting people right now is about a four week turnaround, including the report. If you are talking about Phase 2, it really depends on exactly what it is that you are trying to investigate for and if you are looking at any kind of remediation such as hauling away soil. Often that also depends upon the availability of a driller or hauler or other aspects.

Q. In a Phase 2 could you give a range?

A. Rene Atwater. — If you are doing any minimal subsurface investigation at all, I think that you are looking at about a month to a month and a half absolute minimum just to get a driller on the site, get the samples to the lab and get a 24-hour turnaround at the lab. If you are really pushing a closing date it may make sense to just go back and change that date if possible. Lab analysis is generally the bigger part of the costs. If you have a 24-hour turnaround you are doubling the costs. A 48-hour turnaround is about a 75 percent markup. So if you can go with the standard lab costs, you are at least coming out a little bit better.

Q. I had to have a test done on a diesel tank awhile back and I paid $500 each for the soil samples for a specific diesel leak. Is that within reason?

A. If you are saying the actual lab analysis was $500 per sample, that was very high; but if it was $500 for the engineer who went out there, collected the sample and wrote you back a response, then it wasn't high enough. Typically a diesel analysis is about $100 per sample. If you pay for a rush then you are looking at marking it up. Typically a consultant or an engineer will have a markup that is generally around 15 percent. Ask them to produce a copy of the lab report and the bill, if you are questioning it.
SPEAKER BIOGRAPHIES

Richard W. Hart

Dick Hart was born and raised in Siskiyou County, California. Following graduation from the University of California at Berkeley, he worked for the predecessor bank of what is now First Interstate in Oakland, Corcoran and San Francisco. His 18 years with the bank were spent in branch operations, consumer lending, loan quality control, and audit. During that time he attended San Francisco Law School and, following admission to the Bar, spent the next 11 years with the Bank of California as Associate General Counsel specializing in bank operations, consumer lending, compliance, commercial transactions, and product development. In 1981, Mr. Hart joined Frandzel & Share as a partner in the San Francisco office of the firm, where his primary role was to provide non-litigation legal support services for the firm's 200 California financial institution clients in areas of transactional law, loan workouts and restructuring, bank operations and consumer compliance. In 1991 he formed a partnership called Bank Law Services specializing in phone-in services to subscribers seeking legal assistance in general bank operations problems and compliance. In addition, he also is California counsel for CFI, Inc. and its Laser Pro bank loan document software systems and to Frandzel and Share.

Steven N. Bloom

Steven Bloom is Frandzel & Share's Managing Partner and Co-Chair of the firm's Transactional/Real Property Group. His practice emphasizes commercial transactions, documentation, major real property loan workouts and litigation. He has spoken on these topics before a number of groups in California, including the California Bankers Association and the California League of Savings Institutions. Mr. Bloom received his Bachelor of Arts degree from the University of Southern California and his Juris Doctorate from Loyola University of Los Angeles.

Maurine C. Padden

Maurine Padden has been the Legislative Counsel for the California Bankers Association since January 1989. Maurine is a registered lobbyist who works with members of the State Legislature and their staffs to influence legislations which will affect banks and the way they do business. Her responsibilities include working with the following CBA committees: Commercial Lending, Investments & Funds Management, Operations, Real Estate Investments, Real Estate Lending, Toxics Task Force, Trust State Government Affairs Committee, and the State Government Relations Committee.

Immediately prior to joining CBA, Maurine was Corporate Governance Counsel and Federal and State Legislative Counsel for the State Teachers' Retirement System. Her background also includes a stint as Trial Counsel for the Department of Industrial Relations, where she was the sole litigator for the Division of Labor Standards Enforcement's Northern California/Sacramento Valley jurisdictional area. Prior to that she was administrative Counsel for the State's Office of Administrative Law, where she reviewed proposed regulations for all state agencies, boards and commissions and prepared legal opinions on those proposed regulations.

Maurine obtained her law degree from McGeorge School of Law after graduation from California State University, Sacramento. If you detect a southern drawl when Ms. Padden speaks, please be
mindful of the fact that she also attended the University of Alabama, where she was on the debate team, and she was born in Houston, Texas.

**Mike Fitch**

Mike Fitch was raised on a livestock ranch outside Laytonville, a small community in Mendocino County, California. He has a B.S. degree in Agricultural Business Management from the University of California, Davis; a Master of Agriculture from Oregon State University; and a Master of Science from the Stanford Sloan Program in Executive Management.

Mike served two years as a Lieutenant in the U.S. Army (one year in Vietnam for which he received the Army Commendation Medal for Meritorious Service). He then became a farm manager for a Sacramento valley farming corporation before joining Wells Fargo bank’s agricultural field staff in 1969. In 1972, Mike joined the head office Agricultural Department, was made Vice President in 1975, and assisted with supervision of the Bank’s agricultural field staff, as well as Wells Fargo’s farm loan portfolio and agricultural trust properties.

In 1975, Mike completed a three-year fellowship sponsored by the Agricultural Leadership Foundation designed to improve farm/non-farm communications, and which included a visit to the People’s Republic of China. Wells Fargo, now reported as the largest commercial agricultural bank in the nation, sent Mr. Fitch to the year-long Stanford Sloan Program for Executive Management in 1976-77 and then asked him to strategically plan the Bank’s agricultural and ag-related activities. During the summer of 1982, Mike spent three months in Washington, D.C. with the President’s Private Sector Survey (known as the Grace Commission), where he recommended ways in which the U.S. Department of Agriculture’s Farmers Home Administration could be operated more cost effectively.

Mr. Fitch now acts as Wells Fargo’s spokesman to the agricultural community and represents all agricultural and ag-related interests to Wells Fargo management. Mike is past Chairman of the American Banker’s Association’s Agricultural Bankers’ Division as well as the California Bankers’ Association Agricultural Lending Committee.

**Vernon M. Crowder**

Vernon M. Crowder is a Vice President with Security Pacific National Bank. He is an agribusiness specialist with the Inland Division of the Middle Market Group and he serves as secretary of the Bank’s Agriculture Committee. His responsibilities include product management for the division’s agricultural market. He is also responsible for monitoring governmental activities and economic trends that may impact the Bank’s agricultural loan portfolio. Mr. Crowder, 38, joined Security Pacific in February 1976 as a Senior Research Analyst in the Marketing Information and Research Division. He most recently was in the Economics Group as the California Agriculture Industry Analyst, where he was responsible for the Bank’s agricultural reports.

He is a member of the Executive Board for the American Bankers Association’s Agricultural Division. Formerly the Chairman, he remains an ex-officio member of the California Bankers Associations’ Ag Lending Committee. Crowder was appointed to the board of the California State Export Finance Office in 1985. He served as Chairman of the Board and on its Credit Committee prior to his resignation in July, 1987. Also, he is a Governor appointee and former President of the California State Guide Dog Board.
Mr. Crowder graduated from the University of California at Riverside with a Bachelor of Arts degree in 1973. He received a Master of Administration in Business at U.C. Riverside in 1975. He is also a graduate of the 1985 Pacific Coast Banking School class.

Evan C. Henry

Evan Henry, as Manager of the Environmental Services Department of Bank of America, is responsible for assessment of environmental risks associated with the commercial lending practices of the bank. Mr. Henry has been responsible for development and implementation of hazardous waste-toxic substances policy which includes review of environmental assessments of real property collateral prior to lending and assessment of liabilities presented during foreclosure situations. Mr. Henry also is responsible for technical management of environmental consultants retained by Bank of America to perform site assessments.

Mr. Henry earned a Bachelor of Science degree in geology from Tufts University, Medford, Massachusetts in 1977 followed by a Master of Science degree in hydrology from the University of New Hampshire, Durham, New Hampshire in 1984. Prior to joining Bank of America in 1988, Mr. Henry gained approximately 10 years of professional experience with environmental consulting firms providing hazardous waste assessment and cleanup advice to commercial, industrial and governmental clients. Mr. Henry developed specific experience with assessment of environmental liabilities of real estate transactions and property development. Mr. Henry is a registered geologist in several states and holds the certification as a Registered Environmental Assessor in the state of California.

Roderick Robertson

Rory Robertson has been an Investment Manager with The Prudential Agricultural Realty Group since 1987. He is currently a member of a team of investment professionals responsible for originating long term, fixed rate loans in excess of $5,000,000 which are secured by Agricultural properties and processing facilities. Mr. Robertson has been involved in agricultural lending and property management since 1982, when he graduated from the University of California at Davis with a master's degree in Agricultural Economics.

Susan A. Olson

Susan A. Olson received her J.D. from the University of San Diego School of Law in 1980 and her B.A. from St. Mary's College, Winona, Minnesota in 1976. Ms. Olson has been an Associate Counsel with the Western Farm Credit Bank, Sacramento, California, since May, 1984. Prior to her joining the Credit Bank, Ms. Olson was in private practice with the Sacramento law firms of Carson & Woodruff and Rader, Rader, Goulart & Machey.

Rene Pilcher Atwater

Rene Atwater received her bachelor's degree in business administration, concentrating on petroleum land management at the University of Texas at Austin. She is currently project manager for SEACOR, an environmental engineering firm located in San Francisco. Ms. Atwater is one of the founders of the company which has offices across the country.

Before forming SEACOR, she was environmental auditing services project manager with Dames & Moore. Her projects have included preliminary field investigations for groundwater, soils and
asbestos. She was responsible for the creation and development of Dames & Moore joint venture relationships for distressed properties by having Dames & Moore participate in investments after clean-up or correction of structural or geotechnical problems. Among her other responsibilities are the preparation of reports for lenders, investors and developers.

Previous to joining Dames & Moore, Ms. Atwater was involved with mortgage banking as executive vice president. Her company originated and serviced commercial loans on both the east and west coast. Prior to which she was a national accounts manager, coordinating escrow and title procedures for high liability national accounts, including Chevron, The Hibernia Bank, Wells Fargo, U.S. Post Office, and Westamerica Bank.

Beth A. Gurney

Beth Gurney heads Levine-Fricke's Environmental Site Assessment department. She has a broad background in environmental sciences, more than six years of experience in environmental program administration and project management, and is a Registered Environmental Assessor (R.E.A.) with the State of California. Since joining Levine-Fricke in 1987, she has conducted or managed over 200 environmental site assessments and hazardous substances investigations. She has worked with developers, lenders, lawyers, property buyers and sellers, and government agencies to evaluate potential sources, extent, and implications of environmental liability associated with hazardous substances.

Previously, Ms. Gurney supervised the State of Rhode Island's Ground Water Protection Program. Her responsibilities in this role included oversight of field investigations, enforcement actions, and remedial activities. She played a key role in developing the State's Underground Storage Tank regulatory program, and in formulating Rhode Island's Ground Water Protection Strategy and ground water classification system. Ms. Gurney managed several state-wide studies and projects, including a study of private well water quality, mapping of recharge areas to the State's primary aquifers, and development and demonstration of applications of the ARC/INFO geographic information system to ground-water protection planning.

Michael Mooradian

Michael Mooradian, born and raised in Fresno, has first hand experience with the issue of toxic liability and its affect on agricultural lending and its impact on the farmers. For over fifty years, the Mooradian family business has been farming in the Fresno community. Mr. Mooradian's educational background includes a M.S., Honors, in Environmental Health, with emphasis on water, from the California State University, Fresno, 1980 and a M.S., Hydrology from the University of Arizona, Tucson, 1983. Mr. Mooradian has over 12 years experience in ground water resources and environmental consulting. He is the founder and President of GeoResearch, a statewide environmental service firm with offices in Long Beach, Fremont, San Luis Obispo and Fresno, California.