

1989

Environmental Liens and Title Insurance

Robert S. Bozarth

Follow this and additional works at: <http://scholarship.richmond.edu/lawreview>

 Part of the [Environmental Law Commons](#), [Insurance Law Commons](#), and the [Property Law and Real Estate Commons](#)

Recommended Citation

Robert S. Bozarth, *Environmental Liens and Title Insurance*, 23 U. Rich. L. Rev. 305 (1989).

Available at: <http://scholarship.richmond.edu/lawreview/vol23/iss3/2>

This Article is brought to you for free and open access by the Law School Journals at UR Scholarship Repository. It has been accepted for inclusion in University of Richmond Law Review by an authorized editor of UR Scholarship Repository. For more information, please contact scholarshiprepository@richmond.edu.

ARTICLES

ENVIRONMENTAL LIENS AND TITLE INSURANCE

*Robert S. Bozarth**

I. THE ENVIRONMENTAL PROBLEM

Increased concern for the environment and environmental protection laws have affected title insurance. To understand this effect, it is necessary to examine our environmental problems, the environmental laws and the nature of title insurance. This article also looks at the title insurance industry's reaction to these environmental risks as compared to the reaction of the property/casualty insurance industry.

The Environmental Protection Agency ("EPA") has identified 27,000 sites across the country polluted with substantial toxic and hazardous materials and waste.¹ The cost of returning these sites to pristine condition exceeds what our economy can afford, even if the cleanup is spread over a number of years.² To project an economically attainable estimate for the cleanup, EPA officials must set priorities among the sites and compromise their standards for acceptable levels of cleanup. Even if only the most hazardous sites are neutralized, the cost of cleanup is estimated to be \$50 to \$100 billion.³

The \$100 billion exceeds the surplus of the entire property/casu-

* Counsel, Major Transactions Section of the Law Division, Lawyers Title Insurance Corporation, Richmond, Virginia; B.S., 1967, J.D., 1975, University of Virginia.

1. Wall St. J., May 11, 1988, at 1, col. 6.

2. *Id.* The EPA predicts that cleanup of each polluted site might cost an average of \$25 million per site, but for the most troublesome sites, the agency predicts the cleanup cost could reach as high as \$100 million per site. The EPA has identified 27,000 sites—suggesting a total cleanup bill in the hundreds of billions. However, EPA assistant administrator J. Winston Porter observes that "society won't be willing to spend that kind of money." *Id.*

3. *Id.*

ality insurance industry. The title insurance industry is a small fraction of that size. The insurance industry has insufficient resources to remedy our environmental problem, but policyholders who must correct environmental damage are seeking contribution from their insurance carriers. The insurance industry views this potential exposure as its "most serious economic problem in the 1990's."⁴

The big contrast in these insurance claims is between policyholders and their property/casualty carriers over liability under Comprehensive General Liability ("CGL") policies. For example, Shell Oil Company, the United States Army and the EPA agreed to share cleanup expenses at a chemical warfare plant converted to a pesticide plant.⁵ Shell will pay \$320 million of the first \$700 million in cleanup expenses and 20% of the expenses over \$720 million. Shell is suing 250 insurers in an effort to recover these costs.⁶

Corporations facing environmental cleanup liabilities are reconstructing their CGL policy histories in an effort to discover liability coverage in the old policies. Shell is attempting to use older occurrence policies that expired years and even decades ago, but which may cover portions of Shell's liability for the cleanup.⁷

Environmental cleanups frequently involve pollution of soil and underground water aquifers as well as the water and air. Therefore, title insurance carriers should expect policyholders to seek environmental liability coverage in title insurance policies. The risk to title insurers arises from (i) federal and state statutes that establish liens on real property to compensate a governmental body for

4. *Id.* at 11, cols. 1-2. Site owners are spending millions of dollars in a legal effort to transfer the cost to their insurers. If they succeed, "Crum and Forster will disappear," says Leslie Cheek, Senior Vice President of the casualty underwriter, a subsidiary of Xerox Corporation. Crum and Forster, with premiums of \$4.5 billion a year, is the country's 13th largest property-casualty insurer. *Id.*

Andre Maisonpierre, President of the Reinsurance Association of America, agrees that "[i]f the insurance industry gets stuck with even a quarter of the estimated cleanup costs [it will cause] major insolvencies." *Id.* at 11, col. 2.

5. *Docker, Shell v. Travelers Insurance; Toxic Cleanup: Will Insurers Get the Bill?* AM. LAW., Mar. 1988 (Bus. Supp.) at 6, 9.

6. Wall St. J., May 11, 1988, at 11, col. 2. The county court was too small for lawyers from 30 firms, their support staffs and equipment, so proceedings are being held in the converted auditorium of an old high school building near San Francisco. "The cost of litigation itself, I'm confident, will exceed \$50 million," stated Thorn Rosenthal, a Shell attorney. *Id.*

7. *Docker, supra* note 5, at 9.

money spent on correcting environmental damage⁸ and (ii) customer requests for determinations of past ownership and use of land to evaluation the likelihood of contamination.⁹

II. CERCLA, THE FEDERAL SUPERFUND STATUTE

The Comprehensive Environmental Response, Compensation and Liability Act of 1980¹⁰ ("CERCLA" or "Superfund") created a fund to finance remedial cleanups when "any hazardous substance is released or there is a substantial threat of such a release into the environment."¹¹ The Superfund Amendments and Reauthorization Act of 1986¹² ("SARA") restructured CERCLA and granted the EPA the power to assert liens on lands if CERCLA funds were spent for response costs.¹³ SARA also created a demand for chain of title searches as a requirement for establishing the "innocent party defense" to CERCLA liability. The SARA amendments created direct burdens on real estate title conveyancing which have profoundly affected the title insurance industry.

CERCLA also established the National Priorities List¹⁴ ("NPL"). The NPL designates properties that are contaminated with hazardous materials to such an extent that they require the federal government's immediate attention. Two thousand of the estimated 27,000 contaminated sites in the United States, eventually may be listed on the NPL. Cleanup of the remaining sites will be the responsibility of the property owners and the state environmental departments.

A. CERCLA Liability

CERCLA imposes strict, joint and several cleanup liability, without regard to fault, on an owner or operator of a facility that has released a pollutant or contaminant. The expansive definitions of these terms are important because they identify who will be liable

8. See *infra* notes 46-48 and accompanying text.

9. See *supra* text accompanying notes 4-8.

10. 42 U.S.C. §§ 9601-9657 (1982).

11. *Id.* § 9604(a)(1)(A).

12. Pub. L. No. 99-499, 100 Stat. 1613 (1986) (amending 42 U.S.C. § 9601).

13. Response costs include the cleanup or removal of released hazardous substances, preventative actions, monitoring of sites, storage of materials and permanent relocation of residents. 42 U.S.C. §§ 9601(23), (24), (25) (Supp. IV 1986). The response costs constitute a lien. *Id.* § 9607(1).

14. 40 C.F.R. § 300 app. B (1988) (actual list by rank as of July, 1987).

for cleanup and they demonstrate the broad scope of CERCLA liability. For example, the term "owner or operator" includes all current owners and operators and, in some instances, past owners and operators.¹⁵ A facility is "any site or area where a hazardous substance has . . . come to be located."¹⁶ Liability for cleanups and interest on the amount of damages is imposed on all current owners and operators, some past owners and operators, and persons involved in transporting hazardous substances.¹⁷

The defenses to CERCLA liability are narrowly drawn and difficult to establish. An otherwise responsible party can avoid liability only if he shows that the damages were caused solely by an act of God, an act of war, or the act of a third party who was not his employee or agent and with whom he did not stand in a contrac-

15. In part, the current version of CERCLA defines "owner or operator" as:

(ii) in the case of an onshore facility or an offshore facility, any person owning or operating such facility, and (iii) in the case of any facility, title or control of which was conveyed due to bankruptcy, foreclosure, tax delinquency, abandonment, or similar means to a unit of State or local government, any person who owned, operated, or otherwise controlled activities at such facility immediately beforehand. Such term does not include a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility.

42 U.S.C. § 9601(20)(A) (1982 & Supp. IV 1986).

16. *Id.* § 9601(9)(B).

17. The Code defines persons subject to liability and the costs for which they are liable:

(a) Notwithstanding any other provision or rule of law, and subject only to the defenses set forth in subsection (b) of this section--

(1) the owner and operator of . . . a facility,

(2) any person who at the time of disposal of any hazardous substances owned or operated any facility at which such hazardous substances were disposed of,

(3) any person who by contract, agreement, or otherwise arranged for disposal or treatment, or arranged with a transporter for transport for disposal or treatment, of hazardous substances owned or possessed by such person, by any other party or entity, at any facility or incineration vessel owned or operated by another party or entity and containing such hazardous substances, . . .

(4) . . . shall be liable for—

(A) all costs of removal or remedial action incurred by the United States Government or a State or an Indian tribe not inconsistent with the national contingency plan;

(B) any other necessary costs of response incurred by any other person consistent with the national contingency plan;

(C) damages for injury to, destruction of, or loss to natural resources, including the reasonable costs of assessing such injury, destruction, or loss resulting from such a release; and

(D) the cost of any health assessment or health effects study carried out under section 9604(i) of this title.

The amount recoverable in an action under this section shall include interest on the amounts recoverable under subparagraphs (A) through (D).

42 U.S.C. § 9607(a) (Supp. IV 1986).

tual relationship.¹⁸ In addition, the responsible party must establish that he exercised due care with respect to the hazardous substances and that he took precautions against foreseeable acts or omissions of the third party.¹⁹

A contractual relationship includes "land contracts, deeds, or other instruments transferring title or possession."²⁰ The current owner or operator as well as the owner or operator at the time the hazardous substances were discharged into the environment are liable under section 9607(a) which provides no defense for those who purchased contaminated property.²¹ Thus, a purchaser of contaminated property may be liable for the cleanup of pollution from a prior owner's business because of the contractual relationship inherent in a transfer of title.²²

A lessor can find staggering cleanup liability for their lessee's discharge of hazardous materials. The appalling extent of this liability is illustrated in *Burlington Northern Railroad Co. v. Dant & Russell, Inc. (In re Dant & Russell, Inc.)*.²³ Burlington leased property to Dant & Russell, an adjacent landowner, to operate a

18. Section 9607(b) provides for the following defenses:

(b) There shall be no liability under subsection (a) of this section for a person otherwise liable who can establish by a preponderance of the evidence that the release or threat of release of a hazardous substance and the damages resulting therefrom were caused solely by—

(1) an act of God;

(2) an act of war;

(3) an act or omission of a third party other than an employee or agent of the defendant, or than one whose act or omission occurs in connection with a contractual relationship, existing directly or indirectly, with the defendant . . . if the defendant establishes by a preponderance of the evidence that (a) he exercised due care with respect to the hazardous substance concerned, taking into consideration the characteristics of such hazardous substance, in light of all relevant facts and circumstances, and (b) he took precautions against foreseeable acts or omissions of any such third party and the consequences that could foreseeably result from such acts or omissions;

or

(4) any combination of the foregoing paragraphs.

42 U.S.C. § 9607(b) (1982).

The defenses to CERCLA liability established in subsection (b) expand the definition of owner or operator by expressly including employees, agents and those with a contractual relationship with the defendant.

If a third party deposits hazardous waste on the land of a current owner, that innocent owner must clean up the waste. The EPA will require the cleanup and only intervene to conduct the cleanup if the owner cannot.

19. *Id.*

20. *Id.* § 9601(35)(A) (Supp. IV 1986).

21. *See supra* notes 18-19 and accompanying text.

22. *New York v. Shore Realty Corp.*, 759 F.2d 1032 (2d Cir. 1985).

23. 853 F.2d 700 (9th Cir. 1988).

wood treatment plant. The lease contained an indemnification provision.²⁴ Dant & Russell entered bankruptcy and shortly thereafter, the Oregon Department of Environmental Quality found massive toxic waste contamination.²⁵ Burlington spent \$250,000 to mitigate the most serious hazards. Cleanup costs were estimated at \$10 to \$30 million.²⁶

Burlington renewed the leases after Dant & Russell filed for bankruptcy. The court did not approve the leases, and therefore it did not enforce the indemnification clause. The court also denied administrative priority for the cleanup costs.²⁷

Lenders are at risk as well. CERCLA's definition of owner excludes those holding indicia of ownership to protect a security interest.²⁸ Lenders are not provided a blanket exclusion from liability. For example, CERCLA response costs were imposed on lender, Maryland Bank and Trust Co.²⁹ In the 1970's, Maryland Bank and Trust made business loans to the owners of a 117-acre Maryland farm. The owners used the loans to start a waste disposal business on the farm.³⁰ In 1980, the bank loaned \$335,000 to the owners' son to purchase the farm. The son defaulted and the bank purchased the farm in its own foreclosure sale.³¹ The son then notified the EPA of hazardous wastes on the farm. The EPA investigated, found hazardous substances, and ordered the bank to clean up the site. When the bank refused, the EPA used Superfund monies to remove the drums and the contaminated soil found on the farm. The EPA then sued the bank to recover the cleanup costs.³²

Maryland Bank claimed that it was merely holding indicia of ownership to protect its security interest and that the wastes were dumped by the previous owners.³³ The court found the bank to be an owner or operator under CERCLA. The court cited to Maryland Bank and Trust's long involvement in the affairs of its borrowers and to the extended time over which the bank held title

24. *Id.* at 702.

25. *Id.*

26. *Id.*

27. *Id.* at 703.

28. 42 U.S.C. § 9601(20)(A) (1982).

29. *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573 (D. Md. 1986).

30. *Id.* at 575.

31. *Id.*

32. *Id.* at 575-76. The Bank loaned \$335,000 to the son and then bid \$381,500 at the foreclosure sale. The clean-up cost was \$551,731.50. *Id.*

33. *Id.* at 578.

after the foreclosure as factors which influenced the court's decision.³⁴ The bank would not be considered an owner without this involvement.

Liability for an environmental cleanup coupled with the loss of security for a loan create a lender's worst nightmare. Some banks have already been stuck with huge cleanup bills when property they acquired from improvident borrowers came with environmental liability.³⁵ The problem is serious enough that it attracted the attention of the Comptroller of the Currency.³⁶ Secured lenders face an uncomfortable dilemma with this potential direct liability for a cleanup under CERCLA. If they elect to foreclose on a troubled property, they risk direct liability for cleanup of any hazardous material on the land. The liability is without regard to fault, the value of the property, or the amount of the lender's investment. If lenders choose to forego foreclosure, for all intents and purposes, they are unsecured lenders. The innocent party defense in CERCLA provides some security, but is not a safe harbor from this dilemma.

B. *The Innocent Party Defense to Liability*

The innocent party defense arises from the definitions of owner or operator and contractual relationship.³⁷ The definition of owner or operator excludes "a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility."³⁸ As Maryland Bank and Trust unfortunately discovered, a lender that forecloses may not be entitled to the exclusion if its ownership is

34. *Id.* at 579. The court remanded the case to the trial court to determine if Maryland Bank met the requirements for the third party defense. *Id.* This is a pre-SARA case, and the law is tougher now. It may not take as much involvement to incur liability.

35. Wall St. J., May 11, 1988, at 11, col. 2. For example, Mellon National Bank in Pittsburgh was liable for an undisclosed amount when it involved itself in managing the affairs of a defaulting borrower. Similar situations have been encountered by Midlantic National Bank of New Jersey, Landmark Bank of St. Louis and Maryland Bank and Trust Co. *Id.*

To avoid liability, the National Bank of Fredericksburg, Virginia, chose to forfeit \$200,000 it had loaned a small firm. The borrower, in bankruptcy, faced a \$2.2 million cleanup bill. Senior loan officer Nancy Embrey said, "We don't intend to foreclose such properties." *Id.* at 11, col. 3. In an attempt to avoid liability in the future, banks such as Mellon National now undertake environmental audits of loan customers and foreclosable property. *Id.*

36. *Id.* at 11, col. 2. John Noonan, director of commercial activities for the office, has assigned bank examiners to assess the extent of the problem. *Id.*

37. See *supra* note 15 and accompanying text.

38. 42 U.S.C. § 9601(20)(A)(iii) (1982 & Supp. IV 1986).

not primarily to protect a security interest.³⁹ Participation in the management of the facility can cause the lender to be classified as a responsible owner.

To escape liability for CERCLA response costs, especially after a foreclosure, a lender must also establish that no contractual relationship exists with the borrower. Under SARA, transfer of land creates such a contractual relationship.⁴⁰

Notwithstanding the contractual relationship, the current owner (the foreclosing lender) may still be entitled to the third party defense. The lender/owner must show it had no reason to know when it acquired the property that it was contaminated. The lender can show this by making "all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability."⁴¹ This amendment prompted an outpouring of requests by lenders for chain of title searches to satisfy the "no reason to know" requirement.

Currently, to avoid liability under section 9607(a), a lender must prove three things. First, the lender is limited to indicia of ownership for the protection of a security interest. Thus, the exclusion can be lost if the lender forecloses and does not promptly resell the property. The length of time Maryland Bank and Trust held title to property after foreclosure was one factor leading to direct

39. See *supra* text accompanying notes 29-34.

40. 42 U.S.C. § 9601(35)(A) (Supp. IV 1986).

(35)(A) The term "contractual relationship," for the purpose of section 9607(b)(3) of this title, includes, but is not limited to, land contracts, deeds or other instruments transferring title or possession, unless the real property on which the facility concerned is located was acquired by the defendant after the disposal or placement of the hazardous substance on, in, or at the facility, and one or more of the circumstances described in clause (i), (ii), or (iii) is also established by the defendant by a preponderance of the evidence:

(i) At the time the defendant acquired the facility the defendant did not know and had no reason to know that any hazardous substance which is the subject of the release or threatened release was disposed of on, in, or at the facility.

(ii) The defendant is a government entity which acquired the facility by escheat, or through any other involuntary transfer or acquisition, or through the exercise of eminent domain authority by purchase or condemnation.

(iii) The defendant acquired the facility by inheritance or bequest.

Id.

41. *Id.* § 9601(35)(B). The owner must also show it acquired title after the hazardous substances were placed on the property, and it complied with the due care and precautionary requirements of § 9607(b). *Id.*

liability.⁴²

Second, the lender must prove that it did not participate in the management of its borrower. *United States v. Mirabile*⁴³ involved a CERCLA action against the owners of land formerly used by Turco Coatings, Inc., a paint company. One of Turco's two lenders, American Bank and Trust Company, was able to establish the third party defense. The other lender, Mellon Bank, failed to establish the defense because a bank employee had "day-to-day hands on involvement" in Turco.⁴⁴

Finally, the innocent third party must prove it was unaware that hazardous substances were on the land and there was no reason to suspect their presence. Under the SARA amendments, the lender must inquire into the history of the property to determine if past ownership or use suggests that the property might be contaminated. If the lender and owner can establish these three factors they can avoid liability for response costs.

C. CERCLA Liens

CERCLA, as amended by SARA, permits the EPA to file a lien against the property to recover superfunds used in its cleanup once liability is established.⁴⁵ CERCLA liens have conventional priority,⁴⁶ but may be filed either in: (i) the designated local land records office or (ii) if none is designated, the office of the clerk of

42. *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573, 579 (D. Md. 1986).

43. *United States v. Mirabile*, 15 Env'tl. L. Rep. (Env'tl. L. Inst.) 20992 (E.D. Pa. Sept. 4, 1985).

44. *Id.* at 20997. In *Maryland Bank & Trust Co.*, 623 F. Supp. 573, the Maryland district court also cited the bank's involvement as a factor in determining liability for cleanup costs. See *supra* notes 33-34 and accompanying text.

45. 42 U.S.C. § 9607(l) (Supp. IV 1986).

46. *Id.* The priorities of the CERCLA liens created by SARA are:

(3) Notice and validity. The lien imposed by this subsection shall be subject to the rights of any purchaser, holder of a security interest, or judgment lien creditor whose interest is perfected under applicable State law before notice of the lien has been filed in the appropriate office within the State (or county or other governmental subdivision), as designated by State law, in which the real property subject to the lien is located. Any such purchaser, holder of a security interest, or judgment lien creditor shall be afforded the same protections against the lien imposed by this subsection as are afforded under State law against a judgment lien which arises out of an unsecured obligation and which arises as of the time of the filing of the notice of the lien imposed by this subsection. If the State has not by law designated one office for the receipt of such notices of liens, the notice shall be filed in the office of the clerk of the United States district court for the district in which the real property is located.

Id. § 9607(l)(3).

the United States district court where the land is located.⁴⁷ A title examiner must determine whether the local recorder's office or the United States district court records must be searched in order to find these liens. The Uniform Federal Lien Registration Act or similar state legislation requires CERCLA liens to be filed in the designated land records.⁴⁸

In a reaction to the SARA amendments, the American Land Title Association ("ALTA") entered into an arrangement with the EPA.⁴⁹ EPA will now provide the ALTA with periodic lists of the properties on which the CERCLA liens have been filed. The current EPA list of filed liens is relatively short and the lien amounts are modest. The list is helpful, but the lag in time between the liens being recorded and preparation of the list decreases its usefulness.

Only twenty-two CERCLA liens were filed nationwide in the first year following enactment of SARA.⁵⁰ Consequently, the United States district court clerks have not rushed into elaborate indexing and filing systems for these liens. A title examiner may encounter difficulties in locating a CERCLA lien even if its existence is known or suspected.

47. *Id.*

48. The Uniform Federal Lien Registration Act or similar legislation is enacted in the following states: CAL. CIV. PROC. CODE § 2100 (West 1983 & Supp. 1989); COLO. REV. STAT. § 38-25-101 (Supp. 1987); CONN. GEN. STAT. ANN. § 47-36 (West 1986); IDAHO CODE § 45-201 (Supp. 1988); ILL. ANN. STAT. ch. 82, para. 66 (Smith-Hurd 1987 & Supp. 1988); IND. CODE ANN. § 36-2-11-25 (Burns Supp. 1988); Kan. Stat. Ann. § 79-2613 (SUPP. 1988); Ky. Rev. Stat. Ann. § 382.480 (MICHIE/BOBBS-MERRILL SUPP. 1988); La. Rev. Stat. Ann. § 52:51 (WEST SUPP. 1989); Me. Rev. Stat. Ann. tit. 33, § 1801 (Supp. 1988); MD. REAL PROP. CODE ANN. § 3-401 (Supp. 1988); MASS. GEN. LAWS ANN. ch. 36, § 24 (West Supp. 1988); MICH. COMP. LAWS ANN. § 211.661 (West 1986); MINN. STAT. ANN. § 272.479 (West Supp. 1989); Mo. ANN. STAT. § 14.010 (Vernon Supp. 1989); MONT. CODE ANN. § 71-3-201 (1986); NEB. REV. STAT. § 52-1001 (Reissue 1987); NEV. REV. STAT. ANN. § 108.825 (Michie 1986); N.H. REV. STAT. ANN. § 454-B (Supp. 1988); N.M. STAT. ANN. § 48-1-1 (1978 & Supp. 1988); N.Y. LIEN § 240 (McKinney Supp. 1989); N.D. CENT. CODE § 35-29-01 (1987); OHIO REV. STAT. ANN. § 317.09 (Page Repl. Vol. 1987); OKLA. STAT. ANN. tit. 68, § 24301 (West Supp. 1988); OR. REV. STAT. ANN. § 87.806 (Repl. Vol. 1988); R.I. GEN. LAWS § 34-34-1 (Supp. 1988); S.D. CODIFIED LAWS ANN. § 44-7-1 (Supp. 1988); TENN. CODE ANN. § 66-21-201 (Supp. 1988); TEX. PROP. CODE ANN. § 12.010 (Vernon 1984); VA. CODE ANN. § 55-142.1 (Cum. Supp. 1988); WASH. REV. CODE ANN. § 60.68.005 (Supp. 1989); WISC. STAT. ANN. § 779.97 (West 1981 & Supp. 1988); WYO. STAT. § 29-6-201 (Supp. 1988). Legislation is pending in Mississippi, New Jersey and Pennsylvania.

49. James R. Maher, Executive Vice President of Americans Land Title Association, negotiated this agreement. See *infra* note 132.

50. For additional information contact The American Land Title Association. See *infra* note 131.

D. *The Other Federal Environmental Statutes*

The Resource Conservation and Recovery Act ("RCRA"),⁵¹ the National Environmental Policy Act ("NEPA"),⁵² the Toxic Substances Control Act ("TSCA")⁵³ and other federal statutes⁵⁴ regulate the use of land and the handling of hazardous materials and wastes. The statutes impose new and troubling problems for owners, users and purchasers of real estate. For the most part, these federal statutes regulate the creation, handling, transportation and disposal of hazardous materials. They have a profound impact on the operations of landowners, but have little impact on land conveyances.

CERCLA is the most important federal statute to title insurers. The lien and title chain requirements overshadow any conveyancing regulations in the other statutes. Also, CERCLA is an environmental response statute and establishes a means to clean up hazardous materials released into the environment. CERCLA applies to materials present for a few hours or for a century. The liability for response costs poses a substantial threat to purchasers and to lenders because the unknown presence of hazardous materials on the newly purchased property can lead to response costs. Also, CERCLA is the only response statute which applies to all states, territories and districts.⁵⁵

CERCLA, other federal statutes, and the federal government are not the only players on the field. The states have enacted similar legislation, and in many cases, the remedies surpass any available to the federal government.

III. STATE ENVIRONMENTAL LEGISLATION

There are six areas of concern to title insurers in the body of state law regulating the environment. First, there are state environmental response statutes, the state equivalent of CERCLA.

51. Resource Conservation and Recovery Act, 42 U.S.C. § 6901 (1982 & Supp. IV 1986).

52. National Environmental Policy Act, 42 U.S.C. § 4321 (1982 & Supp. IV 1986).

53. Toxic Substances Control Act, 15 U.S.C. § 2601 (1982).

54. Other significant federal environmental statutes which can have an appreciable impact on landowners are:

1. The Safe Drinking Water Act, 42 U.S.C. § 300(f) (1982 & Supp. IV 1986).

2. The Refuse Act, 33 U.S.C. § 407 (1982).

3. Clean Water Act, 33 U.S.C. § 1251 (1982 & Supp. IV 1986). 4. Clean Air Act, 42 U.S.C. § 7401 (1982 & Supp. IV 1986).

55. 42 U.S.C. § 9601(8) (1982).

Second, there are state statutes which require an inspection and clean bill of health before real property may be transferred. Third, there are statutes dealing with weed control, restoration and closure of mines and wells, regulation of hospitals, dry cleaners, gasoline stations, and other businesses, which may include provisions for liens for enforcement. Fourth, there are statutes that provide for forfeiture of contaminated land or leaseholds. Fifth, there are secret liens which may attach to property without notice in the land records where the property is located. Finally, there are superliens which provide that the lien for reimbursement of cleanup expenses has a priority over all existing liens, even those recorded before the release of hazardous material occurred.

Judgment calls are required to classify state environmental statutes into specific categories. State cleanup remedies are not always contained in a distinct statute or chapter. Often these remedies are contained in environmental waste management statutes similar to the federal RCRA, NEPA, SDWA, the Clean Water Act, and the Clean Air Acts. Provisions distinct from any category can be mixed together and even overlap.

Title insurers are more concerned about the effect of the cleanup remedies than waste management or regulatory provisions. Also, statutes without lien or forfeiture provisions have little effect on land conveyancing and titles, even if they do exert a material influence on any decision to purchase land. Statutes without lien provisions always grant authority to state officials to sue and recover any response costs advanced by the state. Of course, state statutes with lien provisions are not plagued by the federal problem of securing local authorization to file lien notices. The title examiner's burden to determine where to look for a notice of lien is usually simplified.

A. *State Emergency Response Statutes*

State emergency response statutes provide for state cleanup of hazardous waste. These statutes are grouped into three basic categories. In the first category are statutes with no emergency fund and no lien provisions. These are found in states which have not created specific environmental cleanup funding and may only require responsible parties to report releases of contamination. These statutes do not provide for liens because they do not author-

ize the state to spend money to clean up a spill.⁵⁶

In the second and largest group are the statutes that authorize expenditures from emergency funds for remedial responses, but do not establish a lien on the land to secure repayment of the funds.⁵⁷ In 1981, California enacted a statute that authorizes the state attorney general to sue for recovery instead of authorizing a lien.⁵⁸ An independent priority list, modeled on the NPL, includes a list of sites to be cleaned up.⁵⁹ The first two categories of statutes do not present the threat of a lien, but they bear watching because lien provisions can be added.

In the third category are statutes that establish the states have established their own environmental emergency funds similar to the federal Superfund and that provide for liens to secure reimbursement of funds spent as response costs.⁶⁰ These statutes have distinctive features, like superliens, and will be discussed individually.

Virginia is a curiosity because its code has examples of both the second and third category statutes. In 1983, Virginia established the Virginia Disaster Response Fund.⁶¹ The Virginia Hazardous

56. See, e.g., ARIZ. REV. STAT. ANN. § 49-141 (1988); GA. CODE ANN. §§ 12-8-60 to -8-83 (1981 & Supp. 1988); IND. CODE ANN. §§ 13-6-2-1 to -10 (Burns Supp. 1988); NEB. REV. STAT. §§ 81-1501 to -15,146 (1987 & Supp. 1988).

57. See ALASKA STAT. § 46.08.005 (1987); ARK. STAT. ANN. § 8-7-516 (1987); CAL. HEALTH & SAFETY CODE §§ 25300, 25382 (West 1984 & Supp. 1988); COLO. REV. STAT. § 29-22 101 (1986); FLA. STAT. ANN. § 403.011 (West 1986); IDAHO CODE § 39-4417 (1985); Emergency Response Fund, House File 2338, 1988 Iowa Legis. Serv. 397 (to be codified at IOWA CODE ANN. 29C. 8A); KAN. STAT. ANN. § 65-3430 (1985); KY. REV. STAT. ANN. § 224.876 (Baldwin Supp. 1988); LA. REV. STAT. ANN. § 30:2198 (West 1989); MD. ENV'T CODE ANN. § 7-218 (1987); MISS. CODE ANN. § 17-17-1 (Supp. 1988); MO. ANN. STAT. § 260.480 (Vernon Supp. 1989); MONT. CODE ANN. § 75-10-701 (1987); NEV. REV. STAT. ANN. § 459.735 (Michie Supp. 1987); N.M. STAT. ANN. § 74-4-8 (1988); N.C. GEN. STAT. § 130A-310.6 (Supp. 1988) (statute allows access to the Carolina Clean Drinking Water Fund); OKLA. STAT. tit. 62, § 139.47 (1989); R.I. GEN. LAWS § 23-19.1-23 (1985); S.C. CODE ANN. § 44-56-160 (Law. Co-op. Supp. 1988); TEX. WATER CODE ANN. § 26.265 (Vernon 1988); VT. STAT. ANN. tit. 10, § 1283 (1984 & Supp. 1988); VA. CODE ANN. § 44-146.37 (Cum. Supp. 1988) (statute allows access to the Disaster Response Fund); W. VA. CODE § 20-5G-1 (1985); WIS. STAT. ANN. § 25.46 (West Supp. 1988).

58. CAL. HEALTH & SAFETY CODE § 25300 (West 1984) (used CERCLA as a model and referenced CERCLA provisions).

59. *Id.* § 25356.

60. OHIO REV. CODE ANN. § 3734.01 (Anderson 1988); OR. REV. STAT. § 466.205 (1987); VA. CODE ANN. § 0.1-1406 (Cum. Supp. 1988); WASH. REV. CODE ANN. § 70.105B.150 (Supp. 1989).

61. VA. CODE ANN. § 44-146.18:1 (Repl. Vol. 1986).

Materials Emergency Response Program⁶² enacted in 1987, authorized expenditures from the Disaster Response Fund for "hazardous materials emergency response operations."⁶³ However, neither section provides a lien for recovery of expended funds.

In 1986, Virginia enacted the Virginia Waste Management Act⁶⁴ which has many similarities to federal RCRA but establishes a Virginia Solid and Hazardous Waste Contingency Fund.⁶⁵ This fund is to be used for "responding to solid or hazardous waste incidents"⁶⁶ and provides for a lien to secure reimbursement of amounts spent from the fund.⁶⁷

Both the Disaster Response Fund and the Waste Management Act can be classified as environmental response fund statutes although one appears in a waste management chapter. They illustrate the difficulty of classifying state emergency response statutes.

B. *State Environmental Transfer Requirement Statutes*

New Jersey enacted the first statute requiring either (i) a "negative declaration" (indicating to the state that a property is clean), or (ii) an environmental inspection before certain classes of real property may be transferred. The Environmental Cleanup Responsibility Act ("ECRA")⁶⁸ allows the state to order contaminated property cleaned up before it can be abandoned, sold or leased.⁶⁹

As a penalty the New Jersey Department of Environmental Protection or an innocent purchaser may rescind a sale or transfer of the property.⁷⁰ A title insurance policy in New Jersey that omits the exclusion for environmental protection laws risks a total failure of title. Consequently, the New Jersey Insurance Department refuses to allow title insurers to insure against loss or damage as the result of noncompliance with ECRA.⁷¹

ECRA, with its rescission provisions, is easily the most compre-

62. *Id.* § 44-146.34 (Cum. Supp. 1988).

63. *Id.* § 44.146.37.

64. *Id.* § 10.1-1400 (Cum. Supp. 1988).

65. *Id.* § 10.1-1406.

66. *Id.* § 10.1-1406(A).

67. *Id.* § 10.1-1406(c).

68. N.J. STAT. ANN. § 13:1K-6 (West Supp. 1988).

69. *Id.* § 13:1K-11.

70. *Id.* § 13:1K-13.

71. Lawyers Title Insurance Corporation filed such policies and they were not approved. Colleagues in the industry experienced similar denials.

hensive of these state acts. Other states with similar but less potent statutes include Connecticut,⁷² Illinois,⁷³ Minnesota,⁷⁴ Pennsylvania,⁷⁵ and West Virginia.⁷⁶

C. *Collateral Regulation Including Environmental Provisions*

Many state environmental statutes regulate conditions that are not serious enough to make CERCLA's NPL, but require state and local governments to fund environmental responses. These statutes might create liens for nuisance abatement, cutting weeds, removal of condemned structures, and closing or reclamation of mines or wells. Virtually every state has enacted such statutes, but they rarely include lien provisions.⁷⁷

Other statutes to regulate various industries that use, transport, or dispose of hazardous or toxic substances. A state may include penalty provisions for violation of the regulations. Virginia's Waste Management Act⁷⁸ might be classified under this heading, as well as under the environmental response fund statutes. Statutes regulating infectious or chemotherapeutic waste from medical facilities are now appearing in state codes.⁷⁹ Obscurity is the greatest danger these statutes pose to a title insurer. They may be scattered throughout the states' code and may be in the most unlikely locations. Title insurance can protect against loss of priority of an insured mortgage. When a state statute allows environmental liens and the title insurer fails to notice the lien, no exception will be provided in the insurance policy, leaving the insurer liable for environmental liens.

D. *Forfeiture and Recision Statutes*

Forfeiture statutes provide for a forfeiture to the state as reimbursement for cleanups. Recision statutes provide a private right

72. CONN. GEN. STAT. ANN. § 22a-134 (West Supp. 1988).

73. ILL. ANN. STAT. ch. 111-½, paras. 1021(n), 1039(g) (Smith-Hurd 1988).

74. MINN. STAT. ANN. § 115B.16 (West 1987).

75. PA. CONS. STAT. ANN. tit. 35, § 6018.405 (Purdon Supp. 1988).

76. W. VA. CODE § 20-5E;20 (1985).

77. Citation to these statutes would not be helpful and is beyond the scope of this article.

78. VA. CODE ANN. § 10.1-1400 (Cum. Supp. 1988).

79. CAL. HEALTH & SAFETY CODE § 25117.5 (West Supp. 1988); IND. CODE ANN. § 16-1-9.7-1 (Burns Supp. 1988); Infectious and Chemotherapeutic Disposal Act, Act No. 1988-93, 1988 Pa. Legis. Serv. 370 (Purdon) (to be codified at 35 PA. CONS. STAT. § 6019.1-.6).

of action to purchasers or landlords to protect them against loss from enforcement of environmental liens.

The Maine Uncontrolled Hazardous Substance Sites statute⁸⁰ provides for two remedies: a forfeiture and a superlien.⁸¹ The statute defines an "uncontrolled hazardous substance site" as an "area or location . . . at which hazardous substances are or were handled or otherwise came to be located, if . . . the site poses a threat or hazard."⁸² Section 1370, which was part of the original statute, provides that all real estate, appurtenances, improvements, etc., used in violation of the chapter shall be subject to forfeiture to the state.⁸³ The superlien provision, enacted in 1987, appears to make the forfeiture provision unnecessary. Perhaps the superlien provision was intended to replace the forfeiture provisions, but it did not repeal or amend Section 1370.

Rhode Island, in the Hazardous Waste Management chapter,⁸⁴ provides for forfeiture of property used in violation of the chapter.⁸⁵ The forfeiture provision lists only personal property items as examples, and no express language in the statute prevents forfeiture of real estate if the land is used for illegal dumping of wastes.⁸⁶

Ohio authorizes the director of environmental protection to "acquire by purchase, gift, donation, contribution or *appropriation*" facilities containing significant quantities of hazardous wastes.⁸⁷ Appropriation is simply the exercise of the power of eminent domain. If significantly contaminated property and a security interest lien are valued as worthless, the appropriation could be tantamount to forfeiture.⁸⁸

The California Superfund now requires a seller to disclose to the buyer any knowledge or suspicion of the presence of hazardous waste on the property.⁸⁹ Failure to disclose this information subjects the seller to "actual damages and any other remedies pro-

80. ME. REV. STAT. ANN. tit. 38, § 1361 (Supp. 1988).

81. *Id.* §§ 1370, 1371.

82. *Id.* § 1362(3).

83. *Id.* § 1370.

84. R.I. GEN. LAWS § 23-19.1 (1985 & Supp. 1988).

85. *Id.* § 23-19.1-17.1.

86. *Id.*

87. OHIO REV. CODE ANN. § 3734.23 (Anderson Repl. Vol. 1988) (emphasis added).

88. The property could be valued with a net liability and be less than worthless.

89. CAL. HEALTH & SAFETY CODE § 25359.7 (West Supp. 1989).

vided by law."⁹⁰ Additionally, a landlord may void a lease or rental agreement of real property if the lessee or renter fails to notify the owner of the presence or suspected presence of a hazardous substance on or beneath the real property.⁹¹ This amendment does not apply to property used exclusively for residential purposes.⁹²

Whether a forfeiture provision or the power to void a sale or transfer, the risk to the title insurer is the same: total failure of the title. The insurer can be liable to the owner or lessee for the loss or to a lender for the loss of its security under a mortgage or deed of trust.⁹³

E. *Secret Liens*

Some states' environmental statutes require a lien to be recorded in the county where the contaminated land is located. The lien, however, also applies to all other real property located in the state and owned by the party responsible for the cleanup. Needless to say, a title examination will not reveal the lien unless the state records the lien in every county, or the examiner searches the land records in every county where the insured owns real property. Such a lien is a secret lien.

A secret lien can affect conveyances of and security interests in land in two ways. First, the property and title can be carefully inspected to assess the risk of any possible environmental damage. This investigation is useless, however, if contamination on other land owned by the seller gives rise to a lien on all the seller's land.

Second, another form of a secret lien relates back to property transferred prior to the lien. Most statutes apply to land transfers within three years preceding the perfection of the lien.⁹⁴ These provisions apply only to land included within the same property description of the land where the costs were incurred in that three year period.⁹⁵ As long as a purchaser can determine that the land being purchased was not subdivided from a larger parcel in the preceding three years, there should be no risk of a secret relating back.

90. *Id.* § 25359.7(a).

91. *Id.* § 24359.7(b)(2). The lessee is also subject to damages. *Id.* § 25359.7(b)(1).

92. *Id.* § 25359.7(b)(2)(A).

93. The title insurance policy may include defenses in the exclusions from coverage which preclude liability.

94. CONN. GEN. STAT. ANN. § 22a-452a (West Supp. 1988); ME. REV. STAT. ANN. tit. 38, § 1371 (Supp. 1988).

95. CONN. GEN. STAT. ANN. § 22a-425a(c).

F. *Superliens*

Superliens are superpriority liens and are granted priority over all encumbrances on the lien property. Superliens even have priority over encumbrances recorded prior to the superlien or prior to the release of hazardous waste. Proponents justify superliens on the theory that the contaminated property is virtually worthless until it is cleaned up, so a lender with a security interest in the land should not receive a windfall when a state spends its funds to finance the cleanup. Since lenders shy from foreclosing against a property they suspect may require them to respond to a release of pollutants on the property, the theory certainly has some basis.

Arguably, a superlien expedites resolution of the environmental and economic problems caused by a release of hazardous material. A superlien discourages a lender, in a conventional lien state, from dragging its feet on cleanup and foreclosure while hoping that the state will shoulder the costs of the remedial work. When the state's response statute grants the state no lien or only a conventional lien, a lender can foreclose the state's conventional lien and realize a recovery on the freshly cleaned property.

Real estate interests argue that environmental cleanups are not so extraordinary to merit this superpriority lien when a conventional lien will do. The state can wait until the lender forecloses before it files its lien. The state can also bring an action against the new owner for recovery of its response costs. Whether liens or superliens are used, the statutes should be drafted with more care.

Connecticut,⁹⁶ Massachusetts⁹⁷ and New Jersey⁹⁸ enacted the first environmental superlien statutes. These statutes provide for a lien to secure repayment of state expenses for cleanup of pollution, spills, or concentrations of hazardous wastes. Superliens are accorded priority over any transfers or encumbrances created or filed after the superlien laws were enacted. Thus, superliens take priority over all transfers and encumbrances on the property recorded

96. CONN. GEN. STAT. ANN. § 22a-452a (West 1985) (enacted in 1984), *amended by* CONN. GEN. STAT. ANN. § 22a-452A (WEST SUPP. 1988).

97. MASS. GEN. LAWS ANN. ch. 21E, § 13 (West 1983), *amended by* MASS. GEN. LAWS ANN. ch. 21E, § 13 (West Supp. 1988).

98. N.J. REV. STAT. § 58:10-23.11(f) (1982) (enacted 1979), *amended by* N.J. REV. STAT. § 58:10-23.11(f) (Supp. 1988).

after the effective date of the statute.⁹⁹ This is an unprecedented priority. Of course, real estate taxes also enjoy a superpriority, but prospective purchasers and lenders can discover current and delinquent tax liabilities in the title examination. In addition, the total tax delinquency rarely exceeds a fraction of the value of a commercial or industrial property.

The first generation of superlien statutes were very harsh. Residential property was not exempt. A secret lien encumbered all the owner's property, polluted and unpolluted. The Federal National Mortgage Association ("FNMA") threatened to suspend purchasing residential loans from Connecticut and Massachusetts unless the statutes exempted residential property.¹⁰⁰ Applying these superliens to uncontaminated property created a furor. An innocent purchaser of clean property could lose it. When the seller of clean property owned contaminated property anywhere in the state, a lien against the contaminated property affected the clean property.

The statutes in Connecticut, Massachusetts, and New Jersey were amended to cure these objections.¹⁰¹ In 1987, Maine followed Connecticut, Massachusetts and New Jersey with a second-generation superlien statute.¹⁰²

Arkansas, Michigan, and Tennessee have statutes that provide environmental liens priority second only to real estate tax liens, effectively making them superliens.¹⁰³ Idaho appears to create a superlien in its Hazardous Waste Management Act of 1983.¹⁰⁴ Hazardous waste disposal fees are collected via a tax assessment upon the disposal of hazardous wastes, instead of a reimbursement for the cleanup of hazardous wastes.¹⁰⁵ Fee collection is governed by provisions of the income tax act which may give the fees priority over other lienholders.¹⁰⁶

99. See e.g., CONN. GEN. STAT. ANN. § 22a-452a(c) (West Supp. 1988).

100. Ackerman, 'Superfund' Revision Filed, Draws State Coalition's Fire, Boston Globe, May 16, 1984, at 21, col. 1; Isgur, *Nervous Title Insurers are Treading Softly Through Superfund Minifield*, BANKER AND TRADESMAN, Feb. 12, 1988.

101. CONN. GEN. STAT. ANN. § 22a-452a (West Supp. 1988); MASS. GEN. LAWS ANN. ch. 21E, § 13 (West Supp. 1988); N.J. REV. STAT. § 58:10-23.11(f) (Supp. 1988).

102. ME. REV. STAT. ANN. tit. 38, § 1371 (Supp. 1988).

103. ARK. STAT. ANN. § 8-7-516(b) (1987); MICH. COMP. LAWS ANN. § 299.543(3) (West Supp. 1988); TENN. CODE ANN. § 68-46-209(d) (Supp. 1988).

104. IDAHO CODE § 39-4431 (1985).

105. *Id.* § 39-4431(1).

106. *Id.*

The trend towards superliens has faltered recently. Arkansas and Tennessee deleted superlien provisions from their cleanup statutes.¹⁰⁷ In 1988, efforts to create environmental superliens in Kansas, New York, and Pennsylvania were defeated. The Illinois legislature intended to amend a recent bill to exclude a superlien. The superpriority provision remained, however, apparently because of confusion.¹⁰⁸

The Illinois statute is causing so much confusion that it is unlikely that it will be used in its present form to impose a lien on real property. Ironically, the strict environmental focus of these acts may have resulted in laws so intimidating that no administrator will be willing to enforce them, except in the most egregious cases where an innocent third party would not be affected.

IV. THE IMPACT OF BANKRUPTCY

Recent cases illustrate the pitfalls awaiting the unwary when bankruptcy enters the picture. Review of these cases is necessary in order to fully understand the impact of environmental statutes on the lending community.

A. *The Effect of a Borrower's Bankruptcy on a Lender*

A trustee of property in a bankruptcy proceeding must decide whether to abandon or clean up property that contains hazardous materials. In *Midlantic National Bank v. New Jersey Department of Environmental Protection*,¹⁰⁹ a waste oil processing company accepted oil contaminated with PCBs violating state and federal

107. ARK. STAT. ANN. § 8-7-516 (1987) (effective February 9, 1988); TENN. CODE ANN. § 68-46-209 (Supp. 1988) (effective January 1, 1989). Curiously, Arkansas did not disturb a superlien provision in its State Abandoned Mine Reclamation Program. ARK. STAT. ANN. 15-58-404 (1987).

108. The statute, enacted August 31, 1988, provides in relevant part:

An environmental reclamation lien shall be effective upon the filing by the Agency of a Notice of Environmental Reclamation Lien with the county office in which the real property lies and which has responsibility under State or local law for the recording of judgments against real property. . . . An environmental reclamation lien shall be superior to all other liens and encumbrances other than real estate tax liens, except that it shall not be valid as to any subsequent bona fide purchaser, mortgagee or other lienor whose rights in the real property arose prior to the filing of notice of the lien.

Act to amend The Environmental Protection Act, Public Act 85-1347, 1988 Ill. Legis. Serv. 2564 (West) (to be codified at ILL. ANN. STAT. ch. 111 ½ para. 1021.3).

109. 474 U.S. 494 (1986).

environmental laws. The New Jersey Department of Environmental Protection ordered cleanup of a storage facility, and the company filed Chapter 7 bankruptcy. The court-appointed trustee sought permission to abandon the storage facility, claiming that compliance with state and federal regulations would drain the funds from the estate and make the property burdensome and valueless.¹¹⁰ The Supreme Court held:

The Bankruptcy Court does not have the power to authorize an abandonment without formulating conditions that would adequately protect the public's health and safety. . . . [W]e hold that a trustee may not abandon property in contravention of a state statute or regulation that is reasonably designed to protect the public health or safety from identified hazards.¹¹¹

Timing is critical to a discharge of an environmental obligation. In *Ohio v. Kovacs*,¹¹² for instance, the Court held that prepetition cleanup expenses were dischargeable.¹¹³ The Court reasoned that the state's claim against the estate was reduced to a claim for money before the bankruptcy began.¹¹⁴ Thus, prepetition cleanup expenses can be discharged under *Kovacs*, but cleanup expenses incurred after the proceeding has been filed should be paid out of estate funds under *Midlantic Bank*.

Midlantic Bank has exerted little impact on lenders' procedures. No lender aware of the *United States v. Maryland Bank & Trust Co.*¹¹⁵ holding would consider foreclosing on real property abandoned by a trustee in bankruptcy who was attempting to avoid environmental cleanup expenses. However, *Midlantic Bank* may open a door for title insurers' liability arising from the lender's loss of security. This liability is more likely when a loan policy contains carelessly drafted affirmative coverages.

110. *Id.* at 497.

111. *Id.* at 507.

112. 469 U.S. 274 (1985).

113. *Id.* at 283.

114. *Id.* The Court noted, however, that discharge in bankruptcy does not shield a party from criminal prosecution for violating environmental laws. *Id.* at 284.

115. 632 F. Supp. 573 (D. Md. 1986); see *supra* text accompanying notes 29-34.

B. *A Bankruptcy Superlien?*

A party who has expended money to clean up hazardous material on property owned by a bankrupt owner may become a creditor of the bankruptcy estate. The claim against the estate will be worth very little if the party like the State of Ohio in *Kovacs*, is left as an unsecured creditor. The EPA, state environmental departments, and even third parties seek to avoid becoming unsecured creditors under the CERCLA private right of action. The parties characterize the response expense as "the actual, necessary costs and expenses of preserving the estate"¹¹⁶ for administrative expense priority under the Bankruptcy Code. A creditor with administrative expense priority will be satisfied first from estate assets.¹¹⁷

Administrative expense priority is granted sparingly. In *Burlington Northern Railroad Co. v. Dant & Russell, Inc. (In re Dant & Russell, Inc.)*,¹¹⁸ the court denied administrative priority for Burlington's cleanup expenses. Burlington incurred the expenses of cleaning up property leased and contaminated by the bankrupt.¹¹⁹ Since the expenses were not used to preserve the estate, the court denied administrative priority.¹²⁰ The court will allow administrative priority, however, when the state incurs expenses to cleanup contaminated property in the bankrupt's estate.¹²¹

Under *Midlantic Bank* the trustee cannot abandon property when public health and safety require cleanup by a responsible party.¹²² The trustee is obligated to spend estate funds to alleviate the environmental damage.¹²³ If the trustee fails to comply with a state cleanup order, then the state must remedy the environmental hazard at public expense. The state should be entitled to administrative expense priority to recover its response expenses.¹²⁴

116. 11 U.S.C. § 503(b)(1)(A) (1982 & Supp. IV 1986).

117. *Id.* § 507(a)(1) (1982).

118. 853 F.2d 700 (9th Cir. 1988).

119. *Id.* at 709.

120. *Id.* at 706; see also *Southern R.R. v. Johnson Bronze Co. (In re Johnson Bronze Co.)*, 758 F.2d 137, 142 (3rd Cir. 1985).

121. *In re Distrigas Corp.*, 66 Bankr. 382, 386 (Bankr. D. Mass. 1986).

122. *Midlantic Nat'l Bank v. New Jersey Dept. of Env'tl. Protection*, 474 U.S. 494, 507 (1986).

123. *Id.* at 515 (Rehnquist, J., dissenting).

124. *Lancaster v. Tennessee (In re Wall Tube & Metal Prods. Co.)*, 831 F.2d 118 (6th Cir. 1987); *In re Stevens*, 68 Bankr. 774 (Bankr. D. Me. 1987); see also *In re Peerless Plating Co.*, 70 Bankr. 943 (Bankr. W.D. Mich. 1987) (administrative expense priority given to fed-

Superpriority for conventional environmental liens on specific estate property may be justified under section 506(c) of the Bankruptcy Code: "The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim."¹²⁵

As a general rule, administrative expenses are not charged against specific collateral. Under section 506(c), administrative expenses can be charged against the proceeds of the sale of property if the expenses were incurred primarily for the secured creditor to protect and preserve its collateral.¹²⁶ When administrative expenses are deducted first from the sale proceeds of the affected property, the bankruptcy court is allowing a superpriority of the response costs over previously filed mortgages, deeds of trust, and other liens.

Title insurers must take extreme care when drafting affirmative coverages in order to avoid liability for this loss of priority of an insured mortgage or deed of trust. Otherwise, if administrative expenses cause a deficiency of proceeds from the sale of a secured property, the lender might not be fully paid any claim against the title insurance policy.

Recently an insurer offered coverage to protect the insured lender against the risk of mechanics' or materialmen's liens. The policy stated:

This policy affirmatively insures against any loss or damage (not exceeding the amount of insurance) arising because of any superior lien arising from or out of a prior use of the subject property pursuant to any law in effect at the date of this policy.¹²⁷

This endorsement was intended to cover mechanics' liens, but does not expressly mention mechanics' liens. The policy probably covered any similar risk, including the risk that the borrower could go bankrupt because of a superpriority environmental cleanup lien.

eral government).

125. 11 U.S.C. § 506(c) (1982).

126. *Central Bank of Mont. v. Cascade Hydraulics & Util. Serv. Inc.*, 815 F.2d 546 (Bankr. 9th Cir. 1987); *In re Trim-X, Inc.*, 695 F.2d 296 (Bankr. 7th Cir. 1982).

127. This is an excerpt from a policy the author encountered in 1988. The insurance company who wrote the policy shall remain anonymous.

The title insurer never recognized the danger until the endorsement was reviewed for reinsurance.

A lender with an endorsement like this, can avoid the *Maryland Bank* risk. The lender can shift the risk of loss of security to its title insurer by (i) pushing the defaulting borrower into bankruptcy, (ii) allowing the state environmental protection agency to clean up the pollution, (iii) allowing the bankruptcy court to sell the property to reimburse the state for the cleanup, and (iv) making a claim against the title insurance policy for loss of the priority of its security.

V. TITLE INSURANCE ECONOMICS AND ENVIRONMENTAL RISKS

A. *The Nature of Title Insurance*

No other line of insurance is like title insurance. Title insurance is an evidence producing—loss prevention line of insurance structured on a risk elimination concept. Most of the premium paid for title insurance pays for the title search and examination required for the policy.

If title companies had perfect information and correctly interpreted it, they would rarely be called on for indemnification. On the other hand, to acquire the information they do have and use it intelligently is an expensive process. The result—title insurance premiums are composed of a very small risk element and, proportionately, a very large expense element. This also is true of boiler and machinery insurance and elevator liability insurance but with a significant difference. Title insurance protects against past conditions; ordinarily nothing that may happen to the title after transfer is covered. Boiler and machinery and elevator liability insurance cover current and future events. They require payment, therefore, of future premiums while title insurance does not. Once a premium is paid, title insurance continues to indemnify for title defects of the past for as long as title stays in the same hands.¹²⁸

The risk elimination nature of title insurance contrasts with the assumption of risk nature of virtually all other lines. For example, the property/casualty insurance industry's comprehensive general liability insurance spreads risks among a body of policyholders.

128. Leslie & Bethel, *The Title Insurance Industry: A Case for Affirmative Rate Regulation*, 1983 J. INS. REG. 610-11.

Property/casualty, health, and life insurance lines insure on a casualty basis. These lines form risk pools designed by actuarial predictions of loss rates which must be adjusted periodically (usually annually or semiannually) to reflect recent loss experience. These casualty insurers control their losses by writing short term policies and reevaluating the risk, premium, and reserves at the end of each term. They attempt to predict the losses that should occur within the risk pool for the next term and set their premiums accordingly. A heavy percentage of casualty insurance premiums must be reserved for losses. Title insurers, on the other hand, control losses with their title search and examination.

There is a "risk premium" in title insurance. The companies keep careful records of premiums, losses, and expenses and report this in their annual statements—their "Form 9s." . . . It follows that the better they perform the title search and related work, the lower their losses [sic]. Title insurance loss ratios should be low, certainly less than from 6 to 10 percent, or it can be concluded that the title searches are being carelessly completed.¹²⁹

The characteristics of title insurance which distinguish it from other insurance lines are:

- a. A one time premium;
- b. Low premium rates;
- c. Proportionately low loss, but high expense to premium ratios;
- d. An examination of title to identify risks of loss;
- e. Insuring the current status of the title instead of unforeseen future events;
- f. No deductibles; and
- g. A policy term coextensive with the interests insured.

Environmental risks can be title insurance risks. An environmental lien, properly recorded, is insured under the 1984 and 1987 ALTA policy forms.¹³⁰ This risk is appropriate for title insurance

129. *Id.* at 611.

130. The 1984 policy is a revision of the 1970 form. The lien would be an exception to § 1 of Exclusions for Coverage. This section relates to police powers and environmental protection. In the 1987 policy, the lien would be insured as an exception to exclusion for coverage, section 1(d). Policy forms are distributed by:

James R. Maher
Executive Vice President
American Land Title Association

because a title examiner can determine whether a lien is recorded by checking the land title records. However, a lien that may be recorded in the future is a casualty risk because a loss cannot be predicted from the land title records at the date of policy. This risk is not appropriate for title insurance.

The title examination allows a title insurer to control its loss experience. The policy liability duration of a year or less, with adjustments through intensive actuarial analysis of risk, allows casualty insurers to control their loss experience. To survive, title insurers must eliminate risks by their title searches, just as casualty insurers must limit the duration of their policies to a short term. When a title insurer, with a potentially infinite policy term, ventures into the area of casualty risks, the insurer loses its mechanism for controlling loss experience. When the size of the loss potential in environmental risks is combined with the absence of a mechanism for controlling such losses, the risk exceeds the ability of the title insurance industry to bear it.

B. *The Financial Structure of the Title Insurance Industry*

Title insurance companies' financial structure is unique in the insurance industry. Title insurers do not assume the risk of unforeseen future events as do all other insurance lines. Therefore, title insurance loss expense is less and its operating expense is greater than those of other lines of insurance. The following tables compare title insurance with other lines.¹³¹

1828 L Street, N.W.
Washington, D. C. 20036
202-296-3671

See also PUB. L. INST., *TITLE INSURANCE 1988: COMPARING THE 1987 AND 1970 ALTA POLICIES* (Supp. & 1988) [hereinafter *TITLE INSURANCE POLICIES*].

131. ALTA, *FACT BOOK OF THE RESEARCH COMMITTEE OF THE AMERICAN LAND TITLE ASSOCIATION 20-21* (1985) (updated with recent unpublished data from the Research Committee).

**LOSSES AND LOSS ADJUSTMENT EXPENSES
AS A PERCENTAGE OF THE OPERATING DOLLAR
FOR VARIOUS LINES OF INSURANCE**

<u>Year</u>	<u>Title Insurance</u>	<u>Boiler & Machinery</u>	<u>Casualty & Surety</u>	<u>Property & Casualty</u>
1981	8.1	33.2	34.1	75.5
1982	8.4	38.6	37.4	78.6
1983	6.3	40.5	39.9	81.0
1984	7.9	53.8	49.9	88.8
1985	7.7	41.5	77.7	88.8
1986	8.8	41.0	70.8	81.6
1987	8.1	N/A	N/A	N/A
Average	7.9%	41.4%	51.6%	82.4%

**OPERATING EXPENSES AS A PERCENTAGE OF THE OPERATING
DOLLAR FOR VARIOUS LINES OF INSURANCE**

<u>Year</u>	<u>Title Insurance</u>	<u>Boiler & Machinery</u>	<u>Casualty & Surety</u>	<u>Property & Casualty</u>
1981	100.5	58.6	51.6	29.4
1982	101.3	62.1	51.7	30.1
1983	89.6	63.3	47.7	30.8
1984	91.2	64.5	45.6	30.1
1985	91.3	48.4	34.2	27.7
1986	87.0	N/A	N/A	N/A
1987	91.6	N/A	N/A	N/A
Average	93.2%	59.4%	46.2%	29.6%

By simply adding the loss expense and the operating expenses averages, it becomes obvious that the title insurance industry operates on a thin margin. In 1985, the ninety-five companies in the title insurance industry earned almost \$2.5 billion in total operating revenues. They netted only \$1.5 million for an average net operating income of only \$16,305 per company. The industry net operating margin was only .062%.

Because of this financial structure, title insurance companies now appear more circumspect about the risks they undertake. A decision to assume casualty risks would entail a complete restructuring of the industry's loss reserves and a change to premium renewals. This restructuring is not a realistic option.

VI. THE TITLE INSURANCE POLICY AND ITS ENVIRONMENTAL EXCLUSIONS

A. ALTA Policy Forms and Exclusions from Coverage

Title insurance policies are produced in two basic forms, owner policies and loan policies. Owner policies insure the interest of an owner or lessee in the property described in the policy. Loan policies insure the lien of a mortgage or deed of trust on a fee or leasehold interest. The policy conditions and stipulations apportion the liability of the insurer between the two insureds. Therefore, the two policies insure a single risk of loss and will pay for the insured loss only once to indemnify the insurers. In contrast, a property/casualty insurer insures casualty risks of owners and lenders in a single policy. The insurer uses a loss payable clause in the policy to apportion liability to both insureds.

ALTA produces policy forms and endorsements for title insurance used by title insurance companies in most states.¹³² Local forms are used in Texas, New York, Iowa, the far western states, and the Northeast corner of Ohio.¹³³ The ALTA forms, however, are the generally accepted standard in the United States.

In the ALTA policies, a title insurer is directly liable to an owner for any loss caused by a defect lien, or encumbrance on title covered by the owner's policy.¹³⁴ However, the insurer is liable to a lender only if the defect, lien or encumbrance has priority over the lien of the insured mortgage or deed of trust, and the lender's recovery against the property is diminished.¹³⁵ Title insurers use distinct forms for owners and lenders because they are willing to give coverages to lenders that they are unwilling to give to owners. Owners' policies have four insuring provisions compared to eight provisions in loan policies.¹³⁶ In addition, title insurers are usually willing to extend certain additional affirmative coverages to lenders, but are not willing to extend the same coverages to owners.

The 1970 ALTA policy forms contain no express exclusion for

132. See *supra* note 130.

133. Colavito, *Title Association Adopts New Title Insurance Forms*, N.Y. L.J., Mar. 11, 1987 at 21, col. 3. New York recently approved the use of a variation of the 1987 ALTA policies but the older policy forms are still prevalent.

134. TITLE INSURANCE POLICIES, *supra* note 130, Supp. at 7; see also, A.B.A., TITLE INSURANCE: THE LAWYER'S SPANDING ROLE, (1985) (App. B) (sample forms).

135. *Id.* at 19.

136. *Id.* at 7, 19.

environmental matters. The policy excludes the "governmental rights of police power unless notice of the exercise of such rights appears in the public records at [the] Date of Policy."¹³⁷ The 1987 policy forms expressly exclude environmental matters:

EXCLUSIONS FROM COVERAGE

The following matters are expressly excluded from the coverage of this policy and the Company will not pay loss or damage, costs, attorneys' fees or expenses which arise by reason of:

1 (a) Any law, ordinance or governmental regulation . . . restricting, regulating, prohibiting or related to . . . (iv) environmental protection, or the effect of any violation of these laws, ordinances or governmental regulations, except to the extent that a notice of the enforcement thereof or a notice of a defect, lien or encumbrance resulting from a violation or alleged violation affecting the land has been recorded in the public records at the Date of Policy.¹³⁸

The definition of public records was also expanded in the 1987 policy forms:

1. Definition of Terms.

(f) "public records": records established under state statutes at Date of Policy for the purpose of imparting constructive notice of matters relating to real property to purchasers for value and without knowledge. With respect to Section 1(a)(iv) of the Exclusions from Coverage, "public records" shall also include environmental protection liens filed in the records of the clerk of the United States district court for the district in which the land is located.¹³⁹

The ALTA policy form defined the scope of public records because information describing or suggesting the presence of hazardous waste on a property might be found in any of a number of places which are not customarily searched in a title examination. These places could include EPA or state environmental department files, newspaper articles, the Federal Register, and the NPL.

137. *Id.* at 63.

138. *Id.*

139. *Id.* at 69. This definition is in the Conditions and Stipulation section. The CERCLA lien recording provisions introduced by SARA brought about this change.

*Hahn v. Alaska Title Guaranty Co.*¹⁴⁰ provided the impetus for this revised definition of public records. In *Hahn*, the Alaska Supreme Court held that a land order published in the Federal Register constituted constructive notice of matters affecting real estate.¹⁴¹ The court held Alaska Title Guaranty liable for loss caused by failure to take exception to the defect described in the land order.¹⁴²

No ALTA policy form used today includes coverage against environmental liens which might be filed in the future.¹⁴³ The title insurance policy covers the risk that an environmental lien was filed in the land records at the date of policy, and the title insurer missed the notice of lien or failed to take exception to it in schedule B of the policy.¹⁴⁴

Title insurers must also be conscious of environmental risks in affirmative coverages, especially those found in loan policies. These coverages insure the owner of the indebtedness, secured by a mortgage or deed of trust, against loss sustained if the lien should lose priority to advances or interest.¹⁴⁵ Title insurers find increasing difficulty reinsuring some policies if the endorsements do not contain environmental exclusions. Endorsements with a revolving line of credit or future advance, shared appreciation, option or interest rate exchange coverages should contain environmental exclusions.

B. *The Title Insurance Response to CERCLA*

CERCLA poses an obvious risk to title insurers. A lien filed against the property after the date of the policy could be construed as a defect lien or encumbrance insured against by the policy. The industry reacted to this risk by inserting an exclusion against any law, ordinance, or governmental regulation relating to environmental protection.¹⁴⁶ *Chicago Title Insurance Co. v. Kumar*¹⁴⁷ appears to reject liability absent affirmative coverage against environmen-

140. 557 P.2d 143 (Alaska 1976).

141. *Id.* at 147.

142. *Id.*

143. TITLE INSURANCE POLICIES, *supra* note 130, Supp. at 8, 21.

144. *Id.* at 7-34.

145. Rifkin, *Revolving Credit: Credit Line Insurance* in TITLE INSURANCE POLICIES 1988: COMPARING THE 1987 AND 1970 ALTA POLICIES 301 (1988); Rifkin, *Interest Rate Swaps* in TITLE INSURANCE POLICIES 1988: COMPARING THE 1987 AND 1970 ALTA POLICIES, 317 (1988).

146. TITLE INSURANCE POLICIES, *supra* note 130, Supp. at 8, 21.

147. 24 Mass. App. Ct. 53, 506 N.E.2d 154 (1987).

tal loss. In *Kumar*, the court held that a title policy covers defects in existence when the policy is written, but not liens which might arise in the future.¹⁴⁸

The CERCLA liability provisions changed the way the title insurance industry conducts business. Until SARA, no title insurer checked records at the clerk's office of the United States district court. Now that most states have some form of federal lien registration legislation, title examiners will probably return to their former methods of title examination. They will again ignore the district court clerks' office because CERCLA liens must be filed in the land records to be valid. Of course, any CERCLA liens filed with the district court clerks between the enactment of SARA and the effective date of the local state federal lien legislation will remain valid. The risk that such liens will be overlooked is appropriate to title insurance.

Until recently, title insurers eagerly accepted appointment as a trustee or nominee title holder in transactions involving Illinois or Massachusetts land trusts, deeds of trust, and section 1031 tax free exchanges. The insurer expected the title insurance business in that transaction to follow the appointment. Now, title insurance companies allow customers to name them as a trustee or nominee in title risk cleanup liability under CERCLA and similar state cleanup statutes. The title company can be classified as an owner of the property unless it establishes the innocent party defense. Also, the company must show that it entered into the relationship only after sufficient due diligence in evaluating the risk of an environmental release.¹⁴⁹ CERCLA liability is broadly drawn. Conceivably, the EPA could impose liability on a nominee or trustee. Title insurers carefully evaluate the risks of these ventures before agreeing to hold even bare legal title. No authority guides a trustee or nominee. They face liability when they sell property or foreclose and transfer property to an unsuspecting third party if the property is later found to be contaminated.

The SARA amendments to CERCLA¹⁵⁰ may also create a new opportunity for title insurers. Lenders are not equipped to examine the chain of title on property that will secure a loan. Lenders are asking title examiners and title companies for abstracts of

148. *Id.* at 54, 506 N.E.2d at 155.

149. *See*, 42 U.S.C. §§ 9601-9615 (1982 & Supp. IV 1986).

150. Superfund Amendment and Reauthorization Act of 1986 § 9601 (Supp. IV 1986).

the chain of title to determine if the public records give notice of site occupation by an entity which may have contaminated the site. These chain of title searches satisfy the due diligence requirements contained in SARA and are necessary to establish the innocent party defense. These searches may seem to be the natural role of a title examiner, but they open a vast new area of potential examiner's liability. Title insurers are unprepared for this liability. For example, to establish compliance with CERCLA a court may require a search of public records that exceeds the scope of the records customarily searched in a title examination. Latent information or indicators of waste disposal on adjacent land could be located in otherwise routine parts of a document. To illustrate, a deed in a chain of title might contain a metes and bounds description that states a course is "along and with the property now or formerly owned by CWD Ltd Partnership." The fictitious name record might indicate that CWD Ltd Partnership transacted business under the name of Chemical Waste Disposal Company.

The examiner must accurately search the record and prepare the report. The cost of a cleanup can be catastrophic (even to a large, secure lender) and the agreement between the lender and the title examiner may contain no limitation on liability. Even where the title examiner attempts to limit liability, a court may find the limitation self serving and unenforceable. When a title examiner agrees to provide such a chain of title, the terms of the agreement could involve more risk than any other environmental issue facing the title industry.

Nevertheless, title insurers are exploring ways to satisfy this demand. Since January, 1988, several title insurance companies have designed products to provide lenders with reports on the chain of title to the real estate secures their loans. These products take different forms, but a common feature is a provision to limit the risk of the issuing company. No industry standard exists for chain of title searches and may never exist. Product availability varies and its future is uncertain.

C. Title Insurance Superlien Coverages

Title insurance superlien coverage in loan policies was available in Connecticut, Massachusetts, and New Hampshire until 1987.¹⁵¹

151. Conn. Law Tribune, Jan. 19, 1987 at 1.

The coverage insured the lender that its mortgage lien would not lose priority to a superlien from the cleanup of hazardous waste released, spilled, or discharged onto the insured premises on the date of policy. Before issuing the coverage, the title insurers generally required an environmental site assessment indicating a relatively clean site. The policies limited coverage to the mortgage priority issue. The coverage expressly excluded (i) other consequences resulting from discharge of hazardous waste on the insured premises at the date of policy, and (ii) loss of priority of the insured mortgage to a superlien from cleanup of a discharge occurring after the date of policy.

A superlien filed for cleanup of hazardous waste can upset the priority of security interests filed earlier and insured by title insurance. Neither the title examination nor an environmental site assessment can eliminate this risk. Even assessment of environmental risks limited to damage from pollution on the property at the date of policy waste is beyond the skills of title professionals. Title insurers realized that title insurance personnel were ill-equipped to evaluate technical engineering site reports. Such reports indicated the presence of chemicals in trace amounts usually measured in parts per million or billion.

The engineering reports rarely indicated in laymen's terms whether or not the chemicals were harmful. When reports listed an obvious pollutant, e.g., asbestos, PCBs, or mercury compounds, title insurers could not always determine if the concentrations were dangerous. The title insurers' problem is compounded with constant advances in technology. Some chemicals found on a site might be considered harmless today, but new findings a year from now might indicate they are actually harmful. Asbestos, PCBs and chlorofluorocarbons are familiar examples of chemicals once thought beneficial, and now known to be toxic.

Finally, no site survey can locate all concentrations of contamination without churning up all of the soil down to bedrock. Test wells can miss hazardous substances contained in rusting drums. These substances cannot be detected until the corrosion of the drums releases the contents into the soil and water aquifers. A pattern of test wells can also miss a small plume of contamination spreading underground. Ironically, the test wells used to search for the contamination can provide a route for quicker spreading of the contamination once it reaches the well.

The New Jersey Insurance Department consistently refuses to approve any endorsements insuring against loss of priority from enforcement of the New Jersey superlien.¹⁵² The coverage also violates the Connecticut single line restriction for title insurance companies.¹⁵³ The Connecticut Insurance Code contains a single risk restriction which prohibits corporations doing title insurance business from engaging in any other line of insurance business.¹⁵⁴ This restriction recognizes that title insurers are not structured to accept casualty risks. The commissioner of the Connecticut Insurance Department ruled that the superlien coverages offered by title insurers in Connecticut violated the single line restriction.¹⁵⁵ The commissioner stated that the risk of losses could not be eliminated by careful examination of the title records, so the coverage is a casualty coverage.¹⁵⁶

Since environmental liens that arise subsequent to the effective date of a policy of title insurance are not discoverable by a search of all relevant public records and, accordingly, cannot be eliminated, limited or reduced by a title insurer, such liens are not the proper subject of insurance coverage by title insurers. The risk associated with State environmental liens that arise subsequent to the closing of a real estate transaction are pure casualty risks which, under an insurance contract, can only be assumed by an authorized casualty insurer.¹⁵⁷

However, most title insurers had independently decided the superlien risk was too great and withdrew the superlien coverage from the market. Now the major title insurers not only refuse to extend coverage against superliens but also refuse to reinsure policies containing the coverage.

*South Shore Bank v. Stewart Title Guaranty Co.*¹⁵⁸ is the only case construing title insurance superlien coverage. Stewart Title issued a \$2,800,000 policy to South Shore Bank insuring a lien on Connecticut property. The policy included superlien coverage. Af-

152. See *supra* note 71.

153. *Lawyers Title Ins. Corp.*, No. RD 86-22 (Conn. Ins. Dep't Jan. 8, 1987) (declaratory ruling).

154. CONN. GEN. STAT. ANN. § 38-29 (West 1987).

155. *Lawyers Title Ins. Corp.* at 16-17.

156. *Id.* at 14.

157. *Id.* at 16.

158. 688 F. Supp. 803 (D. Mass. 1988).

ter default on the loan, but before foreclosure, an environmental assessment revealed hazardous waste on the premises. At foreclosure, South Shore Bank bid successfully and then sought declaratory judgment against Stewart Title.¹⁵⁹

The district court found that South Shore Bank failed to allege the existence of a lien and that the possibility that a lien might be filed does not trigger the insurance coverage.¹⁶⁰ Of course, this result may change if a state statute compels Connecticut to file a lien for response costs even though South Shore Bank is now either the owner or a former owner. The decision is probably no more than a recognition that South Shore Bank's cause of action was not ripe.

The risk of loss for environmental damage can be breathtaking. Superlien coverage entails the risk of total loss under the loan policy if the expense of cleanup exceeds the value of the property securing the insured mortgage.¹⁶¹ However, the risk of a lender losing security for a loan is not the most troublesome problem posed by environmental laws. Lenders are more concerned about direct liability for the cleanup under CERCLA and similar state cleanup statutes than loss of security for a lien.¹⁶² Cleanup liability can be virtually unlimited while loss of the security of the loan involves a finite amount.

The current effect of superlien statutes in Connecticut and Maine is minimal. Purchasers and lenders are requesting coverage verifying that the insured tract was not part of a larger tract of land within the past three years. Purchasers and lenders are concerned that secret liens may be incorporated into the superliens.

D. ALTA 8.1 Endorsement

The 1987 ALTA policy forms were submitted to title insurance customer groups for review and suggestions. The Federal National Mortgage Association, the largest and most important of the secondary market lenders, conditioned its approval of the forms upon a separate environmental protection lien endorsement for policies insuring residential loans.¹⁶³ ALTA Endorsement Forms 8 and 8.1

159. *Id.* at 804.

160. *Id.* at 805 (citing *Chicago Title Ins. Co. v. Kumar*, 24 Mass. App. Ct. 53, 506 N.E.2d 154 (1987)).

161. See *Burlington N. R.R. v. Dant & Russell, Inc.*, 853 F.2d 700 (9th Cir. 1988).

162. See *supra* notes 29-34 and accompanying text.

163. See Pedowitz, *An Overview of the American Land Title Association 1970 and 1987*

provide this separate protection. ALTA Endorsement Form 8 incorporates by reference the 1987 policy definition of public records. The definition appears under the main policy's conditions and stipulations.¹⁶⁴ The ALTA Endorsement Form 8.1 restates the 1987 policy definition of public records in the body of the endorsement.¹⁶⁵ The form can then be used with the older policy forms. ALTA withdrew the ALTA Endorsement Form 8 because the ALTA Endorsement Form 8.1 is appropriate for both the new and the old policies.

Paragraph (a) of the ALTA 8.1 endorsement gives coverage against environmental protection liens which are of record at the date of policy.¹⁶⁶ This affirmative coverage is congruent with Section 1(a)(iv) of the exclusions from coverage in the 1987 policies.¹⁶⁷

Form in TITLE INSURANCE 1988: COMPARING THE 1987 AND 1970 ALTA POLICIES 9 (1988).

164. *TITLE INSURANCE POLICIES, supra* note 130, Supp. at 7-34.

165. ALTA Enforcement Form 8.1 states:

ENDORSEMENT

Attached to and made a part of _____ Title Insurance Corporation Policy No.

The insurance afforded by this endorsement is only effective if the land is used or is to be used primarily for residential purposes.

The company insures the insured against loss or damage sustained by reason of lack of priority of the lien of the insured mortgage over:

(a) any environmental protection lien which, at Date of Policy, is recorded in those records established under state statutes at Date of Policy for the purpose of imparting constructive notice of matters relating to real property to purchasers for value and without knowledge, or filed in the records of the clerk of the United States district court for the district in which the land is located, except as set forth in Schedule B; or

(b) any environmental protection lien provided for by any state statute in effect at Date of Policy, except environmental protection liens provided for by the following state statutes:

This endorsement is made a part of this policy and is subject to all of the terms and provisions thereof and of any prior endorsements thereto. Except to the extent expressly stated, it neither modifies any of the terms and provisions of the policy and any prior endorsements, nor does it extend the effective date of the policy and any prior endorsements, nor does it increase the face amount thereof.

IN WITNESS WHEREOF, the Company has caused this Endorsement to be signed and sealed as of the _____ day of _____, 19____, to be valid when countersigned by an authorized officer or agent of the Company, all in accordance with its By-Laws.

166. *Id.*

167. *TITLE INSURANCE POLICIES, supra* note 130, supp. at 7-34.

Paragraph (b) is designed to disclose any state statute (but not federal statutes or local ordinances) effective at date of policy which may impair the priority of the insured mortgage.¹⁶⁸ In essence, paragraph (b) is an insured legal opinion that no statute enacted by the state legislature, except the statutes listed on the endorsement, provides for a superpriority lien. Title insurers must search the state statutes and codes for elusive environmental regulatory sections.

The ALTA 8.1 endorsement is designed only for residential transactions. The title insurer who extends this coverage to commercial and industrial loans may face serious pitfalls. As previously discussed, the bankruptcy courts may be in the process of creating superliens out of conventional environmental liens.¹⁶⁹ These pose no danger to the title insurer if no affirmative coverage is given in commercial and industrial loan policies, but an ALTA 8.1 endorsement in such a policy can be dangerous. The title insurer would probably fail to take exception to a conventional lien statute following paragraph (b) of the endorsement because, on its face, the statute poses no threat to the lien of the mortgage. If the lender claims coverage under the endorsement when the priority of its lien is upset by administrative expense priority, the title insurer will probably argue that the superpriority arises under principles of bankruptcy law, not a state statute, so paragraph (b) of the endorsement should not apply.

Title insurers expect protection against such claims based on the express language of the endorsement, but they should recognize that the property/casualty industry's surprises in environmental coverages can occur in title insurance as well. A court may decide that the insured lender had reasonable expectations of coverage under the endorsement.¹⁷⁰ The doctrine of reasonable expectations allows a court to deviate from the express language of the insurance contract. The court can deviate from what the insurer intended to what the insured would have understood the contract to mean. An express exclusion does not mean that the insurer will be able to avoid challenges against its coverage, or even that it will win all of the challenges made. As a result, in nonresidential transactions, title insurers may be unwilling to include paragraph (b)

168. See *supra* note 165.

169. See *supra* notes 109-126 and accompanying text.

170. See *Hohn v. Alaska Title Guar.*, 557 P.2d 143 (Alaska 1976); *Marriott Fin. Servs. Inc. v. Capitol Funds, Inc.*, 288 N.C. 122, 217 S.E.2d 551 (1975).

coverage.

The 1984 and 1987 changes to the ALTA policies follow a path blazed by the property/casualty carriers with their experience with the comprehensive general liability policies. Title insurers should study and use the experience of the property/casualty industry in environmental risks. Title insurance underwriters understand and accept only some risks involving environmental laws. The title industry should focus coverage on these risks.

E. *A Comparison to the Property/Casualty Experience*

The title insurance industry appears to be several years behind the property/casualty insurance industry in awareness of the danger of environmental risks. Prior to 1973, the property/casualty industry used the CGL policy to insure policyholders against the happening of an "occurrence [which] embrace[s] not only the usual accident, but also exposure to conditions which may continue for some unmeasured time."¹⁷¹ Courts construed this language as protecting the policyholders against unexpected and unintended environmental damages, even leakage from underground tanks.¹⁷²

The CGL policy was amended in 1973 to include a pollution exclusion clause.¹⁷³ The clause stated that the exclusion did not apply if a discharge of pollutants was sudden and accidental.¹⁷⁴ Since 1973 this pollution exclusion clause has spurred volumes of litigation.¹⁷⁵ Most courts interpret the exclusion, together with its proviso, as "simply a restatement of the definition of 'occurrence'—that is, that the [CGL] policy will cover claims where the injury was 'neither expected nor intended.'"¹⁷⁶

Recently, some courts have interpreted "sudden" to require an

171. *Broadwell Realty Servs., Inc. v. Fidelity & Casualty Co.* 218 N.J. Super. 516, 533, 528 A.2d 76, 84 (App. Div. 1987) (quoting 3 LONG, *THE LAW OF INSURANCE*, app. 53 (1966)).

172. *Id.* at 535, 528 A.2d at 86.

173. Tyler & Wilcox, *Pollution Exclusion Clauses: Problems in Interpretation and Application Under the Comprehensive General Liability Policy*, 17 IDAHO L. REV. 497 (1981).

174. *Id.* at 500 & n.24.

175. Sullivan & Wright, *Hazardous Waste Litigation: CGL Coverage Issues in CURRENT PROBLEMS AND ISSUES IN LIABILITY INSURANCE* 467 (1987) (contains a state by state chart); Note, *The Pollution Exclusion Clause Through the Looking Glass*, 74 GEO. L.J. 1237 (1986) (compares cases which construe the sudden and accidental language).

176. *Broadwell Realty Servs., Inc. v. Fidelity & Casualty Co.*, 218 N.J. Super. 516, 534, 528 A.2d 76, 85 (App. Div. 1987). The court surveyed current law, academic writings and traced the history of the occurrence policy definition and policy exclusion. *Id.* at 532-34, 528 A.2d at 83-85.

abrupt or precipitous event to trigger coverage.¹⁷⁷ In 1986, the property/casualty industry changed the policy from comprehensive general liability to commercial general liability and dropped pollution coverage. The industry changed the policy name claimants had argued that the term "comprehensive" led them to believe that all liabilities were covered.¹⁷⁸ The onslaught of environmental claims compelled the property/casualty industry to carefully structure their policy language to foreclose any doubt as to whether environmental risks were or were not covered.

ALTA tightened the environmental exclusion in its 1984 policy revision and further refined the exclusion in the 1987 policy forms.¹⁷⁹ ALTA also changed the name of the new ALTA 9 endorsement form from the comprehensive endorsement to the restrictions, encroachments and mineral endorsement.¹⁸⁰

Insurance coverage of environmental risks are little understood outside the insurance industry. The lack of understanding is probably due, in part, to a desire for insurance against all environmental expenses. However, no insurer has ever insured the policyholder for the expense of an environmental cleanup. The CGL policies covered, at most, the liability of the policyholder to others for personal injury or property damage resulting from a sudden spill of toxic or hazardous material, e.g. an accident involving a tank truck. Of course, CGL policies now contain an exclusion intended to eliminate coverage of all environmental risks.

Environmental Impairment Liability ("EIL") insurance is the only property/casualty coverage available today for environmental risks, and its scope is strictly limited.¹⁸¹ An EIL coverage indemnifies the insured against loss for bodily injury or property damage caused by the "discharge, dispersal, release or escape of smoke, soot fumes, acids, alkalis, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon the land, the atmosphere or any watercourse or body of water."¹⁸² The exclusions in the policy exclude losses arising from

177. See *Claussen v. Aetna Casualty & Sur. Co.*, 676 F. Supp. 1571, 1573 (S.D. Ga. 1987).

178. Hamilton & Kowal, *The 1986 Commercial Liability Policy Claims Made Form* in CURRENT PROBLEMS AND ISSUES IN LIABILITY INSURANCE 9 (1987).

179. Rifkin, *Environmental Coverage (Hazardous Waste): The 1987 ALTA 1970 Policy* in TITLE INSURANCE POLICIES 1988: COMPARING THE 1987 AND 1970 ALTA POLICIES 285 (1988).

180. See TITLE INSURANCE POLICIES *supra* note 130.

181. Brenner, *The Toxic-Waste Time Bomb*, 1984 INSTITUTIONAL INVESTOR 163, 166.

182. Definition "F" of the Pollution Legal Liability Policy of the National Union Fire

bodily injury to employees or contractors of the insured and cleanup costs for the insured site. The exclusions apply even if the cleanup is undertaken to mitigate covered bodily injury or property damage.¹⁸³

An EIL policy only covers policyholder liability to third parties who suffer losses as a result of the pollution conditions. For example, coverage would include the personal injury claims against Union Carbide at Bhopal, India and the property damage claims of homeowners in The Love Canal subdivision near Buffalo, New York. Coverage of the expense of a cleanup of hazardous or toxic material on the property of the policyholder is of no help. The policies have a one year, claims made term, so the insurer is protected against errors in the actuarial determination of risk or the wording of the coverage in the policies. At present, the largest EIL policy available is \$15 million.¹⁸⁴

Title insurance environmental coverage can be compared with EIL coverage, the only line of insurance that covers environmental risks.¹⁸⁵ Rate information on EIL policies is difficult to obtain because little coverage is being written. Also, many variables are in the risk analysis. For example, Sun Chemical Corporation requested EIL coverage from Cigna Corporation. Sun Chemical spent \$500,000 on environmental surveys of sixty sites as a part of its application for this coverage.¹⁸⁶ The premium must account for the results of the surveys. The following comparison shows why title insurers are not capable of protecting insureds from environmental risks.¹⁸⁷

Insurance Company of Pittsburgh, Pa.

183. Brenner, *supra* note 181, at 167.

184. See TITLE INSURANCE POLICIES *supra* note 130.

185. The comparison must be made against EIL coverages because the property/casualty industry is stoutly insisting that its CGL policies do not cover environmental clean-up liability. The CGL premiums, therefore, do not reflect environmental risks.

186. Brenner, *supra* note 181, at 167.

187. *Id.*; AMERICAN LAND AND TITLE ASSOC., 1986 ALTA FACT BOOK; LAWYERS TITLE INSURANCE CORP., ANNUAL STATEMENT (1984).

Coverage Comparison

	<u>Cigna</u>	<u>Lawyers Title</u>
Amount	\$6,000,000.	\$6,000,000.
Deductible	\$ 500,000.	None
Insured	Owner	Lender (Potential owner)
Term	1 Year (Claims made)	Period of Insured's interest (Potentially indefinite)

Premium Comparison

	<u>Cigna</u>	<u>Lawyers Title</u>
Premium	\$250,000 to 300,000.	\$11,875.*
Effective Rate	\$42 to 50 Per \$1000	\$1.98 Per \$1000
Premium Reserve	\$195,000	\$751.50

* Our general title insurance rate. Rates may vary depending on location.

Comparative Company Size in 1984

	<u>Cigna</u>	<u>Lawyers Title</u>
Assets	\$39 Billion	\$173 Million
Surplus	\$4.9 Billion	\$54.5 Million
Income	\$102.6 Million	\$9.6 Million

There are some caveats in this comparison between title insurance and EIL insurance:

1. Title insurance covers title risks in addition to environmental risks. EIL covers just environmental risks.
2. The title insurer cannot adjust its coverages once the policy is issued. The term of the insurance is coextensive with the insured's interest in the property, even if the current loss experience indi-

cates a change is necessary.

3. EIL coverage is on a claims made basis. The insured is protected only during the term of the policy. Once the policy term expires, the insured is not protected even though the spill or release of contamination occurs during the term of the policy. EIL insurance policies do not provide for occurrence insurance. Occurrence insurance would protect the insured against liability for a spill which occurred during the term of the policy even if the claim is made after the policy expired. EIL is claims made insurance because the insurance carriers need the most strictly defined term for EIL policies. This allows them to protect themselves against errors in their actuarial projections of loss experience with this volatile risk.

4. The same companies, with some mergers, comprised the title insurance industry throughout the 1980s. Approximately thirty to forty companies offered EIL in 1983-84. Currently, only National Union Fire Insurance Company of Pittsburg, Pennsylvania offers this coverage and it is very conservative in its underwriting.

5. In a title insurance transaction, discovery of significant contamination on the insured premises usually drives the borrower into bankruptcy, leaving the lender and its title insurer exposed to liability. For EIL coverage, the distinction between insureds has no significant importance.

6. In 1984, Cigna's assets were approximately forty times the assets of the entire title insurance industry, not just Lawyers Title. Obviously, the large casualty insurers occupy an entirely different league than title insurers.

7. Cigna did not issue the EIL policy to Sun Chemical because of insufficient reinsurance for the risk.¹⁸⁸ Most major title insurers do not seek reinsurance of title risks until the policy amount exceeds \$20 to \$40 million, depending on size of the company and the risk retention limits imposed by statute, the customer or the company itself. The fact that Cigna sought and could not find reinsurance on this \$6 million policy emphasizes how gingerly property/casualty carriers approach these risks.

8. The comparison is based on 1984 amounts. Environmental impairment liability insurance has been almost unobtainable since then, and title insurance superlien coverage has been virtually un-

188. Brenner, *supra* note 181, at 167.

obtainable since the end of 1985. Only National Union Fire Insurance Company of Pittsburgh, Pennsylvania, is currently willing to underwrite EIL risks. The risk limit is \$15 million on National's policies.

VII. CONCLUSION

In recent years environmental concerns have altered the way lenders and title insurers must approach risks. State and federal governments have enacted an array of laws to correct past carelessness with the environment and to prevent any further damage. These laws have a significant impact on land conveyancing and security interests. Lenders especially are seeking to shift these risks to title insurance companies, but for now the only significant insurance role title insurers play is in the residential market, and only with strictly defined coverages.

The pressure to broaden the title insurers role with commercial superlien coverages now appears to be a dead issue. The new product is the request for reports on chains of title. These have the potential of unlimited liability to the party unfortunate enough to be involved in a subsequent environmental claim. To protect themselves from catastrophic liabilities, title insurers and abstracters must be aware of developments in environmental law and decisions construing the liability of other insurance lines for environmental problems.

