



# What A Lender Must Do To Avoid Environmental Liability



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# CERCLA - LIABILITY UNLEASHED

- Broad Liability Scheme
  - Owners, Operators, Generators, Transporters...
  - Several exemptions to “owner or operator,” including for “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”



# CERCLA - LIABILITY UNLEASHED

- Fleet Factors
  - 11<sup>th</sup> Circuit (1990)
  - Language indicating that a secured creditor who had the “capacity to influence” a borrower’s environmental management of hazardous waste could lose secured creditor exemption, even if “capacity to influence” not exercised by lender
  - “[A] secured creditor will be liable if its involvement with the management of the facility is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose”



# CERCLA - LIABILITY UNLEASHED

- EPA Lender Liability Rule
  - Established test to determine what constitutes “participation in management”
  - Rejected Fleet Factors “capacity to influence” test
  - Court vacated Lender Liability Rule as being beyond EPA’s authority to promulgate



# CERCLA - LIABILITY UNLEASHED

- Asset Conservation, Lender Liability and Deposit Insurance Protection Act (1996)
  - Amends CERCLA to protect lenders from liability
  - Legislative endorsement of EPA rule addressing lender liability
  - The term “owner or operator” does not include a lender that, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect the security interest of the person in the vessel or facility
  - In addition, with respect to foreclosure activities, the Act modified CERCLA’s definition of “owner or operator” to exclude a “lender that did not participate in management of a vessel or facility prior to foreclosure...”



# KEY TO LENDER LIABILITY EXEMPTION

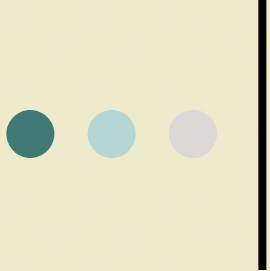
- “Participation in Management”



# WHAT CONSTITUTES “PARTICIPATION IN MANAGEMENT”

- Actually participating in the management or operational affairs of a vessel or facility
- Exercising decision making control over borrower’s environmental compliance related to the facility such that the lender undertakes responsibility for hazardous substances handling or disposal practices related to facility
- Exercising control of a level comparable to that of a manager of the facility, such that the lender has assumed or manifested responsibility for the overall management of the facility, encompassing day-to-day decision-making regarding environmental compliance; or over all, or substantially all, of the operational functions of the facility other than environmental compliance





# WHAT DOES NOT CONSTITUTE “PARTICIPATION IN MANAGEMENT”

- Capacity to Influence (rejecting Fleet Factors)
- Loans
- Monitoring or enforcing the terms and conditions of an extension of credit or security interest, including a term or condition relating to environmental compliance
- Ensuring that collateral is properly maintained
  - Ex: monitor environmental condition at property
- Providing advice in an effort to mitigate, prevent or cure a default or diminution in the value of the facility
- Requiring certain response actions under CERCLA in connection with a release or threatened release of a hazardous substance
- Foreclosing on property



# FORECLOSURE

- Allowable Activities
  - Wind up operation of business
  - Undertake a CERCLA response action
  - Take certain actions to preserve, protect or prepare the property for sale
  - Sell or lease the property



# FORECLOSURE

- If lender seeks to sell, re-lease, or otherwise divest itself of the property, it must do so at the earliest practicable, commercially reasonable time, on commercially reasonable terms, taking into account market conditions and legal and regulatory requirements



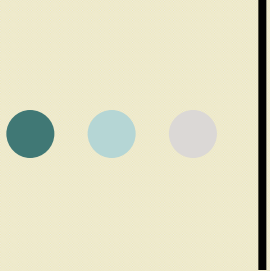
# FORECLOSURE

- Is the lender now totally immune from liability under CERCLA?
  - What about lender that arranges for hazardous wastes to be shipped off site?
  - Does this fall within lender exemption to liability?



# HOW CAN A LENDER PRACTICALLY PROTECT ITSELF FROM LIABILITY?

- Starts at loan origination
- Do not wait until foreclosure



# HOW A LENDER CAN PROTECT ITSELF FROM LIABILITY - FROM THE BEGINNING

- Due Diligence Investigation
  - History of property
    - environmental conditions
  - History of borrower
  - Phase I or Phase II investigation
- Loan Documents
  - Indemnities, representations, etc.
    - Caveat: financial wherewithal of lender
  - Consider bonds, letters of credit or other property as collateral
- Other



# WHAT ABOUT EXISTING LOANS?

- Do not become involved in the operation of the debtor
- Lender may “police” the loan
- Lender may undertake “workout actions” to mitigate default or prevent diminution of the value of property (collateral)
- Environmental insurance



# WHAT ABOUT FORECLOSURE AND POST-FORECLOSURE?

- Lender must show that actions are primarily to protect its security interest
  - Foreclose means acquiring a facility through, among other things, purchase at sale under a judgment or decree, a deed in lieu of foreclosure, or repossession if the facility was security for an extension of credit previously contracted
  - A Phase I environmental site assessment should be performed prior to foreclosure
  - A Phase II or Phase III investigation and a corrective/remedial action may need to be performed prior to foreclosure on secured property





# WHAT ABOUT FORECLOSURE AND POST-FORECLOSURE?

- Before foreclosing, the lender should address its potential environmental loss against the value of the collateral and the remaining debt
- Lenders should be aware of the potential affect any institutional or engineering controls may have on the secured property taken as collateral
- State superfund statutes and potential environmental liability from statutes other than CERCLA must be considered



# WHAT ABOUT FORECLOSURE AND POST-FORECLOSURE?

- Lenders cannot manage collateral after foreclosure primarily for investment purposes, but may maintain business activities
- Lenders may wind up foreclosed businesses, such as by furnishing purchased products and shipping in-house orders
- Lenders may sell or liquidate the business
- Lenders may undertake CERCLA response actions without incurring liability



# CASE STUDIES



# QUESTIONS?