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Environmental Lender Liability Protection

Federal law creates an exemption from environmental liability for lenders under the federal Comprehensive Environmental Response, Compensation, and Liability Act (*"CERCLA"*). 42 U.S.C. § 9601 *et seq*. As a general matter, CERCLA provides that a party who owns or operates a facility can be held directly responsible for cleaning up hazardous waste at or from the facility regardless of whether that party caused or contributed to the contamination. *See* 42 U.S.C. § 9607(a). A lender, however, can be exempt from CERCLA liability in a situation where the lender becomes an owner of contaminated property through foreclosure or otherwise if certain criteria are met.

A lender may escape CERCLA liability in this instance if the lender holds an indicia of ownership in a facility primarily to protect its security interest, provided that the lender (1) does not participate in the management of the facility prior to its foreclosure and (2) disposes of the facility at the "earliest practicable, commercially reasonable time, on commercially reasonable terms," after foreclosure of the loan. 42 U.S.C. § 9601(20)(E).

This exemption, referred to as the Secured Creditor Exemption (*"SCE"*), creates a safe harbor from CERCLA cleanup liability for lenders that acquire property as a result of default. Congress passed the Asset Conservation, Lender Liability, and Deposit Insurance Protection Act of 1996, which codified the SCE, to shield from liability lenders that hold property as security for a debt and are not seeking to profit from any investment opportunity that long-term ownership in the property would present. *See Waterville Indus., Inc. v. Finance Auth. of Me.*, 984 F.2d 549, 552 (1st Cir. 1993); *United States v. McLamb*, 5 F.3d 69, 72 (4th Cir. 1993).

Who Qualifies for the SCE?

The term "lender" is defined broadly for purposes of the SCE. As mentioned above, a lender must hold a "security interest" in the contaminated property, which includes: (i) an insured depository institution, an insured credit union, a bank or association chartered under the Farm Credit Act of 1971; (ii) a leasing or trust company that is an affiliate of an insured depository institution; (iii) any person that makes a bona fide extension of credit (including certain lease financing transactions) or acquires a security interest from a non-affiliated party; (iv) any entity that in a bona fide manner buys or sells loans or interest in loans; (v) a person who insures or guarantees against a default in the repayment of an extension of credit or acts as a surety in such circumstances; and (vi) a person who provides title insurance and that acquires a facility or vessel in the course of underwriting claims or claims settlement. 42 U.S.C. § 9601(20)(G)(iv).

A lender is protected from liability under the SCE only if it holds a security interest to secure repayment of money or other obligations. *See* 42 U.S.C. § 9601(20)(E)-(G). A security interest for these purposes includes a "right under a mortgage, deed of trust, assignment, judgment lien, pledge, security agreement, factoring agreement, or lease and any other right accruing to a person to secure the repayment of money, the performance of a duty, or any other obligation by a nonaffiliated person." 42 U.S.C. § 9601(20)(G)(vi). In determining whether the SCE applies, courts look to why a party holds title to a property. *See In re Bergsoe Metal Corp.*, 910 F.2d 668, 671 (9th. Cir. 1990). As long as "all…traditional indicia of ownership, such as responsibility for the payment of taxes and for the purchase of insurance," are left to the facility's operator, a lender's right to a property is generally considered a security interest for purposes of the SCE. *Id*. Parties that hold "bare title" or that use lease revenues to pay off bonds that finance the property's acquisition have been found to hold a security interest for purposes of the SCE. *Monarch Tile, Inc. v. City of Florence*, 212 F.3d 1219, 1223 (11th Cir. 2000).

"Participate in the Management"

As stated previously, a lender may not participate in the management of a facility prior to foreclosure if it wishes to avail itself of the protections of the SCE. CERCLA provides that participation in management involves "actually participating in the management or operational affairs of a vessel or facility." 42 U.S.C. § 9601(20)(F)(i). Participation in management for these purposes does not include having merely the capacity to

influence or right to control facility operations. 42 U.S.C. § 9601(20)(F)(i). Instead, a lender is only deemed to have participated in the management of the facility in which it holds indicia of ownership if it: (1) exercises decision-making control over the facility's environmental compliance such that the lender has taken responsibility for hazardous substance handling and disposal; or (2) exercises control at a degree comparable to that of a manager over either (a) the day-to-day decision making with respect the facility's environmental compliance or (b) substantially all of the operational functions of the facility unrelated to environmental compliance. 42 U.S.C. § 9601(20)(F)(ii).

The SCE expressly identifies several actions that do not count as participation in management. *See* 42 U.S.C. § 9601(20)(F)(iv). Among them are:

- Including a covenant or warranty of environmental compliance in the terms of the extension of credit;
- Monitoring or enforcing terms of the extension of credit;
- Monitoring and/or undertaking inspections of the facility;
- Requiring a response action or other means of addressing the release of a hazardous substance;
- Providing financial advice or counseling in an effort to mitigate or cure default or diminution in value of the facility;
- Altering the terms of an extension of credit;
- Exercising remedies available for breach of a credit agreement; and
- Conducting a response action under section 9607(d) of CERCLA.

See 42 U.S.C. § 9601(20)(F)(iv). Thus, to receive the benefits of the SCE, lenders should ensure that their actions with respect to a contaminated parcel of property remain within the scope of services that a lender typically provides.

Even after foreclosure, a secured creditor may become "intimately involved with a facility's operations without losing protection under the exemption." *United States v. Fleet Factors Corp.*, 821 F. Supp. 707, 719 (S.D. Ga. 1993). In the past, courts have found that lenders can perform numerous activities, such as "straightening-up [the facility] and [lotting items] for sale." *Id.* at 718. Furthermore, a lender can still qualify for the SCE upon foreclosure if the lender "sells, re-leases (in the case of a lease finance transaction), or liquidates the vessel or facility, maintains business operations, winds up operations, undertakes a response action…or takes any other measure to preserve, protect, or prepare the vessel or facility prior to sale or disposition." 42 U.S.C. § 9601(20)(E)(ii)(II).

Divest Within a Commercially Reasonable Time

In addition to refraining from participating in its management, the SCE requires that a lender divest itself of a facility within a commercially reasonable period of time after gaining title if it wishes to avoid CERCLA liability. Although CERCLA does not define what constitutes a commercially reasonable period of time, courts have generally held that anything under twelve months is acceptable. *See Waterville Indus., Inc.*, 984 F.2d at 553. That said, failing to sell the property within twelve months is likely not determinative as long as "[the lender] made diligent efforts to dispose of the property in a timely fashion." *Id.* at 554. Thus, the ultimate determination of whether the property was divested in a reasonable amount of time hinges on whether the lender acted promptly in light of relevant market circumstances. *See id.* at 553-54.

Limitations of the SCE

Despite its broad reach, the SCE does not protect a lender from liability for environmental contamination in all circumstances. Importantly, a lender will continue to be responsible for contamination caused by the lender's (or its agent's) action or inaction. *See Fleet Factors Corp.*, 821 F. Supp. at 719. A lender may be held liable for environmental contamination that it did not cause if the lender in some way exacerbated its effects or failed to stop an ongoing release after acquiring the property. Accordingly, lenders should carefully consider how and when to interact with contaminants at their facilities even if handling contaminants is related to a permitted activity under the SCE.

The SCE's protection likewise does not extend to operator liability or even to other types of liabilities associated with environmental contamination. For example, the SCE does not insulate a lender against third party environmental claims. A lender may also be required to incur costs to secure a property or address other environmental issues upon foreclosure. Even with this, the property may be less commercially valuable or it may be difficult to sell. Liability protection that may be available to a lender in possession cannot generally be transferred to a third party purchaser.

Furthermore, environmental contamination could have implications under both federal and state laws and, thus, lenders should always consult individual state laws on lender liability protection. State lender liability laws may not exist for every state and, even if they do, the protection these laws provide may be far more limited than the SCE. Individual states

may also have specific qualifications that must be met if a lender is to qualify for liability protection for contaminated sites within their jurisdiction.

Finally, lenders should be aware that CERCLA applies to releases of "hazardous substances," a term that specifically excludes petroleum and petroleum products. Petroleum, including its storage in underground storage tanks (*"USTs"*), is governed by the federal Resource Conservation and Recovery Act (*"RCRA"*). Section 9003(h)(9) of RCRA incorporates the CERCLA lender liability provisions by reference. However, both federal and state regulations pertaining to USTs may have requirements for lender liability protection that differ somewhat from the CERCLA requirements discussed above. Some states, for example, require that lenders empty and close USTs within a specified time following foreclosure for the state's liability protection to apply.

Because the SCE does not protect lenders against all environmental risks, lenders should consider implementing other risk-avoidance strategies. One method lenders can use to protect themselves is to purchase insurance that addresses environmental risks for mortgaged property. But, even if a lender does not purchase insurance and the mortgagor defaults on the loan, in at least some jurisdictions the lender can selectively foreclose on uncontaminated parts of the property in order to avoid environmental liability. *See Pownal Dev. Corp. v. Pownal Tanning Co.*, 171 Vt. 360 (2000). *See also* 1-4 Michael B. Gerrard, Brownfields Law and Practice § 4.04, 4-53 (2016).

For More Information

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