

# Lender Environmental Liability Under CERCLA...and How to Avoid It

By Anne E. Viner

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Real estate lenders have long been concerned with avoiding liability for environmental matters affecting the properties used to secure their loans. Until recently, the main concern has been avoiding liability arising solely from having a security interest in those properties. However, as lenders increasingly find themselves becoming the owners of those properties, it is critical that they understand the heightened risks of environmental liability associated with ownership, as well as steps they can take to minimize those risks.

An overview of potential lender liability under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), commonly known as Superfund, is a helpful place to start. Although there are many other laws and regulations that can give rise to environmental liability, CERCLA is a good example because of its very broad liability provisions. Moreover, most states have CERCLA-equivalent environmental statutes.

## The Nuts and Bolts of CERCLA

CERCLA is a federal law created in 1980 to facilitate cleanup of contaminated sites and allocate responsibility for payment of cleanup costs. The general policy of CERCLA is to require private parties that had some involvement with a contaminated facility to pay for cleanup, rather than taxpayers. CERCLA can be enforced by the federal government or by private parties—essentially anyone seeking to recover money spent investigating and cleaning up a site.

CERCLA identifies five categories of potentially responsible parties (PRPs) that may be subject to liability:

1. The current owner or operator of a property on which a release of hazardous substances has occurred, even if that party did not cause or contribute to the contamination;
2. Any person who owned or operated a property at the time hazardous substances were disposed of there;
3. Any generator of a hazardous substance that is disposed of on another party's property;
4. Any person who arranged with a third party for disposal or treatment of hazardous substances; and
5. Any party that transported a hazardous substance, if the site was selected by the transporter.

One of the most important aspects of CERCLA is the potential for liability for the acts of others, even if the party being held liable is not at fault. For example, the present owner of a facility may be liable for contamination caused by acts of previous owners or tenants, even if the present owner did nothing to cause or exacerbate the contamination. Another key aspect of CERCLA is that there are no time limits on when liability can be imposed (e.g., an owner or operator of a facility can be liable for site remediation 20 years after the facility is transferred or closed, even if the contamination occurred before CERCLA was enacted). A third critical feature of CERCLA is that liability is "joint and several." In other words, liability is not proportionate to the volume, toxicity or extent of contamination caused by each party, and one party may, by itself, have to pay full costs if no others can be found or if the others are insolvent.

## Lender Liability: In General

Fortunately for lenders, CERCLA contains a secured creditor exemption that eliminates owner/operator liability for lenders that hold ownership in a facility primarily to protect a security interest, provided they do not "participate in the management" of the facility.

For CERCLA purposes, "participate in the management" means actually taking part in the day-to-day operational affairs of a facility. Essentially, a lender meets this qualification only if, while the borrower is still in possession of the facility, the lender (i) exercised decision-making control over environmental compliance at the facility, including hazardous substance handling or disposal practices; or (ii) conducted all or substantially all of the daily operational functions (as distinguished from financial or administrative functions) of the facility.

"Participating in the management" under CERCLA does not include (i) merely having the capacity to influence, or the unexercised right to control, facility operations; (ii) performing an act or failing to act prior to the time at which a security interest is created; or (iii) any of the following types of actions, if such conduct does not rise to the level of "participation in the management" as defined in CERCLA:

1. Holding a security interest or abandoning or releasing a security interest;
2. Including a covenant, warranty or other term or condition that relates to environmental compliance in any loan document;
3. Monitoring or enforcing the terms and conditions of a loan or its related security interest (including monitoring or inspecting the facility);
4. Requiring actions to address a release or threatened release of a hazardous substance;
5. Providing financial or other advice to the borrower in an effort to mitigate, prevent or cure default or diminution in the value of the facility;
6. Restructuring the terms and conditions of the loan or security interest, or granting a forbearance;
7. Exercising other remedies for the breach of the loan or security agreement; or
8. Conducting a response action under CERCLA.

### **Lender Liability: In the Context of Foreclosure**

A lender that does not participate in the management of a facility prior to foreclosure will generally not be subject to liability under CERCLA. If the lender eventually does foreclose, it is still possible to avoid liability for the following activities, so long as the lender attempts to sell, re-lease (in the case of a lease finance transaction) or otherwise divest itself of the facility at the earliest practicable time it can do so on commercially reasonable terms, taking into account market conditions and legal and regulatory requirements:

1. Maintaining business activities at the facility;
2. Winding up operations;
3. Undertaking certain environmental remediation actions (subject to very specific guidelines); and
4. Taking other measures to preserve, protect or prepare the facility for sale or disposition.

### **How Can a Lender Protect Itself?**

In general, there are three things a lender can do to best protect itself against liability under CERCLA (and environmental liability generally):

1. Conduct thorough due diligence regarding the facility securing the loan and its owner and operator;
2. Monitor any areas of concern regularly throughout the life of the loan, while being careful not to participate in the facility's management; and
3. Engage experienced, skilled professionals for assistance with the previous two items.

Regarding due diligence, the selection of a contractor to perform the necessary investigations (including Phase 1 and, if necessary, Phase 2 Environmental Site Assessments) can be critical. An experienced contractor will be familiar with the applicable laws and regulations (including CERCLA's "all appropriate inquiry" requirements), and thorough in its examination of the property, interviews of appropriate personnel (e.g., current and former owners and operators) and review of applicable public records. Much Shelist has relationships with environmental contractors nationwide, and can make referrals based on the type of property and loan involved.

While this overview can serve as a basic guide for minimizing the risk of owner/operator liability under CERCLA, lenders should keep in mind that the laws, rules and regulations governing environmental liability are extremely broad and complex. Accordingly, it is critical to consult an experienced attorney before taking any action on environmental matters.

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