Commentary

CERCLA Environmental Liability for Lenders a Look at the New EPA Rule

by Dean Stackel

Introduction

In 1980, Congress enacted the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA"), which requires a variety of "responsible parties" to pay for the cleanup of environmental contamination.

One group of potentially responsible parties under CERCLA are lenders. A lender's liability under CERCLA derives, peculiarly enough, from being excluded from the definition of "owners or operators" of property, who are strictly liable under CERCLA. Under CERCLA a lender will not be liable for environmental remediation costs if the lender, "without participating in the management of a ... facility, holds indicia of ownership primarily to protect his security interest ...." This exclusion from liability is commonly referred to as the security interest exemption.

Since CERCLA does not define what constitutes "participating in management" and "indicia of ownership primarily to protect his security interest," CERCLA left lenders uncertain as to what actions a lender could take before CERCLA liability would attach. This uncertainty was significantly enhanced by varying judicial interpretations of the security interest exemption.

Then, in 1990 the Eleventh Circuit, in United States v. Fleet Factors Corp., sent the lending community into an uproar when it stated that:

> It is not necessary for the secured creditor actually to involve itself in the day-to-day operations of the facility in order to be liable ... [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.

In a footnote, the court added: "Generally, the lender's capacity to influence a debtor facility's treatment of hazardous waste will be inferred from the extent of its involvement in a facility's financial management."

The EPA Rule

To address the confusion created by the case law, the EPA issued a rule (the "Rule"), effective April 29, 1992, which attempts to define such permissible activities by interpreting the above-mentioned phrases from the security interest exemption.

Importantly, the Rule defines participation in management to mean actual participation. Under the Rule, the mere capacity to influence a borrower's hazardous waste decisions will not result in CERCLA liability for lenders.

The EPA considers a lender to be participating in the management of a facility if, while the borrower is still in possession, the lender either:

> (i) exercises decision-making control over the borrower's environmental compliance, such that the lender has undertaken responsibility for the borrower's hazardous substance handling or disposal practices; or (ii) exercises control at a level comparable to that of a manager of the borrower's enterprise, such that the lender has assumed or manifested responsibility for the overall management of the enterprise encompassing the day-to-day decision-making of the enterprise with respect to:
>
> > (A) Environmental compliance or;
> >
> > (B) All, or substantially all, of the operational (as opposed to financial or administrative) aspects of the enterprise other than environmental compliance.

Operational aspects of the enterprise include functions such as that of facility or plant manager, operations manager, chief operating officer, or chief executive officer. Financial or administrative aspects include functions such as that of credit manager, accounts payable/receivable manager, personnel manager, controller, chief financial officer, or similar functions.

The Rule states specific activities which do not constitute "participation in management." The Rule divides these activities into three categories: (1) activities at the inception of the loan, (2) activities in policing the loan, and (3) activities in connection with workouts.

Activities at the Inception of the Loan

The Rule states that any activities prior to the making of a loan do not constitute participation in management.

Activities in Policing the Loan

According to the EPA, activities that will not be considered to be participating in the management of a facility expressly include: requiring the borrower to clean up the facility during the life of the loan or security interest; requiring the borrower to comply with applicable federal, state and local environmental laws during the life of the loan or security interest; and obtaining authority to periodically or regularly monitor or inspect both the facility and the borrower's business and financial condition.

Activities in Connection with Workouts

According to the comments to the Rule, activities that the EPA considers to be permissible during the workout period include: restructuring or renegotiating the terms of the security interest; exercising forbearance; requiring payment of additional rent or interest; extending the payment period; providing specific or general financial or other advice, suggestions, counseling or guidance; or exercising any right or remedy the lender is entitled to by law or under any warranties, covenants, conditions, representations or promises from the borrower.

According to the Rule, a lender may foreclose, purchase the property at foreclosure, then sell, release, liquidate, maintain business activities, wind up operations and undertake remediation provided that the lender undertakes to divest itself of the property in a reasonably expeditious manner. Although the lender may use whatever reasonable means are appropriate, a lender will comply with the Rule if, within 12 months following the time the lender acquires marketable title, the lender either lists the property with a broker or actively advertises the property for sale.

A lender that outbids, rejects or fails to act upon a "written, bona fide, firm offer," received any time after six months following foreclosure, of fair consideration (loosely define as principal plus interest, costs, fees, charges and response costs, less amounts received by the lender) loses its exemption unless the lender is required to make a higher bid pursuant to law. For example, a lender would, according to the EPA, lose its security interest exemption under CERCLA in the following factual scenario: (1) a lender has foreclosed upon real property over six months ago, (2) the real property was security for a loan which had a balance due of principal plus interest of $500,000, (3) the lender had incurred $50,000 in costs, fees, charges and environmental response costs and, (4) the lender received a written offer from a ready, willing and able purchaser for an amount greater than $550,000.

Clear Answers?

Despite the attempt by the EPA to define the range of activities that will not subject lenders to CERCLA environmental liability, lenders cannot completely rely on the EPA's Rule. First, the EPA's definition of participating in management is now subject to judicial interpretation. Second, with respect to the activities the EPA considers acceptable, the language of the Rule often states that those activities are only acceptable if the lender is not participating in management. This qualification seems to beg the question and suggests that a lender can have liability even if its actions are on the EPA's list of acceptable activities. Third, it is uncertain whether the Rule binds private parties who, under CERCLA, may bring their own causes of action to attempt to force the lender to clean up a toxic site. Moreover, what is often overlooked in the lending community is the myriad of state, common law and other federal laws which govern liability for hazardous wastes. Although a lender may escape CERCLA environmental liability, there are many other laws to be wary of.

In conclusion, the EPA has taken a large step in defining what the EPA considers to be permissible lending activities under CERCLA. However, because of the reasons listed above, lenders still must be vary careful in their actions if they intend to escape environmental liability.

For a more detailed analysis of the Rule and suggestions to lenders on how to minimize their exposure to lender liability under CERCLA, please call Trudy Savala at Buchalter, Nemer, Fields & Younger (213) 891-0700 and she will send you an article published in the June issue of Los Angeles Lawyer written by Dean Stackel and Kenneth Swenson entitled "The Ambiguity of Lender Liability Under CERCLA."

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