

**DIVISION OF WASTE MANAGEMENT
N.C. DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES**

TELEPHONE LOG

DATE: 11-7-14

SHEET: 1 OF 1

Call: Placed X , Received _____, Returned _____

PROJECT: Prime Equipment	COUNTY: New Hanover
CONVERSATION WITH: Jim Joyce	TELEPHONE: 919-743-7336
AFFILIATION: K&L Gates	
DISCUSSION:	
<p>Letting him know that the IHSB liability response was on its way. Discussed in further detail the RP determination and its link to a liability determination. Also emailed some general information that he may find helpful.</p>	

Sue Robbins, Hydrogeologist

Robbins, Susanne

From: Robbins, Susanne
Sent: Friday, November 07, 2014 2:43 PM
To: Joyce, Jim L. (Jim.Joyce@klgates.com)
Subject: Informational Document
Attachments: pub2313_1.pdf

As we discussed, this is some general information that you may find useful. It is not a policy or opinion of the Branch or Division.

Sue Robbins, Hydrogeologist
IHSB, Superfund Section
NC Division of Waste Management
Wilmington Regional Office
(910) 796-7411

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LENDER LIABILITY UNDER CERCLA

ENVIRONMENTAL RISKS FOR LENDERS UNDER SUPERFUND: A REFRESHER FOR THE ECONOMIC DOWNTURN

By Matthew H. Ahrens and David S. Langer***

Given the current economic environment, commercial lenders should be prepared to address loans that are either in default or may soon be in default where the collateral includes “environmentally sensitive” property. The evaluation of any such loan should consider the impact of site contamination on the value of the property and the lender’s potential exposure to liability for that contamination. Understanding the potential exposure to environmental liability and how to mitigate such liability should be a part of the lender’s assessment of whether or not to foreclose on the collateral. In addition, lenders should consider potential liability after foreclosure (both for the lender and subsequent purchasers of the foreclosed property) and potential reduction in the value of the collateral.

OVERVIEW OF LIABILITY PURSUANT TO THE COMPREHENSIVE ENVIRONMENTAL RESPONSE, COMPENSATION, AND LIABILITY ACT

The federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), 42 U.S.C. §§ 9601 *et seq.*, commonly known as Superfund, is one of the primary U.S. federal laws imposing liability and obligations for the remediation of contaminated properties. CERCLA can require potentially responsible parties (PRPs) to conduct or pay for the cleanup of contaminated property. Any current “owner or operator” of a “facility” can be considered a PRP.¹

Liability under CERCLA is both “strict” and “joint and several.” “Strict” liability means that parties can be held liable merely because they fall within one of the statutory classes of responsible parties and without regard to fault. A party need not mishandle or release any hazardous substances or violate any laws in order to become a CERCLA PRP. “Joint and several” liability means that any PRP can be responsible for the payment

* *Matthew H. Ahrens is a counsel at Latham & Watkins LLP, practicing in the Environmental and Land Resources Department. He received an A.B. from Dartmouth College and a J.D. from the Vanderbilt University Law School. He can be reached by telephone at (212) 906-1784, or by e-mail at matthew.ahrens@lw.com.*

** *David S. Langer is a counsel at Latham & Watkins LLP, and chair of the New York office’s Environmental and Land Resources Department. He received an A.B. from Princeton University in 1985 and a J.D. from Harvard Law School in 1989. He can be reached by telephone at (212) 906-1788, or by e-mail at david.langer@lw.com.*

1. 42 U.S.C. § 9607(a).

of all of the cleanup costs, although, in certain circumstances, the PRP can seek contribution from other PRPs. As a result, under CERCLA, the owner or operator of a property can be liable for remediation costs even if the contamination pre-dated its ownership or operation of the property. In addition, there is no cap on liability.

However, CERCLA provides certain defenses and exemptions from this potential liability, including a "secured creditor exemption" that can protect lenders from both pre- and post-foreclosure CERCLA liability with respect to a particular facility.² As discussed further below, lenders need to pay careful attention to the requirements for these defenses. If not followed, lenders could be held liable under CERCLA as an operator or as an owner either: (1) by participating in the management of the borrower prior to foreclosure; or (2) by owning or operating the property after foreclosure.

CERCLA LENDER LIABILITY BEFORE 1996

Prior to the amendments to CERCLA in 1996, there was an ongoing dispute over whether a lender could be subject to CERCLA liability merely by extending financing to a facility and retaining a security interest. As initially adopted, CERCLA contained a safe harbor provision for secured creditors. Specifically, the term "owner or operator" was defined to exclude "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."³ As a result, lenders that held a mortgage and did not "participate in the management" of the borrower were not owners or operators and thus were not subject to CERCLA liability.

However, courts were in disagreement as to the scope of this protection. For example, some courts held that protection continued after foreclosure,⁴ and others held that lenders would become "owners" upon foreclosure.⁵ In addition, it was unclear what qualified as "participating in the management" which, as a result, could make a lender an "operator." While some courts held that there must be actual management of the

2. As discussed below, the CERCLA secured creditor exemption only applies to foreclosures on security interests in real property. As a result, this exemption does not apply to equity transfers such as foreclosures on company stock or transfers of stock from a borrower in lieu of a title transfer. In addition, although similar secured creditor exemptions may exist under other federal or state environmental laws, the CERCLA secured creditor exemption does not guarantee protection from liability under those other statutes.

3. 42 U.S.C. § 9601(20)(E).

4. See, e.g., *United States v. Mirabile*, No. CIV. A. 84-2280, 1985 WL 97 (E.D. Pa. Sept. 6, 1985) (applying the "indicia of ownership" exemption to a lender that acquired ownership of a facility through foreclosure and sells or assigns its interest within a few months after the purchase).

5. See, e.g., *Guidice v. BFG Electroplating & Manufacturing Co.*, 732 F. Supp. 556 (W.D. Pa. 1989) (ruling that a bank became liable under CERCLA as an "owner" after foreclosure).

facility, and that the mere capacity to control was not “participating in management,”⁶ other court decisions ruled that the mere ability to exercise control, whether or not such control was actually exercised, counted as “participating in management.”⁷ This latter ruling, the Eleventh Circuit’s *Fleet Factors* decision, sent veritable shockwaves through the lending community, raising concerns that lenders would be liable for contaminated property merely because they had provided financing.

On April 29, 1992, the United States Environmental Protection Agency (EPA) sought to allay the fears generated by *Fleet Factors* by issuing regulations to ensure that the mere ability to control management would not make a lender liable under CERCLA.⁸ These so-called “lender liability rules” provided guidance as to what qualified as “participating in management” and as to when a lender would become an “owner” after foreclosure. However, EPA’s lender liability rules were vacated in 1994 when the D.C. Circuit, in *Kelley v. EPA*, ruled that the EPA lacked statutory authority to restrict liability under CERCLA through regulation.⁹ Shortly after the lender liability rules were vacated, the EPA issued a guidance memorandum stating that it would continue to follow the provisions of the rules as its enforcement policy.¹⁰ Nonetheless, lenders remained concerned regarding the parameters of the secured creditor exemption, since there was no guarantee that EPA’s guidance would be followed by courts in the context of actual CERCLA litigation with third parties, or that EPA’s enforcement policies would not change.

CERCLA LENDER LIABILITY AFTER 1996

Enacted on October 1, 1996, the Asset Conservation, Lender Liability, and Deposit Insurance Protection Act¹¹ (the 1996 Amendments) amended CERCLA to restore lender liability protection. In effect, the 1996 Amendments codified the EPA’s recently vacated lender liability rules.¹² In addition, to avoid any future confusion, the 1996 Amendments defined the term “lender” broadly and expressly stated that the secured

6. *Bergsoe Metal Corp. v. East Asiatic Co. (In re Bergsoe Metal Corp.)*, 910 F.2d 668 (9th Cir. 1990) (concluding that there must be some actual management of the facility before a secured creditor will fall outside the exemption.).

7. See, e.g., *United States v. Fleet Factors Corp.*, 901 F.2d 1550 (11th Cir. 1990), cert. denied 498 U.S. 1046 (1991) (holding that a creditor’s activities constituted participation in management because it had the ability to exercise control over environmental matters, whether or not such control was actually exercised).

8. 57 Fed. Reg. 18,344 (Apr. 29, 1992).

9. *Kelley v. EPA*, 15 F.3d 1100 (D.C. Cir. 1994).

10. 60 Fed. Reg. 63517 (1995).

11. Pub. L. No. 104-208, 110 Stat. 3009-462.

12. See *Kelly v. Tiscornia*, 44 ERC 1951 (6th Cir. 1996) (ruling that the 1996 Amendments were a reinstatement of the EPA’s lender liability rules and an attempt by Congress to codify its provisions).

creditor exemption applied to any person “that is a lender” that did not “participate in management.”¹³

Perhaps most importantly, the 1996 Amendments addressed the two most important questions that were left open after the EPA’s lender liability rules had been vacated: (1) what was “participation in management”; and (2) whether foreclosure would make a lender liable under as an “owner” under CERCLA.

Lender Liability Prior to Foreclosure – Participation in Management

Since passage of the 1996 Amendments, the secured creditor exemption was, in essence, a two prong test: first, a person must qualify as a lender and second, a person must not “participate in management.”

The first prong requires a lender to establish that it holds its security interest primarily to secure the repayment of money or other obligation of another person.¹⁴ Applicable security interests include “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.”¹⁵ At least one court has ruled that a person who held title to a facility under a sale-leaseback arrangement was deemed to be holding a security interest in the property.¹⁶ Courts addressing this requirement have focused on determining *why* the entity holds indicia of ownership used as a security interest.¹⁷

The second prong requires lenders to establish that they did not *actually* participate in management of the property.¹⁸ The 1996 Amendments specified that mere capacity to influence a facility or an “unexercised right to control” a facility does not constitute “participation in

13. Section 101(20)(E)(i) was amended to read “The term ‘owner or operator’ does not include a person that is 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.” 42 U.S.C. § 9601(20)(E)(i). The term “lender” was defined by section 101(20)(G)(iv) to include not only specific regulated banking institutions (such as insured depository institutions, credit unions, and the Federal Home Loan Mortgage Corporation) but also sureties, title insurers, and “any person . . . that makes a bona fide extension of credit to or takes or acquires a security interest from a nonaffiliated person.”

14. 42 U.S.C. § 9601(20)(G)(iv).

15. *Id.*

16. *Kemp Industries, Inc. v. Safety Light Corp.*, 857 F. Supp. 373 (D.N.J. 1994).

17. *In re Bergsoe Metal Corp.*, 910 F.2d 668, 671 (9th Cir. 1990) (holding that a municipal corporation’s title to a property was a security interest because it had leased “all other traditional indicia of ownership,” to the operator and assigned to the bank all of its lease rights and revenues which were equal to the payments due under the bonds); *see also*, *Monarch Tile, Inc. v. City of Florence*, 212 F.3d 1219 (11th Cir. 2000) (adopting the reasoning from the *Bergsoe* opinion). *Monarch Tile, Inc. v. City of Florence*, 212 F.3d 1219 (11th Cir. 2000) (ruling that a governmental body qualifies for CERCLA’s “secured creditor” liability exception when it acquires indicia of ownership in a property for purpose of securing repayment of development bonds).

18. 42 U.S.C. § 9601(20)(F).

management.” A lender is deemed to have participated in management if it: (1) undertakes decision-making control or responsibility for the facility’s hazardous substance handling or disposal practices; or (2) exercises control at the level of a manager over: (a) day-to-day decision making with respect to environmental matters; or (b) the “operational functions [19] (as distinguished from financial or administrative functions[20])” of the facility other than the functions of environmental compliance.²¹ In addition, as amended, CERCLA expressly identifies certain actions that will not qualify as “participation in management,” including:

- holding, abandoning or releasing a security interest;
- including environmental covenants or warranties in a credit or security agreement;
- monitoring or enforcing, or altering, restructuring or renegotiating, the terms and conditions of the extension credit or security agreement;
- conducting one or more inspections of the facility;
- requiring a response action “or other lawful means of addressing the release or threatened release of a hazardous substance”;
- providing financial or other advice or counseling seeking to mitigate, prevent or cure default or diminution in value; and
- exercising other legal remedies for the breach of a credit or security agreement.²²

There is limited case law addressing what actions by a lender qualify as “participation in management.” In one decision after the issuance of EPA’s 1992 lender liability regulations but prior to the 1996 Amendments, the court held that a lender had *not* participated in management even though it had insisted that a CEO be replaced, asked the Small Business Administration to act on its guarantee of a loan, and attempted to collect on accounts receivable that had secured the loan by direct contact with those who owed the money.²³ Although the lender liability rules were subsequently vacated, the 1996 Amendments, in effect, codified these regulations and, accordingly, the court decisions addressing those

19. “Operational functions” are defined to include “a function such as that of a facility or plant manager, operations manager, chief operating officer, or chief executive officer.” 42 U.S.C. § 9601(20)(G)(v).

20. “Financial or administrative functions” are defined to include “a function such as that of credit manager, accounts payable officer, accounts receivable officer, personnel manager, comptroller, or chief financial officer, or a similar function.” 42 U.S.C. § 9601(20)(G)(ii).

21. 42 U.S.C. § 9601(20)(F)(ii).

22. 42 U.S.C. § 9601(20)(F)(iv).

23. *Grantors to Silresim Site Trust v. State Street Bank & Trust Co.*, No. Civ. A. 88-1324-K, 1992 U.S. Dist. LEXIS 20612 (D. Mass. 1992). See also *Z&Z Leasing, Inc. v. Graying Real Inc.*, 873 F.Supp. 51 (E.D. Mich. 1995) (holding that a lender that required its consent prior to a certain financial management actions such as conducting a merger or acquisition did not qualify the lender as an operator).

regulations provide some guidance on the meaning of the current statutory provisions.

In one recent case, *New York v. HSBC USA, N.A.*, the State of New York asserted that the lender did not qualify for the secured creditor exemption because it had “seized” the operating funds of the borrower and left the borrower with no financial ability to comply with environmental regulations.²⁴ The lender had instituted a lock box arrangement on the borrower’s funds, and approved or denied requests for disbursements from the borrower. Allegedly, the lender had refused requests for funds for the disposal of hazardous materials, and this allegedly led to spills and contamination. In settlement negotiations with the State of New York, the lender agreed to pay \$850,000 in civil penalties and \$115,680 in costs.²⁵ Because of the settlement, no judicial precedent was created. Nonetheless, the matter indicates that there are situations where states will seek to impose environmental liability on lenders and provides another data point as to what actions could be considered as being “participation in management.”

Some further guidance can be found in the context of litigation of related CERCLA liability issues, such as whether a corporate shareholder or parent entity can be held liable as an “operator” under CERCLA. For example, in *U.S. v. Bestfoods*, the U.S. Supreme Court held that a party that actively participates in, and exercises control over, the day-to-day environmental operations of a facility may be held directly liable as an operator of that facility.²⁶ However, the Supreme Court also clearly indicated that a parent corporation would not be subject to operator liability under CERCLA as long as its actions are not “eccentric under accepted norms of parental oversight of a subsidiary’s facility.”²⁷ Similarly, one can reasonably expect that a lender will not be held to be “participating in management” of its borrower if the lender is only taking actions to oversee the preservation of its collateral that are not “eccentric” under accepted norms of lender oversight.

In sum, pursuant to the secured creditor exemption, a lender that holds an applicable security interest does not qualify as an “owner or operator” under CERCLA prior to foreclosure unless it “participates in management.” As with parent corporations, a lender that is taking reasonable actions to monitor and preserve the value of its collateral and to enforce the terms of its loan agreements is unlikely to be deemed to have “partici-

24. *New York v. HSBC USA, N.A.*, (S.D.N.Y. No. 07-3160, 2007).

25. *Id.* See “HSBC Bank to Pay \$966,000 to Settle Cleanup of Abandoned Chemical Plant,” A-8, BNA Daily Environment Report (May 31, 2007).

26. *U.S. v. Bestfoods*, 524 U.S. 51 (1998). See also *U.S. v. Atchinson, Topeka & Santa Fe Ry. Co.*, Nos. CV-F-92-5068 OWW, CV-F-96-6226 OWW, CV-F-96-6228 OWW, 2003 WL 25518047 at *57-*58 (E.D. Cal. 2003) (ruling that a person that did not exercise actual control over the operations, did not hire or supervise the employees involved in causing pollution, or exercise direction over the facility’s storage and sale activities is not an “operator”).

27. *Bestfoods*, 524 U.S. at 72.

pated in management.” However, a lender that oversteps this role and exercises decision-making control or responsibility for hazardous substance handling or disposal practices, performs day-to-day decision-making for environmental matters or controls the operational function of the facility as a whole, will risk being deemed the operator of the facility and, as a result, be subject to CERCLA liability.

Lender Liability as an Owner – Post-foreclosure Lender Liability

The 1996 Amendments also added a safe harbor provision that allows a lender to retain its secured creditor exemption from CERCLA liability even after foreclosure on a contaminated property. The statutory language specifies that, in order to qualify for this protection, the lender must not have “participate[d] in management” of the facility prior to foreclosure, i.e., a party that was already subject to “operator” liability under CERCLA cannot escape that liability through the foreclosure safe harbor. After foreclosure, the lender must be able to establish that it has made commercially reasonable efforts to divest itself of the property at the earliest practicable, commercially reasonable time, on commercially reasonable terms, taking into account market conditions and legal and regulatory requirements.²⁸ Under this safe harbor provision, the lender is entitled to act as the owner of the property during the period prior to divestiture, including by taking actions to sell, re-lease (in the case of a lease finance transaction), or liquidate the facility, maintain business activities, wind up the operations of the business, undertake lawful means to address the release or threatened release of a hazardous substance, or take other measures to preserve, protect or prepare the facility prior to sale or disposition.²⁹

While the statutory language provides some clear examples of acceptable behavior, there is no bright line rule for what actions by a lender would be acceptable in the context of a foreclosure or potential foreclosure. Only limited judicial guidance is available. One federal District Court held that a lender had not assumed liability when, before foreclosure, it listed the property for re-lease with several real estate agents, entertained inquiries about the site, leased a portion of the site, contacted environmental firms about the extent of the contamination and for cleanup estimates, and continued to try to find new tenants. When those attempts failed, the lender mailed the keys to a Bankruptcy trustee.³⁰

CERCLA also does not specify what constitutes commercially reasonable efforts to divest property. EPA has provided guidance stating that the “test will generally be met if the lender, within 12 months of foreclosure, lists the property with a broker or advertises it for sale in an appropriate

28. 42 U.S.C. § 9601(20)(E)(ii).

29. 42 U.S.C. § 9601(20)(E)(ii)(II).

30. *U.S. v. Pessess*, No. Civ.A. 90-0654, 1998 WL 937235, at *17 -*19 (W.D. Pa. 1998).

publication.³¹ This guidance does not discuss the consequences of the inability to sell within a given period of time. Clearly, this is a case-by-case determination that will depend upon the market conditions as of and following foreclosure and the Court's view on what business judgments (e.g., sales price) are reasonable. Because any such judgment will be made with the full benefit of hindsight, the lender with possession of the foreclosed property should carefully document its efforts to market the property. In the event that someone later alleges that the lender has lost its protection under the foreclosure safe harbor, the lender will need to establish that it was actively marketing the property and that any actions taken to manage the property or run the business were simply efforts to preserve the value of the foreclosed collateral. If the lender starts to act more like an owner of the business (e.g., by investing capital or seeking opportunities to expand the business), it could run the risk of being deemed the "owner or operator" of the property and become a PRP with regard to any associated CERCLA liability.

Caveats — CERCLA's Secured Creditor Exemption is Not Absolute Protection from Environmental Liability

Even lenders that are within the prerequisites for the CERCLA secured creditor exemption and that foreclose with the intention of taking advantage of the safe harbor provisions need to consider the possibility of environmental liability outside this safe harbor. Environmental liability could still attach to the lender in several ways.

First, even if protection from CERCLA liability is available to the lender, protection may not be available to any third party to which the lender might seek to transfer foreclosed property. As a result, the value of the underlying collateral could be reduced by at least the amount necessary to remediate any contamination. For example, a property that would be worth one million dollars without contamination but requires two hundred thousand dollars to remediate will likely sell for no more than eight hundred thousand dollars. Unless the lender has other available collateral, the cost to remediate the property is effectively paid by the lender.

Second, as noted above, protections available under CERCLA only insulate the lender from liability as a PRP under CERCLA. CERCLA only applies to "hazardous substances," which, as defined in the statute, does not include petroleum; as a result, petroleum-related contamination would not be covered by CERCLA's secured creditor exemption. Certain other federal statutes may also impose liability for contamination. In addition, many states also have laws that parallel CERCLA. Although some of

31. See Question 5, EPA Office of Enforcement Compliance Assurance, "Superfund Frequently Asked Questions: Laws, Policy and Guidance," <http://www.epa.gov/compliance/resources/faqs/cleanup/superfund/laws-faqs.html> (last updated on April 29th, 2008).

these federal and state statutes have secured creditor protections similar to CERCLA,³² the laws applicable to a particular facility will need to be evaluated on a case-by-case basis.³³ Protection for the lender may not be available in all instances.

Third, the CERCLA secured creditor exemption relates to contamination matters and does not extend to costs associated with other environmental compliance matters such as, for example, the regulation of air emissions under the Clean Air Act or wastewater discharges under the Clean Water Act. A lender that seeks to foreclose on an operating facility should consider the potential liabilities for non-compliance and future compliance obligations with respect to such matters.

Fourth, a lender's actions pre- and post-foreclosure may serve as an independent basis for CERCLA liability and cause a lender to be deemed an "operator" responsible for contamination caused during the term of the lender's ownership or control of the property.³⁴ The secured creditor exemption can offer lenders protection from liability for past contamination based upon their status as lenders or as owners after foreclosure. However, in circumstances where the lender's acts or omissions may have caused contamination, liability may still attach. For example, in the *F.P. Woll Co.* case, the lender's motion to dismiss based on the secured creditor exemption was denied even though the lender had promptly sold the assets to a third party after foreclosure. The court ruled that the question of whether the lender had engaged in active management or operation of the facility during the time a release occurred was factual and could only be resolved on summary judgment or at trial.³⁵ Similarly, in the *HSBC* matter, the lender's de facto control over the company's environ-

32. Subchapter IX of the Solid Waste Disposal Act, which addresses the liability of owners or operators of underground storage tanks, incorporates the CERCLA lender liability provisions by reference. 42 U.S.C. § 6991b(h)(9). The underlying regulations specify that participation in management "does not include the mere capacity or ability to influence or the unexercised right to control" underground storage tank operations. 40 C.F.R. § 280.210(a)(1). However, these lender liability provisions do not apply to other areas of the Solid Waste Disposal Act, also known as the Resource Conservation and Recovery Act or RCRA, which regulates the handling, storage, treatment, transport and disposal of hazardous waste. Similarly, the definition of "owner or operator" under the Oil Pollution Act contains substantially identical language to the lender liability provisions under the CERCLA definitions. 33 U.S.C. § 2701(26).

33. For example, the New Jersey Spill Compensation and Control Act contains provisions to protect lenders in the pre- and post-foreclosure context but adds language defining the acceptable means by which a lender can divest itself of the property and establishing a presumptive five-year time limit to complete the divestiture. N.J. STAT. ANN. §§ 58:10-23.11g4-g6 (2008). New York, in contrast, also adopted lender liability protections as part of its 2003 Brownfields Amendments but largely follows CERCLA's language, i.e., not allowing "participation in management" and requiring divestiture "at the earliest practicable, commercially reasonable time." N.Y. ENVTL. CONSERV. LAW § 27-1323(1)(b) (2008).

34. *F.P. Woll Co. v. Fifth & Mitchell St. Corp.*, 96-5973, 1997 U.S. Dist. LEXIS 11685 (E.D. Pa. July 31, 1997).

35. *Id.*

mental management arguably led to it being held liable for resulting contamination and noncompliance.³⁶ Comparable actions by a lender that lead to contamination or non-compliance after foreclosure could lead to the same result. As a result, a lender foreclosing on property can, depending on its actions, be an “operator” of such property, and thus can be potentially liable for any CERCLA violations occurring on the property.

Fifth, the CERCLA safe harbor provisions only offer protection when the lender forecloses on the borrower’s property assets rather than the company stock. If, for example, the lender’s security interest includes a pledge of the borrower’s stock, a foreclosure on the stock will result in the lender becoming the borrower’s parent. The company, as a surviving legal entity, will still have whatever CERCLA liability (along with its other loans, tax obligations and contractual responsibilities) that existed prior to foreclosure. Seeking protection under the U.S. Bankruptcy Code may be an option that would allow a company to reorganize and eliminate some of its liabilities and debts. However, while bankruptcy may help a company to remove some of its CERCLA liability for third-party sites (e.g., off-site landfills), it may not eliminate CERCLA liability for the party that ends up owning the property after completion of the bankruptcy proceedings, whether it is a new owner that purchased the asset or a reorganized debtor.³⁷

Sixth, a lender must exercise due care in its sale of the property after foreclosure. For example, in a recent state court decision, a bank that had purchased property out of foreclosure and then promptly sold the property to a third party was deemed liable under state law for fraud when it failed to disclose known environmental conditions to the buyer.³⁸ However, a federal decision issued prior to the 1996 Amendments held that a lender that foreclosed on property and sold it within a reasonable time (four months) qualified for the security interest holder exemption despite the bank’s failure to inform the purchaser of the property of possible environmental contamination.³⁹

WHAT TO DO (OR NOT DO)

While foreclosure on environmentally-distressed properties will never be risk-free, there are some general prophylactic strategies that can assist lenders or other secured creditors from stumbling into an unwanted environmental nightmare:

1. *Avoid “Participation in Management.”* As discussed above, a lender that has “participated in management” of the property could be held liable as an “operator” under CERCLA. It is essential that the lender limit its involvement in environ-

36. *New York v. HSBC USA, N.A.*, (S.D.N.Y., No. 07-3160, 2007).

37. The treatment of CERCLA liabilities under the U.S. Bankruptcy Code is beyond the scope of this article.

38. *Hess v. Chase Manhattan Bank*, 220 S.W.3d 758 (Miss. 2007).

39. *Northeast Doran, Inc. v. Key Bank of Maine*, 15 F.3d 1 (1st Cir. 1994).

mental issues to oversight of the borrower's environmental management. While it is not advisable to ignore environmental concerns, the lender should not assume responsibility or try to direct the company's environmental decisions or influence those decisions through financial controls.

2. *Conduct Pre-Foreclosure Diligence.* Prior to foreclosure, a lender should seek to understand the environmental condition of the property and the reasonable likelihood and range of environmental liabilities that will be associated with assuming ownership of the property. If current information is not readily available, an environmental consultant should be retained to prepare new Phase I environmental site assessments.⁴⁰ Additional investigations (Phase II assessments) may also be warranted in order to obtain a meaningful estimate of the potential liabilities. The assessment should be conducted to meet the EPA's standards for "All Appropriate Inquiry,"⁴¹ in order to establish a basis for the eventual owner of the property (whether the lender or a subsequent third party purchaser) to assert available defenses to CERCLA liability.
3. *Evaluate Strategic Options for Limiting Liability.* If the diligence identifies actual or reasonably likely environmental issues, the lender will need to assess the level of risk and the scope of the liability and whether to proceed with foreclosure. The evaluation may require more than a simple valuation—i.e., are the environmental liabilities larger than the value of the property—and should also consider other issues, such as (i) is the foreclosure safe harbor provision under CERCLA available?; (ii) will other applicable federal and state laws provide a similar safe harbor?; (iii) can the lender or other subsequent purchaser take advantage of other defenses to CERCLA liability, such as the "innocent purchaser" or "bona fide prospective purchaser" defense?; (iv) should the lender seek environmental insurance coverage to help reduce the level of risk?; (v) can the property be transferred directly to a third party in order to prevent the lender from being in the chain of title?; and (vi) will a stock foreclosure or bankruptcy proceeding provide a better net outcome?
4. *Insist on Good Environmental Management.* After foreclosure, the lender should be proactive and verify that ongoing operations at the property are not creating new environmental liabilities or exacerbating existing conditions. The lender or new owner could potentially be held responsible for post-foreclosure contamination or violations, even if the new lender or owner is simply continuing the prior operating practices. To support this effort, the lender should consider

40. Phase I environmental site assessments are often performed to comply with the ASTM E 1527 standards. ASTM E 1527-05, *Standard Practice for Environmental Site Assessment: Phase I Environmental Site Assessment Process*. See www.astm.org.

41. 40 C.F.R. Part 312.

expanding the pre-foreclosure environmental assessment to include both a more comprehensive environmental baseline and an audit of the business's or property's compliance with environmental law. This evaluation will help the lender correct ongoing problems and assist in defending against claims that post-foreclosure actions have caused additional site contamination or liability.

5. *Keep Records.* Because any assertion of liability against the lender will necessarily arise at a later date, it is important to have credible records that support the lender's entitlement to the applicable defenses or exemptions from liability. For example, the efforts made to resell foreclosed property should be documented. If purchase offers are rejected, the rationale for that rejection should be preserved to support an argument that the offer was not reasonable under the circumstances.