

# Show Me the **Money!** What Lenders Want and Why

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Potential → Proven

...but first: Why are lenders  
what they are today?

CERCLA (1980): Owners  
and operators liable for releases  
of hazardous substances

## **SARA (1986): Innocent Purchaser Defense**

- "Did not know and had no reason to know" of the presence of contamination.
- Show this by having completed prior to acquisition "all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial and customary practice in an effort to minimize liability."

and the Phase I is born

21

RECEIVED

JAN 4 1988

LEASE ADMINISTRATION

ENVIRONMENTAL ASSESSMENT

of

TOLEDO, OHIO

Toledo, OH  
#27

1916 N. 12th Street P. O. Box 2104

Exclusion from definition of "owner or operator" under CERCLA for "a person, who, without participating in 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)(A)

*United States v. Fleet Factors*  
(11th Fed. Cir. 1990)

*"...a secured creditor may incur section 9607(a)(2) liability, without being an operator, by participating in the financial management of a facility to a degree indicating a capacity to influence the corporation's treatment of hazardous wastes. 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.... Nor is it necessary for the secured creditor to participate in management decisions related to hazardous wastes. Rather, 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."*

## EPA'S RULE ON LENDER LIABILITY UNDER CERCLA

July 20, 1992

EPA finalized its long awaited rule on lender liability under CERCLA on April 29, 1992 (the "Rule").

The Rule is to allow lenders the ability to protect their security interest without incurring liability under CERCLA, even to the extent of foreclosing on the contaminated property.

The Rule was originally proposed on June 5, 1991 and was published in the Federal Register for the requisite 30-day comment period on June 24, 1991. EPA received over 350 comments on the Rule and made a number of changes from its proposed form to address the comments.

EPA has indicated that the Rule will be used

CERCLA provides for liability for four classes of persons, commonly called PRPs. The two classes relevant to the Rule are:

- Owners or operators at the time the hazardous substances were disposed of on the property; and
- Owners or operators at the time EPA, the state or private individuals incur cleanup costs.

### THE RULE

The Rule avoids the use of the innocent purchaser defense in discussing lender liability and focuses on the exclusion from the definition of "owner or operator" The

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EPA'S LENDER LIABILITY RULE IS VACATED

February 10, 1994

The U.S. Environmental Protection Agency ("EPA") released its Lender Liability Rule under the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") on June 5, 1991 (the "Rule"). The Rule was promulgated by EPA to define the security interest exclusion from the definition of "owner or operator" under CERCLA. The exclusion provides:

Such term does not include a person, who, without participating in management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the facility.

The State of Michigan and the Chemical Manufacturer's Association filed petitions for review of the Rule in the D.C. Circuit Court of Appeals, which has exclusive jurisdiction to review any regulation promulgated under CERCLA. The court rendered its decision on February 4, 1994 vacating the Rule. Kelly v. Reilly, 1994 WL 27, 881 (D.C. Cir. 1994). The court found that EPA was not granted the authority by Congress under CERCLA to interpret the "security interest" exemption.

The court did recognize the problems the ruling creates for the lenders and encouraged EPA to seek support from Congress in the closing paragraph of the opinion:

We well recognize the difficulties that lenders face in the absence of clarity EPA's regulation would have provided. Before turning to this rulemaking, EPA sought congressional relief and was rebuffed. We see no alternative but that EPA try again.

Lenders are now back in the pre-Rule situation of having to make lending decisions under a cloud of varied interpretations of the courts. Without the Rule, lenders have little insight as to how far they may go in protecting their security interest before crossing the line and becoming an owner or operator. The Rule had gone as far as allowing a lender to foreclose on a property following certain procedures, while still remaining within the exclusion. The current case law does not provide adequate guidance in this area.

The Rule also helped calm the fears of lenders created by the Fleet Factors case by defining "participation in management." Fleet Factors included dicta which suggested that a secured creditor may be liable, without being an operator, if it participates in the management of a facility "to a degree indicating the capacity to influence the corporation's treatment of hazardous waste." The Rule made it clear that the mere capacity to influence or control did not make the lender a participant in management, but that the lender actually had to participate in management or operational affairs.

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CONGRESS PROVIDES ENVIRONMENTAL PROTECTIONS  
FOR LENDERS AND FIDUCIARIES

October 25, 1996

As a part of the recently enacted budget legislation, Congress addressed some major problems in the area of lender liability. In summary, the following modifications were made: (1) the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") was amended to include specific language supporting the Environmental Protection Agency's ("EPA's") rule on lender liability under CERCLA (57 Fed. Reg. 18,344) and to reinstate such rule which was struck down in Kelly v. Reilly, 15 F.3d 1100 (D.C. Cir. 1994); (2) CERCLA was further amended to provide protection for fiduciaries who hold contaminated property, and (3) the Solid Waste Disposal Act was amended to add statutory support for EPA's underground storage tank lender liability rule (60 Fed. Reg. 46,692). This discussion summarizes the protections afforded to lenders and fiduciaries under the new legislation and identifies some remaining problems.



**1996-2008**

## **2002--Federal Brownfields Act**

- **Bona Fide Prospective Purchaser Defense**
- **EPA required to promulgate "All Appropriate Inquiries" Standard**

### **AAI:**

- **Rule effective November 1, 2006**
- **ASTM Standard E 1527-05 meets criteria**
- **Forestland and Rural Property Phase I Rule (December 23, 2008)**



2008

**FOR SALE BANK OWNED**

**VALLAS  
REALTY INC.**

**251-344-1444**

**JOHN P. VALLAS JR.**

▪ **3.28 ACRES**

▪ **661' WATER FRONTAGE  
ON PERDIDO PASS**

▪ **.83 ACRES ON COTTON BAYOU**

▪ **261' WATER FRONTAGE  
ON COTTON BAYOU**

**Lending  
today  
looks  
like  
the  
early  
1990s.**



**Developer/borrower seeks high return on investment**



**while the lender gets dollars in + interest**

## *ISSUES FOR LENDERS ON BROWNFIELDS*

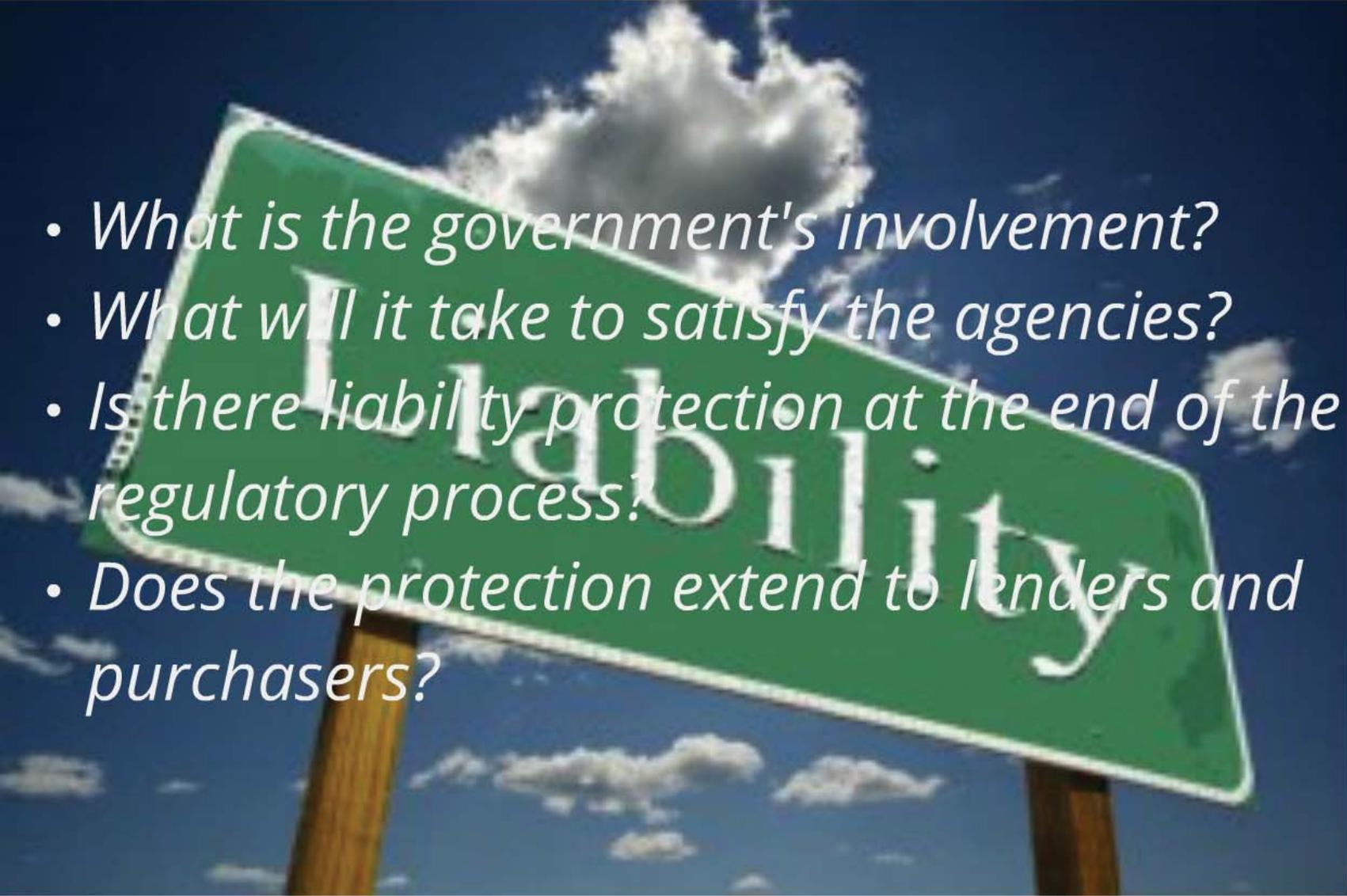
- *Always want a Phase I*
- *Nature and extent of contamination*
- *Potential liability*
- *Post-closing concerns*
- *Protective mechanisms*

## Phase I

- Why, because it's on the checklist
- ASTM Standard
- Acquisition then borrower is user
- If not acquisition, then lender will be user
- Reliance

# CONTAMINATION

- *Type of contamination*
- *Extent of characterization*
- *Cost for remediation????*

- 
- *What is the government's involvement?*
  - *What will it take to satisfy the agencies?*
  - *Is there liability protection at the end of the regulatory process?*
  - *Does the protection extend to lenders and purchasers?*

# POST-CLOSING CONCERNS

# Maintaining BFPP Defense Post-Closing

## 300 Imperial LLC v. Robertshaw Controls Co.

LEXIS 138661 (C.D. Cal. December 29, 2010)--

Purchaser a BFPP:

- Discovered contamination in pre-aquisition testing.
- Purchased in November 2006; tested contents of tanks in May 2007; learned that contents contained contaminants in September 2007; emptied tanks in October 2007.
  - Holding: Exercised "appropriate care with respect to hazardous substances found."
- On appeal to the 9th Circuit Court of Appeals

Ashley II of Charleston, LLC v. PCS Nitrogen, Inc. LEXIS 104772 (D.S.C. Sept. 30, 2010)--  
Purchaser NOT a BFPP:

- Demolished building post closing exposing cracked sumps containing hazardous substances to rain water.
- Allowed dumping of debris and failed to remove for 1 year.
  - Holding: Did not exercise "appropriate care with respect to the hazardous substances found."
- On appeal to the 4th Circuit Court of Appeals

## *Additional post-closing concerns*

- How will the remediation be funded?*
- How will the borrower assure that institutional controls will be maintained?*
- What about unknown concerns?*

# **Lender Protections**

- **Indemnities**
- **Guaranties**
- **Escrows**
- **Insurance**

Security

# Conclusion

- Lenders are conservative due to their history and only receiving a fixed rate of return.
- A Phase I will likely be required so use it to summarize the environmental conditions.
- Be ready to estimate remedial and post-remedial costs.
- Have a funding and security plan for remediation and post-closing compliance.