Tank Trap?

Lender Liability Reform and Expanded Scope of Underground Storage Tank Liability for Owners and Operators

by Robert W. Whetzel and
Todd A. Coomes
Richards, Layton & Finger, P.A.

In the 2013 legislative session, Delaware adopted environmental lien legislation authorizing the Delaware Department of Natural Resources and Environmental Control ("DNREC") to impose environmental liens on real property to recover its cleanup costs. Left unresolved in 2013, but addressed in the recently concluded legislative session, is the broader topic of lender liability for environmental conditions at sites that have been impacted by hazardous or regulated substances.

Environmental Lender Liability - The Basics

Environmental liability statutes, like the federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") and the Delaware Hazardous Substance Cleanup Act ("HSCA"), generally impose liability on "owners" and "operators" of sites that are impacted by a release of hazardous or regulated substances.

Liability is strict, joint and several, and retroactive – meaning that liability is imposed without regard to fault or culpability, and that any one responsible party can be held liable for the entire cost of addressing the environmental condition of an impacted site. Defenses are few and difficult to establish, with the result that a liable party may be forced into funding the cleanup of a site that it had little, if any, responsibility for creating.

Consider, against this background, the activities that lenders typically engage in when conducting due diligence or underwriting, or when facing a non-performing loan requiring workout and potential foreclosure. Consider also the broad provisions in loan agreements allowing the lender to take action to protect its interests, provisions that may strike environmental regulators as including actions taken by facility owners and operators. These uncertainties led to the oft-cited *Fleet Factors* case in the federal Eleventh Circuit Court of Appeals (*United States v. Fleet Factors Corp.*, 901 F.2d 1550 (11th Cir. 1990)), which stated that even the "capability to control" activities at a facility could give rise to "operator" liability under CERCLA.

The *Fleet Factors* decision led to much consternation in the lending community and ultimately to a number of regulatory and legislative reforms. The reforms culminated in the 1996 enactment of amendments to CERCLA to provide greater clarity and certainty to

lenders and fiduciaries. At the state level, notwithstanding the similarities between the federal CERCLA and state HSCA standards of liability, comparable amendments were not enacted – until now.

Delaware's Environmental Lender Liability Reform

In the 2013 Delaware legislative session, the Delaware General Assembly enacted environmental lien legislation to bring Delaware in line with a vast majority of its sister states and the United States with respect to environmental liens, and to provide a tool to protect the State's treasury by recovering money expended by the State on contaminated sites.

During discussions of the environmental lien bill, it was noted that Delaware had not adopted the federal lender liability provisions contained in CERCLA, and the administration committed to address that issue in the 2014 legislative session. The General Assembly has now done so, in the form of three bills (Senate Bill No. 198, House Bill No. 367, and House Bill No. 368) that adopt CERCLA-like lender liability provisions in HSCA, and also in the State's statutes regulating aboveground and underground storage tanks. Senate Bill No. 198, amending HSCA, is instructive of the lender liability provisions provided in the bills.

The HSCA amendments adopt definitions for a "fiduciary" and "lender." A "fiduciary" is defined broadly to include trustees, executors, guardians, and personal representatives. Specifically excluded from the definition of "fiduciary," however, are (i) "A person that is acting as a fiduciary with respect to a trust or other fiduciary estate that was organized for the primary purpose of, or is engaged in, actively carrying on a trade or business for profit, unless the trust or other fiduciary estate was created as part of, or to facilitate, one or more estate plans or because of the incapacity of a natural person" and (ii) "A person that acquires ownership or control of a facility with the objective purpose of avoiding liability of the person or of any other person."

"Lender" is defined to mean:

a. An insured depository institution (as defined in the Federal Deposit Insurance Act at 12 U.S.C. § 1813(c)(2)) or an insured credit union (as defined in the Federal Credit Union Act at 12 U.S.C. § 1752(7)) authorized by law to do business in Delaware;

b. A bank or association chartered under the Farm Credit Act of 1971 (12 U.S.C. § 2001 et seq., as amended) authorized by law to do business in Delaware;

c. A leasing or trust company that is an affiliate of an insured depository institution authorized to do business in Delaware;

d. Any person (including a successor or assignee of any such person) that makes a bona fide extension of credit to or takes or acquires a security interest from a nonaffiliated person;

e. Any legally recognized person authorized to buy or sell loans or interests in loans in a bona fide manner in Delaware;

f. A person that insures or guarantees against a default in the repayment of an extension of credit, or acts as a surety with respect to an extension of credit, to a nonaffiliated person; and

g. A person that provides title insurance and that acquires a facility as a result of assignment or conveyance in the course of underwriting claims and claims settlement.

With these definitions in place, HSCA's standard of liability was amended to specify that a person who acquires, for subsequent disposition, title to or possession of a property to protect a security interest and "does not participate in management of the property" is not liable under HSCA so long as there is no other basis for liability independent from the exemption. Similarly, fiduciaries who have legal title to or manage any property for purposes of administering an estate or trust are exempt.

In general terms, so long as a lender does not "participate in management," the statutory safe harbors will be protective. The term is defined to mean "actually participating in the management or operational affairs of a facility and does not include merely having the capacity to influence, or the unexercised right to control, facility operations." A person that is a lender or fiduciary that holds indicia of ownership primarily to protect a security interest in a property is considered to participate in management only if, while the borrower is still in possession of the property encumbered by the security interest, the person:

- Exercises decision-making control over the environmental compliance related to the facility, such that the person has undertaken responsibility for the hazardous substance handling or disposal practices related to the facility; or
- Exercises control at a level comparable to that of a manager of the facility, such that the person has assumed or manifested responsibility: (i) for the overall management of the facility encompassing day-to-day decision making with respect to environmental compliance; or (ii) overall or substantially all of the operational functions, as distinguished from financial or administrative functions, of the facility other than the function of environmental compliance.

The term "participate in management" does not include performing an act or failing to act prior to the time at which a security interest is created in a property; and, provided the actions do not rise to the level of participating in management above, does not include:

A. Holding a security interest or abandoning or releasing a security interest;

B. Including in the terms of an extension of credit, or in a contract or security agreement relating to the extension, a covenant, warranty, or other term or condition that relates to environmental compliance;

C. Monitoring or enforcing the terms and conditions of the extension of credit or security interest;

D. Monitoring or undertaking one or more inspections of the facility;

E. Requiring a remedy or other lawful means of addressing the release or threatened release of a hazardous substance in connection with the facility prior to, during, or on the expiration of the term of the extension of credit;

F. Providing financial or other advice or counseling in an effort to mitigate, prevent, or cure default or diminution in the value of the facility;

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G. Restructuring, renegotiating, or otherwise agreeing to alter the terms and conditions of the extension of credit or security interest, exercising forbearance;

H. Exercising other remedies that may be available under applicable law for the breach of a term or condition of the extension of credit or security agreement; or

I. Conducting a remedy under this chapter or otherwise under the direction of DNREC.

A person who is a lender that does not otherwise participate in the management of a facility may, after foreclosure, sell, re-lease (in the case of a lease finance transaction), or liquidate the property, maintain business activities, wind up operations, undertake a remedy under HSCA with respect to the facility, or take any other measure to preserve, protect, or prepare the facility prior to sale or disposition. However, such person must seek to sell, re-lease, or otherwise divest the facility at the earliest practicable, commercially reasonable time, on commercially reasonable terms, taking into account market conditions and legal and regulatory requirements.

The HSCA amendments further delineate potential fiduciary liability and provide that the liability of a fiduciary for the release or threatened release of a hazardous substance at, from, or in connection with a facility held in a fiduciary capacity will not exceed the assets held in the fiduciary capacity; provided, however, that the person is not liable under HSCA independently of the person's ownership of a facility as a fiduciary or actions taken in a fiduciary capacity.

The General Assembly enacted similar lender liability reforms in the statutory provision regulating underground storage tanks (USTs). Additionally, in the case of USTs, in the case of foreclosure, a person is not considered an owner if it provides the required in-service or out-of-service notification to the DNREC, and empties all known and registered USTs on foreclosed real property. This provision now imposes affirmative obligations on a foreclosing lender in order to maintain the statutory exemptions from liability.

Underground Storage Tank Liability - A New Era for Owners and Operators

Although not specifically related to lender liability issues, the General Assembly has significantly expanded the scope of liability for owners and operators of USTs, and in some instances this expansion could also impact the interests of a lender.

Historically, the Delaware Underground Storage Act ("DUSTA") was more limited in its scope of liability than HSCA. Under the recently passed legislation, however, DUSTA will impose liability on owners and operators of UST facilities on a retroactive, joint and several basis – subject to several defenses that are intended to alleviate some of the more onerous aspects of this liability scheme.

Significantly, under the amended DUSTA, responsible parties who own, owned, operate, or operated a facility or an underground storage tank located at a facility on or after January 1, 2016, are liable for remediation and corrective action for all released regulated substances on or under the facility, or on or under other real property but that originated or emanated from the facility, regardless of whether any responsible party proximately caused any release, and regardless of when and how the regulated substances were released. The ownership or operational association with the facility establishes the nexus for liability under this section to attach to these responsible parties. These new liability provisions are to become effective in January 2016 and apply to ownership or operation of tanks after that date.

The defenses to liability for a potentially responsible party under the new statutory scheme are limited. First, a potentially responsible party will not be liable for regulated substances if it can establish that the release was caused solely by an act of God, an act of war, or, in certain instances, the act or omission of certain third-parties. The third-party defense applies to an act or omission of a third party other than:

(1) an employee or agent of the responsible party; or

(2) any person whose act or omission occurs in connection with a contractual relationship, existing directly or indirectly, with the responsible party, but not including a contractual relationship in connection with the sale or transfer of the facility by or from the responsible party to a third party.

(3) This defense applies only when the responsible party asserting the defense has exercised due care with respect to the facility, the foreseeable acts or omissions of the third party, and the foreseeable consequences of those acts or omissions. However, notwithstanding the foregoing, where the relationship arises in connection with the sale or transfer of the facility by or from the responsible party to a third party, the defense applies if the responsible party asserting the defense has exercised due care with respect to the facility during the period of ownership or operation of the facility by the responsible party, and with regard to the foreseeable acts or omissions of the third party based on the responsible party's knowledge and information at the time of sale or transfer of the facility.

The third-party defense is complex (at best) and reflects a compromise among the differing interests that surfaced in the legislative process. The third-party defense will, in some cases, protect an owner/operator who did not cause a release, and who exercised due care with respect to the facility. The third-party defense will place a premium on good record-keeping and sound due diligence that documents the existing set of conditions at the time of facility transfer.

Second, a potentially responsible party will not be liable for regulated substances that were released before the time period when the party owned or operated the facility and/or underground storage tank, only if it had no knowledge or reason to know, at the commencement of its ownership or operation, of any prior release. To establish that it had no reason to know of any prior release, the potentially responsible party must demonstrate that on or before the date on which it acquired or began operations at the facility, all appropriate inquiries, as provided in DUTSA, were carried out into the previous ownership and operation of the

facility in accordance with generally accepted good commercial and customary standards and practices. This exemption does not affect or diminish the liability of a responsible party who, by any act or omission, caused or contributed to the release of regulated substances.

The DUTSA amendments provide for an express right of contribution among responsible parties. In resolving contribution claims, the Delaware Superior Court may allocate costs among the responsible parties using such principles of fairness and justice as the Superior Court deems appropriate.

What's A Lender to Do?

In all likelihood, most lenders and institutional fiduciaries in Delaware have well-developed environmental due diligence procedures and guidance, tailored to the federal CERCLA lender liability provisions. Although the Delaware reforms to HSCA and the other state statutes are similar, a review of the applicable policies and guidance may be warranted to ensure consistency with the new state-specific provisions. In addition, the specific new defenses in the Delaware Underground Storage Tank Act warrant consideration to ensure that those provisions have been adequately addressed.

In the context of due diligence and loan underwriting, lenders should be mindful of existing environmental guidelines and policies, and ensure that borrowers and their due diligence environmental consultants perform in accordance with the statutory provisions. In many cases, once a loan is funded and a borrower is performing, the newly enacted legislation may have little actual impact on the lender's activities.

In the context of a non-performing loan, and especially in the case of workout or foreclosure actions, special attention is warranted since the lender's activities in those circumstances may resemble more closely the "participation in management" of an impacted site. Importantly, the new provision of DUSTA imposes certain affirmative, post-foreclosure obligations on a lender to maintain the exceptions from liability. In some cases, assessment of the loan and collateral value may warrant actions other than traditional foreclosure, and involvement of the responsible state agencies may be warranted to seek additional certainty.

Robert W. Whetzel is a director of Richards, Layton & Finger, P.A., in Wilmington, Delaware, and Todd A. Coomes is counsel with the firm. Attorneys at Richards, Layton & Finger, including the authors, were involved in the development of the legislation discussed in this article, but the views expressed in the article are those of the authors and not necessarily those of Richards, Layton & Finger or its clients.