



Commercial Real Estate Loans: Lender's Environmental Liability

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This Practice Note provides a background on a lender's potential environmental liabilities for issuing a loan where real property is the collateral. Specifically, this Note discusses the basic liability framework of the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) and liability protections available to lenders and borrowers. This Note also discusses some of the other state and federal laws that lenders should examine.

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One of the most important aspects of lender due diligence is a thorough assessment of the potential environmental liabilities that may affect the borrower or the loan collateral. A full understanding of potential environmental liabilities is important because:

- If a borrower incurs unexpected environmental liabilities:
 - it may be unable to repay the loan or continue its business operations; or
 - the value of the collateral may be impaired.
- If the lender engages in certain activities, it may be directly liable under state and federal environmental protection laws.
- Addressing environmental liabilities associated with commercial loans is consistent with (and may be required by) sound lending practices and financial industry standards.

Because the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) is potentially the most significant source of liability for commercial real estate lenders, this Note discusses:

- CERCLA's basic liability framework.
 - Liability protections available to lenders and borrowers.
- This Note also discusses in general terms some of the other state and federal laws that lenders should examine.

CERCLA FRAMEWORK

Purpose

Congress enacted CERCLA in 1980. Also known as Superfund, CERCLA authorizes the Environmental Protection Agency (EPA) to investigate and respond to a release or threatened release of hazardous substances into the environment. Significantly, CERCLA enables the EPA to recover clean-up costs from parties potentially responsible for contamination. Liability may attach when:

- Hazardous substances are present at a facility.
- There is a release or threatened release of hazardous substances.
- Response costs have been incurred or are likely to be incurred in the future.

Liability under CERCLA is strict, joint and several, and may reach a wide range of parties that owned, operated or were involved with hazardous substances at a facility. These liability provisions may significantly impact a borrower (and loan collateral), and in some instances may impose direct liability on a lender. Therefore, CERCLA represents a significant source of risk for lenders.

Potentially Responsible Parties

Only "potentially responsible parties" may be held liable for the costs of environmental site remediation. These parties are divided into the following four classes:

- Current owners and operators of contaminated property.
- Any past owners or operators of contaminated property if disposal of hazardous substances on the property occurred during such ownership or operation.
- Persons who arranged for disposal or treatment of hazardous substances.
- Persons who transported hazardous substances to or from any site.

(42 U.S.C. § 9607.)

If a lender becomes an owner or operator of contaminated property through enforcement of its lien, the lender should seek protection under CERCLA's secured creditor exemption (see *Secured Creditor Exemption*). However, the secured creditor exemption likely will not apply to creditors who arrange for disposal or transport hazardous substances. Accordingly, lenders should avoid any role in the management of treatment or disposal operations concerning secured property.

Form of Liability

CERCLA is a strict liability statute. Potentially responsible parties may be liable for environmental remediation costs even if the party did not cause or negligently failed to discover the environmental contamination. Furthermore, CERCLA does not contain a liability cap. A potentially responsible party may be responsible for the entire cost of:

- Addressing site contamination.
- Damage to natural resources.
- Health and environmental assessments.
- Injunctive relief.

Where there are two or more potentially responsible parties, generally the parties are jointly and severally responsible for the expenses. However, costs may be apportioned where a potentially responsible party can prove that, although the harm is of a singular nature, there is a reasonable basis to divide liability. Apportionment is a fact-intensive inquiry. Although no single factor is determinative, courts commonly consider the following factors:

- Area of ownership.
- Duration of operation.
- Types of hazardous materials involved.

In cases where the parties are jointly and severally liable, a potentially responsible party may bring an action for contribution against other potentially responsible parties to allocate expenses. In a contribution action, allocation is based on equitable factors, including knowledge of the potential for environmental harm caused by the hazardous substance.

EXEMPTIONS TO CERCLA LIABILITY

Since its promulgation, Congress has amended CERCLA and the EPA has developed enforcement policies to help protect landowners and lenders from the law's harsh consequences. For lenders, the most significant developments include the:

- CERCLA Lender Liability Rule (see *CERCLA Lender Liability Rule*).
- Secured creditor exemption (see *Secured Creditor Exemption*).
- Brownfields Amendments (see *EPA All Appropriate Inquiry Rule*).
- EPA's "All Appropriate Inquiry" Rule (see *EPA All Appropriate Inquiry Rule*).

CERCLA also contains many statutory defenses that provide some protection for site owners.

CERCLA Lender Liability Rule

In 1992, EPA announced a rule specifying that "participation in the management of a facility" does not include the mere capacity or unexercised right to influence facility operations. The mere capacity language essentially served to overrule the decision in *United States v. Fleet Factors*, which held that lenders could be liable as operators if they merely had the ability to influence facility operations (901 F.2d 1550 (11th Cir. 1990)). The CERCLA

Lender Liability Rule was later struck down on the ground that EPA lacked authority to issue the rule as a binding regulation, but the principles of the rule were later adopted as a policy statement by the EPA and Department of Justice.

Secured Creditor Exemption

CERCLA's secured creditor exemption protects lenders directly by insulating them from liability as potentially responsible parties. Although lenders are not specifically identified as potentially responsible parties under CERCLA, a lender may become an owner or operator by exercising control or participating in the management of the property in an effort to protect its lien. If the lender's activities reach owner or operator status, it becomes a potentially responsible party and may be held liable for environmental remediation costs. The primary protection for lenders in this circumstance is the secured creditor exemption (42 U.S.C. § 9601(20)(E)).

The secured creditor exemption limits the liability of a person who, without participating in the management of a facility, holds indicia of ownership for the primary purpose of protecting a security interest in the facility. To qualify for this exemption, the lender must show that it:

- Holds a security interest in the property.
- Does not participate in the management of the property.

(42 U.S.C. § 9601(20)(A).)

For the first requirement, a security interest includes rights under any of the following instruments:

- Mortgage or deed of trust.
- Assignment.
- Judgment lien.
- Pledge.
- Security agreement.
- Factoring agreement.
- Lease.
- 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.

(42 U.S.C. § 9601(20)(G)(vi).)

The secured creditor exemption does not apply when the creditor holds a security interest primarily for investment purposes.

To satisfy the second requirement, the lender must not "actually participate" in the management or operation of the facility. Actual participation does not include the mere capacity to influence or the unexercised right to control the facility. Distinguishing between participation in management that may create liability and typical loan-related activities can be difficult for lenders. Generally, a lender may monitor and preserve the value of the collateral, but a lender may lose the protection of the secured creditor exemption if it begins to overstep those boundaries and make decisions about operations at the property.



Examples of activities that constitute participation in management include the exercise of:

- Decision-making control regarding environmental compliance related to the property, such that the person has undertaken responsibility for hazardous substance handling or disposal practices.
- Control at a level similar to that of a manager of the facility, such that the lender has assumed responsibility for day-to-day decision making on environmental compliance or substantially all operational functions of the property other than environmental compliance.

(42 U.S.C. § 9601(20)(F)(i)-(ii).)

Activities that do **not** constitute participation in management include:

- Performing, or failing to perform an act before a security interest is created in the facility.
- Having a covenant, warranty or other term or condition related to environmental compliance in the contract or security agreement.
- Monitoring or enforcing the terms and conditions of the loan.
- Monitoring or inspecting the facility.
- Requiring a response action in connection with a release or threatened release of a hazardous substance.
- Providing financial or other advice to the borrower in an effort to mitigate, prevent or cure default or devalue the property.
- Restructuring the terms and conditions of the extension of the loan.
- Exercising other remedies for breach of the loan.
- Conducting a response action under CERCLA or under the direction of an on-scene coordinator under the National Contingency Plan.

(42 U.S.C. § 9601(20)(F)(iii)-(iv).)

To maintain the protections of the secured creditor exemption, a lender should:

- Educate loan officers and other employees of the potential risks of CERCLA liability.
- Develop lending policies or guidelines for addressing potentially contaminated property.

Sensitive or higher risk sites should be evaluated more carefully, both in loan underwriting and in connection with workouts or possible foreclosure, to ensure that activities remain within those allowed by the exemption.

Additionally, because the secured creditor exemption protects lenders only from owner or operator liability, lenders must ensure that they do not arrange for the disposal or treatment of hazardous substances or transport a hazardous substance to or from any site (42 U.S.C. § 9601(20)).

Lender as an Owner in Foreclosure

Foreclosing on potentially contaminated property presents risks and challenges for lenders. If the lender takes ownership of the property, the lender may lose its protection under CERCLA's

secured creditor exemption. However, sometimes foreclosing on the collateral is necessary, so lenders should take steps to minimize the potential for liability.

Before foreclosing, the lender should consider its ability to sell the property. In the foreclosure context, the borrower is unlikely to have sufficient resources to fund a cleanup. If there is a known environmental issue that requires remediation, the costs of remediation will reduce the net proceeds available from a sale. In this era, a knowledgeable buyer will likely insist on price reductions and other concessions to address actual or potential site contamination.

Lenders should also consider the impact of state Superfund laws and other federal environmental protection laws. These laws may have different requirements for protection, or they may not have any lender protection provisions. For example, a lender is not protected from problems related to air emissions under the Clean Air Act or wastewater discharge under the Clean Water Act.

Lenders should consider obtaining an environmental site assessment before foreclosure to identify potential environmental costs associated with the facility. If significant environmental issues are identified during the assessment, the lender may determine that foreclosure is not an economically viable solution. Further, if the lender does proceed with the foreclosure action and takes title to the real property for an extended period of time, the lender, as an owner, may be able to limit its liability. The assessment establishes a baseline measuring the extent of environmental contamination when the lender took ownership.

In the event of a foreclosure, the lender has certain protections under CERCLA to avoid liability as an owner of contaminated property. A foreclosing lender avoids liability if it makes commercially reasonable efforts to sell the property at the earliest practicable time. Whether a lender's efforts to sell are commercially reasonable depends on market conditions and the legal and regulatory requirements affecting the property. (42 U.S.C. § 9601(20)(E)(ii)(II).)

If a lender attempts to sell the property in this manner, and does not participate in the management of the property before the foreclosure action, the lender may generally take any of the following actions after foreclosure:

- Maintain business activities.
- Wind up operations.
- Undertake a response action to environmental contamination.
- Sell, re-lease or liquidate the property.
- Take actions to preserve, protect or prepare the property for sale.

(42 U.S.C. § 9601(20)(E)(ii).)

However, these foreclosure protections are not a safe harbor for lenders that do not qualify for the secured creditor exemption before a foreclosure action. A lender faced with owner or operator liability after foreclosure has the burden to prove that it held a security interest in the property and that it did not participate in the management of the property before foreclosure.

Lender as an Operator Absent Foreclosure

Absent foreclosure, lenders risk liability as operators of contaminated property if the borrower defaults and the lender chooses to exercise significant control over the borrower's activities on the property. If the lender's control over the borrower causes the lender to "participate in the management or operation of the property," the lender will lose its protection under CERCLA's secured creditor exemption. Specifically, the lender's involvement in daily operations at the property is most likely to constitute participation in management.

Lenders may face liability exposure when negotiating a workout for a troubled loan. When negotiating a workout plan, the lender must ensure that it does not become overly involved in the operations on the property. Generally, if the lender does not participate directly in the operation of the property and does not control the borrower's environmental activities, it will not be subject to liability as an operator.

CERCLA DEFENSES FOR OWNERS AND OPERATORS

CERCLA contains many statutory defenses that are potentially available to site owners and operators. In certain circumstances, these defenses protect innocent landowners, bona fide purchasers, contiguous property owners and others from CERCLA liability. The owner and operator defenses can protect borrowers from CERCLA liability, and therefore offer protection to lenders by minimizing the risk of default and preserving the value of the collateral in a foreclosure.

As originally enacted, CERCLA imposed liability on an owner or operator of a site without regard to fault. The 1986 amendments to CERCLA added a highly qualified innocent landowner defense that provided protection under certain circumstances for owners that acquired a site without knowledge of a release. In 2002, Congress enacted the Brownfields Amendments to CERCLA, which established additional defenses and protections for buyers with knowledge of property contamination if they meet certain statutory requirements.

CERCLA now provides the following defenses that may potentially be applicable to borrowers and lenders:

- Landowner defenses (see *Landowner Defenses*).
- Act or omission of a third party (see *Act or Omission of a Third Party*).
- Act of God (see *Act of God and Act of War*).
- Act of war (see *Act of God and Act of War*).

(42 U.S.C. §§ 9601(35) and 9607(b).)

Landowner Defenses

For a real estate owner to obtain protection from liability under the landowner provisions of CERCLA, the owner must be either:

- An innocent landowner.
- A bona fide prospective purchaser.
- A qualified contiguous property owner.

Each of these defenses require that the owner must:

- Not be affiliated with any liable parties.
- Meet certain post-closing responsibilities to maintain liability protection.
- Conduct "all appropriate inquiries" into the previous ownership and uses of the property before site acquisition (see *EPA All Appropriate Inquiry Rule*).

Generally, a lender wants its borrower to be protected by at least one of these landowner provisions because if the borrower is responsible for cleanup costs, it may impair the borrower's ability to repay the loan or operate its business.

Innocent Landowner Defense

An innocent landowner is a purchaser that did not know or have reason to know that any hazardous substance was disposed of on, in or at the facility. To obtain protection under this exemption, the owner must prove that:

- The property was acquired by the potentially responsible party after the disposal of hazardous substances took place.
- The original potentially responsible party did not know or have reason to know about the hazardous substance.

(42 U.S.C. §§ 9601(35)(A)(1) and 9607(b)(3).)

Additionally, to qualify as an innocent landowner, the buyer must conduct all appropriate inquiries into the previous ownership and uses of the facility consistent with the EPA's standards (see *EPA All Appropriate Inquiry Rule*).

Factors considered in determining whether a party qualifies for innocent owner protection under CERCLA include:

- The buyer's specialized knowledge or experience.
- The buyer's knowledge of the difference between the purchase price and the value of the property free of contamination.
- Any commonly known or reasonably ascertainable information about the property.
- Any obvious signs of property contamination.
- The buyer's ability to detect the contamination.

(42 U.S.C. §§ 9601 (35) and 9607(b)(3).)

If an owner meets the "innocent owner" standards, it must also prove both that the owner:

- Exercised due care concerning the hazardous substance concerned.
- Took precautions against foreseeable acts or omissions of a third party and the foreseeable consequences from those actions.
- Maintained post-purchase requirements (see *Maintaining the Defenses Post-closing*).

Lenders typically require borrowers to conduct environmental site assessments to meet the "all appropriate inquiries" requirement for innocent owner protections (see *EPA All Appropriate Inquiry Rule*). If the borrower is not protected, it may be responsible for cleanup costs, which may impair its ability to meet its obligations under the loan. The value of the secured property is also likely to decrease if contamination is found on or near the property.



Bona Fide Prospective Purchaser

A bona fide prospective purchaser is protected from CERCLA liability even if the purchaser had knowledge of property contamination at the time of purchase. To obtain protection under this provision, the purchaser must prove the following by a preponderance of the evidence:

- The purchaser is not potentially liable for contamination at the site.
- The purchaser acquired the property after January 11, 2002.
- All disposal of hazardous substances on the property occurred before the purchaser acquired the facility.
- The purchaser made all appropriate inquiries into previous ownership and uses before acquiring the property.
- The purchaser is not affiliated with a potentially responsible party.
- The purchaser maintained its post-purchase requirements (see *Maintaining the Defenses Post-closing*).
- The purchaser complied with information requests and subpoenas.

(42 U.S.C. § 9601(40).)

Contiguous Property Owner

A contiguous property owner is a party that owns property that is contiguous or otherwise similarly situated to the facility that is the source of contamination. This exemption protects parties that are affected by environmental contamination or hazardous conditions coming from neighboring property.

To qualify as a contiguous property owner, the owner must prove that both:

- A neighboring facility caused the contamination.
- The neighboring facility was the only source of the contamination.

The owner must also prove that it:

- Did not cause, contribute or consent to the release or threatened release.
- Made all appropriate inquiries before purchasing the property.
- Has no affiliation with a potentially responsible party.
- Did not know or have reason to know before the purchase that the property is or could be contaminated from other real property not owned or operated by the owner.
- Maintained post-purchase requirements (see *Maintaining the Defenses Post-closing*).

(42 U.S.C. § 9607(q)(1)(A).)

Act or Omission of a Third Party

The third party defense protects owners whose property contains contamination as a result of the acts or omissions of a third party. This defense applies if the owner can prove that:

- A completely unrelated third party caused the hazard on the property.
- The owner exercised due care concerning the hazardous substance and took reasonable precautions to protect the property.

(42 U.S.C. § 9607(b).)

Act of God and Act of War

The act of God and act of war defenses are not commonly used. However, they protect landowners and lenders whose property becomes contaminated by natural disasters or military actions. The potentially responsible party must prove that the act of God or act of war was the sole cause of the contamination.

Maintaining the Defenses Post-closing

An owner that qualifies as an innocent landowner, bona fide prospective purchaser or contiguous owner under CERCLA has continuing obligations after purchasing the land to maintain the liability protection. These obligations begin the day the owner takes title to the property. To maintain protected status as an innocent landowner, a bona fide prospective purchaser or a contiguous property owner, the owner generally must:

- Provide all legally required notices for the discovery or release of a hazardous substance.
- Take reasonable steps to stop or prevent continuing or threatened future releases and exposures.
- Prevent or limit human and environmental exposure to previous releases.
- Provide full cooperation, assistance and access to persons authorized to conduct response actions or restorations.
- Comply with land use restrictions and not impede effectiveness of institutional controls.
- Comply with information requests and subpoenas.

(42 U.S.C. §§ 9601 (40) and 9607(b)(3) and (q).)

AFFILIATION

Affiliation is a concept that limits the applicability of the landowner defenses to persons that do not have any relationship with other potentially responsible parties for the real property at issue. Affiliation includes direct and indirect familial relationships as well as many contractual, corporate and financial relationships. However, affiliation specifically excludes the contractual, corporate or financial relationships created by the instruments by which title to the property is conveyed or financed (42 U.S.C. § 9601(40) (H)).

Additionally, an entity cannot utilize the landowner defenses if the entity acts as a conduit for the reorganization of a potentially responsible party. This prevents a potentially responsible party from forming a separate entity to act as a buyer or owner of a piece of real property for which the party would otherwise be liable.

If the transaction is an acquisition that involves potentially contaminated property, the lender should thoroughly examine whether the borrower has any affiliation to the seller. Any affiliation would jeopardize the borrower's ability to take advantage of CERCLA's landowner defenses.

EPA ALL APPROPRIATE INQUIRY RULE

Although CERCLA (as amended by the Brownfields Amendments) frequently references an "all appropriate inquiry" standard, the requirement was not initially defined. The Brownfields Amendments required the EPA to develop standards for conducting all appropriate inquiries into potential environmental contamination on the land.

The EPA published a rule, which became effective on November 1, 2006, entitled "Standards and Practices for All Appropriate Inquiries" (AAI Rule) to provide clear and definite standards for parties seeking protection under the defenses created by the Brownfields Amendments (*40 C.F.R. § 312*).

Performing an evaluation that meets the AAI Rule standards enables the borrower to gain protection from CERCLA cleanup liability if the borrower qualifies as an innocent landowner, bona fide purchaser or contiguous property owner. Lenders do not need to conduct AAI investigations to qualify for the secured creditor exemption. However, many lenders choose to complete one for additional protection.

Many lenders require an AAI investigation on certain categories of every transaction. However, the AAI investigation requirements can be costly and time consuming. Lenders and borrowers should collectively decide on a site-specific basis if they want to conduct the AAI investigation or if a lesser form of environmental due diligence is sufficient. Lenders will typically consider risk tolerance levels and other business considerations in the loan approval and indemnification process when making a decision regarding the need for these investigations.

The AAI Rule added regulatory obligations for certain aspects of the investigation, including requirements relating to:

- Consultants.
- Scope of investigation.
- Time limits.

Consultants

The AAI Rule contains specific requirements for environmental consultants. For the investigation to satisfy the AAI Rule, a qualified environmental professional must conduct certain portions of the inspection and analysis of the subject facility and property. If anyone other than a qualified professional performs these portions, it is not recognized under the AAI Rule as a valid investigation and the buyer does not secure protection under CERCLA.

The AAI Rule requires the environmental professional to have the training necessary to exercise professional judgment in developing

opinions and conclusions about conditions that may lead to a release of hazardous substances. Specifically, the AAI Rule requires a combination of:

- **Experience.** Relevant full-time experience includes participation in either AAI investigations, environmental site assessments or other site investigations which involve the understanding of surface and subsurface environmental conditions and the processes used to evaluate them.
- **Education.** Necessary education varies depending on the amount of experience. However, the education must be in either science or engineering fields. The environmental professional must also remain current in his field through participation in continuing education or other activities.
- **Certification.** The environmental professional responsible for the final opinions will generally either have a Professional Engineer's or Professional Geologist's license or registration. Federal and some state governments have certification programs for qualified individuals to be able to perform environmental site assessments.

To qualify under the AAI Rule, the environmental professional must have at least one of the following:

- Ten years of full-time relevant experience.
- A current Professional Engineer's or Geologist's license or registration from a state and three years of full-time relevant experience.
- At least a bachelor's degree from an accredited school in a discipline of engineering or science and five years of full-time relevant experience.
- A license or certification from the federal or a state government to perform environmental inquiries and three years of full-time relevant experience.

(*40 C.F.R. § 312.10*.)

Scope of Investigation

The AAI Rule sets out a list of investigation components that must be conducted for the buyer to be protected by CERCLA's landowner defenses. These components can be divided into:

- The environmental professional's inquiry.
- Environmental record search.
- Other information collection (whether by the environmental professional, buyer or other person).

A complete list of AAI Rule requirements is contained in Sections *312.20 to 312.31* of Chapter 40 of the Code of Federal Regulations. According to the AAI Rule, the ASTM industry standards may be used to comply with the AAI Rule requirements. ASTM requirements are available on ASTM International's *website*. The objective set forth in the ASTM standard for Phase I environmental investigations is to conduct all appropriate inquiry into the previous ownership and uses of the property to allow the purchaser to qualify for the CERCLA defenses to liability.



Time Limits

The AAI Rule requires the investigation to address historical site activities dating back to the older of:

- The date it can be shown that the property contained structures.
- The time the property was first used for residential, agricultural, commercial, industrial or government purposes.

The AAI Rule imposes time limits to ensure that the results of the investigation are recent, relevant and as accurate as possible. Generally, the investigation (and all other due diligence) must be completed less than one year before the purchase or loan closing date, but certain activities must be conducted or updated within 180 days of acquiring the property. These activities include:

- The site visit of the facility and adjoining properties.
- Interviews with past and present owners, operators and occupants.
- An environmental record search.
- The declaration by an environmental professional.

(40 C.F.R. § 312.20.)

These requirements force the buyer to ensure that a new investigation or a thorough review of a past investigation is completed specifically for the present real estate transaction.

ADDITIONAL FEDERAL AND STATE LAWS IMPACTING LENDER LIABILITY

In addition to CERCLA, property owners may face liability for environmental issues under any of the following federal or state laws. As with CERCLA, lenders have potential direct and indirect exposure to legal or financial risk in these areas:

- **Solid Waste Disposal Act (SWDA)/Resource Conservation and Recovery Act (RCRA).** These comprehensive environmental statutes regulate waste management in the US by establishing basic waste management requirements for hazardous wastes, solid wastes and underground storage tanks (UST). In addition to the federal requirements, the statutes permit state governments to implement additional requirements to account for individual state needs, resources and economies. Lenders should be aware of the following regulatory programs under the RCRA:
 - the hazardous wastes program is designed to manage hazardous wastes from “cradle to grave.” For facilities that generate, treat, store or dispose of hazardous substances, RCRA’s comprehensive program for owners and operators of these facilities can cause significant regulatory requirements for a lender that forecloses or takes control of the facility;
 - the solid wastes program applies to the handling and disposal of solid waste materials, providing guidance to states and regulated communities for waste issues. Permitting and monitoring of municipal and non-hazardous waste landfills remains a state responsibility. The SWDA authorizes large fines for liability relating to improper waste

disposal, and a lender should avoid becoming involved in waste disposal or management thereof; and

- the UST program requires owners to register their USTs and imposes certain environmental standards. Similar to CERCLA’s lender liability rule, there is a secured creditor exception for lenders who hold security interests in USTs that are used to store petroleum products or real estate containing petroleum USTs.
- **Clean Air Act (CAA).** The goal of the CAA is to prevent pollution that would harm the nation’s airways. The costs and potential liabilities for a borrower relating to CAA permitting requirements and ongoing compliance may be significant. Accordingly, if a borrower’s facility is subject to CAA requirements, the lender should consider the current and future CAA costs and potential liabilities, and their effect on the value of the lender’s collateral.
- **Clean Water Act (CWA).** The CWA regulates the discharge of pollutants into US waters. The CWA requires permits for installation of water treatment systems to allow for the discharge of a facility’s pollutants as well as storm water permits for construction projects. A foreclosing lender should ensure that the borrower obtains all necessary permits and is in compliance with the law before taking control of a facility or development. Some states provide specific instructions to a foreclosing lender.
- *Common law.* Lenders and borrowers can face potential liability under common law theories such as nuisance and negligence.
- **Asbestos laws.** Many industrial-grade real estate projects have asbestos issues and must comply with local regulations. Depending on the extent of the asbestos, a borrower found liable under asbestos laws may be unable to repay the lender.

Additionally, many states have passed hazardous substance cleanup statutes. These laws may or may not be modeled after CERCLA, and laws similar to CERCLA may have been interpreted differently by state courts. Lenders should work closely with an environmental professional who has knowledge of the local laws, but some potential issues to consider are as follows:

- **Potentially responsible parties.** Increasingly, state courts are being asked to consider the scope of responsible party liability under state hazardous substance cleanup laws. For example, the US Supreme Court issued a decision on arranger liability under CERCLA in *BNSF Railway Co. v. United States* (556 U.S. 599 (2009)). Following that case, the Montana Supreme Court reviewed a trial court’s arranger liability finding under CERCLA (Montana’s superfund law) in *State ex rel. Department of Environmental Quality v. BNSF Railway Co.* (246 P.3d 1037 (Mont. 2010)). Unlike in the US Supreme Court decision, the Montana Supreme Court found that, under the applicable Montana state law, an entity does not need to specifically intend to dispose of a hazardous substance for imposition of arranger liability. It was sufficient that the entity “possessed or was otherwise responsible for the materials it shipped and that “[a] necessary and foreseeable consequence of shipping the material was unloading the material.”

- **Liability imposed.** While most state hazardous substance cleanup laws use a strict liability standard, some states have implemented laws that establish proportionate share liability. These laws may allow a party's liability to be limited based on causation or the extent of its responsibility or fault. While this type of state law may provide additional protection to a purchaser (and thus the lender) for a to-be-acquired property, even a proportional share of a site's remediation may be costly and impair the value of the collateral. The standard of judicial review, when available, may also differ under state laws.
- **Lender protection.** Many states have adopted some form of lender protection as part of their state hazardous substance cleanup laws. These programs must be individually reviewed and considered in the context of each lending scenario because the statutory language as well as the regulatory guidance may differ from the federal scheme.
- **Brownfields programs.** Many states have developed Brownfields programs that may provide additional liability protection to lenders, developers and governmental agencies (development authorities and municipalities). While these programs are useful in potentially providing additional liability protection, they may also include regulatory re-openers or contractual requirements that may impair or diminish the use or value of a site in the future.

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(<http://us.practicallaw.com/4-507-0496>)
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For the links to the documents referenced in this note, please visit our online version at <http://us.practicallaw.com/3-520-7824>

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