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CERCLA Lender Liability Exemption: Updated Questions and Answers

Office of Site Remediation Enforcement
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Background

In 1980, Congress enacted the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) that, for the first time, gave the U.S. EPA the authority to respond to human health and environmental hazards posed by hazardous substances at sites. As a result, EPA could either choose "enforcement first" requiring that liable parties conduct the cleanup or EPA itself could conduct the cleanup and subsequently seek cleanup costs from liable parties. Under Section 107 of CERCLA, liable parties are:

(1) the current *owner and operator*;
(2) any *owner or operator* at the time of disposal of any hazardous substances;
(3) any person who arranged for the disposal or treatment of hazardous substances, or arranged for the transportation of hazardous substances for disposal or treatment; and
(4) any person who accepts hazardous substances for transport to the site and selects the site.

Under Section 101(20)(A) of CERCLA, a person is an "owner or operator" of a facility if that person:

(1) owns or operates that onshore or offshore facility; or
(2) owned, operated or otherwise controlled activities at that facility immediately before title to the facility, or control of the facility, was conveyed to a unit of state or local government due to bankruptcy, foreclosure, tax delinquency, abandonment or similar means.

However, Section 101(20)(A) of CERCLA excludes from the definition of an "owner or operator" any "person, who, without participating in the management of a . . . facility, holds indicia of ownership primarily to protect his security interest in the . . . facility."

In 1996, Congress passed the Asset Conservation, Lender Liability, and Deposit Insurance Protection Act (Asset Conservation Act). In 1997, EPA issued "Policy on Interpreting CERCLA Provisions Addressing Lenders and Involuntary Acquisitions by Government Entities," which provided guidance on interpreting the Asset Conservation Act.

This fact sheet highlights the main rules and EPA policy governing CERCLA environmental liability for secured creditors for the cleanup of contaminated property. The following questions and answers focus on conditional liability protections from "owner or operator" liability under CERCLA. This document supersedes the April 2006 "CERCLA Lender Liability Exemption Questions and Answers."

Questions & Answers

IF I LOAN MONEY TO A BORROWER THAT IS SECURED BY AN INTEREST IN CONTAMINATED PROPERTY AND EPA BRINGS A CERCLA ENFORCEMENT ACTION TO REMEDIATE THE CONTAMINATION AT THAT PROPERTY, WILL I BE HELD LIABLE FOR ANY CLEANUP COSTS?

CERCLA Section 101(20) contains a secured creditor exemption that eliminates owner/operator liability for lenders who hold ownership in a CERCLA facility primarily to protect their security interest in that facility, provided they do not "participate in the management of the facility."

WHAT TYPE OF ACTIVITIES DO NOT CONSTITUTE "PARTICIPATING IN THE MANAGEMENT OF A FACILITY?"

The term "participate in management" does not include:

- merely having the capacity to influence or the unexercised right to control facility operations;
- performing an act or failing to act prior to the time at which a security interest is created in a facility;
- holding a security interest or abandoning or releasing a security interest;
- 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;
- monitoring or enforcing the terms and conditions of the extension of credit or security interest;

- 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 diminution in the value of the facility;
- restructuring the terms and conditions of the extension of credit or security interest, or exercising forbearance;
- exercising other remedies for the breach of the extension of credit or security agreement; or
- conducting a response action under CERCLA or under the National Contingency Plan, provided that these actions do not rise to the level of participation in management within the meaning of the statute.

42 U.S.C. § 9601(20)(F)(i), (iii) and (iv).

WHAT TYPES OF ACTIVITIES CONSTITUTE "PARTICIPATION IN THE MANAGEMENT OF A FACILITY" WITHIN THE MEANING OF CERCLA?

A lender "participates in management" (and will not qualify for the exemption) if the lender "actually" participates in the management or operational affairs of a facility. Merely having the capacity to influence or the unexercised right to control the facility does not constitute "participating in management."

Furthermore, a lender "participates in management" if the lender, while the borrower is still in possession of the facility encumbered by the security interest:

- exercises decision-making control regarding environmental compliance related to the facility and, in doing so, undertakes responsibility for hazardous substance handling or disposal practices; or
- exercises control at a level similar to that of a manager of the facility and, in doing so, assumes or manifests responsibility with respect to:
  - day-to-day decision-making on environmental compliance, or

- all, or substantially all, of the operational (as opposed to financial or administrative) functions of the facility other than environmental compliance.

42 U.S.C. § 9601(20)(F)(i)-(ii).

IF I AM FORCED TO FORECLOSE ON OR TAKE TITLE TO CONTAMINATED PROPERTY, WHAT STEPS CAN I TAKE AFTER FORECLOSURE AND STILL REMAIN EXEMPT FROM "OWNER OR OPERATOR" LIABILITY UNDER CERCLA?

After foreclosure, a lender who did not "participate in management" prior to foreclosure may generally:

- maintain business activities;
- wind up operations;
- undertake a response action under CERCLA Section 107(d)(1) or under the direction of an on-scene coordinator;
- sell, re-lease or liquidate the facility; or
- take actions to preserve, protect or prepare the property for sale.

A lender may conduct these activities provided that the lender attempts to sell or re-lease the property held pursuant to a sale or lease financing transaction, or otherwise divest itself of the property at the earliest practicable, commercially reasonable time using commercially reasonable means.

42 U.S.C. § 9601(20)(E)(ii).

IF I TAKE TITLE TO THE CONTAMINATED PROPERTY AS A SECURED CREDITOR, WHAT MIGHT BE OF INTEREST TO FUTURE OWNERS ABOUT THEIR POTENTIAL CERCLA CLEANUP OBLIGATIONS PRIOR TO PURCHASING THE PROPERTY?

In 2002, Congress passed the "Small Business Liability Relief and Brownfields Revitalization Act" (Brownfields Amendments), creating a new landowner liability protection from CERCLA for bona fide prospective purchasers. CERCLA §§ 101(40) and 107(r)(1). Prior to the Brownfields Amendments, a person who purchased property with knowledge of the contamination was subject to "owner or operator" liability under CERCLA. Prospective landowners may now purchase property with knowledge of contamination and obtain protection

from liability, provided that they meet certain pre- and post-purchase requirements. CERCLA does not require lenders to notify future owners of landowner rights or potential cleanup obligations.

To meet the pre-purchase requirements to qualify as a bona fide prospective purchaser, a person must:

(1) not be potentially liable;
(2) acquire the property after January 11, 2002;
(3) establish that all disposal occurred before the person acquired the facility;
(4) make all appropriate inquiries into previous ownership and uses prior to acquiring the property; and
(5) not be affiliated with a potentially responsible party.

A more detailed discussion of "all appropriate inquiry" and "affiliation" may be found below.

42 U.S.C. § 9601(40).

"All Appropriate Inquiry"

Prospective purchasers of contaminated property who wish to achieve status as a protected bona fide prospective purchaser, innocent landowner or contiguous property owner must perform "all appropriate inquiries" into the previous ownership and uses of the property prior to acquisition of the property. EPA's final rule was published in the Federal Register (70 FR 66070) on November 1, 2005 and went into effect on November 1, 2006. Generally, the final rule requires that all appropriate inquiries be conducted, or updated, within one year prior to acquiring the property. However, the final rule also requires that certain activities be conducted or updated within 180 days prior to acquiring the property. EPA's final rule setting standards and practices for conducting all appropriate inquiries is codified at 40 CFR 312. EPA's final rule recognizes the ASTM E1527-05 Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process as compliant with the requirements of EPA's final rule.

42 U.S.C. § 9601(40)(B).

Affiliation

Bona fide prospective purchasers must demonstrate that they are not potentially liable nor affiliated with any other person who is potentially liable for costs of cleanup at the property. "Affiliated with" includes direct and indirect familial relationships and many contractual, corporate and financial relationships, but excludes contractual, corporate or financial

relationships created by the instruments by which title to the property is conveyed. An entity cannot be a bona fide prospective purchaser if it is the result of a reorganization of a business entity that was potentially liable.

42 U.S.C. § 9601(40)(H).

ONCE A LANDOWNER QUALIFIES FOR THE BONA FIDE PROSPECTIVE PURCHASER LIABILITY EXEMPTION, ARE THERE ANY OTHER REQUIREMENTS THEY MUST SATISFY TO MAINTAIN THEIR NON-LIABLE STATUS AS A BONA FIDE PROSPECTIVE PURCHASER?

To maintain their bona fide prospective purchaser status (i.e., meet all post-purchase requirements), landowners must meet continuing obligations during their property ownership. To meet continuing obligations, bona fide prospective purchasers must:

(1) provide all legally required notices with respect to the discovery or release of a hazardous substance;
(2) exercise appropriate care with respect to the hazardous substances by taking reasonable steps to stop or prevent continuing or threatened future releases and exposures, and prevent or limit human and environmental exposure to previous releases;
(3) provide full cooperation, assistance and access to persons authorized to conduct response actions or natural resource restoration;
(4) comply with land use restrictions and not impede effectiveness of institutional controls; and
(5) comply with information requests and subpoenas.

42 U.S.C. § 9601(40).

In 2003, EPA issued guidance entitled "Interim Guidance Regarding Criteria Landowners Must Meet in Order to Qualify for the Bona Fide Prospective Purchaser, Contiguous Property Owner, or Innocent Landowner Limitations on CERCLA Liability" (Common Elements) to address both pre- and post-purchase requirements. This document is available on EPA's Web site at: http://www.epa.gov/compliance/resources/policies/cleanup/superfund/common-elem-guide.pdf.

IF I QUALIFY FOR THE SECURED CREDITOR EXEMPTION, CAN I STILL BE HELD LIABLE FOR THE CONTAMINATION UNDER OTHER PROVISIONS OF CERCLA OR FEDERAL ENVIRONMENTAL LAWS?

The secured creditor exemption removes qualifying lenders from the definition of "owner" or "operator" under CERCLA. However, CERCLA also imposes liability on persons who arrange for the transportation of hazardous substances for disposal or treatment. Other

federal environmental laws have different liability standards and may be relevant to secured creditors. More information on potentially relevant federal cleanup laws may be found at: http://www.epa.gov/compliance/cleanup.

WHAT OTHER BENEFITS MIGHT I GET FROM LENDING TO BORROWERS FOR CLEANUP AND REDEVELOPMENT PROJECTS?

The Community Reinvestment Act also encourages lenders to invest to cleanup or redevelop industrial sites as part of an effort to revitalize the low- or moderate-income communities in which the properties are located. Investments qualify if the financing leads to the removal of contamination and contributes to redevelopment activities. More information on Community Reinvestment Act credits can be found at http://www.ffiec.gov/cra/.

Further Information: If you have any questions regarding this fact sheet, please contact Carlos R. Evans at (202) 564-6331 within the Office of Site Remediation Enforcement. More information about CERCLA liability is available on EPA's Web site at http://www.epa.gov/compliance/cleanup/superfund/liability.html.