CERCLA, BROWNFIELDS, and LENDER LIABILITY

What is CERCLA?

The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA or Superfund) authorizes the U.S. Environmental Protection Agency (EPA) to respond to human health and environmental hazards posed by hazardous substances at properties. Under CERCLA, EPA can require liable parties to conduct cleanups or EPA can conduct a cleanup and subsequently seek cleanup costs from liable parties. Section 107 of CERCLA defines a liable party as: (1) the current *owner and operator* of a contaminated property; (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 property and selects the disposal site.

Under Section 101(20)(A) of CERCLA, a person is an "owner or operator" of a facility (or property) if that person: (1) owns or operates the 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 state or local government due to bankruptcy, foreclosure, tax delinquency, abandonment or similar means.

Are Lenders Liable for Contamination under CERCLA?

Banks that hold mortgages on property as secured lenders are exempt from CERCLA liability, if certain criteria are met. 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." Generally, "participation in the management" may apply if a bank exercises decision-making control over a property's environmental compliance, or exercises control at a level similar to that enjoyed by a manager of the facility or property. "Participation in management" does *not* include actions such as property inspections, requiring a response action to be taken to address contamination, providing financial advice, or renegotiating or restructuring the terms of the security interest. In addition, the secured creditor exemption provides that simply foreclosing on a property does not result in liability for a bank, provided the bank takes "reasonable steps" to divest itself of the property "at the earliest practicable, commercially reasonable time, on commercially reasonable terms." Generally, a bank may maintain business activities and close down operations at a property, so long as the property is listed for sale shortly after the foreclosure date, or at the earliest practicable, commercially reasonable time.

How Did the "Brownfields Amendments" Change CERCLA Liability?

In 2002, Congress passed the "Small Business Liability Relief and Brownfields Revitalization Act" (Brownfields Amendments). These amendments created a new landowner liability protection from CERCLA for bona fide prospective purchasers ("BFPP"). Prior to the Brownfields Amendments, a person who purchased property with knowledge of the contamination was subject to "owner or operator" liability under CERCLA. Since the enactment of the Brownfields Amendments, prospective landowners may now purchase property with knowledge of contamination and obtain protection from liability, provided they meet certain pre- and post-purchase requirements.

To qualify as a BFPP, a person must: (1) not be potentially liable for contamination on or at a property; (2) acquire the property after January 11, 2002; (3) establish that all disposal of hazardous substances

occurred before the person acquired the facility; (4) make ***all appropriate inquiries*** into previous ownership and uses of the property *prior to* acquiring the property; and (5) not be affiliated with a party responsible for any contamination.

In addition, after purchasing a property, to maintain BFPP status, landowners must comply with "continuing obligations" during their property ownership. To comply with the continuing obligations, BFPPs 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 the effectiveness of institutional controls; and (5) comply with information requests and subpoenas. For more information on continuing obligations see: http://www.epa.gov/compliance/resources/policies/cleanup/superfund/common-elem-guide.pdf

What is "All Appropriate Inquiries?"

"All appropriate inquiries" (AAI) is the process of evaluating a property's environmental conditions and assessing potential liability for any contamination. EPA issued standards and practices for conducting all appropriate inquiries (70 FR 66070) that became effective on November 1, 2006. The AAI requirements are applicable to any party who may potentially claim protection from CERCLA liability as an innocent landowner, a bona fide prospective purchaser, or a contiguous property owner. EPA recognizes the *ASTM E1527-05 Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process* as fully compliant with the AAI final rule. For more information on the AAI requirements see: http://www.epa.gov/brownfields/regneg.htm

How Does AAI Apply to Lenders?

The AAI rule primarily applies to borrowers who want to claim protection from CERCLA liability as innocent landowners, bona fide prospective purchasers or contiguous property owners. The rule does not change the CERCLA liability exemption for banks that hold mortgages on property as secured lenders. The secured lender exemption is *not* conditioned upon a bank or lender undertaking AAI prior to issuing a mortgage or prior to the property being purchased by the borrower.

Although banks and lenders are afforded protection from CERCLA liability through the secured creditor exemption, banks may choose to further protect themselves from loss (due to decreases in the value of the property or collateral) by requiring that borrowers qualify for liability protections. Banks therefore may want to encourage their borrowers to comply with the provisions established for BFPPs and ensure that borrowers properly conduct AAI prior to acquiring a property.

It is important to note that it is still possible for a bank or lender to be liable for contamination on or at a property, if it is found to be acting as either an owner or operator of a contaminated property. See information above for an explanation of the secured creditor exemption and the definition of "participation in the management" of a property. Also, even if a financial institution qualifies for the secured creditor exemption from CERCLA liability, it is still possible that a particular state may have stricter laws governing lender liability for contaminated properties.