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Best Practices For Post-Foreclosure Lender Environmental Liability

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THE RECENT SETTLEMENT between Bank of America and the Environmental Protection Agency is one recent illustration of where lenders can go wrong in managing certain real-property loans, resulting in liability under CERCLA, RCRA and other federal and state environmental laws. In addition to the recent Bank of America case, there are a number of situations where lenders have had to pay to perform a cleanup because of the actions they took following foreclosure.

To summarize the case (which resulted in Bank of America paying the EPA more than $80,000), the bank erred in a number of ways. First, following an auction of some of the borrower's equipment and inventory, it failed to remove tanks and other associated equipment containing hazardous wastes.

Then, the bank failed to winterize the facility containing these containers, which resulted in a waterline break and release of hazardous waste. The end result was the EPA conducting a removal action.

Upon testing, the EPA found hazardous substances in the run-off and alleged that these releases occurred due to improper management and storage of hazardous substances during the period that the bank controlled the property. Because the releases occurred during the time Bank of America "exercised control" over the property, the EPA deemed the bank to be a CERCLA operator.

The secured creditor exemption of CERCLA, RCRA and many state environmental laws provide that a lender may maintain business operations, wind down operations, take measures to preserve, protect and prepare property for sale or disposition and even undertake certain response actions — so long as the lender attempts to divest itself of such property "at the earliest practicable, commercially reasonable time, on commercially reasonable terms…" (42 U.S.C. Section 9601(20)(E)(ii)).

What does this mean? Well, there is no bright-line test, which means everything a lender does will be subject to court scrutiny.

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Under a now defunct EPA rule, a lender was deemed to be in compliance if, within 12 months following the time it acquired marketable title, it either listed the property with a broker or actively advertised the property for sale.

A lender that did not accept a "written, bona fide, firm offer," received any time after six months following foreclosure, of fair consideration (loosely defined as all amounts owed to lender not already paid) could lose its exemption. Although not bulletproof, these are still good guidelines. Lenders should carefully document their efforts to market and sell any real property in foreclosure.

Lenders also have to take care to avoid a situation like the one Bank of America faced. Many times, when a lender forecloses, it sells collateral consisting of inventory, equipment, etc. In many situations, lenders avoid taking title to such collateral because they fear they will lose their CERCLA exemption. Instead, they hire auctioneers to conduct these sales.

In some cases, areas where hazardous waste containers are found are roped off (and such containers kept out of the auction). The lender then leaves those containers in the abandoned facility. If environmental authorities find out that there are abandoned hazardous waste containers at the facility, they typically order the lender to pay for the removal of the materials. The lender may argue that the containers were not part of its collateral (and not its responsibility). This argument will likely fail.

So, a lender that has taken control of a facility to conduct an auction and leaves behind hazardous waste containers (or other hazardous materials) can be deemed to have caused a threatened release of hazardous substances. Lenders should consult an environmental attorney before taking control of a facility, in order to evaluate possible environmental liabilities and create a plan of action to reduce risk.

Of importance to note, if a lender is found to have gone outside the bounds with pre-foreclosure activities, it also won't be protected in a post-foreclosure situation. In one New York Case (New York v. HSBC Bank USA, National Association) HSBC had to pay a nearly $1 million settlement, stemming, primarily from HSBC's refusal to fund waste disposal costs of Westwood Chemical Corp. in connection with a plan provided by Westwood to HSBC during a workout.

This refusal to fund resulted in hazardous materials being abandoned, and again, as a result of a winter freeze in the shut down facility, leaking. The state Department of Environmental Conservation asserted that HSBC's refusal amounted to an exercise of control over the site ultimately causing hazardous waste release.

These are just a few of the many ways lenders can go out of bounds of federal and state environmental safe harbors. Although it is almost impossible to eliminate risk when lending to "dirty" borrowers, lenders need to make sure they have policies and procedures in place that are enforced, to minimize risk. •

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