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EPA Lender Liability Rule For Underground Storage Tanks

THE federal Environmental Protection Agency recently issued its lender liability regulation clarifying the regulatory obligations that may be imposed on creditors holding security interests in underground storage tanks storing petroleum and real estate containing the tanks (collectively USTs) under the federal Resource Conservation and Recovery Act.¹ The RCRA lender liability rule becomes effective on Dec. 6.

The lending and real estate community will be familiar with many of aspects of the Rule because it was modeled after the lender liability rule issued under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA).² However, the Rule has several impor-



tant features which may require financial institutions to alter their foreclosure practices.

Under RCRA, UST owners and operators must ensure that the USTs comply with UST technical standards, take corrective actions to remediate contamination and properly close the USTs when they are taken out of service.³

RCRA contains an exception which provides that a secured creditor who has indicia of ownership in USTs will not be responsible for complying with the regulatory requirements imposed on owners if the indicia of ownership is held primarily to protect a security interest, if the lender does not participate in the management of the USTs and if the lender is not engaged in petroleum production, refining and marketing.⁴

Secured creditors qualifying for the exemption are "holders." The term includes the loan originator and subsidiary who was assigned the loan, participants in loan syndications, any successor-in-interest such as a subse-

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quent purchaser of the security interest on the secondary market, a loan guarantor, a surety as well as persons who act on the benefit of a holder, such as a court-appointed receiver.⁵

This phrase means evidence of an ownership interest in USTs.⁶ These interests include mortgages, deeds of trusts, liens, surety bonds and guarantees of obligations, title held pursuant to lease financings and legal or equitable ownership interests in USTs acquired through foreclosure. The phrase also may apply to assignments, pledges or other forms of encumbrances.⁷

The indicia of ownership must be held "primarily" to secure a loan or obligation although that does not have to be the sole reason for the transaction. Thus, a lender having a secondary reason for maintaining the indicia of ownership (e.g., interest income, investment purpose) will not void the exemption.⁸ However, if the security interest is held primarily as an investment, the exemption will not apply.⁹

Management

A creditor who holds "indicia of ownership" in a UST primarily to protect a security interest may lose its regulatory exemption if it participates in the management of the USTs. Under the Rule, a holder will be a management participant when the holder actually controls the operation. The mere ability to influence control of UST operations or the existence of unexercised rights does not constitute management participation.¹⁰ However, following foreclosure, a lender will be considered to be operating the USTs if the creditor allows them to continue to store petroleum.¹¹

Fair Consideration

The Rule defines "fair consideration" as an amount equal to or in excess of the outstanding principal owed to the holder plus any unpaid interest, rent or penalties. "Fair consideration" also includes all reasonable and necessary costs incurred by the holder during workouts or foreclosure, including costs to prepare or preserve the USTs for resale. Also included are environmental compliance and corrective action costs.¹²

For junior lienholders, "fair consideration" will be the value of all outstanding senior security interests plus the value owed to the junior creditor.¹³

"Fair consideration" is intended to apply to all cash offers so that lenders will not be required to accept a bid that contains unfavorable non-monetary terms or "bundled" sales where the price for all the properties taken

as a whole would be unacceptable.¹⁴

The Rule provides that holders may require a pre-loan environmental investigation and cleanup, or provide financial advice or guidance to prospective borrowers without losing their regulatory exemption.¹⁵ Moreover, a lender will not forfeit its exemption by knowingly taking a security interest in contaminated collateral.¹⁶

Loan Administration

Holders may exercise financial or administrative oversight of a borrower's operations without losing their regulatory exemption. A holder acting as a credit manager, accounts payable or receivable manager, personnel manager, controller or chief financial officer will be considered acting to protect its security interest and will not void the regulatory exemption.¹⁷

However, when the holder performs functions akin to a plant manager, operations manager, chief operating officer or executive officer, the holder will be viewed as participating in the management of the USTs. A holder's actions will be analyzed on a case-by-case basis.

Under the Rule, holders may monitor the borrower's environmental or financial condition, require that the borrower comply with applicable environmental laws, compel the borrower to perform environmental audits and to report releases of petroleum from USTs or remediate contamination.¹⁸ The mere inclusion of environmental warranties or covenants will not cause a holder to lose its regulatory exemption.

Moreover, holders may undertake a variety of environmental actions themselves or even hire the environmental contractors to perform the work without jeopardizing their regulatory exemption.¹⁹ For example, holders may upgrade or replace USTs to ensure they comply with technical standards without being considered participating in the management of the USTs so long as the actions are consistent with the requirements of the RCRA UST program requirements.²⁰

Workouts

The Rule provides that holders may engage in common workout practices without losing their regulatory exemption so long as the workout activities do not qualify as participating in the management of the UST.²¹

The Rule contains a non-exclusive list of permissible workout activities that do not fall within the category of management participation. These actions include: restructuring or renegotiating the terms of the security

interest; requiring payment of additional rent or interest; exercising forbearance; exercising rights pursuant to assignment of accounts or other amounts owing to an obligor; exercising rights pursuant to an escrow agreement pertaining to amounts owing to an obligor; providing specific or general financial advice; and exercising or enforcing any rights or remedies the holder is entitled to under law or under any warranties, covenants or representations made by the borrower.

Since this is a non-exclusive list, lenders should re-examine their workout practices to ensure that they do not violate the management participation test.

Cases interpreting the similar workout provision of the CERCIA Lender Liability Rule have broadly construed what encompasses permissible workout activities. Thus, so long as the lender does not divest the borrower of its decision-making ability over the operations of the USTs, workout activities should not cause a lender to lose its regulatory exemption.²²

Foreclosure

Holders may foreclose on USTs if the holder acts diligently to acquire title and then seeks to divest itself of the USTs in a reasonably expeditious manner using commercially reasonable means.²³ Under the Rule, foreclosure is considered completed when the holder obtains legal, marketable or equitable title and has gained access to the USTs.²⁴

The Rule contains a "bright-line" test that holders may use to establish

that they have been seeking to divest in an expeditious manner. Under this test, a holder must list the property or advertise it for sale on a monthly basis in a suitable publication or general circulation newspaper where the USTs are located within 12 months following foreclosure or the effective date.²⁵

A holder who follows the bright-line test can avail itself of the regulatory exemption. However, a holder that chooses a different approach will have the burden to establish it held indicia of ownership primarily to protect its security interest.²⁶

In addition, the Rule provides that a holder may not reject, outbid or fail to act upon a written offer of "fair consideration" within 90 days of receipt when the offer is received six months after foreclosure or the effective date, whichever is later.²⁷ A holder who outbids or refuses an offer of fair consideration will no longer be deemed to be holding the indicia of ownership primarily to protect a security interest

and will be an owner of the USTs for purposes of the UST regulatory program.

The EPA indicated that a person will be considered to be engaged in the daily operation of a UST merely by allowing it to store product.²⁸ After foreclosure, a holder will not be considered an operator if there is someone such as another lessee who is willing to assume responsibility for the USTs and for complying with the requirements of the program.²⁹

However, if the holder displaces the borrower during foreclosure and there is no one else to assume responsibility for the USTs, the holder will be considered an operator. Such a holder will not qualify for the regulatory exemption unless it complies with the temporary closure requirements of the UST program within 60 days of foreclosure or the effective date (whichever date is later), or another reasonable date approved by a state agency that has authority to administer the program.³⁰

The UST temporary closure procedures require that the holder empty the USTs, leave vent lines open and functional as well as cap and secure all other lines, pumps, manways and ancillary equipment. In addition, a holder must maintain the corrosion protection and report any suspected releases from the USTs. If a holder simply allows product to be stored in a UST while the holder is trying to sell the property, the holder will be considered an operator for purpose of complying with the program.

Where a holder is unaware of the presence of a UST at the time of foreclosure, the Rule provides that the 60 day period for emptying and securing the USTs will not begin to run until the holder discovers the existence of the UST.³¹

Under the federal UST program, USTs that are temporarily out-of-service for 12 months or more must undergo permanent closure.³² The Rule provides that if a holder cannot dispose of the USTs within 12 months, the holder will have to conduct an environmental site assessment (ESA) if the USTs are not equipped with leak detection equipment.³³

Any release that is detected during the ESA must be reported although the holder will not be required to take corrective action.³⁴ The 12 month period runs from the effective date or the date when the UST was emptied, whichever date is later.

So long as the holder complies with the release reporting requirement and performs the ESA when required, the holder may keep the USTs in temporary closure until a subsequent purchaser acquires title to the USTs.³⁵ The subsequent purchaser will have the responsibility for determining

whether to bring the USTs back into service or to permanently close the USTs.³⁶

The Rule does not extend the regulatory exemption to lenders who may have title to USTs through their trustee or fiduciary roles because lenders acting in these capacities do not make UST-related loans.³⁷

The Rule only applies to the federal UST program so compliance with the rule only protects against federal enforcement. Since administration of the federal UST program has been delegated to most of the states, the rule will offer little protection to lenders until the delegated states enact their own counterparts to the Rule.

Section 7002 of RCRA authorizes private parties to seek injunctive relief against any person who has "contributed to" releases of solid waste that are causing significant threats to human health and the environment.³⁸

A federal appellate court recently ruled that §7002 allows private parties to seek monetary damages.³⁹ A holder who qualifies for the regulatory exemption could still be subject to injunctive relief and perhaps monetary damages if the plaintiff can establish that the holder "contributed" to the disposal of petroleum from USTs, such as where a holder unwittingly places leaking USTs into temporary closure and does not perform any corrective action.

If the USTs continue to leak during the holder's ownership or if the contamination worsens during this period, a plaintiff could argue that the holder has "contributed to" the harm.

The Rule does not apply to entities who are involved in the production, refining or marketing of petroleum even where a marketer-creditor has indicia of ownership in USTs to secure credit extended to a customer who purchased petroleum products.⁴⁰

(1) 42 U.S.C. 6901 et seq.

(2) 42 U.S.C. 9601 et seq. The CERCLA lender liability rule was vacated by the federal Court of Appeals for the District of Columbia Circuit in *Kelley v. EPA*, 15 F.3d 1100 (D.C. Cir. 1994). The CERCLA lender liability rule now serves as an internal EPA guidance document.

(3) 40 C.F.R. 280

(4) 42 U.S.C. 6991b(h)(9)

(5) 40 C.F.R. 300.1100(a)(1).

(6) 40 C.F.R. 280.200(c)

(7) *Id.*

(8) *Id.*

(9) 60 F.R. 46698 (Sept. 7, 1995)

(10) 40 C.F.R. 280.210(a)(1)

(11) 60 F.R. 46703 (Sept. 7, 1995)

(12) 40 C.F.R. 280.210 (c)(ii)(A)

(13) *Id.*

(14) 60 F.R. 46701 (Sept. 7, 1995)

(15) 40 C.F.R. 280.210(b)(1)

(16) *Id.*

(17) 40 C.F.R. 280.210(a)(2)

(18) 60 F.R. 46699 (Sept. 7, 1995)

(19) 60 F.R. 46699 (Sept. 7, 1995)

(20) 40 C.F.R. 280.210(2)(i)(B)

(21) 40 C.F.R. 280.210(b)(2)(ii)

(22) *Id.* at 18357.

(23) 40 C.F.R. 280.210(c)(1)(i)

(24) 60 F.R. 46701 (Sept. 7, 1995)

(25) 40 C.F.R. 280.210(c)(2)(i). The rule defines a general circulation newspaper as one with a circulation over 10,000, or one suitable under any applicable federal, state, or local rules of court for publication required by court order or rules of civil procedure. *Id.*

(26) 60 F.R. 46702 (Sept. 7, 1992)

(27) 40 C.F.R. 280.210(c)(ii)(B)

(28) 60 F.R. 46703 (Sept. 7, 1995)

(29) 40 C.F.R. 280.230(b)(1)

(30) 40 C.F.R. 280.210(b)(2)

(31) 40 C.F.R. 280.230(b)(2)(ii)

(32) 40 C.F.R. 280.71-74

(33) 40 C.F.R. 280.230(b)(3)(ii)(C)

(34) 60 F.R. 46705 (Sept. 7, 1995)

(35) 40 C.F.R. 280.230(b)(4)

(36) 60 F.R. 46705 (Sept. 7, 1995)

(37) 60 F.R. 46709 (Sept. 7, 1995)

(38) 42 U.S.C. 6972(a)(1)(B)

(39) *KFC Western Inc v. Meghrig*, No. 92-56597, 1995 WL 81766 (9th Cir. March 1, 1995)

(40) *Id.* at 46708