Environmental Liability

New Secured Creditor's Exemption for Underground Storage Tanks

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The federal Environmental Protection Agency (EPA) recently issued its long-awaited lender liability regulation interpreting the scope of the secured creditor's exemption under the federal Resource Conservation and Recovery Act (RCRA). The regulation (the RCRA lender liability rule) clarifies the regulatory obligations and liabilities of financial institutions and other entities who hold security interests in underground storage tanks (USTs) used to store petroleum products or in real estate containing petroleum USTs. The rule went into effect on December 6, 1995.

The RCRA secured creditor exemption provides that a secured creditor who has indicia of ownership in a UST system or a property containing a UST system will not be liable as an owner of the UST system if the indicia of ownership is held primarily to protect a security interest and the lender does not participate in the management of the UST system.

Lenders probably will be familiar with many aspects of the RCRA lender liability rule because this rule is modeled after the lender liability rule adopted by the EPA under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA). However, the RCRA lender liability rule has several important features that may require financial institutions to alter their foreclosure practices. Highlights of the rule follow.

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Security interest does not create liability

Financial institutions and other creditors who take a security interest in USTs or property containing USTs primarily to secure repayment of a loan or performance of an obligation will not be deemed to be an owner of the USTs so long as the secured creditor does not participate in the management of the USTs. A lender will not forfeit its exemption by knowingly taking a security interest in contaminated collateral. The fact that a creditor may have a secondary motive for maintaining a security interest in the USTs, such as revenue from interest charges, will not by itself cause the creditor to forfeit its immunity from liability.

Participating in management

A creditor who holds "indicia of ownership" in UST property primarily to protect a security interest may lose its regulatory exemption and become subject to the requirements of the UST program if it participates in the management of the USTs. The term "participation in the management" does not include the mere ability to control or influence day-to-day operation of the USTs but, instead, requires actual involvement in the management or control of the decision making or operations of the USTs. However, following foreclosure, a lender will be considered to be operating the USTs if the creditor allows the USTs to continue to store petroleum in the USTs. Actions that lenders usually take during loan administration or during workouts will not constitute participation in management of USTs. The RCRA lender liability rule defines "full consideration" as the amount equal to or in excess of the outstanding principal owed to the holder immediately preceding the acquisition of full title, or possession in the case of a lease financing transaction, plus any unpaid interest, rent, or penalties arising either before or after foreclosure. The term also includes all reasonable and recurring costs incurred by a lender during workouts or foreclosure, including environmental compliance costs. For junior creditors, the term includes the value of all outstanding senior security interests as well as the value owed to the junior creditor.

Loan Administration

The rule allows lenders to require a preloan investigation or cleanup and also to provide advice to a prospective borrower without forfeiting their immunity. Moreover, a lender may knowingly obtain a security interest in contaminated property without losing its regulatory exemption. Creditors holding security interests may exercise financial or administrative oversight of a borrower's operations without losing their regulatory exemption. A secured creditor acting as a credit manager, accounts payable or receivables manager, personnel manager, controller, or chief financial officer will be considered to be acting to protect its security interest and will not void the regulatory exemption. However, when the creditor performs functions akin to a plant manager, operations manager, chief operating officer, or executive officer, it will be viewed as participating in the management of the USTs. These actions will be analyzed on a case-by-case basis.

Under the RCRA lender liability rule, secured creditors may monitor the borrower's environmental or fi-

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

Moreover, secured creditors may undertake a variety of environmental actions themselves or even hire the environmental contractors to perform the work without jeopardizing their regulatory exemption. For example, secured creditors may upgrade or replace USTs to ensure that the USTs are in compliance with the technical standards of the USTs so long as the actions are consistent with the requirements of the RCRA UST program requirements.

Workouts

The RCRA lender liability 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 property. The activities that are permissible in a workout include the following: 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 secured creditor is entitled to under law or under any warranties, covenants, or representations made by the borrower.

Since this is a nonexclusive list, lenders should examine their workout practices to ensure that they do not violate the management participation test. Cases interpreting the similar workout provision of the CERCLA lender liability rule have broadly construed what encompasses permissible workout activities.

Foreclosure

A creditor who obtains legal, equitable, or marketable title to USTs or property containing USTs through foreclosure proceedings will fall within the exemption so long as the creditor attempts to sell or divest itself of the foreclosed UST property in a "reasonably expeditious manner."

The RCRA lender liability rule contains a bright-line test that holders may use to establish that they have been seeking to divest the UST property in an expeditious manner. Under this test, a holder must list or advertise the UST property for sale or disposition on a monthly basis in a suitable real estate publication, trade journal, or a newspaper of general circulation covering the area where the property is located within 12 months following foreclosure or the effective date (whichever date is later). A holder who follows the bright-line test will automatically be able to 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 and that it is not an owner for purposes of the UST regulatory program. In addition, a holder may not reject, outbid, or fail to act upon a bona fide offer of fair consideration

within 90 days of receipt of the offer when the offer is received six months after foreclosure or the effective date, whichever is later.

When winding up operations after foreclosure, a creditor may take security measures or other actions that may be necessary to protect and preserve the USTs (including steps to minimize the release of petroleum into the environment) without incurring liability as an owner of the USTs.

Postforeclosure

After foreclosure, a holder will not be considered an operator if there is someone such as another lessee who is willing to assume control for the UST property and responsibility for complying with the requirements of the UST program. However, if the holder displaces the borrower during foreclosure and there is no one else to assume responsibility for the UST property, the holder will be considered an operator of the USTs. Such a holder will have to comply with the EPA rules for temporary closure in order to remain within the exemption. The RCRA lender liability rule requires the creditor to empty the USTs and to take certain actions, such as capping lines and leaving vent lines open, within 60 days after foreclosures or the effective date of the rule. When a lender is unaware of the presence of a UST at the time of foreclosure, the RCRA lender liability rule provides that the 60-day period for emptying and securing the USTs will not begin to run until the lender discovers the existence of the UST. If a lender simply allows a product to be stored in a UST while the lender is trying to sell the property, the lender will be considered an operator for purposes of the UST program.

Under the federal UST program, USTs that are temporarily out of service for 12 months or more must undergo permanent closure, which generally involves either removing the UST or filling it with inert material and then remediating any soil or groundwater contamination. The RCRA lender liability rule alters the permanent closure requirements for holders of USTs that are temporarily out of service. If the lender cannot dispose of the UST property within 12 months of foreclosure, it must perform an environmental site assessment for USTs that are not equipped with leak detection equipment. Creditors will have to report any releases discovered during the environmental site assessment or from the release detection devices but will not be required to take corrective action. Moreover, the creditor will not be required to comply with the permanent closure requirements for USTs that are out of service for more than 12 months provided the environmental site assessment is performed when required and complies with the UST release reporting requirements. Lenders that follow these requirements will not be deemed to be the owner or operator of the UST.

So long as the holder complies with the release reporting requirements and performs the ESA when required, the holder may keep the USTs in temporary closure until a subsequent purchaser acquires title to the USTs or the property containing the USTs. The subsequent purchaser would then have the responsibility for determining whether to bring the USTs back into service or to permanently close the USTs.

Issues the Rule Does Not Cover

The RCRA lender liability rule only applies to the federal UST program, so compliance with the rule only protects lenders against enforcement by the federal government. Since the UST program is now largely administered by the states, the rule will offer little protection to lenders until states enact their own counterparts to the federal UST rule. In addition, the federal rule does not apply to financial institutions holding title while acting as trustees or fiduciaries.

Moreover, it also does not protect lenders against actions filed by third parties seeking recovery of cleanup costs, since third-party claims under RCRA may be brought against anyone who is "contributing to" a release and is not limited to owners or operators. Section 7002 of RCRA authorizes private parties to seek injunctive relief against any person who has "contributed to" the past or present handling, storage, or disposal of solid wastes that poses an imminent and substantial risk to human health and the environment. A federal appellate court ruled earlier this year that Section 7002 allows private parties to seek monetary damages.

Nearly all of the states have established UST trust funds that may be used to assist UST owners and operators with the costs of corrective actions. These trust funds have proven to be a successful and cost-effective way for remediating UST contamination. The eligibility requirements for these state programs vary as well as the amount of funding or reimbursement. However, compliance with the requirements of the rule does not assure that foreclosing creditors will be eligible for reimbursement. Indeed, in some states, creditors who take advantage of the rule may not be eligible for reimbursement because they will not be considered owners or operators of the USTs. Finally, the rule does not apply to USTs used to store heating oil or to aboveground storage tanks.

The RCRA lender liability rule does not apply to entities 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.

In some cases, lenders may decide that they may obtain a greater return on their security interests if the business is maintained as a going concern and may choose to keep the USTs in service to store or dispense product. Under such circumstances, lenders will be considered an operator of the USTs and will not be able to take advantage of the protection offered by the RCRA lender liability rule.