



MASELLI WARREN PC

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## Limiting a Lender's Liability for Environmental Contamination of Mortgaged Properties *By Brian A. Mills, Esq.*

As Halloween approaches, we are reminded of all things spooky and frightening. In the world of commercial real estate, few things are as frightening as the specter of environmental contamination. To lenders, environmental contamination may be more frightening than loan default. Bankers know they can always write off a bad asset but are often concerned about whether, by taking a property into REO, the bank becomes responsible for cleanup of any hazardous materials on-site.

While every case should be considered individually on a "totality of the circumstances" basis, the applicable laws seek to provide protection for lenders in the form of exemptions from the general definitions of who can be held liable for environmental contamination.

The primary source of law in the area of responsibility for environmental contamination is the *Federal Comprehensive Environmental Response Compensation and Liability Act*, commonly called "CERCLA." CERCLA, which became law in 1980, identifies four classes of Potentially Responsible Parties ("PRPs") against whom liability for contamination of a property can be imposed – one of which is the "current owner or operator of the site." A literal interpretation of this provision would appear to include lien-holding lenders (in "deed of trust" States) or, in "lien States" (such as New Jersey and Pennsylvania),

mortgagees who take title to a property either via foreclosure or a negotiated resolution with a borrower/mortgagor. New Jersey and Pennsylvania have adopted their own counterpart versions of CERCLA which are also applicable and contain exceptions that largely mirror the federal law.

Although CERCLA, as originally adopted, contained an exception to the definition of

availed by banks such as the appointment of a receiver during a foreclosure proceeding, would trigger liability under CERCLA.

The banking industry's fears over the "management" carve-out to the exception were realized in a 1991 decision by the 11th Circuit Court of Appeals in Georgia. In *U.S. v. Fleet Factors*, the Court broadly interpreted the "management" clause of CERCLA and held a mortgagee liable for environmental cleanup because the lender had the ability to exercise control over environmental matters under the loan documents, regardless of whether that ability was actually exercised. 901 F.2d 1550 (11th Cir. 1990).

In 1996, responding to inconsistent rulings in the various federal District and Circuit Courts of Appeal with regard to mortgagee liability under CERCLA, including the *Fleet Factors* case, Congress amended CERCLA with the *Asset Conservation, Lender Liability and Deposit Insurance Act*.

The amendment, and related regulations adopted by the Environmental Protection Agency therewith, sought to alleviate industry concerns by more precisely defining the lender exceptions under CERCLA with an eye towards distinguishing between a lender that affirmatively assumes management in a manner consistent with seeking to enjoy the benefits of ownership from one which acts in a way most consistent with loss mitigation.

### DID YOU KNOW?

A lender that seeks to compel a borrower to pay the bank's legal costs for the preparation of loan documents in a transaction secured by real estate in New Jersey must disclose in, or within 10 days after the issuance of, the loan commitment, the basis for the determination of such fees and an estimate of what the total fee will be. If the fee will "materially exceed" the estimate, the lender must notify the borrower prior to closing. This applies to all loans secured by real estate located within New Jersey.

N.J.S.A. 46:10A-6

owner or operator for parties holding a lien against the contaminated real estate, the exception was limited by language in the statute providing that the holder of a collateral interest in the real estate is not exempt from liability if it participates in "management" of the property. The "management" carve-out to the exception cast concern over whether traditional strategies and remedies typically

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Today, we now know that “participating in the management” of a facility does not include having an unexercised right to influence facility operations or enforcing the terms of a mortgage against a facility. See 42 U.S.C. 9601(20)(F). Instead, protections of the exception are forfeited only if the lender actually participates in the management or operational affairs of a facility. Relevant factors to such an analysis include: the exercise of decision-making control regarding environmental compliance by the lender, the assumption of day-to-day decision-making over environmental compliance at the property by the lender, or the assumption of substantially all of the operational functions of a facility other than environmental compliance by the lender. Further, following foreclosure, a lender who becomes the owner may generally continue operating the business in the ordinary (but environmentally compliant) course, wind up operations, voluntarily undertake a clean-up, sell or lease the facility and/or otherwise preserve the property for sale without

becoming a “responsible party” under CERCLA. To avoid liability, however, the lender should seek to divest the property promptly in a commercially reasonable fashion. 42 U.S.C. 9601(E)(ii).

Lenders facing a default of a loan secured by a potentially contaminated property can enjoy the protections of CERCLA and the *Asset Conservation, Lender Liability and Deposit Insurance Act* by ensuring its enforcement efforts do not constitute management of the property. In such a case, the lender should work closely with counsel from an early stage to ensure that appropriate documentation is being maintained and that an appropriate foreclosure strategy is employed: before during and after foreclosure. And of course some situations are more treacherous than others. For instance, a property to which contamination migrated from an off-site source would be less concerning than a property which is contaminated by the owner or operator thereof.

In any event, Lenders that deem the “management of the property” exceptions a minefield not worth traversing can take the more cautious route and foreclose the operating entity’s lease as well as the borrower’s ownership interest in the foreclosure lawsuit to avoid any possibility of being deemed a “responsible party” under CERCLA.

For sure none of this is happy food for thought for lenders. But Congress recognized that without willing lenders, brownfield sites would never be redeveloped. Instead, new land would be developed leading to loss of open space in the newly developed areas while causing further blight and urban decay in and around the “brownfields.” The lender exceptions to CERCLA and its progeny were adopted to avoid this and make industrial properties a bit less spooky to lenders which can, with the assistance of knowledgeable counsel and a carefully executed foreclosure strategy, avoid responsibility for the environmental sins of its borrowers and their tenants.

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