WILMERHALE

Limits on Lender and Fiduciary Liability

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On September 30, 1996, the Asset Conservation, Lender Liability and Deposit Insurance Protection Act of 1996 (Act) was signed into law as part of the federal omnibus spending bill. The Act, responding to lender and fiduciary concerns about potential environmental liability, provides relief under two federal environmental statutes. By adhering to the Act, lenders and fiduciaries can avoid clean-up liability under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA, or Superfund), as well as the underground storage tank (UST) provisions of the Resource Conservation and Recovery Act (RCRA).

In effect, the Act codifies a portion of the failed 1992 Environmental Protection Agency (EPA) rule and subsequent EPA policy which generally held lenders liable for contamination only when they participated in management decisions dealing with hazardous substances.[1]

Background

CERCLA contains a liability exemption/ safe harbor provision for secured parties. That provision excludes from the definition of an "owner or operator" of a facility a person who, without participating in the management of the facility, holds indicia of ownership primarily to protect a security interest in the facility. The statute provided no further explanation of the exemption.

For years, lenders' concerns have focused on the court's decision in United States v. Fleet Factors (724 F. Supp. 955 (S.D. Ga. 1988), 901 F. 2d 1550 (C.A.D.C. 1990), reh'g denied, 911 F. 2d 742 (en banc), cert. denied, 498 US 1046 (1991)) which held that the safe harbor exemption for lenders was not available in situations where the lender was in a position to influence a borrower's waste disposal decisions, even if it did not actually do so.

EPA responded to Fleet by promulgating a rule supposedly interpreting the secured lender exemption (57 Fed. Reg. 18344 (1992)). The rule made clear that actual conduct rather than the ability to influence conduct generally was necessary before liability would attach. However, the EPA's rule was invalidated in 1994 in Kelly v. EPA (15 F. 3d 1100 (C.A.D.C. 1994) on the grounds that EPA exceeded its authority by promulgating a rule that extended beyond the bounds of the statute.

Following the Kelly decision, the EPA and the Department of Justice (DOJ) issued a joint policy stating that they would nonetheless follow the vacated rule. Much of that policy has now been

incorporated into the Act.

Key Provisions of the Act

With the passage of the Act, a level of certainty has now been provided to lenders and fiduciaries in dealing with borrowers' facilities and trust assets.

A. Limitation on Liability - Lenders

This portion of the Act is applicable to a wide range of "lenders," including:

- insured depository institutions;
- insured credit unions;
- a bank chartered under the Farm Credit Act of 1971;
- a leasing or trust company that is affiliated with an insured depository institution;
- any person making a bona fide extension of credit to or taking or acquiring a security interest from a nonaffiliated person;
- the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Federal Agricultural Mortgage Corporation, or another entity that in a bona fide manner buys or sells loans or interests in loans;
- persons that insure or guarantee against a default in the repayment of an extension of credit, or act as surety with respect to an extension of credit to nonaffiliated persons; and
- persons that provide title insurance and that acquire a facility as a result of assignment or conveyance in the course of underwriting claims.

The Act excludes from CERCLA's definition of "owners and operators" lenders holding indicia of ownership that do not participate in "management" functions at the borrower's facility (or vessel). Participation in management at a facility includes the following situations:

- where a lender actually participates in the operational affairs of the facility, beyond merely having the capacity to influence decisions;

- where the lender, while the borrower is still in possession of the facility, exercises decision making control over the environmental compliance at the facility such that the lender is responsible for hazardous substance handling or disposal practices; or

- where the lender exercises control at a level comparable to that of the facility's manager, such that the lender has assumed or manifested responsibility for day-to-day decisions relating to environmental compliance or where the lender has overall or substantial responsibility for operational functions of the facility other than for the environmental compliance functions.

Similarly, the Act provides a list of potential lender activities that, if conducted, maintain for the lender the protection of the secured lender exemption. These activities include:

- holding, abandoning or releasing a security interest;

- incorporating into the terms of an extension of credit, or in a contract or a security agreement relating to an extension, a covenant, warranty or other condition that relates to environmental compliance;

- monitoring or enforcing the terms and conditions of the extension of credit or security interest;

- monitoring or undertaking inspections at the facility;

- requiring a response action or other lawful means of addressing the release or threatened release of a hazardous substance in connection with the facility prior to, during or on the expiration of the term of the extension of credit;

- providing financial or other advice or counseling in order to mitigate, prevent or cure default or diminution in the value of the facility;

- restructuring, renegotiating or otherwise altering the terms and conditions of the extension of credit or security interest, including the exercise of forbearance;

- exercising other remedies that may be available under applicable law for the breach of a term or condition of the extension of credit; or

- conducting a response action under _107(d) of CERCLA or under the direction of a coordinator appointed under the National Contingency Plan, if not otherwise restricted.

B. Limitation on Liability - Fiduciaries

In general, the Act shields the individual assets of a fiduciary by limiting their liability for the release or threatened release of hazardous substances from a fiduciary-owned facility to the value of the assets held in that capacity. As under the lender provisions, the Act defines categories of fiduciary relationships that benefit from the liability exception. They include persons acting for the benefit of another party as a bona fide:

- trustee;
- executor;
- administrator;
- custodian;
- guardian of estates or guardian ad litem;
- receiver;
- conservator;
- committee of estates of incapacitated persons;
- personal representative;
- trustee acting under an indenture agreement, trust agreement, lease or similar financing agreement for debt securities, certificates of interest or certificates of participation in debt securities, or other forms of indebtedness as to which the trustee is not, in the capacity of trustee, the lender; or
- representatives in any other capacity that the EPA Administrator, after public notice,

determines to be similar to the capacities listed above.

The Act establishes a safe harbor for fiduciaries, stating that there will be no personal liability to the fiduciary if the fiduciary is:

- undertaking or directing other persons to undertake a response action under §107(d)(1) of CERCLA or under the direction of a coordinator appointed under the National Contingency Plan;
- undertaking or directing another person to undertake lawful means of addressing a hazardous substance at the facility;
- terminating the fiduciary relationship;
- including in the terms of the fiduciary relationship a covenant, warranty or other condition that relates to compliance with an environmental law or monitoring, modifying or enforcing a term or condition;
- monitoring or undertaking inspections of the facility;
- providing financial or other advice or counseling to other parties to the fiduciary relationship, including the settlor or beneficiary;
- restructuring, renegotiating or otherwise altering the terms and conditions of the fiduciary relationship;
- administering as fiduciary, a facility that was contaminated before the fiduciary relationship began; or
- declining to take any of the actions described above, with the exception of those related to response actions.

Fiduciaries are specifically excluded from the benefits of the Act (a) when a person is acting as a fiduciary with respect to a trust actively carrying on a business for profit, unless the trust was created due to the incapacity of a natural person; or (b) when a person acquires ownership or control of a facility in order to avoid liability.

Limits of the Act and Additional Considerations

While the legislation provides some measure of relief, the Act should not be considered a blanket exception to lender or fiduciary liability at contaminated properties. Several issues should still be considered in these relationships.

- Fiduciaries remain liable as "owners or operators" under CERCLA to the extent of the trust's assets. The Act only protects the separately-held individual assets of fiduciaries.

- The Act does not affect liability under state laws although analogous state laws often contain similar lender and fiduciary protective provisions.

- Lenders and fiduciaries must still pay heed to both newly occurring and preexisting contamination, and take appropriate steps to assess and remediate the situation themselves, or have others do so. The Act does not limit the liability of a fiduciary for a release, if the negligence of the fiduciary causes or contributes to that release.

- Because the Act uses a "bright line" test, once lenders and fiduciaries stray beyond the safe harbor, liability may attach without limit or consideration of comparative fault.

- Superfund was debated extensively in the reauthorization process this year. This Act addresses only a single topic of that debate. There was no change to the strict, joint and several, retroactive liability of Superfund.

- It is doubtful that the Act will cause lenders or fiduciaries to be less careful or cautious, but it will enable them to make loans to and assume business relationships with entities which deal with hazardous substances.

- Passage of the Act also means that defaulting borrowers will have less negotiating leverage with lenders fearful of foreclosing or repossessing contaminated properties. Lenders should now be able to deal more effectively with such borrowers.

[1] The Act also amends the liability provisions contained in RCRA's UST section. First, the Act excludes as "owners and operators" those persons holding indicia of ownership that do not participate in the "management" of a UST, provided they are not engaged in the production, refining or marketing of petroleum. Second, the Act adopts the CERCLA provisions for fiduciaries in determining a person's liability as an owner or operator of a UST.

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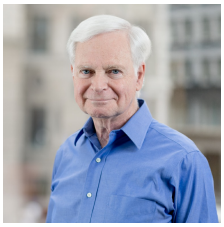

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