

TEXAS LAWYER

March 21, 2011

An **ALM** Publication

Avoid Environmental Issues in Foreclosures

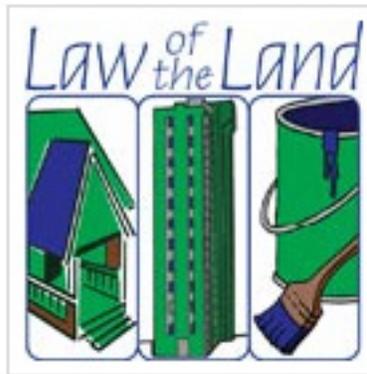
By Elizabeth E. Mack and Susan M. Rainey

It's a bad day for the loan officer who forecloses on a loan and unwittingly assumes major environmental liability. Some environmental issues have such a great impact on the property's value and risk profile that a decision not to foreclose is simple. Consider a dry cleaner with significant groundwater contamination that could migrate under a residential neighborhood: The risk of private tort liability may be too much for the lender to shoulder.

But most properties present less obvious issues. With some careful attention to environmental details, astute lawyers can help lenders avoid potential environmental regulatory headaches during and after foreclosure.

Lawyers need to know how to maintain a client's secured-creditor exemption in real life. Secured-creditor exemptions, which provide protection from regulatory environmental cleanup liability, are a comfort to lenders. Federal and state laws contain liability exemptions at 42 U.S.C. §9601(2), Texas Health & Safety Code §361.701, Texas Water Code §26.3514, and in many other states' environmental cleanup laws.

Environmental statutes typically impose strict liability. A property



owner is liable to respond to contamination, regardless of whether it caused the mess. Prior to secured-creditor laws, lenders faced an obvious dilemma regarding contaminated property: Foreclose and become the owner with the accompanying liability, or forego the security.

The secured-creditor exemption allows a lender to hold and foreclose on a security interest, and, despite holding title to the property, avoid regulatory ownership liability, provided that the lender follows the requirements of the secured-lender laws. The key for attorneys, of course, is ensuring that the lender does what is necessary to maintain the exemption after foreclosure.

A first step is to consider the corporate and transactional structure

used in foreclosure. The entity holding the security interest (and foreclosing) reaps the benefit of these protections from environmental liability.

Often, however, the lender wants to use a single-purpose entity to buy the property at a foreclosure sale. Texas law extends the exemption to successors and assignees of the lender. But other states' laws, such as New Jersey's secured-creditor statute, are not clear regarding assignees or only reach the lender.

If state law does not extend environmental-liability protection to these successor entities, lenders must balance the benefits of the single-purpose entity against the potential value of the secured-creditor liability protection. If there is a risk that the lender cannot comply with the secured-creditor exemption's requirements, or if there is meaningful threat of private tort liability (which secured-creditor laws do not cover), a single-purpose entity may provide more protection from potential environmental liability.

The exemption statutes generally prescribe what a lender must, can and cannot do after foreclosure to avoid environmental regulatory liability. To preserve the exemption,

most states, including Texas, require the lender to market the property for sale within a reasonable time and to accept reasonable offers.

The lender is entitled to manage the business activities of a property to maintain its value and still enjoy the exemption. However, a lender must take care with its management activities. Take, for example, leasing: Although a lender may be tempted to find new tenants for low-occupancy properties, the lender must be cautious about leasing to new tenants that use chemicals or other hazardous materials. The secured-creditor exemption vanishes if a new tenant causes an environmental issue — the spiffy new printer spilling solvents, even unintentionally, could be all it takes.

In short, lawyers for lenders should map out the foreclosure plan with the applicable exemption statutes in mind.

Outside the Exemption

Next, attorneys should think about the impact of environmental law outside the secured-creditor exemption. The secured-creditor exemption from environmental liability is a valuable umbrella. But not all environmental-regulatory issues fall under it, and it offers no protection from private tort claims. After taking title, lenders need to comply with many environmental laws as owners of the property,

including some laws specific to Texas.

Lenders and their counsel should be aware that property uses may trigger certain specific regulatory requirements. For example, if the property is a gasoline station, the lender has secured-creditor exemptions available under Texas law. But, if the borrower (rather than the borrower's tenant) is the gas station owner and operator, a lender wanting to preserve the exemption has only a short window after foreclosure to close the tanks and will be required to perform any necessary cleanup associated with the tanks. The presence of tanks must also be specifically disclosed to any buyer in transfer documents — a requirement that may surprise lenders who are not in the business of owning tanks.

Other regulatory issues may need attention, too. For example, if the property is enrolled in a cleanup program such as the Texas Commission on Environmental Quality's Voluntary Cleanup Program, lenders should review the property's progress in the program and consider whether the lender should be the primary applicant to the program. Properties under construction also may need some environmental review, including updating storm water permits with the new owner's name.

Even if the property is not in a regulatory program, properties

undergoing foreclosure can be in poor condition. This can create a different set of environmental issues: think deteriorating asbestos, crumbling lead-based paint, water leaks and suspect mold.

In addition to federal and state laws regulating work with asbestos or lead-based paint, Texas is one of the few states imposing licensing requirements for professionals inspecting and cleaning mold conditions. Lenders need to engage companies with proper licensing and training for property condition work.

Foreclosures raise many legal issues, and each property will have different potential environmental concerns. Looking ahead at environmental laws will help avoid an environmental foreclosure headache.

Elizabeth E. Mack is a partner in and Susan M. Rainey is an associate with Locke Lord Bissell & Liddell in Dallas. Mack chairs the firm's environmental section and serves on the firm's board of directors. Rainey is a former project manager at the Texas Commission on Environmental Quality.