

IDENTIFYING AND INDEMNIFYING AGAINST ENVIRONMENTAL RISK

By

Jeff Civins and Mary Mendoza
Haynes and Boone, LLP

49th Annual Mortgage Lending Institute
September 18, 2015 – Austin, Texas
November 6, 2015 – Dallas, Texas

haynesboone

BASIC PREMISES/CONCLUSION

- Environmental laws are complex and may result in significant risks to lenders, their borrowers, and their collateral
- A basic understanding of environmental law is helpful to managing those risks
- Environmental risks are manageable by extra-contractual and contractual tools
- A well-drafted and negotiated environmental indemnity agreement is a powerful tool for managing environmental risk

TOPICS TO BE DISCUSSED

- Concerns to lenders
- Overview of environmental laws
- Liabilities arising from environmental laws
- Superfund
- Environmental risk management tools
- Managing environmental risk through contract
- Environmental indemnity agreements
 - Parties
 - Definitions
 - Reps and warranties
 - Covenants
 - Indemnification provisions

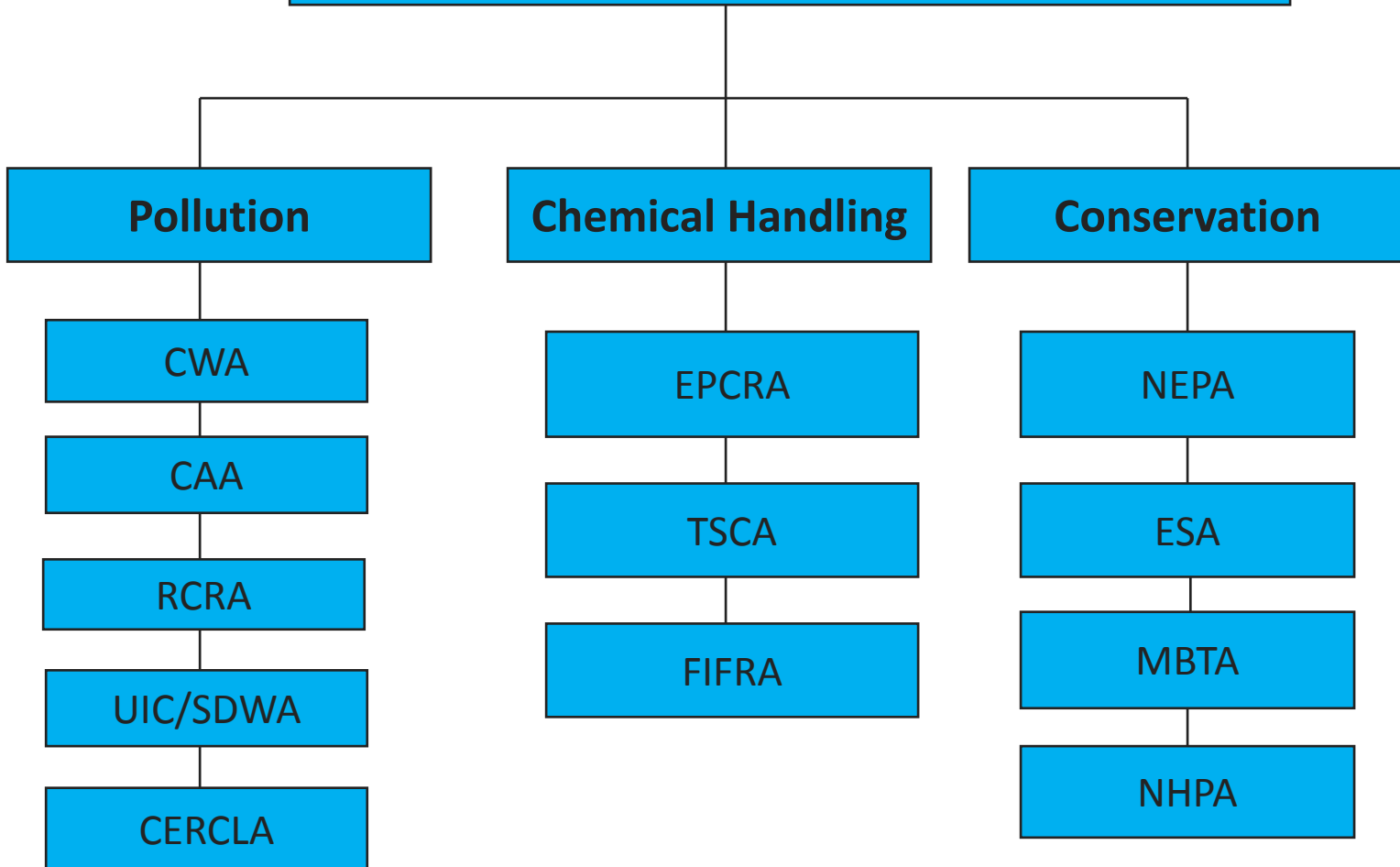
CONCERNS TO LENDERS

- Indirect Liability – Economic Loss
 - Ability of borrower to repay loan
 - Diminution in value of collateral
 - Subordination of security interest to an environmental lien
- Direct Liability

ENVIRONMENTAL LAWS – WHAT ARE THEY?

Environmental laws are laws that regulate activities or conditions because of their effect or potential effect on public health and welfare and the environment

Federal Environmental Programs



FEDERAL ENVIRONMENTAL PROGRAMS

- CWA – Clean Water Act
- CAA – Clean Air Act
- RCRA – Resource Conservation and Recovery Act
- UIC/SWDA – Underground Injection Control Program of the Safe Drinking Water Act
- CERCLA – Comprehensive Environmental Response, Compensation and Liability Act, a/k/a “Superfund”
- EPCRA – Emergency Planning and Community Right to Know Act
- TSCA – Toxic Substances Control Act
- FIFRA – Federal Insecticide, Fungicide and Rodenticide Act
- NEPA – National Environmental Policy Act
- ESA – Endangered Species Act
- MBTA – Migratory Bird Treaty Act
- NHPA – National Historic Preservation Act

LEGAL SOURCES OF ENVIRONMENTAL LIABILITIES AND RESPONSIBILITIES (FEDERAL, STATE AND LOCAL)

- Statutes
- Rules
- Permits
- Administrative and Judicial Orders
- Ordinances
- Common Law
 - Nuisance
 - Negligence
 - Trespass
 - Strict Liability
 - Products Liability
 - Contract

Factual Sources of Environmental Liabilities and Responsibilities

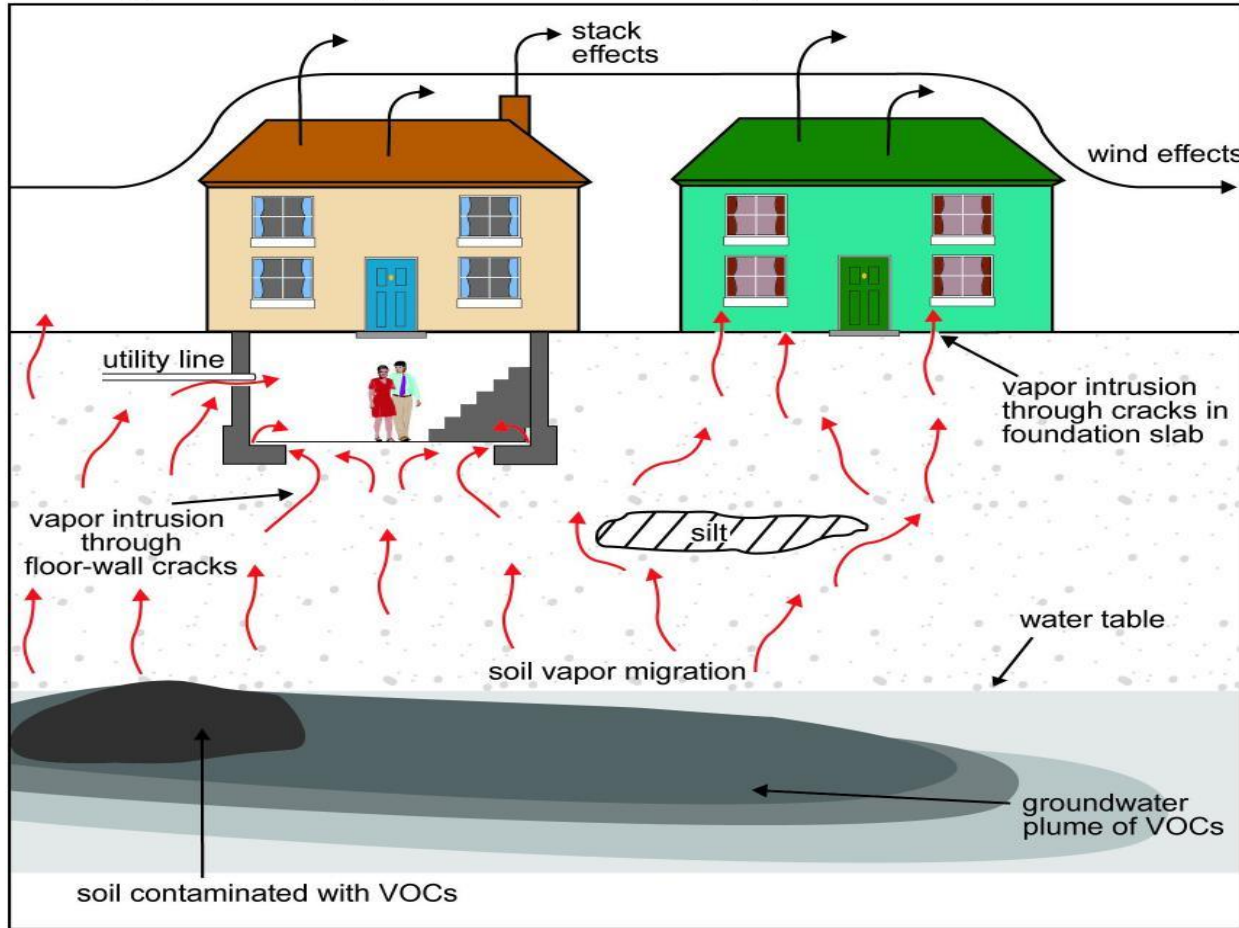


BAD THINGS THAT CAN AFFECT A PROPERTY

- Chlorinated solvents
- Petroleum hydrocarbons
- MTBE
- PCBs
- Mold
- Asbestos
- Lead in drinking water
- Lead paint
- Underground storage tanks
- Indoor air pollution
- Radon
- Recognized environmental conditions
- Vapor intrusion



Figure 1. Migration of Soil Vapors to Indoor Air



This figure depicts the migration of volatile chemicals from contaminated soil and groundwater plumes into buildings. Volatile chemicals are shown to enter buildings through cracks on the foundation and openings for utility lines. Atmospheric conditions and building ventilation are shown to influence vapor intrusion.

GOOD THINGS THAT CAN AFFECT A PROPERTY

- Bad things, like contamination, are a concern because of the legal consequences associated with them, but so too are good things because of the protections the law affords them
- Good things include:
 - Endangered species
 - Water bodies and wetlands
 - Aquifers
 - Historical sites
- The presence of good things may result in, among other things, significant restrictions on property use



EXAMPLES OF DEVELOPMENT-RELATED ENVIRONMENTAL REQUIREMENTS

- TCEQ landfill determination test requirement applicable to persons developing a tract greater than 1 acre (30 TAC Sections 330.952(a)(2) & 330.953(a))
- TCEQ Stormwater Permit--Notice of Intent filing and stormwater pollution prevention plan (SWPPP) requirements applicable to construction activities of greater than one acre
- Endangered Species Act determination/authorization/mitigation
- Wetlands (Waters of the US”) determination/authorization/mitigation
- Sole source aquifer rules
- Watershed protection ordinances

ENVIRONMENTAL LIABILITIES AND CONCERNS

- Cost of Compliance (time and money)
- Cost of Non-Compliance
- Penalties – Civil and Criminal
- Injunctive Relief (mandatory and prohibitory)
- Cost of Investigation and Remediation
- Damages to Natural Resource
- Damages to, and Diminution in Value of, Property
- Damages to People (Toxic Tort)
- Land Use Restrictions
- Stigma Damages

For transactions involving real estate, Superfund is the most significant environmental statute because of the substantial liabilities it imposes based not on a violation, but rather on a mere nexus to a contaminated property

LIABILITY UNDER CERCLA

- CERCLA imposes liability for the cost of:
 - Investigation
 - Remediation
 - Natural Resource Damages
- Liability is strict - without fault
- Liability is generally joint and several
- Liability is retroactive
- There are defenses, but they are limited

CERCLA – POTENTIALLY RESPONSIBLE PARTIES (PRPS)

- Present owners and operators of a facility from which there is a release or threatened release of hazardous substances
- Past owners and operators of a facility (at the time of disposal)
- Arrangers who arranged for hazardous substances to be disposed at a facility
- Transporters who selected the disposal facility

SECURED LENDERS AS PRPS

Secured lenders are afforded special treatment by CERCLA and RCRA* (and state analogs)

**(as amended by the Asset Conservation, Lender Liability and Deposit Insurance Protection Act of 1996).*

SECURED LENDERS PROTECTION UNDER CERCLA*

- **Pre-Foreclosure** – for secured lenders who do not participate in management, *i.e.*, do not exercise
 - decision-making control over environmental compliance, *e.g.*, hazardous waste management
 - overall operational management
- **Post-Foreclosure** – for secured lenders who hold property only to protect security interest, *i.e.*, take steps consistent with safe harbor provisions and seek to sell, re-lease or otherwise divest themselves of assets at earliest practicable, commercially reasonable time, on commercially reasonable terms

*CERCLA /RCRA protection does not protect against liabilities under other statutes or the common law

TRADITIONAL CERCLA DEFENSES

- Act of God
- Act of War
- Act of Third Party
 - exercised due care with respect to hazardous substances
 - took precautions against foreseeable acts of 3rd parties

CERCLA'S TRANSACTIONAL DEFENSES

- **1980-Superfund**
 - provided a third party defense
 - defense was precluded if the act of the third party causing the contamination occurred in connection with a contractual relationship with the defendant
- **1986-Superfund Amendments and Reauthorization Act (SARA)**
 - added an innocent purchaser defense so even if there were a contractual nexus the purchaser would be protected if the purchaser did not know and had no reason to know of contamination
 - “Had no reason to know” was embodied in “all appropriate inquiry” or “AAI”

CERCLA'S TRANSACTIONAL DEFENSES (CONTINUED)

- 2002 Brownfields Amendments
 - provided guidance regarding AAI
 - added 2 new defenses – Bona Fide Prospective Purchaser and Contiguous Land Owner -- which also required AAI
- EPA promulgated AAI rule , codified in 40 CFR Part 312, and has sanctioned use of a recently revised standard -- ASTM E1527-13 -- for the conduct of Phase 1s

RELATIVE VALUE OF CERCLA DEFENSES

- Third Party Defense > Bona Fide Prospective Purchaser Defense > Contiguous Land Owner & Innocent Land Owner/Purchaser Defenses
- Transaction-related defenses require “all appropriate inquiry” and no affiliation, as well as satisfaction of continuing obligations

CERCLA DEFENSE LIMITATIONS

- Provide no protection for
 - Petroleum contamination
 - Stock acquisition
 - Other federal and state statutes
 - Common law
- Unlike prospective purchaser agreements, give no certainty as to what is required and must be raised as a defense in litigation

ENVIRONMENTAL RISK MANAGEMENT TOOLS

- Statutory Protections—Defenses and Safe Harbors
- Due Diligence
 - Environmental Conditions
 - Environmental Compliance
- Brownfields Programs, *e.g.*,
 - Voluntary Cleanup Program
 - Innocent Owner/Operator Program
 - Dry Cleaners Remediation Program
- Insurance and other financial assurance mechanisms
- Contractual

MANAGING ENVIRONMENTAL RISK THROUGH USE OF LOAN CONTRACTS

- Types
 - Loan Agreement
 - Environmental Indemnity

- Relationship
 - Need for consistency
 - Avoidance of overlap

CONTRACT PROVISIONS

- Parties—Borrower and Guarantor
- Definitions
- Requirement of Due Diligence
- Reps and Warranties
- Covenants
- Cooperation and Access
- Remedies
- Indemnification
 - Indemnifying parties
 - Indemnified parties
 - Trigger
 - Loss
 - Survival/Termination/Sunset

KEY DEFINITIONS

- Environmental Laws
 - Future
 - Common Law
 - Guidance Documents
 - OSHA
- Hazardous Substances
 - Regulated
 - Commonly used
- Release
 - Migration
 - Vapor intrusion

REPRESENTATIONS AND WARRANTIES

- General considerations
 - Scheduled carve outs
 - Knowledge and materiality qualifiers
 - Overlap with other provisions
- Specific representations
 - Compliance
 - On-site conditions—presence and releases of hazardous substances
 - No claims
 - Liens or encumbrances

COVENANTS

- Compliance
- Use and release of hazardous substances
- Notice of environmental problem, agency and third party communications, and litigation or other claims
- No liens
- Cooperation and access
- Performance of an environmental assessment
- Remediation

OTHER PROVISIONS

- Requirement of Due Diligence
- Cooperation
- Access

INDEMNIFICATION

- Indemnifying Parties
- Indemnified Parties
- Trigger
 - Contract breach
 - Third party v. first party claims
 - Other
- Remedies
 - Losses
 - Remediation
 - Diminution in value
- Survival/Sunset/Termination—relevance of environmental assessment
- Environmental insurance as an add-on or alternative

CONCLUSION/BASIC PREMISES

- Environmental laws are complex and may result in significant risks to lenders, their borrowers, and their collateral
- A basic understanding of environmental law is helpful to managing those risks
- Environmental risks are manageable by extra-contractual and contractual tools
- A well-drafted and negotiated environmental indemnity agreement is a powerful tool for managing environmental risk

Questions?

IDENTIFYING AND INDEMNIFYING AGAINST ENVIRONMENTAL RISK

By

Jeff Civins

jeff.civins@haynesboone.com

and

Mary Mendoza

mary.mendoza@haynesboone.com

49th Annual Mortgage Lending Institute
September 18, 2015 – Austin, Texas
November 6, 2015 – Dallas, Texas

haynesboone