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Managing Arkansas Environmental Issues in the Lending/Foreclosure Process: October 9th Arkansas Bankers Association Mega Conference Presentation

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I undertook a presentation at the Arkansas Bankers Association Mega Conference titled:

Managing Arkansas Environmental Issues in the Lending/Foreclosure Process

The Presentation addressed transactional environmental issues from a financial institution's perspective.

A focus of the Presentation was how such issues affect the various aspects of a bank's lending operation, such as:

- Loan underwriting
- Loan documentation
- Loan modification/renewals
- Loan monitoring/supervision
- Distressed assets and restructuring workouts, foreclosure, and bankruptcy

The relevance of such environmental issues to the bank were deemed to include:

- Bank Direct Liability
- Impact Value of the Collateral (Improved and Unimproved Properties)
- Borrower Ability to Repay the Loan

The methods for addressing and managing environmental liabilities discussed included:

- Common Transactional Environmental Issues
- Relevant Federal/Arkansas Environmental Programs
- Managing Risk through Loan Documents, Environmental Assessments and Other Measures
- Loan Document Language Issues
- Environmental Assessments
- Statutory Exemptions/Trust Fund

The role of environmental issues in a commercial transaction, including lending, were specified:

- Materiality will obviously vary from deal to deal.
- Perception of issue as material is as important as reality. (Examples – mold or asbestos)

- Trap to be avoided is reducing efforts to address environmental issues based on lower value of facility or property.
- Party must make that choice being fully advised of risks.
- Bank's role in attempting to minimize environmental risks associated with the collateral can benefit borrower.

The measures a party (including a lender) will undertake to address an environmental issue in a transactional context was deemed to depend upon:

- Type of transaction (lease, buy/sell/financing, asset v. stock, etc.)
- Party represented (buyer, seller, lessor, lessee, borrower, secured creditor, investor, etc.)
- Type and materiality of the environmental issue in the context of the transaction
- Relative leverage of the party (Banks can typically require borrowers to undertake an assessment if reasonable)
- Tools reasonably (cost-effective?) available to allocate responsibility and/or quantify issue
- Party's appetite for risk? (is there an understanding that compliance and/or agency blessing does not necessarily mean that in the appropriate scenario third party lawsuits or impacts on future bank financing might be an issue?)

The ability to better quantify environmental issues and treat many of them as routine in a transactional context (as opposed to 25 years ago) is arguably due in part to:

- Familiarity;
- Improved ability to quantify environmental issues;
- Experience;
- Revised or clarified liability principles;
- Improved assessment techniques;
- Easier access to government records;
- Standardized assessment;
- Efforts by the federal and state agencies to reduce, to the extent possible, the environmental regulatory/liability impediments to financing and/or acquiring/leasing existing facilities ("brownfields" programs); and
- Governmental trust funds

The various typical environmental conditions that may arise with certain facilities or properties were addressed but there was a focus on newer and evolving issues, such as:

- Meth Labs
- Marijuana Cultivation Facilities
- Drinking Water Issues

In particular, the complexity associated with marijuana cultivation facilities was addressed.

In terms of managing risks, the two types of initial environmental assessments were discussed, such as:

- Environmental Assessments (catch-all for addressing varying types of issues and tailor to facility)
- Phase I Environmental Assessment

The difference between each of the previously referenced assessments was noted. In addition, the similarities and differences between appraisals and environmental assessments was discussed.

Of particular interest was the rationale for undertaking environmental assessments which arguably include:

- To access the innocent landowners defense under Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)
- To assess environmental liability and cost issues

- To quantify the extent of contamination and determine costs before/after purchase for use in negotiations
- To identify existing or potential environmental hazards
- To identify whether or not a neighboring property has the potential to impact the subject property
- To determine if further investigation is required

However, it was emphasized that in some cases instead of a standard ASTM Phase I Environmental Assessment it may make more sense to tailor the investigation to the type of property (i.e., assessing storage tank compliance at a convenience store, etc.). Further, ASTM Phase I environmental issues that are excluded, such as lead-based paint, asbestos, etc., the need to occasionally include these items was discussed (i.e., purchase of a building and a determination as to whether asbestos is present in the event of renovation, which can drive costs).

Related issues included federal and state agency no further action letters (including the need to recognize reopeners).

The foreclosure process was discussed and the elements associated with maintaining the federal CERCLA secured creditor exclusion.

Obviously important are the loan documents and the various warranties and indemnities that specifically address environmental issues. Of particular concern was the fact that “compliance language” sometimes does not address certain potentially material issues such as asbestos, lead-based paint, mold, etc.

Finally, the Arkansas Underground Storage Tank program was discussed and the potential role it plays in providing some mitigation of risk for both the borrower and lender.

A copy of the Presentation can be downloaded [here](#).