

## Chapter 9. Post-default Environmental Risk Management

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### A. General

#### 1. Definitions

Definitions of the environmental terms used in this SOP, which are capitalized whenever they appear, are located in Appendix 2 of [SOP 50 10 5](#), which can be found on SBA's Web site at [www.sba.gov](http://www.sba.gov) by selecting "Tools" on the homepage, and selecting "SOPs" under "Library & Reference."

**Note:** The term "Property" as used in this Chapter refers only to commercial property—not residential property.

#### 2. Regulations

All 7(a) Lenders and CDCs, including PLP Lenders and PCLP CDCs, must obtain SBA's written approval before taking title to Contaminated Property or control of a business that handles Hazardous Substances. [13 C.F.R. § 120.536 \(a\)\(5\)](#)

### B. When an Environmental Investigation Is Required

#### 1. Before Taking Title to Property

A Post-default Environmental Investigation must be conducted before taking title to any Property in order to determine whether it is Contaminated unless a prudent lender would conclude that an investigation was not necessary under the circumstances.

#### 2. Before Taking Control of a Business Using Hazardous Substances

A Post-default Environmental Investigation must be conducted before taking control of a business that handles Hazardous Substances in order to ascertain the risks involved. Exceptions to this policy may only be authorized by the SBA Loan Center Director after consultation with the Associate General Counsel for Litigation.

### C. Use of Environmental Professionals

All Transaction Screen, Phase I and Phase II Environmental Site Assessments must be performed by an Environmental Professional and be accompanied by a Reliance Letter, the template for which is located in Appendix 3 of [SOP 50 10 5](#). A Reliance Letter is not required for an Environmental Questionnaire and Records Search with Risk Assessment, and only the risk assessment portion must be completed by an Environmental Professional.

### D. Environmental Investigation Process

The type and scope of the Post-default Environmental Investigation required varies depending on the risk of Contamination. This SOP provides minimum standards. To comply with prudent lending standards, additional tests or inquiries may be required. Generally, however, unless access to the property is restricted or the collateral consists of a commercial condominium, (See the *Exceptions* listed below.), the Post-default Environmental Investigation associated with an SBA Loan should proceed as flows:

- Step 1:** Determine whether any underground liquid fuel storage tanks are located on the Property. If there are, a Phase I Environmental Site Assessment ("ESA") is required unless the tanks are associated with a gas station or a dry cleaning operation in which case, the procedures set forth below in Paragraph E apply and must be followed.
- Step 2:** Determine the NAICS codes for the Property's uses since the SBA Loan was funded.
- Step 3:** Determine whether any of the NAICS codes match a code located on the list of NAICS Codes of Environmentally Sensitive Industries located in Appendix 4 to [SOP 50 10 5](#).

#### Match:

- (1) Gas stations and dry cleaning facilities—follow the procedures set out in Paragraph E below.
- (2) All other environmentally sensitive industries—begin the Environmental Investigation with a Phase I ESA.

**No Match:**

At a minimum, the Post-default Environmental Investigation should begin with an Environmental Questionnaire, (which for liquidation purposes may be completed by the Liquidation Officer), and Records Search with Risk Assessment; or a Transaction Screen.

**Step 4:** Complete any additional testing, record searches or other inquiries recommended by the Environmental Professional who conducted the initial investigation required by Step 1 or 3.

**Step 5:** In addition to the foregoing requirements, if taking control of a business that handles Hazardous Substances is contemplated, the Post-default Environmental Investigation should also include an environmental audit to determine whether the business has the required environmental permits and is otherwise in compliance with applicable Environmental Laws.

**Exceptions:**

1. **Commercial Condominiums**—If the collateral consists of a single unit in a multi-unit building, the Post-default Environmental Investigation may begin with an Environmental Questionnaire and Records Search with Risk Assessment.
2. **Restricted Access**—If it is not possible to gain access to the Property to complete all of the steps outlined above, the reason should be documented in the loan file, prudent judgment exercised, and the best possible due diligence under the circumstances conducted. This includes, at a minimum, a Records Search with Risk Assessment.

**E. Special Procedures for Gas Stations and Dry Cleaners**

The Post-default Environmental Investigation for SBA Loans secured by any interest in real or personal property associated with the operation of a gas station or a dry cleaning facility at any time since the SBA Loan was funded should include the following:

**1. Site Assessment**

- a. A Phase I ESA, or a Phase II ESA if the gas station or dry cleaning facility is more than five years old, conducted by an independent Environmental Professional who holds a current Professional Engineer's or Professional Geologist's license and has three years of full-time relevant experience;

- b. The results of any further investigation recommended by the Environmental Professional conducting the ESA; and
- c. If the Property is Contaminated, a detailed estimate of the recommended method and cost of Remediation; and

## **2. Equipment Testing**

Testing of all trade fixtures and equipment related to the operation of the business, including underground storage tanks, lines and related equipment, by an independent contractor using a methodology acceptable to the Government Entity with oversight authority.

## **F. Environmental Investigation Report**

### **1. Documentation Requirement**

The Post-default Environmental Investigation Report must be kept in the loan file for inspection by SBA. If a Post-default Environmental Investigation was not conducted, the reason why an Environmental Investigation was not conducted must be documented in the loan file and explained in the Wrap-up Report.

### **2. Age of Report**

A Post-default Environmental Investigation Report must be less than 180 days old at the time it is relied on.

## **G. Obtaining SBA Approval of Loan Actions with Environmental Risk**

### **1. When Required**

#### **a. Before Taking Title to Contaminated Property**

If the Post-default Environmental Investigation Report concludes that the Property is Contaminated, SBA's prior written approval must be obtained from the appropriate SBA Loan Center prior to taking title to the Property. ([13 C.F.R. § 120.536\(a\)\(5\)](#)) (See Paragraph H below regarding the information that must accompany a request for SBA approval.)

**b. Before Taking Control of Business**

Regardless of the conclusions reached in the Post-default Environmental Investigation Report, SBA's prior written approval must be obtained from the appropriate SBA Loan Center prior to taking control of a business that handles Hazardous Substances. ([13 C.F.R. § 120.536 \(a\)\(5\)](#)) (See Paragraph H below regarding the information that must accompany a request for SBA approval.)

**2. How to Obtain**

To obtain prior written approval from SBA to take title to Contaminated Property or control of a business that handles Hazardous Substances, a written request should be submitted to the appropriate SBA Loan Center with a copy to the SBA District Counsel responsible for the geographic area where the Property or business is located. The request should include a risk-benefit analysis that discusses, at a minimum, the balance owed on the loan and other relevant facts such as:

**a. Fair Market Value of Property or Business**

Include a copy of the Post-default Appraisal establishing the fair market value of the Property or business;

**b. Nature and Extent of Contamination**

Include copies of all relevant Reports and Reliance Letters, including a copy of the Report covering the results of the environmental compliance audit required by Step 5 in Paragraph D if the request is for approval to take control of a business that handles Hazardous Substances;

**c. Remediation**

If Remediation is necessary or on-going, include a discussion of the:

- (1) Recommended method of Remediation;
- (2) Status of on-going Remediation, if any;
- (3) Environmental Professional's estimated cost of Remediation;
- (4) Environmental Professional's estimated completion date of Remediation;

- (5) Government Entity's designation, if any, of the Person(s) responsible for the cost of Remediation; and
- (6) Person(s) currently paying for any on-going Remediation;

**d. Anticipated Recovery**

Recoverable Value of the Contaminated Property or anticipated recovery from operating the business;

**e. Feasibility of Recovery from Other Sources**

Estimated recovery from other sources such as additional collateral or Obligor;

**f. Mitigating Factors**

**(1) Indemnification Agreement**

An SBA Environmental Indemnification Agreement executed by a Person who possesses sufficient financial resources to cover the cost of Remediation;

**Note:** If the loan balance is less than the cost of Remediation, indemnitors may wish to exercise their option of paying the loan balance in full, in which case, there is no need to acquire title to Contaminated Property or to take control of the Borrower's business.

**(2) Active Remediation Completed**

A written statement from the responsible Government Entity that active Remediation is complete and the results of any ongoing monitoring are acceptable;

**(3) "No Further Action" Letter**

A "no further action letter" or "closure letter" from the responsible Government Entity stating that no further Remediation or monitoring is required;

**(4) Minimal Contamination**

Documentation showing that the extent of Contamination and cost of Remediation is minimal or insignificant compared to the Recoverable Value of the Property;

**(5) Availability of Government Clean-up Funds**

A written statement from a Government Entity that the Property has been unconditionally approved to participate in a solvent fund that will cover the full cost of Remediation;

**(6) Escrow Account**

Documentation showing that an escrow account, which contains a minimum of 150% of the total estimated cost of Remediation, has been established to pay the Remediation costs in full and SBA, the 7(a) Lender or CDC is a party to the agreement governing the account;

**(7) Groundwater Contamination Originated Offsite**

Documentation showing that the Contamination consists solely of groundwater Contamination that originated from another property, and:

- (a) Another Person with sufficient resources is performing Remediation pursuant to a Remediation action plan that has been approved by the appropriate Government Entity; or
- (b) The applicable Environmental Law does not hold an owner or operator liable for groundwater Contamination that originates from another site; or
- (c) The responsible Government Entity has provided satisfactory written assurance that it will not hold the Property owner liable for the Contamination;

**(8) Insurance**

Documentation showing that environmental pollution insurance coverage is in place that will cover the full cost of Remediation;

**(9) Consent Decree**

Consent Decree or equivalent issued by the responsible Government Entity establishing that a third party is responsible for the Contamination; and

**(10) "Other Factor(s)"**

Documentation of other factors that may have a mitigating effect such as an agreement not to sue present and future Property owners from the responsible Government Entity, or evidence that Engineering or Institutional Controls are in place that will prevent the spread of Contamination or reduce the risk of human contact with it.

**Note:** General questions concerning SBA's environmental policy and procedures should be directed to SBA District Counsel for the geographic area where the Property is located.

**H. SBA Review of Requests to Acquire Title to Contaminated Property**

**Note:** SBA environmental engineers, who are located at SBA's Sacramento Loan Processing Center, are available for consultation with SBA Liquidation Officers and Legal Counsel regarding technical environmental issues.

**1. Liquidation Officer's Responsibility**

The Liquidation Officer handling the SBA Loan is responsible for reviewing requests to take title to Contaminated Property and for providing a recommendation as to whether the Agency should approve the request based on an analysis of the following factors:

- a. Fair market value of the Property based on a Post-default Appraisal;
- b. Nature and extent of the Contamination based on the Post-default Environmental Investigation Report;
- c. Cost of Remediation;
- d. Recoverable Value and marketability of the Property;

- e. Estimated recovery from other sources such as additional collateral or pursuit of Obligors;
- f. Mitigating factors relied on by the Lender or CDC as well as any other factors that could reduce the financial risk associated with acquiring title.

## 2. **Legal Counsel's Responsibility**

SBA District Counsel for the area where the Property is located must review all requests to acquire title to Contaminated Property and provide a legal opinion as to whether the Agency should approve the request based on an analysis of the following factors:

### a. **Applicable Law**

The applicable federal, state and local law governing liability for the Contamination.

### b. **Post-default Environmental Investigation Report**

The nature, extent and source of the Contamination, the cost of Remediation and other findings and conclusions set out in the Post-default Environmental Investigation Report.

### c. **Mitigating Factors**

The mitigating factors relied on by the Recommending Official as well as any others that might be available to the 7(a) Lender, CDC or SBA.

### d. **Legal Defenses**

Legal defenses available to the 7(a) Lender, CDC or SBA such as:

- (1) Federal or state law providing liability protection to lenders, and federal laws protecting Government Entities that acquire property involuntarily such as [CERCLA](#) Sections 101(2)(D) and 101(35)(A);
- (2) Determination by the responsible Government Entity that a third party is responsible for the Contamination, e.g., Super Fund Site Consent Decree or Water Quality Control Board finding regarding ground water Contamination that originated off-site; or

- (3) Government Entity's agreement not to sue.

**e. Litigative Risk**

- (1) Litigative risk associated with affirmative litigation if necessary to enforce an Environmental Indemnification Agreement, to compel a third party to Remediate the Property, etc.; or
- (2) Litigative risk associated with defensive litigation if suit is filed against the 7(a) Lender, CDC or SBA to recover the cost of Remediation or damages for wrongful death, personal injury or property damage caused by Contamination at the Property.

**f. Time and Cost of Litigation**

If litigation will be necessary, an estimate of the time as well as the necessary, reasonable and customary costs involved.

**3. Approving Official's Responsibility**

The Supervisory Liquidation Officer is responsible for deciding whether, and if so, under what circumstances, SBA should approve a request to take title to Contaminated Property, and whenever the decision is to recommend approval, for forwarding the Loan Action request to the Director of the Office of Financial Assistance, who must obtain the concurrence of the Associate General Counsel for Litigation.

**I. SBA Review of Requests to Take Over Business Using Hazardous Substances**

**1. Recommending Official's Responsibility**

The Liquidation Officer handling the SBA Loan is responsible for reviewing requests to take control of a business that handles Hazardous Substances and for providing a recommendation as to whether the Agency should approve the request based on an analysis of the following factors:

- a. Findings and conclusions contained in the Post-default Environmental Investigation Report including the results of the environmental compliance audit required by Step 5 of Paragraph D;
- b. Monetary risk involved, i.e., potential liability for Contamination including the cost of Remediation;

- c. Risk mitigating factors;
- d. Accuracy of the estimated recovery from operating the business;
- e. Estimated recovery from other sources such as additional collateral or pursuit of Obligors;
- f. Extent to which the anticipated recovery outweighs the risk associated with operating the business.

## **2. Legal Counsel's Responsibility**

The SBA District Counsel for the area where the business is located must review all requests to take over the operation of a business that handles Hazardous Substances, and must:

- a. Review the Post-default Environmental Investigation Report, including the results of the environmental compliance audit required by Step 5 of Paragraph D, and the Recommending Official's comments on the proposed Loan Action;
- b. Apply the applicable Environmental Law to the facts to determine whether the 7(a) Lender, CDC or SBA is likely to incur liability for Contamination if it becomes an operator;
- c. Determine whether the proposed legal strategies, such as petitioning the court to have a receiver appointed to operate the business, are sufficient for reducing the risk;
- d. Balance the legal and accompanying monetary risk against the estimated recovery; and
- e. Render a legal opinion as to whether, and if so, under what circumstances, SBA should approve the request.

## **3. Approving Official's Responsibility**

The Supervisory Liquidation Officer is responsible for deciding whether, and if so, under what circumstances, SBA should approve a request to take control of a business that handles Hazardous Substances, and whenever the decision is to recommend approval, for forwarding the Loan Action request to the Director of the Office of Financial Assistance, who must obtain the concurrence of the Associate General Counsel for Litigation.