Buffalo Environmental Law Journal

Volume 4 | Number 1 Article 3

10-1-1996

Lender Liability under CERCLA: Options for Lenders Faced with Potential Liability

John Charles Bell
University of Baltimore School of Law (Student)

Lender Liability Under CERCLA: Options for Lenders Faced with Potential Liability

John Charles Bell*

TABLE OF CONTENTS

---

* May, 1997 J.D. Candidate, University of Baltimore School of Law.

I. Introduction

The Comprehensive Environmental Response Compensation and Liability Act (CERCLA) was enacted in 1980 to give the government and private individuals the power to hold those who release hazardous substances liable for the cost of the clean-up.[1] There are two prerequisites for holding a party liable under CERCLA. The first relates to the site and the substance. Under section 107(a), a party can only be held liable if (1) the substance is "hazardous;" (2) there is a "release" or "threat of release;" and (3) that release or threat of release comes from a "facility."[2]

The broad interpretations of the definitions of these terms has allowed almost all hazardous substance clean-up actions to be brought under CERCLA. In fact, very few substances are exempt from the label "hazardous" and almost all sites, buildings and vessels would qualify as "facilities" for the purpose of liability under CERCLA.[3]

The second prerequisite to liability involves the party. There

---

1 United States v. Maryland Bank & Trust Co., 632 F. Supp. 573, 576 (D.Md. 1986); H.R.Rep. No. 1016, 96th Cong., 2d Sess. 1(1980), *reprinted in* 1980 U.S.C.C.A.N. 6119.

2 42 U.S.C. §9607(a) (1994 & Supp. 1995).

3 ALLAN J. TOPOL & REBECCA SNOW, *Superfund Law & Procedure* §5.8 458, 469-70 (1992); 42 U.S.C. §§9601, 9602 (1994 & Supp. 1995). The CERCLA definition of "hazardous" incorporates substances designated as hazardous waste under the Resource Conservation and Recovery Act (RCRA), toxic pollutants under the Clean Air Act and Clean Water Act, hazardous substances under the Toxic Substance Control Act, and any substance designated as hazardous under CERCLA section 102. For the purpose of liability under CERCLA, a facility is "(A) any building, structure, installation, equipment, pipe . . ., well, . . .impoundment, ditch, landfill, storage container, motor vehicle,. . . or (B) any site or area where a hazardous substance has been deposited . . . or otherwise come[s] to be located; but does not include any consumer product in consumer use."

are four classes of potentially liable parties (PRP's) under CERCLA: (1) Past owners or operators; (2) parties who arranged for disposal of the substance; (3) transporters who, after selecting the disposal site, carried the hazardous substance from the generator to the disposal site; and (4) current owners or operators.[4]

"Owner/operator" is defined in section 101(20)(A) of CERCLA. Included in the definition is an exemption for those who hold an indicia of ownership primarily to protect a secured interest.[5] Some commentators have noted, however, that the exact nature of this exemption is unclear.[6] In 1994, the D.C. Circuit vacated an Environmental Protection Agency (EPA) Final Rule that had attempted to define and clarify exactly what actions will lead to lender liability for hazardous substance contamination.[7] As a result of the court's decision, there has been considerable confusion and uncertainty in commercial lending institutions about what actions may be taken without losing the secured lender exemption.

This paper will examine the options available for secured lenders faced with potential liability under CERCLA. Part I will be a general analysis of the purpose of CERCLA. A discussion of the sections of the act which have been held to provide for the liability of secured creditors will be included. Part II will provide a chronological history of the courts treatment of lender liability

---

4 42 U.S.C. §9607(a) (1994 & Supp. 1995).

5 42 U.S.C. §9601(20)(A) (1994 & Supp. 1995).

6 *See, e.g.* John W. Ames et al., *Toxins-Are-Us: Charting the Waters of an Unsafe Harbor*, 1994 A.B.I. JNL. LEXIS 2642, *2 (Apr. 1994); Bradford C. Mank, *The Two-Headed Dragon of Siting and Cleaning Up Hazardous Waste Dumps: Can Economic Incentives or Mediation Slay the Monster?*, 19 B.C. ENVTL. AFF. L. REV. 239, 248 n.60 (Fall/Winter 1991); Peter N. Lavalette, *The Security Interest Exemption Under CERCLA: Timely Relief from the EPA*, 24 U. TOL. L. REV. 473, 476 (Winter 1993).

7 Kelley v. Environmental Protection Agency, 15 F.3d 1100, 1109 (D.C. Cir. 1994), *cert. denied*, American Bankers Assoc. v. Kelley, 115 S. Ct. 900 (1995).

under CERCLA. A discussion of the EPA Final Rule regarding lender liability and the subsequent decision by the D.C. Circuit Court to vacate this rule will be included. Part III will address the options for secured lenders faced with potential liability under CERCLA, including the consequences and possible drawbacks for each option.

II. Analysis of the Purposes of CERCLA

The Comprehensive Environmental Response Compensation and Liability Act (CERCLA) was enacted in 1980 to address the clean-up liability and prevention of hazardous waste contamination such as that which occurred in Love Canal, a suburban neighborhood near Niagara Falls, New York.[8] Included in the original CERCLA was a provision authorizing the creation of a fund to be used to finance the Environmental Protection Agency's remediation efforts (Superfund).[9] As it became clear that the $1.6 billion authorized by Congress would not be nearly enough to clean up the many thousands of hazardous waste sites around the country, provisions were developed by which the Superfund could be replenished.[10] One such provision allowed the government to hold those parties responsible for the contamination liable for the cost of

---

8 TOPOL, *supra* note 3, at §1.1. During the 1940's and 1950's, the Love Canal was used by Hooker Chemicals and Plastics Corporation to dispose of hundreds of 55-gallon drums containing hazardous chemical waste. The property was then donated to the Niagara Falls Board of Education which, in turn, constructed a school on the site. Single family homes were also built adjacent to the canal. Discovery of the contamination led to the abandonment of the school and the homes.

9 H.R.REP. NO. 1016, 96th Cong., 2d Sess. 1 (1980), *reprinted in* U.S.C.C.A.N. 6119, 6134.

10 Carol vanBergen, *The Economic Implications of Increased Lender Liability for Hazardous Waste Cleanup*, 1 GEO. MASON U. L. REV. 93, 96 (1994).

the clean-up.[11] Section 107(a) of CERCLA states that "the owner and operator of . . . a facility . . . shall be liable for all costs of removal or remedial action incurred by the United States Government or a State."[12] This liability has been characterized by the courts as being joint and several liability, meaning that any responsible party may be made to pay the entire cost of the clean-up.[13]

The impact intended by Congress in adopting this section has been the subject of intense debate. Critics have complained of the lack of legislative history regarding this section, and the ambiguity of the language defining "owner and operator" has resulted in several cases reaching opposing conclusions about the liability of a secured lender.[14] While lenders acting to protect a secured interest are exempt from the definition of "owner/operator," the extent of this exemption is unclear. Lenders may take precautions to protect their secured interest; however, actions which are deemed by the courts to be "participation in management" will render the exemption inapplicable and may result in the lender being held liable. The reluctance of the courts to decide on a clear standard and their inability to define "participation in management" has only added to the confusion about the degree of action a lender may take without losing the secured creditor exemption.

---

11 42 U.S.C. §9607(a) (1994 & Supp. 1995).

12 *Id.*

13 *United States v. Colorado & Eastern R.R. Co.*, No. 94-1041 and No. 93-1422, 1995 U.S. App. LEXIS 5562, at *11 (Mar. 17, 1995) ("It is well settled that §107 imposes joint and several liability on PRPs regardless of fault"). *See also County Line Inv. Co. v. Tinney*, 993 F.2d 1508 (10th Cir. 1991); *United States v. Chem-Dyne Corp.*, 572 F. Supp. 802, 809-811 (S.D. Ohio 1983).

14 vanBergen, *supra* note 10, at 94.

III. History of Lender Liability Under CERCLA

The initial decision in the area of lender liability under CERCLA was rendered in *United States v. Mirabile*.[15] In that case, the District Court for the Eastern District of Pennsylvania held that one way a secured lender could be held liable under CERCLA is to have participated in the day-to-day operations at the site.[16]

One of the lenders in that case, Mellon Bank National Association (Mellon), became involved when its predecessor in interest, Girard Bank, advanced capital to the paint manufacturing enterprise located on the contaminated property. This loan was secured by the inventory and assets of the corporation.[17]

The court found that Girard's actions presented an issue of fact as to whether it participated in the management of the facility. During the term of the loan, a Girard Bank loan officer was a member of the Advisory Board, a group of executives who oversaw the operation of the facility.[18] After the corporation filed its bankruptcy petition, Girard Bank became even more involved in overseeing the finances of the corporation.[19] Because the degree of Mellon's participation in management presented an issue of fact, the court denied its motion for summary judgment.[20]

Another lender in the case, American Bank & Trust (ABT), became involved after foreclosing on property securing a loan in

---

15 No. Civ.A.84-2280, 1985 WL 97, 15 Envtl. L. Rep 20,994 (E.D. Pa. Sept. 6, 1985).

16 *Id.* at *6.

17 *Id.* at *5.

18 *Id.*

19 *Id.* at *5, *8. Testimony revealed that Girard Bank demanded that additional sales efforts be made and that the corporation accept Girard's supervision if it wanted to continue to receive Girard funds. *Id.* at *8.

20 *Id.* at *9

default.[21] It held title to the property for approximately four months during which time it secured the property against vandalism, inquired into the disposal of drums left on the property, and, through its loan officer, visited the property for the purpose of showing it to prospective purchasers. In December, 1981, ABT assigned its interest to the Mirabiles. Subsequently, the Mirabiles were named as defendants in a lawsuit to recover costs associated with hazardous waste cleanup brought by the United States Government under CERCLA. The Mirabiles joined ABT, among others, as third party defendants.

In a summary judgment action brought by ABT, the court found that ABT's actions in this matter were clearly for the purpose of protecting its security interest in the property.[22] It stated that congressional intent in enacting CERCLA was to impose liability on "those who were responsible for and profited from improper disposal practices."[23] Because ABT made no effort to continue operations and acted in a prudent and reasonable manner at all times, the court thought it clear that liability should not be imposed upon ABT.[24] It declined to rule, however, on exactly which activities would be permitted under CERCLA.[25]

The next year, a decision by the District Court for the district of Maryland made foreclosure on property a hazardous venture for lenders. In *United States v. Maryland Bank & Trust Co.*,[26] the court held that the secured lender exemption applies only to those parties who hold an indicia of ownership to protect a security interest at the time of cleanup.

The property involved in that case is located in California,

---

21 *Id.* at *2.
22 *Id.* at *6.
23 *Id.*
24 *Id.*
25 *Id.*
26 632 F. Supp. 573 (D.Md. 1986).

Maryland. During the 1970's, Maryland Bank & Trust (MBT) loaned money to the owner of the property for two of his trash removal businesses. Also during the 1970's, the owner of the property permitted hazardous waste to be dumped on his property.[27] In 1980, MBT issued a loan to M.W. McLeod to purchase the property.[28] Shortly thereafter, he defaulted on the loan and MBT instituted a foreclosure action. On May 15, 1982, MBT took title to the property and continued to be record owner of the property until the time of the suit.

In 1983, EPA was informed by the Director of Environmental Hygiene for St. Mary's County, Maryland of the existence of hazardous wastes at the site. An EPA inspection confirmed the presence of hazardous wastes and a removal action was instituted and a cost recovery action brought against MBT under CERCLA.

MBT argued that it was exempt from liability because it merely held an indicia of ownership to protect its security interest. However, the court held that the secured lender exemption only applies to those who hold an indicia of ownership to protect a security interest *at the time that cleanup begins*.[29] The court stated that by taking title to the property at the foreclosure sale, MBT had caused its security interest to ripen into full title. MBT was liable for cleanup costs because it held full title at the time cleanup began.

According to the court, the secured lender exemption was intended by Congress to protect those who were required at common law to hold title while the mortgage is in force.[30]

---

27 *Id.* at 575.

28 *Id.*

29 *Id.* at 579.

30 *Id.* Depending on the state in which it is located, there are two positions a lender may take when financing property. Most states follow the "lien" theory in which the lender does not hold actual title to the property but merely has the right to foreclose and sell the property if the borrower defaults on the loan. By comparison, about twelve states follow the "title" theory of mortgages in which

Congress did not, as MBT implicitly contended, intend to protect a former mortgagee currently holding title after purchasing the property at a foreclosure sale. The court disagreed with the holding in *Mirabile*,[31] but it stated that it would be possible to distinguish the two cases.[32] They can be distinguished based on the "reasonableness" of the lenders' actions. Where the bank in *Mirabile* only held the property for four months, MBT held title to the property for almost four years.[33] The court, however, did not decide what would have been the holding had MBT attempted to sell the property immediately after foreclosure.

Lender liability under CERCLA was even more broadly defined in *United States v. Fleet Factors Corp.*,[34] where the Eleventh Circuit explicitly rejected the *Mirabile* standard and held that a secured creditor may incur liability even without meeting the definition of operator.[35] Day-to-day participation in the operations at the facility was no longer required; *Fleet Factors* held that a secured lender may incur liability "by participating in the financial management of the facility to a degree indicating a capacity to influence the corporation's treatment of hazardous wastes."[36] In this case, the court found that Fleet Factor's activities could support the inference that it could have affected the disposal of hazardous

---

the lender actually takes title to the property when issuing a loan. *See also* vanBergen, *supra* note 9, at 98.

31 *Maryland Bank & Trust*, 632 F. Supp. at 580.

32 *Id.* at 579.

33 vanBergen, *supra* note 10, at 101-102.

34 901 F.2d 1550 (11th Cir. 1990), *cert. denied*, 111 S.Ct 752 (1991).

35 *Id.* at 1557.

36 *Id.* While EPA characterized this language as dicta in their Lender Liability Rule, most commentators have recognized it as a holding. *See, e.g.*, James R. Deason, Note, *Clear as Mud: The Function of the National Contingency Plan in a CERCLA Cost Recovery Action*, 28 GA. L. REV. 555, 566 (1994); Frank S. Alexander, *Federal Intervention in Real Estate Finance: Preemption and Federal Common Law*, 71 N.C. L. REV. 293, 319 n.144 (Jan. 1993).

waste if it so chose.[37]

In 1976, Fleet Factors entered into a "factoring"[38] arrangement with Swainsboro Print Works (SPW) whereby Fleet agreed to advance funds to SPW in exchange for assignment of SPW's accounts receivable. As collateral, Fleet obtained a security interest in SPW's facility and all of its equipment. This factoring arrangement continued until 1981, when Fleet stopped advancing funds to SPW because SPW's debts to Fleet had exceeded the value of SPW's accounts receivable.[39] Shortly thereafter, Fleet foreclosed on its security interest, auctioned the collateral equipment and contracted to have the premises cleaned." On January 20, 1984, the Environmental Protection Agency ("EPA") inspected the facility and found 700 fifty-five gallon drums containing toxic chemicals and forty-four truckloads of material containing asbestos."[40]

During the time that the factoring arrangement existed between Fleet and SPW, Fleet participated in many aspects of SPW's business. It established prices and shipping schedules,[41] determined employee layoffs,[42] supervised the office administrator,[43] received and processed tax forms,[44] controlled access to the facility,[45] and required SPW to seek its approval before shipping goods to customers.[46] The court found these actions to constitute enough

---

37 *Fleet Factors*, 901 F.2d at 1560.

38 Factoring is defined as a "sale of accounts receivable of a firm to a factor at a discounted price. The purchase of accounts receivable from a business by a factor who thereby assumes the risk of loss in return for some agreed discount." BLACK'S LAW DICTIONARY 532 (5th ed. 1979).

39 *Fleet Factors*, 901 F.2d at 1552.

40 *Id.* at 1553.

41 *Id.* at 1559.

42 *Id.*

43 *Id.*

44 *Id.*

45 *Id.*

46 *Id.*

support for the inference that Fleet Factors could have influenced SPW's hazardous waste disposal if it so chose. Because this inference was supported, the court held that Fleet Factor's motion for summary judgment on the issue of its exemption from liability as a secured lender was properly denied.[47]

By holding secured lenders liable for merely being able to affect the lender's disposal of hazardous waste, the court sought to encourage lenders to fully investigate a potential debtor's waste disposal system [48] and to require creditors to insist upon compliance with acceptable standards "as a prerequisite to continued and future financial support."[49]

Although the *Fleet Factors* decision did increase awareness in the lender community of the need to protect oneself from possible CERCLA liability, it also contributed to the lenders' desire to distance themselves from any aspect of a borrower's business.[50] The possibility of being held liable under CERCLA merely for the ability to influence disposal of hazardous waste led lenders to question which, if any, activities would be permitted.

A. The EPA Final Rule on Lender Liability

By defining unclear phrases in CERCLA and defining and specifying a range of activities that may be taken by a secured lender without losing the exemption granted by section 101(20)(A), EPA sought to limit CERCLA liability for secured lenders.[51] The EPA's Final Rule on Lender Liability first sought to define three key phrases that are otherwise not defined in CERCLA. The first

---

47 *Id.* at 1560.
48 *Id.* at 1558.
49 *Id.*
50 *Kelley*, 15 F.3d at 1104.
51 National Oil and Hazardous Substances Pollution Contingency Plan; Lender Liability Under CERCLA, 40 C.F.R. §300.1100 (1994).

of these phrases was "indicia of ownership."[52]

For the purpose of section 101(20)(A), the rule stated that indicia of ownership meant simply "evidence of interests in real or personal property."[53] The EPA did not seek to limit the type ownership indicia that may be held under the exception.[54] However, the rule stated that the indicia of ownership must be held primarily as protection for a security interest.[55]

The second phrase defined in the final rule was "primarily to protect a security interest."[56] To bring an ownership interest within the exception, the interest had to be "maintained primarily for . . . securing payment or performance of a loan . . . and not an interest in property held for some other reason."[57] The rule did not allow those who held an ownership interest in property primarily to protect an investment interest to take advantage of the secured lender exemption.[58] For example, many lending institutions will hold an interest in property to protect an investment in a corporation. Under the final rule, this type of secured interest would not be protected by the secured lender exemption. However, a lending institution that had a revenue interest in a loan that created a security interest would be considered a secured creditor and

---

52 *Id.* at 92.

53 *Id.*

54 *Id.* Evidence of ownership interests include, but are not limited to, "mortgages, deeds of trust, liens, surety bonds and guarantees of obligations, title held pursuant to a lease financing transaction in which the lessor does not initially select the leased property, . . . [or] legal or equitable title obtained pursuant to foreclosure, and their equivalents."

55 *Id.* at 93.

56 *Id.*

57 *Id.*

58 *Id.* In *Maryland Bank & Trust Co.*, the court stated that the bank was holding an ownership interest in the property to protect its investment interest. *Maryland Bank & Trust Co.*, 632 F.Supp. at 579.

therefore would be exempt from liability under CERCLA.[59]

The third phrase defined in EPA's final rule was "[p]articipation in the management of a facility . . ."[60] In this definition, EPA sought to limit the broad definition set forth in *Fleet Factors* by stating that actual participation in the management or operation of the facility was necessary to hold a person liable as an owner/operator.[61] The capacity or unexercised right to influence was no longer to be considered participation in the management of the facility. Although EPA included a list of permissible lender activities in the rule,[62] it conceded that not all possible situations could be foreseen. As a guideline for determining if an activity would cause a lender to lose the secured lender exemption, EPA outlined a general test of participation in management.[63]

Under the general test outlined in the EPA final rule, a lender holding a secured interest would not be considered to be participating in management unless, while the borrower was still in possession, the lender either:

> (1) exercises decisionmaking control over the borrower's environmental compliance, such that the [lender] had undertaken responsibility for the borrower's waste disposal or hazardous substance handling practices;
>
> or
>
> (2) exercises control at a level comparable to that of a manager of the borrower's enterprise, such

---

59 National Oil and Hazardous Substances Pollution Contingency Plan; Lender Liability Under CERCLA, 40 C.F.R. §300.1100 (1994).

60 *Id.*

61 *Id.*

62 *Id.* at 94.

63 *Id.* at 93.

> that the [lender] has assumed or manifested responsibility for the overall management of the enterprise encompassing the day to day decisionmaking of the enterprise with respect to:
> (A) Environmental compliance; or
> (B) All, or substantially all, of the operational (as opposed to financial or administrative) aspects of the enterprise other than environmental compliance.[64]

The purpose of this general test was to provide a basic framework within which a lender's actions could be assessed. Under the first prong of the test, a lender would be outside of the exemption if it actually participated in decisions affecting the borrower's environmental compliance.[65] This prong allowed those who merely had the ability to influence but did not exercise it to receive the protection of the secured lender exemption.

The second prong of the test was an attempt to exclude from the exemption those lenders who controlled many aspects of the borrower's business but did not assume responsibility for environmental compliance. [66] Under the second prong, these actions by a lender will void the secured lender exemption because the ability to carve out environmental compliance responsibilities demonstrates that the lender "has manifested or assumed operational responsibility at a management level that includes such matters, and doing so is considered to be participation in the facility's management."[67]

---

64 National Oil and Hazardous Substances Pollution Contingency Plan; Lender Liability Under CERCLA, 40 C.F.R. §300.1100 (1994).

65 *Id.*

66 *Id.*

67 National Oil and Hazardous Substances Pollution Contingency Plan; Lender Liability Under CERCLA 57 Fed. Reg. 18,344 (1992) (codified at 40 C.F.R.

The general test was to be used in assessing common lender actions not specifically addressed by the rule. If the lender's activities were consistent with the test, the lender would be covered by the secured lender exemption. The rule also provided that a lender would be covered by the exemption if its actions were included in a specific list of permissible actions.

Permissible activities included in the rule were divided into those acts by the lender at the inception of the loan,[68] those acts taking place during the term of the loan (the policing of the loan),[69] and those acts after the foreclosure on the property securing the loan.[70] The listed activities in the rule were based on court decisions regarding the scope of the exemption and on input from commentators. Although courts had attempted to draw a rough line between those actions that were and were not permitted, the purpose of the EPA rule was to "define with greater precision the point at which a holder's actions pass from oversight and advice to actually facility management."[71] The rule stated that prior to the loan inception, the lender was not considered to have a secured interest in the property absent evidence to the contrary. With respect to the general test of participation in management, a lender's actions before the transaction were irrelevant.[72] Therefore, a lender could give specific or general advice or suggestions without fear that these actions would be used for determination of participation in management. Additionally, the rule allowed a lender to request or even undertake an environmental inspection of the property prior to

---

§300.1100).

68 40 C.F.R. §300.1100 (1994).

69 *Id.*

70 *Id.* at 95.

71 National Oil and Hazardous Substances Pollution Contingency Plan; Lender Liability Under CERCLA 57 Fed.Reg. 18,344 (1992) (codified at 40 C.F.R. §300.1100).

72 *Id.*

the inception of the loan without affecting its status under the secured lender exemption.[73]

If an inspection revealed contamination but the contamination was minimal or the chance of default was slight, a lender might choose to continue with the transaction. The rule allowed a lender in this situation to maintain its status as an exempt secured lender even though it required the borrower to clean up the site during the term of the loan;[74] required assurance of the borrower's compliance with applicable federal, state and local environmental rules;[75] and/or secured permission to periodically inspect the facility.[76] The rule, however, stated that these types of actions by a lender would not result in the lender becoming the insurer of environmental safety at the facility. Lender liability under the rule could not be based upon the inclusion of environmental warranties in the loan contract.[77]

During the term of the loan, the lender may determine that action needs to be taken to safeguard the secured interest from loss. This determination is usually made when default is imminent or has already occurred. These actions, commonly referred to as loan "work out" activities,[78] are undertaken to prevent, mitigate or cure a default by the borrower and to prevent the loss of value of the security.[79] These activities are considered common lender activities and, so long as they were consistent with the general test of participation in management, the rule stated that the lender would

---

73 40 C.F.R. §300.1100 (1994).
74 *Id.*
75 *Id.*
76 *Id.*
77 *Id.*
78 *Id.*
79 National Oil and Hazardous Substances Pollution Contingency Plan; Lender Liability Under CERCLA 57 Fed.Reg. 18,344 (1992) (codified at 40 C.F.R. §300.1100).

not be taken out of the secured lender exemption.[80]

To avoid liability after foreclosure, the EPA rule required that the lender continue to act primarily to protect its security interest.[81] Acting to protect a security interest means that the lender must attempt to prevent as much of the loss as is reasonable. Not acting to prevent loss would void the exemption. The exemption would be voided if, for example, the lender did not seek to sell the property within a reasonable amount of time.[82] The rule offered a bright line mechanism through which a lender could retain the secured lender exemption. To be eligible to use this mechanism, the lender was required to list the property with a broker or otherwise advertise it on a monthly basis within twelve months of taking title.[83] Additionally, the lender was forbidden to reject or outbid any other fair offer.[84] Doing so would result in violation of the bright line mechanism and possibly a finding that the secured lender exemption had been voided.

The EPA's Final Rule on Lender Liability was an attempt to determine what level of involvement is sufficient to void the CERCLA secured lender exemption. However, a 1994 D.C. Circuit Court decision held that the EPA had overstepped its boundaries in making this determination.

---

80 *Id.*

81 40 C.F.R. §300.1100 (1994).

82 *Id.*

83 *Id.*

84 *Id.* Fair offer is defined as the value of the security interest. The value of the security interest is calculated as an amount equal to or greater than the sum of the outstanding principal, plus any unpaid interest, rent or penalties, plus all reasonable and necessary costs or fees, plus response costs incurred under CERCLA section 107(d)(1), less any amounts already received by the lender in connection with the property.

B. Judicial Treatment of Lender Liability after the Final Rule

In *Kelley v. Environmental Protection Agency*,[85] the court vacated the final rule defining the scope of lender liability under CERCLA.[86] The court stated that the EPA had no authority to promulgate a substantive rule on lender liability [87] and furthermore, the rule should not be given deference as an interpretive rule.[88]

Agency authority to promulgate substantive rules must be expressly or implicitly intended by Congress.[89] EPA attempted to show evidence of congressional intent to allow it define section 107 liability first through the broad language of section 105.[90] Section 105 authorizes EPA "to reflect and effectuate the responsibilities and powers created by this chapter."[91] EPA argued that defining liability under section 107 should be characterized as a "responsibility and power."[92] The court rejected that argument, however, as not a specific delegation of authority to interpret section 107.[93]

Another EPA argument was that section 106 implicitly granted it authority to define liability.[94] Under that section, a party ordered by EPA to clean up a site may petition EPA for reimbursement of its costs.[95] A refusal by EPA to reimburse the party may result in

---

85 15 F.3d 1100 (D.C. Cir. 1994), *cert. denied.*
86 *Id.* at 1109.
87 *Id.* at 1108.
88 *Id.* at 1108.
89 *Id.* at 1105.
90 *Id.*
91 *Id.*; 42 U.S.C. §9605 (1994).
92 *Kelley*, 15 F.3d at 1105.
93 *Id.*at 1105,1106. The court stated that section 105 "refers to the nature of actions parties must take in response to contamination- not their ultimate liability . . ." *Id.* at 1106.
94 *Id.*; 42 U.S.C. §9606 (1994).
95 *Id.*

a federal court ordering reimbursement if it determines that the party was not liable or that the EPA order was arbitrary, capricious or illegal. EPA argued that it determines liability issues when it determines whether or not to grant the petition for reimbursement.

The court reached another conclusion. Under the court's reading of section 106 of CERCLA, in a reimbursement proceeding EPA acts merely as would a defendant in a civil lawsuit.[96] In deciding whether to grant reimbursement, EPA is in effect deciding whether to settle a suit. Just as in a civil lawsuit, the defendant's reasons for not settling should not be considered by the court in deciding liability issues.[97] Additionally, questions of liability under section 107 can be brought to court without any government involvement. Under these circumstances, EPA could quite possibly become involved in a case as a plaintiff seeking to recover its costs. According to the court, "it cannot be argued that Congress intended EPA, one of many potential plaintiffs, to have authority to, by regulation, define liability for a class of potential defendants."[98]

Because there is no clear congressional intent to grant EPA authority to define liability under section 107 of CERCLA, the court held that EPA's final rule could not be considered as a substantive rule of law.[99] The court next considered the assertion by EPA that the rule should be given deference as an interpretive rule.

According to the court, EPA may only bring questions of liability to federal court as a prosecutor.[100] Congress did not give EPA authority to determine the interpretation of liability under CERCLA.[101] Where this authority has not been given, judicial

---

96 *See Kelley*, 15 F.3d at 1107.
97 *Id.*
98 *Id.*
99 *Id.* at 1109.
100 *Id.* at 1108.
101 *Id.*

deference to an agency's interpretation is "inappropriate."[102]

The *Kelley* decision to vacate the EPA final rule once again left the lending industry with no clear standard by which to determine what actions will result in CERCLA liability. In essence, the D.C. Circuit Court's vacating of the EPA's final rule brought back the participation in management standard as outlined in *Fleet Factors*. However, criticism of the broad reach of *Fleet Factors* led two courts to decline to follow its standard.

In *In Re Bergsoe Metal Corp.*,[103] the Ninth Circuit Court of Appeals held that there must be some actual participation in management by the creditor before it will lose the secured lender exemption.[104] However, the court declined to decide which actions will cause a lender to fall outside the exemption, stating that there was no need to decide that issue because the lender involved in *Bergsoe* did not participate in the management of the facility whatsoever.[105]

In this case, Bergsoe Metal Corporation entered an agreement with the Port of St. Helens to build a lead recycling facility. The agreement consisted essentially of a sale-and-lease-back arrangement between Bergsoe and the Port, which in turn mortgaged its interest to the United States National Bank of Oregon. Bergsoe was required to make its lease payments directly to the bank, and the lease expired when the money owed on the sale-and-lease-back arrangement was paid in full.

Bergsoe, through its shareholders, EAC, argued that the Port was liable for any cleanup costs under CERCLA because its actions during the term of the loan constituted participation in management. The court, however, disagreed with EAC's argument. It stated that

---

102 *Id.*
103 910 F.2d 668 (9th Cir. 1990).
104 *Id.* at 672.
105 *Id.*

regardless of the rights the Port may have had,[106] "it cannot have participated in management if it never exercised them."[107]

In another case, *Z & Z Leasing, Inc. v. Graying Reel, Inc.*,[108] the District Court for the Eastern District of Michigan, Southern Division, refused to adopt the "narrow" *Fleet Factors* test.[109] The court stated that to do so would "largely eviscerate the exemption Congress intended to afford secured creditors."[110] However, this decision did not alleviate any of the confusion surrounding lender liability. Although the court refused to adopt the *Fleet Factors* test, it also refused to outline a specific standard through which liability could attach.[111]

According to the court, secured lenders must routinely have some involvement in their borrower's financial affairs in order to protect their interests.[112] In this case, the court stated that the Bank's actions were "prudent and routine steps to protect its security interest only."[113] The court, therefore, refused to punish the bank for requiring a borrower to obey the law.[114]

---

106 *Id.* at 672-673. The lease granted the Port certain rights, among them the right to inspect the premises and to reenter and take possession upon foreclosure. The court found these rights to be reasonable rights retained by almost all secured lenders.

107 *Id.* at 673.

108 873 F. Supp. 51 (E.D. Mich. 1995).

109 *Id.* at 55.

110 *Id.*

111 *Id.*

112 *Id.* at 55.

113 *Id.* at 55. The bank's actions in this case consisted of imposing certain negative covenants upon the borrower. The borrower was required to obtain written permission from the bank prior to amending operative documents; merging or selling assets; incurring indebtedness; agreeing to guarantee obligations; purchasing assets or stock; creating or incurring liens; making loans; purchasing or leasing fixed assets; or purchasing, redeeming or acquiring its capital stock.

114 *Id.* at 55-56.

By refusing to adopt the strict *Fleet Factors* standard, the courts in *Bergsoe* and *Z & Z Leasing* gave lenders some reason to believe that routine lender actions will not lead to liability under CERCLA. However, the possibility remains that courts in the future will strictly follow *Fleet Factors*.[115] Lenders, therefore, must take steps to reduce the risk of CERCLA liability.

IV. Options for Secured Lenders faced with Potential Liability

The traditional means by which a lender would avoid risk was to avoid the risky property altogether. However, with regard to CERCLA liability, this approach is unrealistic.[116] Almost all environmental assessments of commercial property reveal some form of potential environmental risk.[117] From a lender's perspective, this means that any loan secured by commercial property is a risk. However, because commercial lending is a major function of most large banks, complete withdrawal from commercial lending would deprive most lending institutions of a primary source of revenue.[118] Withdrawal from the commercial lending arena, therefore, is not an option. This does not mean, however, that lending institutions should choose the other extreme by ignoring the possibility of CERCLA liability and continuing their traditional lending practices. Although no method of avoiding

---

115 vanBergen, *supra* note 10, at 106.

116 Laura E. Peck, Note, *Viable Protection Mechanisms for Lenders Against Hazardous Waste Liability*, 18 HOFSTRA L. REV. 89, 106 (1989).

117 Jeffrey C. Fort et al., *Due Diligence for Environmental Issues in Transactions*, *in* Attorney's Guide to Environmental Liability in Transactions, 1-1, 1-9 (Illinois Institute for Continuing Legal Education ed., 1991). "It cannot be overemphasized that each and every property may conceal hidden environmental risks."

118 Peck, *supra* note 116, at 105.

CERCLA liability is completely safe, some common sense and a combination of certain actions will serve to prevent lender liability under CERCLA in most cases.

A. Environmental Audits

Before the inception of the loan, requiring an independent environmental assessment of the property may help a lender to identify possible environmental hazards.[119] An environmental audit will not protect a lender from liability should it enter the transaction; however, an audit may give the lender an idea of the extent of the contamination and the amount of money that may be needed to clean up the site.[120] This information could be used in assigning a risk factor to the loan and also in determining the amount of liability insurance that may be required.

1. Assessment of the Property

Environmental auditing before the inception of the loan serves the purpose of informing the lender of the possibility of environmental problems.[121] However, there are some drawbacks to the audit procedure. The first drawback is the cost of the audit itself.[122]

To be effective, an environmental audit must be performed by

---

119 *Id.* at 107. *See also* Patricia A. Shackelford, *Easing the Credit Crunch: A "Functional" Approach to Lender Control Liability under CERCLA*, 19 B.C. ENVTL. AFF. L. REV. 805, 847 (Summer 1992) (many lenders now require environmental audits as a precondition to financing).

120 Peck, *supra* note 116, at 107.

121 *Id.*

122 T.J. Becker, *Clean-up Costs, Red Tape tie up Recycling Sites*, CHI. TRIB., Jan 15, 1995, Real Estate Section, at 1. A simple environmental audit can cost from $1,000 to $10,000. More detailed examinations can reach $70,000.

an independent auditing team of adequate size and training.[123] Additionally, the auditing team must be provided with accurate, detailed information of past, present and future uses for the site.[124] Because there is a general lack of expertise in the lending industry regarding environmental compliance,[125] an accurate environmental audit requires that outside experts be consulted. Although the cost of retaining these experts and conducting the pre-loan audits will eventually be passed on to borrowers in the form of higher loan fees,[126] the possibility of fewer loan applications because of the higher costs may require the lender to bear some of the burden of its borrowers' environmental compliance.

Another drawback associated with environmental auditing is that each audit is merely an analysis of one moment in time.[127] As a company's activities and the legal requirements which apply to those activities change, the procedures recommended by an audit may become obsolete.[128] While on one hand the purpose of an audit is to predict the future of environmental compliance procedures, a prediction cannot be used as a true-risk minimizing factor.[129] Therefore, to effectively minimize risk, environmental auditing must be incorporated into a program of assessing environmental compliance throughout the term of the loan.[130]

---

123 Peck, *supra* note 116, at 108.
124 *Id.* at 109.
125 vanBergen, *supra* note 10, at 10.
126 *Id.*
127 Peck, *supra* note 116, at 113.
128 *Id.*
129 *Id.*
130 *Id.* at 114. *See also* Valerie A. Zondorak, *A New Face in Corporate Environmental Responsibility: The Valdez Principles*, 18 B.C. ENVTL. AFF. L. REV. 457, 491 n.185 (Spring, 1991) (A comprehensive environmental audit would entail "using checklists and questionnaires to evaluate compliance . . . ; reviewing worker's compensation 'loss runs' to evaluate pollution and health problems; making periodic visits to facilities to review compliance efforts; . . . evaluating

Continued assessment of the facility and the regulations affecting the facility may, however, possibly increase a lender's chance of liability. Requiring periodic environmental audits after the inception of the loan may be viewed as "participation in management" under a strict application of the *Fleet Factors* standard.[131] Although *Fleet Factors* has been roundly criticized,[132] it has not been overruled. As a result, there is no guarantee that its standard for participation in management will not be used to hold a lender liable for requiring continued environmental assessment of a borrower's facility.

2. Assessment of the Law

Another type of environmental audit that may be used by lenders to minimize risk is an assessment of all environmental laws and regulations applicable to a certain transaction.[133] The lender could develop a risk assessment checklist or matrix[134] through which compliance with environmental regulations could be evaluated.

---

the history of all real estate owned by the corporation . . . and performing a site inspection.").

131 Peck, *supra* note 116, at 114.

132 *See, e.g.*, Geoffrey K. Beach, Note, *Secured Creditor Lender Liability After United States v. Fleet Factors Corp.: Vindication of CERCLA's Private Enforcement Action*, 41 CATH. U. L. REV. 211, 217 (1991); *Fleet Factors Creates Dilemma for Lenders, ABA Conferees Told*, 5 Toxics L. Rep. (BNA) No. 3, at 113 (June 20, 1990); Michael I. Greenberg & David M. Shaw, Note, *To Lend or Not To Lend- That Should be the Question: The Uncertainties of Lender Liability Under CERCLA*, 1991 Duke L.J. 1211, 1212 (1991).

133 Peck, *supra* note 116, at 110.

134 *Id.* at 110 n.120. An example of a matrix would be "[o]ne hundred possible activities . . . listed in the matrix along one axis, with 88 possible impacts listed along the other axis. Thus, 8,800 interactions can be displayed or indicated by means of this matrix." (*quoting* J. HEER & D.J. HAGERTY, ENVIRONMENTAL ASSESSMENTS and STATEMENTS 159 (1977)).

This type of system may be favorable to lenders because it does not require activities which may be viewed as participation in management of the facility and furthermore, it evaluates the legal requirements for the borrower and will identify noncompliance.[135] A lender may also prefer to use this type of system to develop a response to a borrower's default on possibly contaminated property. By analyzing past case law and the language of current regulations, a lender may be able to predict what actions it may take without incurring CERCLA liability.[136] For example, a lender would probably avoid liability as an owner/operator under CERCLA if it could show that it did not foreclose on the property and that the actions it took were typical of a reasonable, prudent lender.[137] This approach is in no way guaranteed; however, there is a strong likelihood that reasonable, prudent actions by a lender to protect its secured interest will not result in CERCLA liability.

There are certain drawbacks to environmental law assessment as a strategy to minimize CERCLA liability. First, the cost involved may be quite high.[138] Accurate environmental law assessment requires expertise in environmental law. As was the case with environmental compliance assessment, this type of expertise is not common in the lending industry.[139] Therefore, outside environmental law experts would need to be consulted. Because the scope of liability under CERCLA is constantly changing,[140] this consultation would have to be ongoing, resulting in ongoing costs and higher loan fees.

---

135 Peck, *supra* note 116, at 111.

136 Zondorak, *supra* note 130, at 470.

137 *See* Z & Z Leasing, Inc. v. Graying Reel, Inc., 873 F. Supp. 51, 55 (E.D. Mich. 1995); *In re Bergsoe Metal Corp.*, 910 F.2d at 672.

138 vanBergen, *supra* note 10, at 110.

139 *Id.*

140 Stanley M. Spracker & James D. Barnett, *Lender Liability under CERCLA*, 1990 COLUM. BUS. L. REV. 527, 551.

Second, courts have not addressed every possible action that may be taken by a secured lender with regard to possibly contaminated property. Therefore, it is likely that the lender will face the need to act in a way not previously sanctioned in case law. In those situations, the lender would need to rely on its own common sense assessment of what constitutes reasonable lender activity.

Third, conclusions and predictions regarding lender liability under CERCLA are limited to the jurisdiction on which they are based. An eleventh circuit decision such as *Fleet Factors* may or may not be followed in a different forum.[141] If a lender conducts business in many jurisdictions, the amount of data and upkeep necessary to make an informed decision about the best forum in which to defend a lawsuit may be astronomical.

Although there are drawbacks to all types of environmental audits, lending institutions continue to rely on them to provide insight into the possibility of liability under CERCLA.[142] This insight, coupled with another option such as environmental insurance, may work to decrease the cost to the lender in the event of a default on contaminated property.

B. Environmental Liability Insurance

The use of liability insurance is another step a lender may take to protect itself against losses stemming from hazardous waste cleanup.[143] Policies such as those offered by the Colorado firm

---

141 John W. Ames et al., *Toxins-Are-Us: Superfund Reform and Lender Liability in Congress--Dredging the Safe Harbor in the Wake of Kelley*, 1994 A.B.I. Jnl., *available in* LEXIS 2695, *5 (June 1994).

142 John W. Milligan, *It's Not Easy Being Green*, U.S. BANKER, Dec. 1994, at 40.

143 Peck, *supra* note 116, at 115.

ERIC Group, Inc.[144] provide protection for both borrowers and lenders against hazardous waste cleanup costs. These policies provide the procedures for pre-loan environmental audits as well as the engineers needed to perform the audits.[145] The policy then protects the lender from the costs associated with cleaning up pollution not detected by the environmental audit.[146]

The costs for these policies range from "$5,000 to $10,000 per $1 million of insured value;"[147] however, these costs are substantially less than the potential cost of a CERCLA cleanup. Additionally, a lender may find that these costs may be passed on to the borrower in some cases. For instance, a borrower involved in a multi-million dollar loan transaction would be unlikely to risk rejection of the loan based on the addition of $10,000 to $20,000 in insurance costs.[148] Although liability insurance may prevent a lender's losses in some situations, it is not practical in every case.[149]

The high cost of such insurance is prohibitive in loan transactions involving less valuable property.[150] To spend $10,000 to insure a $100,000 loan may seem unthinkable to most lenders. However, a lender may want to consider this insurance even in a transaction involving less valuable property if the transaction involves a high risk of potential contamination.[151] An outlay of $10,000 by the lender may reduce its profits if there is no contamination, but it may also protect the future of its business if

---

144 vanBergen, *supra* note 10, at 112.
145 *Id.*
146 *Id.*
147 *Id.*, (*quoting Insurance Offered for Superfund Liabilities*, U.P.I., May 31, 1991 and June 1, 1991).
148 vanBergen, *supra* note 10, at 113.
149 Peck, *supra* note 116, at 121-122.
150 vanBergen, *supra* note 10, at 113.
151 *Id.*

contamination is discovered.[152]

V. Conclusion

Congressional inability to clearly define terms and judicial unwillingness to set a bright line standard regarding lender liability under CERCLA has created a need for those in the lending industry to exercise a little common sense.[153] With the exception of *Fleet Factors*, courts have been reluctant to hold lenders liable for the acts of borrowers.[154] Moreover, Fleet's actions in its agreement with SPW clearly went beyond the scope of reasonable lender actions; no doubt Fleet would have been liable as an operator for its actions under any standard.[155] Notwithstanding *Fleet Factors*, it is unlikely that a secured lender will be held liable under CERCLA if its actions were those of a reasonable, prudent lender.[156]

There is no question that lenders should fully investigate property to be held as security in a loan agreement. If there is any question of past contamination, the lender should either reject the loan application outright or require an environmental audit prior to

---

152 *Id.*

153 Robert P. Simons, *The Consequences of the Overturning of the EPA Lender Liability Rule*, 76 J. COM. LENDING 43 (Apr. 1994).

154 While the court in *Maryland Bank & Trust* held the bank liable for the cost of the clean up, it did so based on the fact that MBT's interest had ripened into full title at the time of the clean up, not based on MBT's status as a secured lender. 632 F. Supp. at 579.

155 Simons, *supra* note 153, at 44.

156 See Randall J. Burke, *Much Ado About Lending: Continuing Vitality of the Fleet Factors Decision*, 80 GEO. L.J. 809, 828 (Feb. 1992). While "reasonable and prudent" may not be a bright line standard, some uncertainty in the lending industry may be desirable "if it results in lenders exercising increased caution in issuing loans and demanding assurances of insurance coverage and environmental compliance verification."

entering the transaction.[157] Although an environmental audit will not preclude liability, it will give the lender an idea of the extent of the contamination. Additionally, it will give the lender an idea of the amount of insurance that will be required to adequately protect it from possible loss.

If the lender has already entered the loan agreement, it should remove itself as much as possible from the borrower's business. Some advice or suggestions may be given by the lender, but all decisions regarding the operation of the enterprise should be made by the borrower.

If the borrower has defaulted or is likely to default on possibly contaminated property, *Maryland Bank & Trust* has taught us that to purchase after foreclosure is a dangerous proposition. A lender may do so in order to protect its security interest, but it is dangerously close to crossing the line between being a secured lender with an exemption and a current operator with a liability. The lender's best option in these circumstances is to request that the borrower perform an environmental audit and agree to loan additional funds to assist in the clean up if feasible. If the borrower would be in no position to continue the business after a clean up, or the environmental audit reveals that the damage is so widespread that clean up would be too costly, the lender may save itself future problems by writing the debt off and moving on to less risky ventures.

Until such time as Congress specifically delegates authority to EPA to define liability as it sees fit, or Congress itself defines what lender liability will be, lenders must act cautiously, prudently, and with common sense in making loans and in foreclosing on property securing a loan.

---

157 Shackelford, *supra* note 119, at 847.