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You can imagine the scenario. Improvident Bank of Anytown, U.S.A. (Improvident) makes a $50,000 loan to Billy A. Davis d/b/a Local Underwear Company (BADLUC) to enable BADLUC to upgrade its equipment and modernize its production process. Although some risks clearly existed in making the loan, Improvident's due diligence investigation uncovered no significant problems and, besides, Davis had been a good customer of the bank for many years. As part of the consideration for the loan, Improvident takes a security interest in BADLUC's accounts, inventory, and other personal and real property.

BADLUC's business booms for a few years. Then suddenly the bottom falls out of the underwear market. An influx of cheap apparel from abroad sharply reduces the demand for BADLUC's high quality (but high priced) wares. Soon, BADLUC is unable to make regular loan payments. Improvident and BADLUC attempt various work out plans, but to no avail. BADLUC ultimately files a Chapter 7 bankruptcy petition. Immediately afterwards, Improvident moves to foreclose and take possession of BADLUC's property in an effort to satisfy the balance of the loan. Upon taking title to the property, however, Improvident discovers several partially buried drums in the lot behind the main plant. State and federal investigators are called to the scene. They quickly determine that the drums and surrounding soil contain high levels of unknown but obviously noxious chemicals. The EPA orders clean-up crews to remove the drums and toxic soil and to install monitoring wells. Months later, Improvident gets a curt letter from the EPA: "Pursuant to . . . you owe us $5 million plus . . . ." Will

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Improvident be responsible for the payment of an amount one hundred times larger than its initial loan?

The answer, of course, depends upon the circumstances. This note will explore those circumstances in the context of a specific source of lender liability found in the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA or the "Act").[1] The analysis begins with a general description of CERCLA and, in particular, the uncertain contours of the security interest exemption under which many lenders endeavor to find refuge. Next, the judicial gloss which several court cases have placed on the exemption will be explored in an attempt to clarify its key elements. This note will then examine the EPA's recently promulgated regulation designed to further refine the law, and the corresponding judicial response to this effort. Finally, recommendations will be made for legislative action with regard to this CERCLA exemption.

I. CERCLA AND THE STATUTORY EXEMPTION FOR LENDERS

CERCLA is a comprehensive federal statutory regime designed to enhance the government's authority in promptly responding to and seeking reimbursement for the costs of cleaning up a release[2] of one or more hazardous substances[3] into the environment. Four broad classes of persons[4] are potentially responsible under the Act for such costs, in an action either by the government or by private parties seeking contribution.[5] Section 107(a) of CERCLA imposes liability on: (1) current owners or operators; (2) prior owners or operators; (3) generators; and (4) transporters.[6] The liability which attaches to these persons is widely re-

[1] Pub. L. No. 96-510, 94 Stat. 2767 (1980)(codified as amended at 42 U.S.C. §§ 9601-75 (1988 & Supp. IV 1992)).

[2] The statute defines "release" broadly as virtually any kind of leak or emission of hazardous substances into the environment, subject to a few exceptions. *See* 42 U.S.C. § 9601(22).

[3] The list of "hazardous substances" is exceedingly lengthy. *See* 42 U.S.C. § 9601(14); Designation of Hazardous Substances, 40 C.F.R. § 302.4 (1992).

[4] "The term 'person' means an individual, firm, corporation, association, partnership, consortium, joint venture, commercial entity, United States Government, State, municipality, commission, political subdivision of a State, or any interstate body." 42 U.S.C. § 9601(21).

[5] New York v. Shore Realty Corp., 759 F.2d 1032, 1041-42 (2d Cir. 1985) (action by state against private parties).

[6] 42 U.S.C. § 9607(a). Those liable under the statute include specifically:

garded as strict[7] and, where the harm is not divisible, joint and several.[8] Moreover, CERCLA provides a 9607(a) defendant with few defenses with which to combat this potentially staggering liability.[9]

The term "owner or operator" is defined in the statute in several different ways, depending upon the kind of property which is

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> (1) the owner and operator of a vessel or a facility, (2) any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of, (3) any person who by contract, agreement, or otherwise arranged for disposal or treatment, or arranged with a transporter for transport for disposal or treatment, of hazardous substances owned or possessed by such person, by any other party or entity, at any facility or incineration vessel owned or operated by another party or entity and containing such hazardous substances, and (4) any person who accepts or accepted any hazardous substances for transport to disposal or treatment facilities, incineration vessels or sites selected by such person, from which there is a release, or a threatened release which causes the incurrence of response costs, of a hazardous substance . . . .

Id.

[7] Rather than expressly providing for a strict liability standard, Congress instead chose to reference the standard under § 311 of the Clean Water Act in 33 U.S.C. § 1321. 42 U.S.C. § 9601(32). Nevertheless, most courts believe Congress intended to impose strict liability. *See, e.g.*, Tanglewood East Homeowners v. Charles-Thomas, Inc., 849 F.2d 1568, 1572 (holding current owners strictly liable); *Shore Realty*, 759 F.2d at 1042 (holding corporate owner and its shareholder and officer strictly liable). One commentator argues that courts often impose liability inconsistently and in ways contrary to CERCLA's statutory design; he suggests that courts more closely examine the purposes and policies underlying the statute when deciding questions of liability. Michael P. Healy, *Direct Liability for Hazardous Substance Cleanups Under CERCLA: A Comprehensive Approach*, 42 CASE W. RES. L. REV. 65 (1992).

[8] *See, e.g.*, United States v. Monsanto, 858 F.2d 160, 171 (4th Cir. 1988) (mandating joint and several liability where the parties fail to establish a reasonable basis for apportioning liability), *cert. denied*, 490 U.S. 1106 (1989); United States v. Chem-Dyne Corp., 572 F. Supp. 802, 810 (S.D. Ohio 1983) ("[W]here two or more persons cause a single and indivisible harm, each is subject to liability for the entire harm.") (citations omitted).

[9] Liability under § 107(a) is "subject only to the defenses set forth in subsection (b) of this section [107(b)]." 42 U.S.C. § 9607(a). Section 107(b) enumerates only three narrow defenses to CERCLA liability. Where the acts or omissions that led to the hazardous substance release and accompanying damage are caused solely by "(1) an act of God, (2) an act of war," or (3) an unrelated third party, or some combination thereof, the defendant has a defense from liability. 42 U.S.C § 9607(b). There appear to be no cases in which a defendant has attempted to assert an "act of war" defense to liability, and the "act of God" defense has rarely succeeded. *See, e.g.*, Wagner Seed Co. v. Daggett, 800 F.2d 310, 316-17 (2d Cir. 1986) (holding defendant not responsible for a spill caused by lighting striking a chemical warehouse). For a statutory definition of "act of God," see 42 U.S.C. § 9601(1). The statute does not define "act of war." In reality, the third party defense of 107(b)(3) is the only statutory defense typically available to 107(a) defendants. *See* Elizabeth A. Glass, *Superfund and SARA: Are There Any Defenses Left?*, 12 HARV. ENVTL. L. REV. 385 (1988) (discussing nonstatutory defenses to CERCLA).

the subject matter of the CERCLA claim.[10] Significant here, the statute also carves out a broad exemption for lenders and other secured creditors by providing that "a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility," is not an "owner or operator" of contaminated property subject to liability.[11] In other words, so long as a lender does not "participate in the management" of its borrower, it will not be liable for costs and other damages incurred in cleaning up and disposing of the borrower's contaminated property, where the lender holds "indicia of ownership" in order "primarily to protect its security interest" in such property.

II. CASE LAW CONSTRUCTION OF THE SECURITY INTEREST EXEMPTION

The statute does not provide any guidance about the meaning of the security interest exemption's key phrases: "indicia of ownership," "participating in management," and "primarily to protect a security interest."[12] The legislative history of this provision is "sparse."[13] As a result, the job of interpreting the exemption ap-

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[10] An "owner or operator" is defined as

> (i) in the case of a vessel, any person owning, operating, or chartering by demise, such vessel, (ii) in the case of an onshore facility or an offshore facility, any person owning or operating such facility, and (iii) in the case of any facility, title or control of which was conveyed due to bankruptcy, foreclosure, tax delinquency, abandonment, or similar means to a unit of State or local government, any person who owned, operated or otherwise controlled activities at such facility immediately beforehand.

42 U.S.C. § 9601(20)(A).

[11] *Id.* The Act defines a "facility" broadly as

> (A) any building, structure, installation, equipment, pipe or pipeline . . ., well, pit, pond, lagoon, impoundment, ditch, landfill, storage container, motor vehicle, rolling stock, or aircraft, or (B) any site or area where a hazardous substance has been deposited, stored, disposed of, or placed, or otherwise come to be located; but does not include any consumer product in consumer use or any vessel.

CERCLA § 101(9), 42 U.S.C. § 9601(9). A "vessel" is "every description of watercraft or other artificial contrivance used or capable of being used, as a means of transportation on water." CERCLA § 101(28), 42 U.S.C. § 9601(28).

[12] *Id.*

[13] *See, e.g.*, United States v. Maryland Bank & Trust Co., 632 F. Supp. 573, 578 (D. Md. 1986) ("[S]ection 107(a) . . . is not a model of statutory clarity."); Lender Liability Under CERCLA, 57 Fed. Reg. 18,344, 18,345 (1992) (to be codified at 40 C.F.R. §§ 300.1100-.1105) ("The scant legislative history of the security interest exemption does not shed much light on this issue [of actual participation in management]."). An examina-

pears to rest with the courts. Several cases subsequent to CERCLA's enactment have attempted in various ways to define each of these elements more precisely.[14] A discussion of this case history will help to clarify the scope of the lender liability exemption and to expose some of the exemption's major shortcomings which ultimately led the EPA to promulgate its Lender Liability Rule.[15]

A. *In re T.P. Long Chemical, Inc.*

The first case to construe the security interest exemption was a bankruptcy decision called *In re T.P. Long Chemical, Inc.*[16] In a Chapter 7 proceeding, the EPA applied for a section 506(c)[17] reimbursement by the bankruptcy estate of T.P. Long Chemical, Inc., a company which ran a rubber recycling plant, to recover the costs it incurred in the cleanup and removal of hazardous substances from the company's rubber recycling plant.[18] The judge found the bankruptcy estate to be an "owner or operator" and therefore liable under CERCLA.[19]

One issue concerned whether the EPA was entitled to reimbursement out of the proceeds paid to a secured creditor, BancOhio, from a sale of its collateral because the estate's unen-

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tion of this "sparse" history reveals that the exemption was drafted in order to address the problem that would exist in those states which adhered to the common law title theory (as opposed to the lien theory) whereby the granting of a mortgage conveys actual title to the mortgagee. *See* H.R. REP. NO. 172, 96th Cong., 1st Sess., pt. 1, at 36 (1979), *reprinted in* 2 SENATE COMM. ON ENV'T AND PUB. WORKS, 97TH CONG., 2D SESS., A LEGISLATIVE HISTORY OF THE COMPREHENSIVE ENVIRONMENTAL RESPONSE, COMPENSATION AND LIABILITY ACT OF 1980 546 (Comm. Print 1983). A lender in those states could incur CERCLA liability for doing nothing more than accepting a mortgage. H.R. REP. NO. 172. The effect of the exemption, therefore, was to immunize a class of lenders from liability to the same extent as their counterparts in lien theory states.

[14] *See* United States v. Fleet Factors Corp., 901 F.2d 1550, 1555-56 (11th Cir. 1990), *reh'g denied*, 911 F.2d 742 (en banc), *cert. denied*, 498 U.S. 1046 (1991); Guidice v. BFG Electroplating & Mfg. Co., Inc., 732 F. Supp. 556 (W.D. Pa. 1989); United States v. Nicolet, Inc., 712 F. Supp. 1193 (E.D. Pa. 1989); *Maryland Bank*, 632 F. Supp. 573; United States v. Mirabile, 15 Envtl. L. Rep. (Envtl. L. Inst.) 20,994 (E.D. Pa. 1985); *In re* T.P. Long Chem., Inc., 45 B.R. 278 (N.D. Ohio 1985); *see also infra* notes 16-75 and accompanying text.

[15] Lender Liability Under CERCLA, 40 C.F.R. § 300.1100 (1992); *see also infra* notes 82-111 and accompanying text.

[16] 45 B.R. 278 (N.D. Ohio 1985).

[17] Section 506(c) of the Bankruptcy Code, 11 U.S.C. § 503(b)(1)(A), allows as an administrative expense the actual costs of preserving an estate. *Id.* at 282. EPA argued that its remediation costs should be reimbursed as administrative expenses. *Id.* at 282.

[18] *T.P. Long Chem.*, 45 B.R. at 279-81.

[19] *Id.* at 284.

cumbered assets were insufficient to cover the cleanup costs.[20] In support of its position, the EPA argued that BancOhio, which held a security interest in the company's personal property, would become liable as an owner or operator if it had attempted to repossess and sell that portion of its collateral which was the cause of the hazardous substance pollution.[21] The judge rejected the EPA's argument, citing the security interest exemption as authority.[22] The court held that even if BancOhio had repossessed the collateral under the terms of the security agreement, CERCLA liability would not be triggered because BancOhio would not have held indicia of ownership for a purpose other than primarily to protect its security interest.[23] Since BancOhio also had not participated in the management of the plant, it was held not liable as an owner or operator.[24]

In the bankruptcy judge's view, merely holding a security interest in contaminated property does not give rise to CERCLA liability as an owner or operator. A secured party which repossesses and takes title to its collateral does so primarily to protect its security interest and, based upon the language of the statute, should not thereby lose the exemption's protection. Some other conduct is clearly required in order for a secured party to fall outside the exemption.

B. *United States v. Mirabile*

United States v. Mirabile[25] was the first case in which an Article III court was called upon to construe the security interest exemption. In *Mirabile* the federal government had initiated an action to recover its costs in removing hazardous waste from real property owned by Anna and Thomas Mirabile on which a paint manufacturing business operated by Turco Coatings, Inc. ("Turco") was located.[26] Several third party defendants moved for summary judgment, among them, American Bank and Trust Company ("American") and Mellon Bank (East) National Association ("Mellon") which had provided financing to Turco. The

[20] *Id.*
[21] *Id.* at 288.
[22] *See supra* note 14.
[23] *Id.* at 288-89.
[24] *Id.*
[25] 15 Envtl. L. Rep. (Envtl. L. Inst.) 20,994 (E.D. Pa. 1985).
[26] *Id.* at 20,994-20,995.

Mirabiles alleged that American and Mellon became liable as owners or operators, in addition to Turco, because of their active involvement with the debtor. In response, American and Mellon did not dispute the Mirabiles' factual contentions, but they argued that as a matter of law the financial control they exercised over Turco was not enough to void the application of the security interest exemption to their case.

American's potential liability stemmed from its 1981 foreclosure and high bid at the sheriff's sale of the property. Four months after the sale, American assigned its bid to the Mirabiles who accepted the sheriff's deed.[27] Prior to assigning the bid, however, American had inquired into the cost of removing drums stored on the property, secured some buildings against vandalism, and showed the property to prospective purchasers.[28] It argued that foreclosure only transferred equitable and not legal title to it; therefore, it was not an "owner" under the meaning of the statute.[29] Furthermore, the minimal level of management activity and the foreclosure were actions consistent with protecting its security interest, and so it should fall within the exemption.[30] The court agreed and sustained American's summary judgment motion.[31] "[B]efore a secured creditor such as [American] may be held liable, it must, at a minimum, participate in the day-to-day operational aspects of the site."[32]

The court contrasted American's permissible activities against those undertaken by the other secured creditor, Mellon. Two of Mellon's loan officers served on an advisory board established by Turco to manage the facility on a day-to-day basis while in bankruptcy.[33] Although the evidence was conflicting (and therefore precluded summary judgment in Mellon's favor), one loan officer was alleged to have visited the plant on a frequent, perhaps daily, basis and made significant manufacturing and plant personnel decisions.[34] The court reasoned that such activity, if proven, would require a finding of liability. In contrast, mere

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[27] *Id.* at 20,996.

[28] *Id.*

[29] *Id.*; *see also supra* note 6 and accompanying text.

[30] *Mirabile*, 15 Envtl. L. Rep. at 20,996.

[31] *Id.* at 20,997.

[32] *Id.* at 20,996.

[33] *Id.* at 20,997.

[34] *Id.*

"participation in purely financial aspects of operation" would not result in a loss of the exemption.[35]

The *Mirabile* Court thus concluded that the security interest exemption would not automatically be lost by a foreclosure on contaminated property. Foreclosure to protect a security interest is a permissible activity under the security interest exemption. Moreover, it distinguished creditors who participated in the actual, day-to-day operations of a facility from those involved with its financial management. The capability to influence financial decisions of a company, which could indirectly affect its waste disposal practices, is not enough to void the security interest exemption under *Mirabile*.

C. *United States v. Maryland Bank & Trust Co.*

Another prominent case, *United States v. Maryland Bank & Trust Co.*,[36] takes a different view with regard to a creditor's ability to foreclose on property while still receiving the protection of the security interest exemption. As security for a loan, Maryland Bank took a mortgage on farm property which subsequently became the location for a garbage business.[37] When the debtors defaulted on the loan, the bank proceeded to foreclose and purchase the property at the resulting sale.[38] The next year the EPA initiated a removal action at the site and later sued the bank as record owner of the property for over $550,000 in cleanup costs.[39]

The court rejected Maryland Bank's claim that it should be afforded the protection of the security interest exemption.[40] The court held that the bank lost the exemption and became liable under CERCLA when it foreclosed and took title to the contaminated property of a defaulting borrower.[41] In essence, when the bank took title pursuant to the foreclosure sale it simply become a section 107(a)(1)[42] current owner and no longer held a security interest; the exemption was effective only during the life of the

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[35] *Id.* at 20,996.

[36] 632 F. Supp. 573 (D. Md. 1986).

[37] *Id.* at 575.

[38] *Id.*

[39] *Id.*

[40] *Id.* at 579.

[41] *Id.*

[42] CERCLA § 107(a)(1), 42 U.S.C. § 9607(a)(1) (1988); *see also supra* note 6 and accompanying text.

mortgage.[43] The court also voiced a policy concern that the bank would otherwise receive an unjust windfall from the government's cleanup efforts if it were allowed to sell the property without having to share the costs of remediation.[44]

The *Maryland Bank* court dismissed as dicta the holding of *Long Chemical* and rejected the rule of *Mirabile*.[45] Nevertheless, one can distinguish Maryland Bank's foreclosure conduct from that in *Mirabile* and reconcile the two district court cases. In *Mirabile*, American never took legal title to the property; it only assigned its superior bid to the Mirabiles who themselves took title. In *Maryland Bank*, however, the bank actually took title to the property, became the legal owner, and continued as such until the time the EPA commenced the action. By taking title, the *Maryland Bank* Court reasoned, a bank's security interest terminates and with it goes the protection of the exemption.

> The [security interest] exemption . . . covers only those persons who, at the time of the clean-up, hold indicia of ownership to protect a *then-held* security interest in the land. The verb tense of the exclusionary language is critical. The security interest must exist at the time of the clean-up. The mortgage held by MB&T (the security interest) terminated at the foreclosure sale of May 15, 1982, at which time it ripened into full title.[46]

The *Maryland Bank* court never considered the degree of bank involvement in the management of the facility's operations. Under its holding, it did not need to do so. Although the court acknowledged that the bank had held the property for an extended period of time—nearly four years—before reselling it (whereas American held the bid for its property only four months), the court did not indicate whether it would have reached a different result had the property been resold immediately or promptly after the foreclosure sale.[47] Read broadly, *Maryland*

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[43] *Maryland Bank*, 632 F. Supp. at 579.

[44] *Id.* at 580 ("In essence, the defendant's position would convert CERCLA into an insurance scheme for financial institutions, protecting them against possible losses due to the security of loans with polluted properties.").

[45] *Id.*

[46] *Id.* at 579 (emphasis added) (quoting 55 AM. JUR. 2D *Mortgages* § 785 (1975)).

[47]

> Because MB & T has held the property for such an extended period of time, this Court need not consider the issue of whether a secured party which purchased the property at a foreclosure sale and then promptly resold it would be precluded from asserting the [security interest] exemption. The United

Bank leaves open the question of whether a bank could ever protect its security interest through foreclosure without risking substantial CERCLA liability.

D. United States v. Nicolet, Inc.

In *United States v. Nicolet, Inc.*,[48] another action from the Eastern District Court of Pennsylvania,[49] the government sought recovery of at least $2.5 million in abatement costs associated with a "16 acre 'mountain' " of asbestos material located next to a manufacturing facility in Ambler, Pennsylvania.[50] Nicolet, Inc. purchased the site in 1962 from a British company, Turner and Newall ("T & N"), which had acquired the facility during the 1930s through stock purchases of the original company, Keasbey.[51] The primary issue here was to what extent must a mortgagee participate in the management of a facility to be liable as an owner or operator under CERCLA.

The EPA claimed that T & N was liable under CERCLA as an "owner or operator" because, among other things, it held a mortgage while it was a substantial participant in the management of the facility during the period of improper asbestos disposal.[52] In denying T & N's motion to dismiss (which it treated as a summary judgment motion), the court held that under Pennsylvania law the mortgage could be considered "indicia of ownership," hence T & N's CERCLA liability depended solely upon the level of its participation in managing the facility.[53] The court further held that the government had stated a claim against T & N and adopted a standard of management participation consistent with that articulated in *Mirabile*: "[E]xisting case law suggests that a mortgagee can be held liable under CERCLA only if the mortgagee participated in the managerial and operational aspects of the

> States District Court for the Eastern District of Pennsylvania recently held that a former mortgagee that purchased the property at foreclosure sale and assigned it four months later was exempt from liability. *United States v. Mirabile*.

Id. at 579 n.5.

[48] 712 F. Supp. 1193 (E.D. Pa. 1989).

[49] *Mirabile* also originated from this court. *See supra* notes 25-35 and accompanying text.

[50] *Nicolet*, 712 F. Supp. at 1196.

[51] *Id.*

[52] *Id.*

[53] *Id.* at 1204.

facility in question."[54] In sum, under both *Mirabile* and *Nicolet*, actual involvement with facility operations, as opposed to merely influencing financial decisions, is required to lose the security interest exemption.

E. *Guidice v. BFG Electroplating & Manufacturing Co., Inc.*

Like *Maryland Bank*, *Guidice v. BFG Electroplating and Manufacturing Company, Inc.*[55] says a mortgagee is liable as an owner or operator because of its foreclosure and subsequent purchase of contaminated collateral. Berlin Metal Polishers ("Berlin") had established a line of credit and installment loans with The National Bank of the Commonwealth ("National Bank").[56] Upon Berlin's default on its loan obligations, National Bank officials assisted Berlin in obtaining a government loan and provided other financial advice.[57] The court held these activities insufficient to void the security interest exemption because they did not involve operational or waste disposal aspects of Berlin's business.[58]

The situation changed, however, when National Bank took title. Following its purchase of the property, National Bank incurred liability as an owner of the property.[59] The court identified the division in the case law, as represented by *Mirabile* and *Maryland Bank*, regarding the question of whether the lender's purchase of contaminated collateral at a foreclosure sale automatically voids the security interest exemption. For two reasons the court decided to adopt the strict *Maryland Bank* approach, which holds that when a mortgagee becomes an owner it loses its security interest (and its exemption) notwithstanding the duration of its ownership.[60] First, the "policies underlying CERCLA" do not permit banks to reap the benefits of the cleanup at government expense.[61] Second, the fact that when Congress adopted the SARA

[54] *Id.* at 1205.

[55] 732 F. Supp. 556 (W.D. Pa. 1989).

[56] *Id.* at 558.

[57] *Id.* at 562.

[58] *Id.*

[59] *Id.* at 563.

[60] *Id.*

[61] The *Maryland Bank* court stated that the Congressional intent of the exemption, based upon an early House report, was to protect lenders in those states governed by the common law of mortgages (under which mortgagees are considered to hold legal as well as equitable title to the collateral) and not all mortgagees who subsequently acquire title by,

amendments[62] to CERCLA it failed to amend the statute to specifically exclude from the definition of "owner or operator" those lenders who acquire through foreclosure and that evinced an intent to hold such lenders liable.[63]

Guidice joins *Maryland Bank* in adopting the strict foreclosure rule. This position stands in sharp contrast to that taken by *Mirabile* and *Long Chemical*, which requires some other significant conduct, i.e., actual participation in the management of a facility, in addition to foreclosure before CERCLA liability will be imposed on the holder of a security interest. While divided along that line, the courts in 1989 at least appeared to be in agreement about the other contentious element, what level of "participation in management" the bank or lender could not exceed before losing the exemption. Such agreement would not be long enjoyed.

F. *United States v. Fleet Factors Corp.*

Given the development of prior case law, many were surprised at the outcome of *United States v. Fleet Factors Corp.*,[64] in which the Eleventh Circuit Court of Appeals essentially rejected the actual management participation approach adopted by *Mirabile* and *Nicolet* (and also *Long Chemical*) in favor of a much broader test of "participation in management," which significantly curtails the scope of protection afforded by the security interest exemption. The defendant in the case, Fleet Factors Corporation ("Fleet"), had entered into a standard "factoring" arrangement under which, in exchange for providing financing to a Georgia cloth printing facility called Swainsboro Print Works (SPW), it took an assignment of SPW's accounts receivable and a security interest in SPW's facility, inventory, equipment, and fixtures.[65] Three years later, SPW filed for bankruptcy protection

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for example, foreclosure. United States v. Maryland Bank & Trust Co., 632 F. Supp. 573, 579 (D. Md. 1986); *see also supra* note 13.

[62] Superfund Amendments and Reauthorization Act of 1986, Pub. L. No. 99-499, 101 Stat. 1613 (1986)(codified at 42 U.S.C. §§ 9601-75 (1988)).

[63] *Maryland Bank*, 632 F. Supp. at 579; *see also* Roslyn Tom, *Interpreting the Meaning of Lender Management Participation Under Section 101(20)(A) of CERCLA*, 98 YALE L.J. 925, 926 (1989).

[64] 901 F.2d 1550 (11th Cir. 1990), *reh'g denied*, 911 F.2d 742 (en banc), *cert. denied*, 498 U.S. 1046 (1991).

[65] *Id.* at 1552.

under Chapter 11, which proceeding was converted to a Chapter 7 two years later.[66]

While SPW was liquidating its assets, Fleet continued to collect accounts receivable under the factoring agreement.[67] About five years after its arrangement with SPW had begun, Fleet foreclosed on the inventory and equipment and arranged with Baldwin Industrial Liquidators ("Baldwin") to auction off the remaining property. Baldwin sold part of the property and directed Nix Roger ("Nix") to remove the remainder using, in Nix's words, "whatever means necessary."[68] Fleet never took title to the real property, and the county government eventually became record owner following a tax foreclosure sale. One month after Nix abandoned the facility, the EPA discovered and subsequently initiated a cleanup of seven hundred drums of toxic chemicals and forty-four truckloads of asbestos-laden material.[69] The EPA then sued Fleet, among others, as a former owner or operator of the facility[70] to recover nearly $400,000 in remediation costs.

The case before the court of appeals was postured as an interlocutory appeal of the order denying Fleet's motion for summary judgment. As such, the court observed that it was bound to view the evidence in a light most favorable to the government and, further, that Fleet had the burden of proving it qualified for the security interest exemption.[71] In analyzing Fleet's potential operator liability, the court examined Fleet's activities during three separate time periods: (1) Phase I, beginning in 1976 when the parties entered into the factoring agreement until the conversion of SPW's bankruptcy into a Chapter 7 in February, 1981; (2) Phase II, an approximately one-year period covering SPW's cessation of operations, Fleet's foreclosure on the inventory and equipment, and Fleet's contracting with Baldwin to sell the remaining property; and (3) Phase III, from May 1982, the time of the Baldwin contract, to the present (including the time of the EPA cleanup).[72]

In explaining its construction of the exemption's management participation element, the court specifically rejected the *Mirabile/*

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[66] *Id.*

[67] *Id.*

[68] *Id.* at 1552-53.

[69] *Id.* at 1553.

[70] *See* CERCLA § 107(a)(2), 42 U.S.C. § 9607(a)(2) (1988).

[71] FED. R. CIV. P. 56(c); *Fleet Factors*, 901 F.2d at 1553.

[72] *Fleet Factors*, 901 F.2d at 1555-57, 1560.

Nicolet distinction, which the district court below had relied upon in finding Fleet potentially liable only for its activities during Phase III, between permissible involvement in financial decision making and impermissible involvement in day-to-day operations.[73] The appellate court concluded that because of CERCLA's "overwhelmingly remedial" purpose and the "plain language of the exemption," a narrower reading of the security interest exemption was required.[74] The court thereafter articulated a new test, which many now regard as dicta,[75] for the level of participation in management of a facility in the security interest exemption:

> Under the standard we adopt today, a secured creditor may incur section 9607(a)(2) liability, without being an [actual] operator, by *participating in the financial management of a facility to a degree indicating a capacity to influence* the corporation's treatment of hazardous wastes. It is not necessary for the secured creditor actually to involve itself in the day-to-day operations of the facility in order to be liable—although such conduct will certainly lead to the loss of the protection of the statutory exemption. Nor is it necessary for the secured creditor to participate in management decisions relating to hazardous waste. Rather, *a secured creditor will be liable if its involvement with the management of the facility is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose.* We, therefore, specifically reject the formulation of the secured creditor exemption suggested by the district court in *Mirabile*.[76]

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[73] *Id.* at 1556.

[74] *Id.* at 1557.

[75] *See, e.g.*, Lender Liability Under CERCLA, 57 Fed. Reg. 18,344, 18,345 (1992) (to be codified at 40 C.F.R. § 300.1100) ("This uncertainty [in the law] was heightened by *dicta* in the [Fleet Factors] opinion."); David R. Berz & Peter M. Gillon, *Lender Liability Under CERCLA: In Search of a New Deep Pocket*, 108 BANKING L.J. 4, 5-6 (1991) (noting *Fleet* was "roundly condemned by the financial community"); Michael L. Greenberg & David M. Shaw, Note, *To Lend or Not to Lend, That Should Not be the Question: The Uncertainties of Lender Liability Under CERCLA*, 41 DUKE L.J. 1211, 1232 (1992) ("[T]he Eleventh Circuit's interpretation of the exemption has received substantial criticism."); Bruce P. Howard & Melissa K. Gerard, *Lender Liability Under CERCLA: Sorting Out the Mixed Signals*, 64 S. CAL. L. REV. 1187, 1199 (1991) (arguing that the "court did not need to fashion an overbroad liability standard to hold the lender liable"); Sean P. Madden, Comment, *Will the CERCLA be Unbroken? Repairing the Damage After Fleet Factors*, 59 FORDHAM L. REV. 135, 148-49 (1990) ("The reaction to *Fleet Factors* was swift and overwhelmingly negative." (footnote omitted)).

[76] *Fleet Factors*, 901 F.2d at 1557-58 (footnotes and citations omitted and emphasis added).

Applying this new test to the facts as alleged by the government, the court held that Fleet failed to meet its burden of proof and that material issues of fact existed as to whether it could be held liable as an operator of the facility during Phase II and Phase III. It affirmed the district court's denial of Fleet's summary judgment motion and remanded the case for trial.[77] If Fleet's involvement with SPW during Phase I were limited to advancing funds, paying utilities, and advising SPW of its credit limits, then it would fall within the exemption.[78] However, Phase II and III saw Fleet's alleged involvement with SPW "substantially increase":

> Fleet required SPW to seek its approval before shipping its goods to customers, established the price for excess inventory, dictated when and to whom the finished goods should be shipped, determined when employees should be laid off, supervised the activity of the office administrator at the site, received and processed SPW's employment and tax forms, controlled access to the facility, and contracted with Baldwin to dispose of the fixtures and equipment at SPW. These facts, *if proved*, are sufficient to remove Fleet from the protection of the secured creditor exemption.[79]

The court also rejected Fleet's contention that, although it participated in the management of SPW during Phase III, it should not be liable because it did so primarily to protect its security interest. The relevant inquiry, according to the *Fleet Factors* Court, "is the nature and extent of the creditor's involvement with the facility, not its motive."[80]

Much has been written about the *Fleet Factors* decision and the considerable concern it has caused financial institutions.[81] The result of *Fleet Factors* seems to be that a secured creditor in a

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[77] *Id.* at 1560.

[78] *Id.* at 1559.

[79] *Id.* (emphasis added).

[80] *Id.* at 1560.

[81] *See, e.g.*, Brian W. Smith, *Cleanup Law Hazardous to Banks With Deep Pockets*, AM. BANKER, July 18, 1990, at 4. *But see* Stephen Kleege, *Lenders Doubt Report That Belittles Cleanup Liability*, AM. BANKER, Apr. 2, 1991, at 6 (noting that liability exposure has been exaggerated); Brent Nicholson & Todd Zuiderhoek, *The Lender Liability Dilemma: Fleet Factors History and Aftermath*, 38 S. DAKOTA L. REV. 22, 39-43 (1993) (observing that few of the nation's largest banks, including Fleet Norstar the parent corporation of Fleet Factors Corporation, appear to have made any substantive changes in their lending policies since the *Fleet Factors* decision).

position to potentially affect waste disposal decisions, even if it does not actually participate in managing a facility, would have difficulty qualifying for the security interest exemption. By failing to elaborate on exactly what involvement was "sufficiently broad" enough to trigger the "capacity to influence" standard of operator liability, the Eleventh Circuit Court of Appeals left many lenders justifiably confused about the kinds of assistance, if any, they could safely provide troubled borrowers.

III. THE EPA'S ATTEMPT AT CLARIFICATION: THE LENDER LIABILITY RULE

The uncertainty engendered by *Fleet Factors* led the EPA to promulgate its own regulation interpreting the security interest exemption (the "Lender Liability Rule" or "Final Rule").[82] A proposed EPA rule[83] was published June 24, 1991, and after a public comment period the Final Rule[84] was promulgated on April 29, 1992, to be effective immediately.[85]

A. *Purpose of the Rule*

The Lender Liability Rule attempts to resolve the uncertainty about the security interest exemption in a light most favorable to financial institutions. Its avowed purpose is to more clearly define the three statutory elements of the security interest exemption so as to "permit a person covered by the exemption to undertake a broad range of activity in the course of protecting a security interest in a facility that is subject to CERCLA, without being consid-

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[82] Lender Liability Under CERCLA, 40 C.F.R. § 300.1100 (1992). There appear to have been at least three prior drafts of the rule. Two were "leaked" to the public and not published in the Federal Register. One came out in September, 1990. *EPA Draft Proposal Defining Lender Liability Issues Under the Secured Creditor Exemption of CERCLA*, 21 Env't Rep. (BNA) No. 24, at 1162 (Oct. 12, 1990). The other draft was released in January, 1991. *Proposed Draft Rule on Lender Liability Under CERCLA With Accompanying Letter From EPA to OMB*, 21 Env't Rep. (BNA) No. 43, at 1908 (Feb. 22, 1991). The third draft was published in the Federal Register as a notice of proposed rule and request for comment. Lender Liability Under CERCLA, 56 Fed. Reg. 28,798 (1991) (proposed June 24, 1991). The last draft was published as the Final Rule. Lender Liability Under CERCLA, 57 Fed. Reg. 18,344 (1992) (to be codified at 40 C.F.R. § 300.1100); *see infra* notes 83-111 and accompanying text.

[83] Lender Liability Under CERCLA, 56 Fed. Reg. 28,798 (1991) (proposed June 24, 1991).

[84] Lender Liability Under CERCLA, 57 Fed. Reg. 18,344 (1992) (to be codified at 40 C.F.R. § 300.1100).

[85] 57 Fed. Reg. 18,344, 18,374 (1992); 5 U.S.C. § 553(d)(1) (1988).

ered to be participating in the management of the facility."[86] The EPA also sought to balance the holder's need to protect its security interest with the EPA's mandate to clean up sites and recover its costs from liable parties.[87] The overall thrust appears to favor a more liberal application of the exemption.[88] The summary to the Final Rule, however, warns that the exemption should not be construed as a loan guarantee or as insurance for lenders' poor loan decisions.[89] It serves as a shield against liability for hazardous waste cleanup only and not against the risks of and damages associated with a reduction in the market value of property due to unforeseen contamination.[90]

B. *"Indicia of Ownership"*

Under the Lender Liability Rule, evidence of an interest in real or personal property, for purposes of the exemption, includes nearly all types of collateral normally held by financial institutions: mortgages, deeds of trust, legal or equitable title pursuant to foreclosure and their equivalents, title held pursuant to lease financing transactions, liens, surety bonds, guaranties of obligations, assignments, pledges, and other rights or forms of encumbrance against property.[91] In order to protect loan guarantors and sureties, the Final Rule additionally provides that a financial institution is not required to hold title or a security interest in order to maintain indicia of ownership.[92] Unsecured creditors, who hold no indicia of ownership, remain unprotected by the exemption.[93]

The most significant change here is that the acquisition of full title to property through foreclosure would clearly qualify for the security interest exemption.[94] This change appears to be the EPA's answer to the question posed by *Maryland Bank*.[95] As long

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[86] 57 Fed. Reg. 18,344, 18,346 (1992).

[87] *Id.* at 18,347.

[88] The textual evolution from the proposed version to the Final Rule reflect EPA's intent to broaden the range of permissible activities and thus expand the class of lenders entitled to the exemption. *Compare* 56 Fed. Reg. 28,798; 28,808-10 (1991) *with* 57 Fed. Reg. 18,344, 18,382-85 (1992).

[89] 57 Fed. Reg. at 18,346; *see also* United States v. Maryland Bank & Trust Co., 632 F. Supp. 573, 580 (D. Md. 1986).

[90] 57 Fed. Reg. 18,344, 18,346 (1992).

[91] 40 C.F.R. § 300.1100(a) (1992).

[92] *Id.*

[93] 57 Fed. Reg. 18,344, 18,352 (1992).

[94] *See* 40 C.F.R. § 300.1100(d).

[95] *See supra* note 47 and accompanying text.

as foreclosure occurs primarily to protect a security interest, a financial institution will not expose itself to CERCLA liability as an owner or operator.

C. *"Primarily to Protect a Security Interest"*

Indicia of ownership must be "held *primarily* for the purpose of securing payment or performance of an obligation."[96] Indicia held primarily for an investment or some other purpose will void the exemption. A holder may certainly have other reasons for holding indicia, including sound investment reasons, but the primary one must be for the protection of its security interest.[97]

In *Maryland Bank*, for example, the court implied that the bank may have lost its exemption because, in addition to holding "title" to the property rather than a mere "security interest," it held title for four years—too long a period following foreclosure.[98] Since the bank failed to sell or even attempt to sell the property promptly and apply the proceeds of such sale to the outstanding loan balance, one could presume that it held the indicia of ownership primarily as an investment and not primarily to safeguard its security interest. This practice continues to be impermissible under the Lender Liability Rule. Finally, the Rule recognizes that security interests may arise from other financial transactions, provided their primary purpose is to secure a loan or other obligation, including "sale and leasebacks, conditional sales, installment sales, trust receipt transactions, certain assignments, factoring agreements, accounts receivable financing arrangements, and consignments."[99]

D. *"Participation in Management"*

In direct response to the broad definition set forth in *Fleet Factors*,[100] the Lender Liability Rule defines management participation more narrowly as "actual participation in the management or operational affairs of the vessel or facility by the holder, and does not include the mere capacity to influence, or ability to influ-

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[96] 40 C.F.R. § 300.1100(b)(emphasis added).

[97] *Id.*

[98] *See supra* note 47 and accompanying text.

[99] 40 C.F.R. § 300.1100(b)(1).

[100] *See supra* notes 73-76 and accompanying text.

ence, or the unexercised right to control facility operations."[101] During the period that the borrower is in possession of the property, a holder may be considered a participant in management when it: (1) "exercises decisionmaking control over the borrower's environmental compliance, such that the holder has undertaken responsibility for the borrowers hazardous substance handling or disposal practices;" or (2) exercises management control over the borrower's enterprise to the extent that it controls the day-to-day decisionmaking over either (a) environmental compliance or (b) substantially all of the enterprise's operational aspects other than environmental compliance.[102]

The Lender Liability Rule lists several activities which are specifically deemed *not* to constitute participating in management.[103] First, all pretransaction activities such as requiring or conducting environmental inspections/audits, requiring a borrower to clean up property, or requiring assurances of compliance with environmental laws and regulations as conditions for a loan, will not be construed as participating in management.[104] Second, many ordinary loan work out activities,[105] consistent with preserving a security interest, are also expressly permissible:

> Work out activities include, but are not limited to restructuring or renegotiating the terms of a security interest; requiring payment of additional rent or interest; exercising forbearance; requiring or exercising rights pursuant to an assignment of accounts or other amounts owing to an obligor; requiring or exercising rights pursuant to an escrow agreement pertaining to amounts owing to an obligor; providing specific or general financial or other advice, suggestions, counseling, or guidance; and exercising any right or remedy the holder is entitled to by law or under any warranties, covenants, conditions, representations or promises from the borrower.[106]

Third, the Final Rule allows considerable flexibility regarding permissible foreclosure and liquidation activities. Legal or equitable title held pursuant to "foreclosure and its equivalents" will not invalidate the exemption, as long as such title is taken or held in

[101] 40 C.F.R. § 300.1100(c)(1).
[102] *Id.*
[103] 40 C.F.R. § 300.1100(c)(2).
[104] 40 C.F.R. § 300.1100(c)(2)(i).
[105] 40 C.F.R. § 300.1100(c)(2)(ii).
[106] 40 C.F.R. § 300.1100(c)(2)(ii)(B).

order to protect primarily a security interest in the property.[107] These are all permitted:

> "[F]oreclosure and its equivalents" include purchase at a foreclosure sale; acquisition or assignment of title in lieu of foreclosure; termination of a lease or other repossession; acquisition of a right to title or possession; an agreement in satisfaction of the obligation; or any other formal or informal manner . . . by which the holder acquires title to or possession of the secured property.[108]

While holding title pursuant to foreclosure, the holder may sell, re-lease, liquidate, continue operations, wind up affairs, and do whatever is commercially reasonable to preserve the value of holder's security interest without losing the exemption.[109]

As a guide to secured creditors, the Lender Liability Rule enumerates three specific examples of post-foreclosure conduct which will likely be viewed as evidence that title is taken for a reason other than primarily to preserve a security interest: (1) failure within twelve months of foreclosure to list the property with an appropriate broker or agent for sale and to advertise at least monthly; and (2) outbidding, rejecting, or failing to act within ninety days on a firm, written offer of fair consideration (the amount of outstanding debt plus other liens and costs) made six months following foreclosure.[110] Additionally, a holder continues to remain liable for improper disposal, treatment, or transportation of hazardous waste following foreclosure.[111] Provided it avoids the latter three caveats, a lender may presumably hold title to foreclosed property indefinitely without being subject to CERCLA liability as an owner or operator under the Lender Liability Rule.

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[107] 40 C.F.R. § 300.1100(d).

[108] 40 C.F.R. § 300.1100(d)(1).

[109] *Id.*

[110] 40 C.F.R. §§ 300.1100(d)(2)(i), (ii).

[111] *See supra* note 6 and accompanying text.

IV. THE AFTERMATH OF THE EPA'S LENDER LIABILITY RULE

A. Subsequent Case Law Treatment of the Security Interest Exemption

Although the Lender Liability Rule was not expected to have retroactive effect,[112] soon after its promulgation several courts relied on it as authority in deciding existing cases involving the construction of the security interest exemption. Already five published opinions have given it some weight in deciding whether a defendant should be afforded the protection of the exemption.[113] Other cases have cited the Final Rule and either ignored it or stated that it does not apply to events occurring prior to its promulgation.[114]

The Lender Liability Rule does indeed clarify the meaning of the exemption, but in doing so it essentially overrules *Fleet Factors* and *Maryland Bank*, two leading cases in this area. Despite the Final Rule's rather abrupt break with the case law, no court thus far has criticized the substance of the rule as contrary to the language or purpose of the statute. Initially it appeared that courts would be willing to defer to the EPA's interpretation of the exemption in spite of contrary case law.[115]

B. Kelley v. EPA: The Death of the Lender Liability Rule

The EPA issued the Lender Liability Rule as an amendment to the National Oil and Hazardous Substances Pollution Contingency Plan[116] (the "Plan") and based its authority to issue the

[112] 57 Fed. Reg. 18,344, 18,374 (1992).

[113] *See* Northeast Doran, Inc. v. Key Bank of Maine, No. CIV. 92-0247-B, 1993 WL 313629 (D. Me. June 4, 1993), *aff'd*, No. 93-1699, 1994 WL 13835 (1st Cir. Jan. 28, 1994); U.S. v. Fleet Factors Corp., 821 F. Supp. 707 (S.D. Ga. 1993); U.S. v. Fleet Factors Corp., 819 F. Supp. 1079 (S.D. Ga. 1993); Kelley v. Tiscornia, 810 F. Supp. 901 (W.D. Mich. 1993); Ashland Oil, Inc. v. Sonford Products Corp., 810 F. Supp. 1057 (D. Minn. 1993).

[114] *See, e.g.*, Northeast Doran, Inc. v. Key Bank of Maine, No. 93-1184, 1994 WL 13835, at *2 n.1 (1st Cir. Jan. 28, 1994); U.S. v. McLamb, 5 F.3d 69, 73 (4th Cir. 1993).

[115] One commentator concluded that under the standard set forth in Chevron U.S.A. v. Natural Resources Defense Council, 467 U.S. 837 (1984), courts should give the rule deference. Peter N. Lavelette, *The Security Interest Exemption Under CERCLA: Timely Relief from the EPA*, 24 TOLEDO L. REV. 473, 499-504 (1993). Since Congress did not speak directly to the issue, courts should accord deference to the EPA's reasonable interpretation of the security interest exemption as stated in its Rule. *Id.* at 504.

[116] *See* 40 C.F.R. pt. 300 (1992). The President (and EPA by delegation) is authorized by CERCLA to develop a comprehensive national plan for identifying, evaluating and

rule on, among others, sections 105,[117] 106,[118] and 115[119] of CERCLA.[120] Section 113(a) of CERCLA provides a ninety-day right of judicial review in the D.C. Circuit Court of Appeals of any regulation promulgated under CERCLA.[121] Two parties filed suit challenging the EPA's authority to issue this rule.[122] These actions were consolidated, and on February 4, 1994, a three-judge panel issued a two-to-one decision, *Kelley v. EPA*, declaring the rule to be invalid.[123]

As a preliminary matter, the *Kelley* court noted that the EPA had attempted to get Congressional approval for its interpretation of the exemption prior to instituting its rulemaking proceeding.[124] Having failed to convince Congress of the need to amend the statute, the EPA subsequently decided to issue the Lender Liability Rule.[125]

Following a discussion of EPA's responsibilities under the CERCLA and the history of the security interest exemption, the court in *Kelley* identified and rejected the three bases upon which the EPA claimed authority to issue binding regulations clarifying the scope of the exemption. First, the court held that notwith-

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removing hazardous substances from contaminated facilities. *See* CERCLA § 105(a), 42 U.S.C. § 9605(a) (1988).

[117] The statute provides that "the President [or EPA by delegation] may, from time to time, revise and republish the . . . plan." *See* 42 U.S.C. § 9605(a). This plan is also referred to as the "National Contingency Plan" or hereinafter as simply the "Plan."

[118] Congress gave the President (and EPA by delegation) authority to take immediate action to prevent the release or threatened release of a hazardous substance which could result in "an imminent and substantial endangerment to the public health or welfare or the environment." 42 U.S.C. § 9606(a). Such actions are called "abatement actions."

[119] Congress authorized the President to delegate his responsibilities under CERCLA to other federal agencies. *See* 42 U.S.C. § 9615. The President by executive order has delegated many of these responsibilities to EPA. *See* Exec. Order No. 12,580, 52 Fed. Reg. 2,923 (Jan. 23, 1987), *reprinted as amended by* Exec. Order No. 12,777, 56 Fed. Reg. 54,757 (Oct. 18, 1991), *in* 42 U.S.C.A. § 9615 (West Supp. 1993). One such responsibility is amending and revising the Plan. Exec. Order No. 12,580 at § 1(b)(1). Read in light of the President's delegation to EPA and other federal agencies, all CERCLA provisions which grant the President authority also give authority to designated agencies.

[120] 57 Fed. Reg. 18,344, 18,346 (1992).

[121] *See* 42 U.S.C. § 9613(a).

[122] *See* Kelley v. EPA, No. 92-1312 (D.C. Cir. filed July 28, 1992); Chemical Mfrs. Ass'n v. EPA, No. 92-1314 (D.C. Cir. filed July 28, 1992).

[123] 15 F.3d 1100 (D.C. Cir. 1994) [hereinafter *Kelley*]. Mikva, Silberman, and Henderson were the judges who served on the panel. Judge Silberman wrote the majority opinion, and Chief Judge Mikva filed a separate dissenting opinion.

[124] *See* H.R. 4494, 101st Cong., 2d Sess., 136 CONG. REC. 1505 (1990).

[125] *See Kelley*, 15 F.3d at 1104.

standing the broad grant of authority given by section 105,[126] which gives the EPA responsibility to develop and revise the National Contingency Plan, and section 115,[127] which grants the President delegation powers, Congress did not evince an intent to confer on the EPA any authority to issue regulations regarding liability under section 107(a).[128] In the court's view, the EPA was attempting to use the authority it had to issue regulations under section 105 to promulgate regulations which were actually related to section 107. The court also held inapplicable other specific authorizing provisions within section 105.[129] Second, the court rejected the EPA's reliance on provisions granting it enforcement powers,[130] stating that these powers essentially made the EPA an environmental prosecutor. In keeping with this analogy, the court explained that it is the judge, rather than the prosecutor, which ultimately must decide questions of liability.[131] Third, the court was not persuaded by the EPA's "strongest argument:" its reliance on subsection 106(b)(2)[132] which seems to require the EPA to resolve liability issues in reimbursement actions. In those cases, the court noted, the EPA is merely acting in the capacity of a party defendant. If a defendant in a CERCLA action appealed the EPA's initial decision denying reimbursement, the district court would not be required to give deference to or even consider the EPA's view of liability.[133] Furthermore, although the EPA may be required to make an initial determination of liability under 106(b), that section does not empower the EPA to select

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[126] Section 105(a) mandates that "[w]ithin one hundred and eighty days after December 11, 1980, the President [i.e. EPA] shall, after notice and opportunity for public comments, revise and republish the national contingency plan . . . , *to reflect and effectuate the responsibilities and powers created by this chapter*." CERCLA § 105(a), 42 U.S.C. § 9605(a) (1988) (emphasis added).

[127] *See supra* note 119.

[128] *Kelley*, 15 F.3d at 1105.

[129] *Id.* at 1106.

[130] *See, e.g.*, 42 U.S.C. § 9607(a)(4)(A)(authorizing the government to recover remediation costs from liable parties); 42 U.S.C. § 9606(a) (giving EPA authority to issue orders).

[131] *Kelley*, 15 F.3d at 1106.

[132] 42 U.S.C. § 9606(b). This subsection gives parties the right to petition EPA for a reimbursement of their costs incurred in cleaning up a hazardous waste site. *Id.* In order to succeed, the petitioner must establish by a preponderance of the evidence that it is not liable for its response costs and that its costs were reasonable, or that the EPA acted unlawfully in ordering it to clean up the site. *Id.* EPA must make the initial decision to reimburse, and this decision can be appealed to a district court within 30 days. *Id.*

[133] *Kelley*, 15 F.3d at 1107.

the criteria it uses to make those decisions; such criteria are more appropriately developed by the judiciary or by Congress.[134]

The EPA argued in the alternative that if the court found its Lender Liability Rule not to be a binding "legislative" regulation, it should give deference to it as an "interpretative" regulation,[135] a nonbinding interpretation of an ambiguous statute by an agency charged with that statute's enforcement. Recognizing that the distinction between legislative and interpretative rules is rather opaque, the court nevertheless stated that the rule as drawn:

> [B]ears little resemblance to what we have traditionally found to be interpretative regulation. The EPA does not really define specific statutory terms, but rather takes off from those terms and devises a comprehensive regulatory regimen to address the liability problems facing secured creditors. This extensive quasi-legislative effort to implement the statute does not strike us as merely a construction of statutory phrases.[136]

Moreover, without statutory authority, even an interpretative regulation is not entitled to deference by the court.[137] The court, therefore, granted the petition for review and vacated the regulation, effectively invalidating the Lender Liability Rule.[138]

CONCLUSION

It is important to acknowledge that while *Kelley* attacks the EPA's authority to promulgate the Lender Liability Rule, it does not speak to the substance of the EPA's interpretation of the exemption. The court did not say that the EPA's interpretation was contrary to the statute or to the purposes underlying CERCLA. To date, no court has done so. However, *Kelley* does leave the Lender Liability Rule without binding effect and invites subsequent courts to ignore it. Thus, the uncertainty engendered by *Fleet Factors* and *Maryland Bank*, which the rule sought to address, has once again been resurrected.

Congress could address the uncertainty in this area of lender liability law in one of two ways. It could simply amend the statute and empower the EPA to make regulations interpreting the secur-

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134 *Id.*
135 *See supra* note 115.
136 *Kelley*, 15 F.3d at 1108.
137 *Id.*
138 *Id.* at 1109.

ity interest exemption.[139] Such express authority would address the principal problem with the Lender Liability Rule raised in *Kelley v. EPA*.[140] Unfortunately, it would also mean that the EPA probably would have to initiate a new notice and comment proceeding and issue a new rule. This procedure would likely take several more years and, thus, do little in the short term to resolve the lingering issues identified above.

Alternatively, Congress itself could explain the meaning and scope of the exemption. First, it could indicate in the statute whether foreclosure upon contaminated property should automatically result in liability or whether other conditions are necessary. Second, it could clarify what it means by "participation in the management" of a facility, whether it means day-to-day operational involvement or merely the "capacity to influence" under *Fleet Factors*. Finally, Congress could address several gaps in the statute which the rule leaves open: the extent of fiduciary liability,[141] liability of unsecured creditors,[142] and lender liability under other law.[143]

Action by Congress could go a long way toward settling the questions raised by the security interest exemption, the EPA's Lender Liability Rule, and the related case law developments. In the absence of further Congressional direction, lenders like Improvident in the introductory hypothetical would be wise to avoid possible liability through the use of well-known pretransaction risk avoidance techniques, such as due diligence investigations, site inspections, environmental audits, and, lastly, denial of credit. Should a lender nonetheless find itself in Improvident's position, it might try to conform its conduct to that prescribed in the Lender

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[139] Such an effort is currently underway. On February 7, 1994, Senators Baucus and Lautenberg introduced President Clinton's bill to amend and reauthorize CERCLA, "The Superfund Reform Act of 1994." *See* S. Res. 1834, 103rd Cong., 2d Sess., 140 CONG. REC. 1047-04 (1994). Among its numerous provisions, the bill proposes to give EPA express authority to promulgate regulations concerning the limitations on lender liability. *Id.* at 278.

[140] *See supra* notes 116-136 and accompanying text.

[141] 57 Fed. Reg. 18,344, 18,349 (1992).

[142] *Id.* at 18,344.

[143] For example, similar concerns have been raised about the issue of lender liability under the Resource Conservation and Recovery Act (RCRA). Pub. L. No. 94-580, 90 Stat. 2795 (codified at 42 U.S.C. §§ 6901-92 (1988)). *See also* 57 Fed. Reg. 18,344, 18,349 (1992).

Liability Rule, which finds some recent case law support.[144] However, the more prudent lender will strive to follow the mandate of *Fleet Factors* and its progeny and hope that Congress comes to the rescue soon!

[144] *See supra* note 115 and accompanying text. Their value has sharply declined because of *Kelley*.