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ARTICLES

EPA'S LENDER LIABILITY RULE: EXORCISING THE POLLUTED MORTGAGE

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The 1974 hit movie *The Exorcist* relates the chilling story of a Jesuit priest's successful performance of a rite of exorcism on a disturbed teenage girl.[1] Financial institutions[2] hope that a similar exorcism from hazardous waste cleanup cost claims will result from the United States Environmental Protection Agency's (EPA) recently promulgated Lender Liability Rule (EPA's Rule or EPA Rule).[3] When the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)[4] was passed in 1980, banks had no cause for alarm with the enactment of CERCLA because it provided an exemption from liability based on ownership for any lender holding "indicia of ownership primarily to protect his security interest" in a hazardous waste facility.[5] Based on the statutory language, it was reasonably clear that Congress did not intend to impose liability on secured creditors for merely securing a debt with a deed of trust or mortgage. Unfortunately, lender liability for hazardous waste cleanup costs arose in the mid-1980s out of three lower federal court decisions[6] and the Eleventh Circuit's controversial, to say the least, 1990 decision in *United States v. Fleet Factors Corp.*.[7]

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This article is a revision of an earlier article styled *Recent Developments in Lender Liability Under CERCLA: Coping With 'Animal House' Disorder* that appeared in the Fall, 1992 issue of the American Bar Association's Tort and Insurance Practice Section's Tort and Insurance Journal. 28 TORT & INS. L.J. 40 (1992). This article is dedicated to John S. Montedonico, former senior partner of Montedonico, Glankler, Brown & Gilliland, who is now retired and living in Memphis, Tennessee.

1. ROBERT B. RAY, A CERTAIN TENDENCY OF THE HOLLYWOOD CINEMA, 1930-1980 262 (1985).

2. Throughout this article, the terms "financial institution," "lender," "mortgagee," "secured creditor," "lending instution," and "bank" are used interchangeably.

3. 40 C.F.R. § 300.1100 (1992).

4. 42 U.S.C. §§ 9601-9675 (1988 & Supp. III 1991).

5. 42 U.S.C. § 9601(20)(A) (1988); *see generally* DONALD C. NANNEY, ENVIRONMENTAL RISKS IN REAL ESTATE TRANSACTIONS: A PRACTICAL GUIDE 213-59 (2d ed. 1993).

6. United States v. Mirabile, 15 Envtl. L. Rep. (Envtl. L. Inst.) 20,992 (E.D. Pa. Sept. 4, 1985); United States v. Maryland Bank & Trust Co., 632 F. Supp. 573 (D. Md. 1986); Guidice v. BFG Electroplating and Mfg. Co., Inc., 732 F. Supp. 556 (W.D. Pa. 1989).

7. 901 F.2d 1550 (11th Cir. 1990).

The purpose of this paper is to trace the development of lender liability for hazardous waste cleanup costs under CERCLA. The major issues faced by lenders under CERCLA are: (1) the extent to which a secured creditor may involve itself in the debtor's operations, especially during a loan workout program, without becoming a CERCLA "owner or operator" and liable for cleanup costs; and (2) whether a lender who forecloses on collateral and takes title is liable under CERCLA.[8]

As can be expected from this recent, politically sensitive, and complex legislation, courts have not articulated a bright-line test to measure a financial institution's conduct.[9] Courts have been forced to balance two competing policies: the national environmental policy of providing expeditious cleanup of toxic waste sites, especially from parties who have the economic means to fund cleanup, and of preventing the creation of future hazardous waste sites, and the equally compelling policy of affording protection to innocent parties and not placing undue burdens on banks, especially in troubled economic times.[10] Hopefully, the EPA Rule will provide mortgagees with appropriate guidance and protection.

The evolution of the EPA Rule is an excellent case history of how the legislature, judiciary, and administrative agencies make, in an uncoordinated fashion, national environmental policy. As one commentator noted, while environmental statutes articulate some of society's highest values, "their structure more closely resembles a shack on Tobacco Road than a Gothic Cathedral."[11]

Sections I and II will briefly outline CERCLA's statutory scheme and CERCLA's so-called "security interest" exemption, respectively. Section III will review three lower federal court decisions, *United States v. Mirabile*,[12] *United States v. Maryland Bank & Trust Co.*,[13] and *Guidice v. BFG Electroplating and Manufacturing Co., Inc.*,[14] respectively. Section IV will discuss the Eleventh Circuit's recent decision; its confusing case law aftermath will be explained in Section V. Section VI will consider the legislative and administrative proposals, including EPA's Rule, to remedy *Fleet Factors*. Section VII will discuss two recent federal court decisions that upheld EPA's Rule. Finally, a few suggestions on how mortgagees can cope with this problem will be offered in Section VIII.

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8. Jeffrey Willis, *The Substantive Law of Lender Liability*, 26 TORT AND INS. L.J. 742, 759-60 (1991).

9. *Id.* at 759-63.

10. Carolyn C. Cornell, *The Toxic Mortgage: CERCLA Seeps Into the Commercial Lending Industry*, 63 ST. JOHN'S L. REV. 839, 858 (1989).

11. ROBERT V. PERCIVAL, ENVIRONMENTAL REGULATIONS: LAW, SCIENCE, AND POLICY (1992).

12. 15 Envtl. L. Rep. (Envtl. L. Inst.) 20,992 (E.D. Pa. Sept. 4, 1985).

13. 632 F. Supp. 573 (D. Md. 1986).

14. 732 F. Supp. 556 (W.D. Pa. 1989).

I. CERCLA's Statutory Scheme

A. *The Hazardous Waste Problem*

The size of this nation's hazardous waste problem is staggering. American business produces considerable toxic waste as a byproduct of their industrial, manufacturing, and agricultural processes.[15] In 1986, the EPA estimated that American industries generate approximately 266 million metric tons of toxic waste each year.[16] In 1979, the EPA estimated that there were between 30,000 and 50,000 toxic waste sites in the United States.[17]

As of October, 1986, the EPA's Comprehensive Environmental Response, Compensation, and Liability Information System (CERCLIS), a computerized system used to keep track of toxic waste sites eligible for remedial action, listed about 23,000 sites.[18] As of February 1991, EPA has listed 1,198 sites on its National Priorities List (NPL); these sites are the ones that EPA has targeted for cleanup in the near future. Of the 1,198 NPL sites, 116 are federal facilities, usually operated by the United States Department of Energy or the United States Department of Defense.[19] In February of 1992, EPA proposed to add 30 new sites to the NPL; these sites ranged geographically from Upper Marion Township, Pennsylvania, to Yigo, Guam.[20]

As if the EPA's estimates are not bad enough, the United States General Accounting Office estimates that a more comprehensive inventory of toxic waste sites across the United States could possibly increase this estimate to about 425,380.[21] Moreover, EPA estimates that between $13.1 to $22.1 billion will be spent to cleanup the 1,200 to 2,000 most dangerous sites.[22]

B. *The Congressional Solution*

In the late 197O's, media reports on hazardous waste sites, such as New York's Love Canal and Kentucky's Valley of the Drums, focused public attention on the national hazardous

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15. Cornell, *supra* note 10, at 839.

16. Robert E. Taylor, *EPA Offers Aid to Firms to Cut Hazardous Waste*, WALL ST. J., Oct. 31, 1986, at 48.

17. H.R. REP. NO. 1016, 96th Cong., 2d Sess., pt. 1, at 17, *reprinted in* 1980 U.S.S.C.A.N. 6119, 6120-21.

18. Timothy B. Atkeson et al., *An Annotated Legislative History of the Superfund Amendments and Reauthorization Act of 1986 (SARA)*, 16 Envtl. L. Rep. (Envtl. L. Inst.) 10,363, 10,389, & n.146 (Dec. 1986).

19. 40 C.F.R. § 300, App. B (1992).

20. U.S. ENVIRONMENTAL PROTECTION AGENCY, DESCRIPTIONS OF 30 SITES PROPOSED TO THE NATIONAL PRIORITIES LIST IN FEBRUARY 1992 (1992).

21. *Hazardous Waste: GAO Finds 425,380 Potential Superfund Sites; Florio Hits EPA for Delays in Site Assessments*, 18 Env't Rep. (BNA) 2043 (Jan. 22, 1988).

22. Stacey A. Kipnis, *The Conflict Between CERCLA and FIRREA: Environmental Liability of the Resolution Trust Corporation*, 39 UCLA L. REV. 439, 440 (1991).

waste disposal problem. Responding to public pressure, CERCLA was quickly passed in the last days of the 96th Congress in December of 1980.[23] Given its speedy passage, CERCLA's legislative history is sparse, forcing the judiciary to fill in the statutory gaps. Courts have generally construed CERCLA in a liberal fashion, consistent with the general principle that courts should liberally construe statutes enacted for the preservation and protection of public health.[24]

CERCLA requires the cleanup of inactive and abandoned hazardous waste sites, regardless of the legitimacy or illegality of the dumping.[25] CERCLA's goal is to fix liability on parties who are responsible for improper waste disposal practices.[26] As will be noted below, federal courts have generally applied CERCLA in a broad and liberal fashion in an effort to advance the statute's pollution abatement goals. In general, CERCLA authorizes the EPA to identify abandoned hazardous waste sites across the United States, rank those sites by degree of hazard on the NPL, and take enforcement action whenever there is a release or threatened release of a hazardous substance into the environment. Pursuant to CERCLA section 111, EPA's cleanup program was initially financed through the $2.6 billion Hazardous Response Trust Fund (Superfund).[27]

CERCLA provides EPA with two potent enforcement tools. First, pursuant to CERCLA section 106, EPA may file a suit for injunctive relief or issue an administrative order mandating potentially responsible parties (PRPs) to clean up the toxic waste site.[28] Second, EPA, pursuant to section 107 of CERCLA, may use Superfund monies, perform the cleanup, and seek reimbursement for pollution abatement costs from PRPs. A section 107 action is essentially a restitution suit, whereby EPA can recover all removable and remedial costs, plus interest.[29]

CERCLA designates four categories of PRPs that may be liable under CERCLA. They are: (1) present owners or operators of hazardous waste facilities; (2) past owners or operators of hazardous waste facilities who disposed of hazardous substances during their ownership or operation; (3) parties, known as "generators," who produce toxic waste and arrange for its transportation to hazardous waste facilities owned or operated by other parties; and (4) transporters who carry hazardous waste to facilities.[30] A current owner, even through innocent,

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23. Patricia L. Quentel, *The Liability of Financial Institutions for Hazardous Waste Cleanup Costs Under CERCLA*, 1988 WIS. L. REV. 139, 145 (1988).

24. Scott Wilsdon, *When a Security Becomes a Liability: Claims Against Lenders in Hazardous Waste Cleanup*, 38 HASTINGS L.J. 1261, 1292 (1987).

25. *Id.* at 1261; *see also* Laura E. Peck, *Viable Protection Mechanisms For Lenders Against Hazardous Waste Liability*, 18 HOFSTRA L. REV. 89, 92 (1989).

26. Quentel, *supra* note 23, at 141-50.

27. 42 U.S.C. § 9611 (1988 & Supp. III 1991).

28. 42 U.S.C. § 9606 (1988).

29. 42 U.S.C. § 9607 (1988).

30. *Id.*

is liable even though the toxic waste disposal occurred during a prior ownership.[31] The liability imposed upon a past owner or operator insures that a polluting party may not escape liability by conveying the contaminated realty.[32]

Courts have held that CERCLA imposes strict liability without the necessity of showing negligence, fault, or causation.[33] Moreover, federal courts, following the seminal cases of *United States v. Chem-Dyne Corp.*,[34] *United States v. Conservation Chemical Co.*,[35] and *United States v. Ottati & Goss, Inc.*[36] have consistently ruled that joint and several liability, as well as strict[37] and retroactive liability,[38] may be imposed. This allows EPA to recover cleanup costs from one PRP, thereby relieving it of the onerous burden of suing all PRPs.[39]

Congress ameliorated the harshness of joint and several liability by including a right to contribution in the Superfund Amendments and Reauthorization Act (SARA). Contribution rights can be asserted in cross-claims or third-party claims by a defendant in an EPA enforcement action or in a separate contribution action.[40] CERCLA's joint and several liability/contribution features allows EPA to target "deep pocket" defendants in its enforcement actions without foreclosing their rights to seek contribution.[41]

In October 1986, CERCLA was amended by SARA mandating a five year hazardous waste abatement program with an additional $8.5 billion injected into the Superfund Program and requiring more stringent cleanup standards.[42] With SARA's tougher cleanup standards,

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31. New York v. Shore Realty Corp., 759 F.2d 1032, 1043-45 (2d Cir. 1985).

32. Cornell, *supra* note 10, at 849.

33. Quentel, *supra* note 23, at 151-55.

34. 572 F. Supp. 802 (S.D. Ohio 1983).

35. 619 F. Supp. 162, 191, 198-99 (W.D. Mo. 1985).

36. 630 F. Supp. 1361, 1395-96 (D. N.H. 1985).

37. Quentel, *supra* note 23, at 153-56. *See, e.g.*, New York v. Shore Realty Corp., 759 F.2d 1032, 1044 (2d Cir. 1985) (CERCLA imposes strict liability on facility's current owner without regard to causation).

38. United States v. Shell Oil Co., 605 F. Supp. 1064, 1072-73 (D. Colo. 1985); *see also* Roslyn Tom, *Interpreting the Meaning of Lender Management Participation Under Section 101(20)(A) of CERCLA*, 98 YALE L.J. 925 (1989).

39. Wilsdon, *supra* note 24, at 1270.

40. 42 U.S.C. § 9613 (1988).

41. Cornell, *supra* note 10, at 844 n.26.

42. Superfund Amendments and Reauthorization Act of 1986 (SARA), Pub. L. No. 99-499, 100 Stat. 1613 (1986).

Lee Thomas, EPA's former Administrator, projected that remedial responses for permanent site cleanup will increase from $8 million to approximately $30 million per site.[43]

In *United States v. American Cyanamid Co.*,[44] the court observed, in a closing passage that could act as a model *coda* for every CERCLA case, as follows:

> There is much about CERCLA that, at times, is fundamentally unfair to all parties. . . .
>
> For defendants involved in hazardous waste sites, CERCLA deals a harsh blow by imposing strict liability. No matter how careful one is about disposing hazardous waste, the liability remains. CERCLA liability is also joint and several. Therefore, the proportionate amount of waste one is responsible for is rendered immaterial. It is no wonder that defendants, faced with large clean-up costs, litigate matters even when the case against them is clear cut.
>
> However, with all the dollar figures in this section of the case, it is easy to lose sight of the underlying purpose of CERCLA and of this action. The attention of the United States has recently focused on the increased environmental degradation of our land. The EPA, using Superfund money, can immediately begin to clean-up a polluted site. . . . Not only does quick response save financial resources, but is saves further environmental trauma to land, water, animals, [and] people.
>
> In the future, Congress may act to change CERCLA and related environmental statutes. The policy decisions involved in rewriting such legislation will be important and far-reaching. Until that time, CERCLA remains the avenue of response to hazardous waste sites.[45]

In short, liability under CERCLA has the unfortunate feature of being easy to obtain and expensive to discard. As the former Assistant Attorney General Roger Marzulla stated: "With only slight exaggeration, one government lawyer has described a . . . [CERCLA] trial as requiring only that the Justice Department lawyer stand up and recite: 'may it please the Court, I represent the government and therefore I win.'"[46] Because of the high costs of hazardous waste cleanup, the judicial trend has been to extend liability to parties, such as mortgagees, whose connection to the site may be less than obvious.[47]

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43. Address by Lee M. Thomas, EPA Administrator, ALA-ABA Hazardous Waste, Superfund, and Toxic Substance Seminar (October 23, 1986).

44. 786 F. Supp. 152 (D. R.I. 1992)

45. *Id.* at 164-65 (citations omitted); *see also* Alex A. Beehler, Steve C. Gold, and Steven Novick, *Contesting of CERCLA Costs By Responsible Parties — There is No Contest*, 22 Envtl. L. Rep. News and Analysis (Envtl. L. Inst.) 10763, 10777 (December, 1992).

46. Roger J. Marzulla, *Superfund 1991, How Insurance Firms Can Help Clean Up the Nation's Hazardous Waste*, 4 Toxics L. Rep. (BNA) 685 (Nov. 8, 1989).

47. Wilsdon, *supra* note 24, at 1261.

C. *The Superfund Program to Date*

As a result of CERCLA's pro-recovery statutory scheme, the United States Department of Justice has compiled an excellent litigation record in hazardous waste enforcement actions on behalf of its agency client, EPA. However, the Superfund Program has not been without its critics and problems. At the beginning of the Reagan Administration, the Superfund Program was embroiled in the political controversy surrounding EPA Administrator Gorsuch. This was in addition to the normal and difficult legal, scientific, and administrative problems associated with the startup of any environmental enforcement program.

In addition to these problems, the Superfund Program has been criticized as being slow and costly. Out of a total of approximately 1200 sites on the NPL, only 63 sites have actually been cleaned up as of June of 1991.[48] The cleanup figure rose to 149 sites in September, 1992.[49] Furthermore, the Superfund process has always been slow; a 1991 study by the Congressional Budget Office indicated that the timeframe from discovery to cleanup was approximately 15 years.

The Superfund Program is also an extremely expensive program. The estimated costs of the 63 cleanups completed by July of 1991, and the intermediate work on many other sites, was at least $15 billion of federal and PRP funds. The estimated minimum cost for remediation for sites now on the NPL is $26 billion in todays dollars. Unfortunately, there is substantial evidence that EPA's figures are too low. According to the University of Tennessee's Hazardous Waste Remediation Project, the NPL list will probably grow to about 3,000 sites, and the total cost will probably be in the range of $150-700 billion, depending on the number of sites covered and the stringency of cleanup criteria.[50]

II. The Security Interest Exemption

As set forth above, because CERCLA's goal was to make those persons who contaminated the environment pay for its cleanup, the statute mandated liability against the owners and operators of hazardous waste facilities. However, Congress specifically excluded from liability an entity that held a security interest in a hazardous waste facility and did not participate in its management. The so-called "security interest" exemption is set forth at CERCLA section 101(20)(A) and exempts from the definition of "owner or operator" any "person, who, without participating in the management of a . . . facility holds indicia of ownership primarily to protect his secured interest in the . . . facility."[51] The statute and the accompanying legislative history provide little guidance as to what degree of lender participation in the management of the facility will result in lender liability. However, while courts have almost universally construed CERCLA's liability provisions liberally, courts have read the security interest exemption in an inconsistent fashion.

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48. ORIN KRAMER AND RICHARD BRIFFAULT, CLEANING UP HAZARDOUS WASTE: IS THERE A BETTER WAY? 23 (1993).

49. Daily Environment Report (BNA), A-9 (Oct. 29, 1992).

50. KRAMER AND BRIFFAULT, *supra* note 48, at 23-33.

51. 42 U.S.C. § 9601(20)(A) (1988).

As a result of varying judicial interpretations of CERCLA section 101(20)(A), confusion and uncertainty pervade lender liability standards under CERCLA.[52] The confusion over the intended meaning of section 101(20)(A) arises from three sources: (1) economic and political pressure both for and against applying the exemption; (2) legislative history that does not fully articulate Congress' intent; and (3) the ambiguity of the phrase "participation in management."[53]

The usual risk taken by a financial institution in making a loan is a credit risk; i.e., the borrower may not have the economic resources to repay the loan. If a bank takes collateral, such as a deed of trust to secure the loan, the credit risk includes a component of collateral risk in that upon the borrower's default, the encumbered property may not have sufficient value to provide for loan repayment. Thus, CERCLA liability can increase a lender's risk well beyond the dollar amount of its credit and collateral risks.[54] Furthermore, the lender liability "crises" stems not from the numbers of banks that have been held liable, but the banking community's fear of potential liability. Financial transactions depend upon predictability and certainty.[55] Because of this problem, the American Bankers Association reported that eighty-eight percent of the banks surveyed have altered their credit practices to avoid cleanup liability.[56] Since financial transactions depend upon predictability and certainty, a uniform CERCLA liability rule is desireable.

At the core of this debate lies the question of the desired role of a mortgagee at a hazardous waste facility. A "high" threshold of liability allows a lender to become more involved with a plant's environmental matters without fear of liability, although it might provide less incentive for a lender to monitor a borrower's environmental compliance program.[57] One commentator has argued that a "high" threshold will result in banks being more willing to engage in diligent monitoring and workouts of problem loans. This will result in a benefit to society in that lenders could help prevent future polluted sites through aggressive oversight.[58] A "low" threshold standard encourages greater environmental compliance efforts, but some have argued that a fear of liability may result in a bank's refusal to lend to high-risk borrowers or small businesses or to engage in workout programs.[59]

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52. Michael I. Greenberg and David M. Shaw, *To Lend or Not to Lend - That Should Not Be the Question: The Uncertainties of Lender Liability Under CERCLA*, 41 DUKE L.J. 1211 (1992).

53. *Id.* at 1216.

54. Michele Beigel Corash and Lawrence Behrendt, *Lender Liability Under CERCLA: Search for a Safe Harbor*, 43 SW. L.J. 863, 864 (1990).

55. Patricia A. Shackelford, *Easing the Credit Crunch: A "Functional" Approach to Lender Control Liability Under CERCLA*, 19 B.C. ENVTL. AFF. L. REV. 805, 846-50 (1992).

56. *Id.* at 846.

57. Randall J. Burke, *Much Ado About Lending: Continuing Vitality of the Fleet Factors Decision*, 80 GEO. L.J. 809, 822 (1992).

58. *Id.* at 825-26.

59. Greenberg and Shaw, *supra* note 52, at 1259-61.

In analyzing the lender liability cases, five themes derived from CERCLA's legislative history provide the cornerstone of the judiciary's analysis of CERCLA section 101(20)(A). First, CERCLA has the narrow function of identifying and cleaning up toxic waste sites. Second, the legislative history supports a policy that places liability on those parties who are responsible for the creation of contaminated sites. This is the "polluter must pay" theory. Third, CERCLA seeks to foster responsible environmental practices and higher standards of care in hazardous substance handling by providing a financial deterrent to unpredictable parties. Fourth, CERCLA's legislative history provides support for a general rule of statutory construction that resolves ambiguities in CERCLA's language in favor of compelling liability. The final theme is that CERCLA's interpretation may be guided by common law, as well as state and federal statutory law. Although this approach has been ignored by courts interpreting lender liability issues, it has been central to the analysis of CERCLA liability for other categories of PRPs. In developing lender liability law, the federal court has developed what can be characterized as a federal common law of CERCLA lender liability.[60]

III. The Lower Court Trilogy

A. United States v. Mirabile

The Eastern District of Pennsylvania in *Mirabile* was the first court to comprehensively consider the issue of lender liability for CERCLA costs. The United States sued to recover costs incurred in the removal of hazardous waste from property in Phoenixville, Pennsylvania.

During the 1970's, Arthur C. Mangels Industries, Inc. (Mangels) owned the subject real property and operated a paint manufacturing facility at the site. In February 1973, American Bank and Trust Company (ABT) loaned a sum of money to Mangels that was secured, in part, by a mortgage on the property. In 1976, Turco Coatings, Inc. (Turco) acquired the majority of the outstanding shares of Mangels and thereafter continued operations at the site. In January of 1980, Turco filed a petition in bankruptcy under Chapter 11 of the Bankruptcy Code. In December 1980, Turco ceased all operations at the facility; ABT's mortgage remained in effect throughout this period.

In 1981, the Bankruptcy Court dismissed Turco's Chapter 11 proceeding, enabling ABT to proceed with foreclosure on the property. At the sheriff's sale in August 1981, ABT was the highest bidder. Several months later, ABT assigned its bid to Ana and Thomas Mirabile (Mirabile), who accepted the sheriff's deed to the realty. During the period between the foreclosure sale and ABT's assignment of its bid to Mirabile, ABT took the following actions with respect to the property: (1) secured the building against vandalism; (2) made inquiries as to the approximate cost of disposal of hazardous waste drums located on the property; and (3) showed the property to various prospective purchasers.

In addition to financing by ABT, Turco entered into a financing agreement with Girard Bank, the predecessor in interest of Mellon Bank (East) National Association (Mellon Bank), in 1976. Under the agreement, Girard Bank would advance working capital to Turco; these advances were secured by inventory and assets of Turco. Thereafter, the Turco Advisory Board was established to supervise Turco's operations. A loan officer from Girard Bank was a member of the Advisory Board and monitored the financial condition of Turco. After Turco

60. Greenberg and Shaw, *supra* note 52, at 1219-22.

ceased operations in late 1980, Girard Bank took possession of Turco's inventory which was subsequently disposed of through private sales and a public auction.

In deciding summary judgment motions, the court was faced with whether the lenders were "owners" or "operators" within the meaning of the statute, thereby subjecting them to liability for pollution abatement costs.[61] With respect to ABT's summary judgment motion, Judge Newcomer found that ABT's activities at the property were limited in nature and did not constitute participation in the management of the site.[62] Judge Newcomer stated:

> Thus, it would appear that before a secured creditor such as ABT may be held liable, it must, at a minimum, participate in the day-to-day operational aspects of the site. In the instant case, ABT merely foreclosed on the property after all operations had ceased and thereafter took prudent and routine steps to secure the property against further depreciation.[63]

While there was some question as to whether under Pennsylvania law ABT had taken title at the foreclosure sale, Judge Newcomer's decision had the effect of allowing a foreclosing mortgagee to take title to the site and to claim the security interest exemption if its involvement with the site was limited. With respect to the Mellon Bank summary judgment motion, evidence indicated that Girard Bank's participation on the Turco Advisory Board related to general financial matters and the loan officer did not discuss production or waste disposal. If that had been the full extent of Girard Bank's participation in the site, the court indicated that it would have had little difficulty in granting Mellon Bank's requested relief. However, the evidence showed that as the financial condition of Turco worsened, the lending institution's participation at the site became more intense and involved day-to-day monitoring of the operations. The evidence presented a genuine issue of material fact, leaving the court with no alternative but to deny Mellon Bank's requested relief.[64]

Thus, *Mirabile* stands for the proposition that provided a bank does not become overly entangled in the affairs of the actual owner or operator of a hazardous waste site, the lender may not be held liable for cleanup costs, even if it forecloses and takes title. *Mirabile* thus articulated a "day-to-day" standard, equating "participating in the management of a facility" with being a CERCLA "operator."[65] Monitoring a borrower's financial condition is simply not enough to establish liability.[66]

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61. United States v. Mirabile, 15 Envtl. L. Rep. (Envtl. L. Inst.) 20,992, 20,994-96 (E.D. Pa. Sept. 4, 1985).

62. 15 Envtl. L. Rep. (Envtl. L. Inst.) at 20,996; *see* In re T.P. Long Chem., Inc., 45 B.R. 278 (Bankr. N.D. Ohio 1985) (lender held not liable because it did not participate in management of facility); *see also* Quentel, *supra* note 23, at 161-70.

63. 15 Envtl. L. Rep. (Envtl. L. Inst.) at 20,996.

64. *Id.* at 20,996-97.

65. George Anhang, *Cleaning Up the Lender Management Participation Standard Under CERCLA in the Aftermath of Fleet Factors*, 15 HARV. ENVTL. L. REV. 235, 239 (1991); *see also* Wilsdon, *supra* note 24, at 1275-80.

66. Peck, *supra* note 25, at 100-02.

B. United States v. Maryland Bank & Trust Co.

In *Maryland Bank & Trust Co.*, the District of Maryland was faced with the issue of whether a bank, which formerly held a mortgage on realty, later purchased the land at a foreclosure sale, and continued to own it, must reimburse EPA for the cost of decontaminating the property. In deciding this issue, the court recognized that the toxic wastes were dumped on the property prior to the bank's foreclosure purchase.

From 1944 until 1980, Hershell McLeod, Sr. and Nellie McLeod owned a 117 acre farm located near California, St. Mary's County, Maryland. On this property, Hershell McLeod, Sr. operated a trash and garbage business, permitting the dumping of hazardous waste on the property during 1972 or 1973.

In 1980, Mark Wayne McLeod applied for a $335,000 loan from Maryland Bank and Trust Company (MB&T) to purchase the site from his parents. He purchased the property in December of 1980 through the MB&T loan, but he soon failed to make the required payments on the mortgage. Consequently, MB&T instituted a foreclosure proceeding against the property in 1981, purchased the property at the foreclosure sale in May of 1982 with a bid of $381,500, and took title to the property.

As a result of the hazardous waste on the property, EPA in 1983 requested that MB&T decontaminate the property. When MB&T refused, EPA removed 276 drums of chemical waste and 1,180 tons of contaminated soil. Thereafter, EPA sued MB&T to recover the cleanup expenses of approximately $550,000.

In seeking dismissal of the action, MB&T sought refuge under the security interest exemption in CERCLA section 101(20)(A). However, District Judge Northrop held that the exemption does not apply when the mortgagee forecloses on the property and takes title.[67] He stated:

> The exemption of Subsection (20)(A) 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.[68]

The broad interpretation of the security interest exemption claimed by the bank, the court held, was contrary to the legislative policies underlying CERCLA.[69] District Judge Northrop stated:

> Under the scenario put forward by the bank, the federal government alone would shoulder the cost of cleaning up the site, while the former mortgagee-turned-owner would benefit from the clean-up by the increased value of the now unpolluted land.

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67. United States v. Maryland Bank & Trust Co., 632 F. Supp. 573, 574-79 (D. Md. 1986).

68. *Id.* at 579.

69. *Id.* at 580.

> At the foreclosure sale, the mortgagee could acquire the property cheaply. All other prospective purchasers would be faced with potential CERCLA liability, and would shy away from the sale. Yet once the property has been cleared at the taxpayers' expense and becomes marketable, the mortgagee-turned-owner would be in a position to sell the site at a profit.
>
> 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. Mortgagees, however, already have the means to protect themselves, by making prudent loans. Financial institutions are in a position to investigate and discover potential problems in their secured properties. For many lending institutions, such research is routine. CERCLA will not absolve them from responsibility for their mistakes of judgment.[70]

The bottom line of *Maryland Bank & Trust Co.* is that upon foreclosure and taking title, a lending institution may be liable under CERCLA. This result is consistent with traditional common law. A mortgagee who comes into possession of realty is personally liable for tort injuries resulting from its use of the real property or its failure to perform duties imposed by law upon landowners. Similarly, under the common law tort of nuisance, a nuisance action is recognized against the party
in possession of the property that contains hazardous conditions.[71] After the issuance of this decision, many banks substantially increased their pre-closing inquiries as to the waste disposal practices of their potential borrowers.

C. Guidice v. BFG Electroplating and Manufacturing Co., Inc.

In the 197O's, Berlin Metal Polishers (Berlin Metal) operated a metal polishing company on property in Punxsutawney, Pennsylvania (Berlin Property). Berlin Metal was managed and owned by the Rumco family.

In May 1981, the National Bank of the Commonwealth (Bank) approved a line of credit for Berlin Metal secured by assignment of accounts receivable. Thereafter, in September 1975, the Bank approved a loan to construct a new wastewater treatment facility. When the loan went into default, the Bank purchased the Berlin Property for $145,000 at the sheriff's sale and received the deed to the Berlin Property in May 1982. During the Bank's ownership, it paid insurance premiums and property taxes on the Berlin Property. In January 1983, the Bank conveyed the property to Russell D'Aiello, Trustee for the Rumco family.

The parties stipulated that the main issue was whether the Bank was liable as a former owner or operator of the Berlin Property where there was a release of toxic waste. There were two time frames in which the court had to consider whether the Bank was an owner or operator of the Berlin Property: the period prior to the foreclosure and purchase of the site and the period of the Bank's ownership after mortgage foreclosure.

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70. *Id.* (footnotes omitted).

71. City of Newark v. Sue Corp., 304 A.2d 567, 569 (Sup. Ct. App. Div. 1973); *see also* Wilsdon, *supra* note 24, at 1289-90.

As to the liability of the Bank prior to its foreclosure and purchase of the property, the court noted that existing case law, primarily *Mirabile*, suggested that prior to foreclosure, a mortgagee is exempt from CERCLA liability under the security interest exemption so long as the mortgagee does not participate in the managerial and operational aspects of the facility. Given the state of the law, the question then became whether the Bank was participating in the management or control of the facility. After Berlin Metal defaulted on the loan and prior to foreclosure, the Bank took steps to protect its interest in the property. More specifically, those steps included meeting with officials from Berlin Metal to ascertain the status of its financial condition and operations. Moreover, a Bank official visited the property and reported the results of his inspection to the Bank. Thereafter, a series of meetings took place between the lender and the Rumco family concerning the possible restructuring of the debt. The evidence suggested that the financial institution did not control operational, production, or waste disposal activities on the site. Accordingly, the court regarded the Bank's activities prior to foreclosure as insufficient to void CERCLA's security interest exemption.

As to the liability of the Bank after foreclosure, District Judge McCune noted the divergence of case law set forth in *Mirabile* and *Maryland Bank & Trust Co.*.[72] Under *Mirabile*, the court noted that the exemption from CERCLA liability applied so long as the financial institution limited its activities to the financial aspects of site management and did not become embroiled in the "nuts-and-bolts, day-to-day production aspects of the business."[73] Thus, foreclosure and repurchase were natural consequences in the protection of a security interest. On the other hand, *Maryland Bank & Trust Co.* held that when a mortgagee becomes an owner of the property, the security interest exemption is lost. The court adopted the *Maryland Bank & Trust Co.'s* approach and believed that to allow a financial institution a "free ride" and a potential windfall caused by the increased value of the decontaminated property would be contrary to CERCLA's goal.[74] The court stated: "When a lender is the successful purchaser at a foreclosure sale, the lender should be liable to the same extent as any other bidder at the sale would have been."[75]

In blending *Mirabile* and *Maryland Bank & Trust Co.*, it can be argued that *Guidice* provided mortgagees with a reasonably understandable standard to guide post-default activities, both before and after foreclosure. These three lower court decisions set the stage for bank's *Bad Day in Black Rock* in *Fleet Factors*.

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

In 1976, Swainsboro Print Works, Inc. (SPW), a cloth printing facility, entered into a factoring agreement with Fleet Factors Corporation (Fleet Factors) in which Fleet Factors agreed to advance funds against the assignment of SPW's accounts receivable. As collateral for these advances, Fleet Factors also obtained a security interest in SPW's textile facility and

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72. Guidice v. BFG Electroplating and Mfg. Co., Inc., 732 F. Supp. 556, 557-62 (W.D. Pa. 1989).

73. *Id.* at 563 (quoting United States v. Mirabile, 15 Envtl. L. Rep. (Envtl. L. Inst.) 20,992, 20,996 (E.D. Pa. Sept. 4, 1985).

74. *Id.*

75. *Id.*

all of its equipment, inventory, and fixtures. Three years later, SPW filed for bankruptcy protection under Chapter 11. In February 1981, SPW ceased operations and began to liquidate its inventory. In December 1981, SPW was adjudicated bankrupt under Chapter 7, and a trustee then assumed title and control of the facility. Fleet Factors foreclosed in May 1982 on its security interest in some of SPW's inventory and equipment, but never foreclosed on the realty.

In January 1984, the EPA inspected the facility and found 755 drums containing toxic chemicals and 44-truck loads of material containing asbestos. In responding to this environmental threat, EPA incurred expenses of nearly $400,000 at the SPW facility. In July 1987, the facility was conveyed to Emanuel County, Georgia, at a foreclosure sale resulting from SPW's failure to pay state and county taxes.

EPA thereafter sued the principal officers and stockholders of SPW and Fleet Factors to recover the expenses of abating the environmental threat at the facility. The Southern District of Georgia denied the summary judgment motions filed by EPA and Fleet Factors, resulting in an appeal to the Eleventh Circuit.

The lower court, as a matter of law, rejected EPA's claim that Fleet Factors was a present owner of the facility. The trial court, however, found a sufficient issue of fact as to whether Fleet Factors was an owner or operator of the facility at the time the waste was disposed of to warrant the denial of the lender's summary judgment motion.

As to whether Fleet Factors was a present owner, the Eleventh Circuit held that CERCLA should be construed so that the present owner and operator of a facility is that individual or entity owning or operating the facility at the time the plaintiff initiated the lawsuit. When this litigation was instituted in July 1987, the owner of the facility was Emanuel County, Georgia. Under CERCLA, however, a state or local government that has involuntarily acquired title to a facility is generally not held liable as the owner or operator of the facility.[76] The present owner or operator is considered to be any person who owned, operated, or otherwise controlled activities at such facility "immediately beforehand."[77] The evidence was undisputed that from December 1981, when SPW was adjudicated a bankrupt, until the July, 1987 tax foreclosure sale, the bankrupt estate and trustee were the owners of the facility. Moreover, the evidence was clear that neither Fleet Factors nor any of its agents had anything to do with the facility after December, 1983. In short, Fleet Factors was not a CERCLA present owner or operator.

After disposing of the present owner issue, Circuit Judge Kravitch then turned to the issue of whether Fleet Factors was a past owner or operator.[78] "The construction of the secured creditor exemption is an issue of first impression in the federal appellate courts."[79] EPA urged the Eleventh Circuit to adopt a narrow and strictly literal interpretation of the exemption that excludes from its protection any lender that participates in any manner in the management of a hazardous waste facility. This approach, the Eleventh Circuit held, would largely eviscerate the exemption Congress intended to afford to secured lenders.

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76. United States v. Fleet Factors Corp., 901 F.2d 1550, 1552-55 (11th Cir. 1990).

77. *Id.* at 1555.

78. *Id.* at 1555-56.

79. *Id.* at 1556.

Fleet Factors, in turn, suggested that the Court adopt the *Mirabile* distinction between permissible participation in the financial management of the site and impermissible participation in the day-to-day or operational management of a facility.[80] In rejecting the positions of EPA and Fleet Factors, the court stated:

> Under the standard we adopt today, a secured creditor may incur section 9607(A)(2) liability [past owner or operator liability], without being an 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*.[81]

In formulating this "capacity to influence" standard, liability would not be imposed where a secured creditor monitored aspects of a debtor's business.[82] "Likewise, a secured creditor can become involved in occasional and discrete financial decisions relating to the protection of its security interest without incurring liability."[83]

The Eleventh Circuit believed that its standards would have three positive results. First, it would encourage potential mortgagees to thoroughly investigate hazardous waste disposal practices of potential borrowers. Second, this standard will encourage lenders to monitor the hazardous waste policies and systems of their debtors and insist upon compliance of applicable environmental standards as a pre-condition to continued financial support. Third, once a lender's involvement with a hazardous waste facility becomes sufficiently broad that it can anticipate losing its exemption from CERCLA liability, it will have a strong inducement to institute proper waste disposal at the facility rather than ignoring the problem. In applying these new standards to the facts, the Eleventh Circuit agreed with the court below that the EPA had alleged sufficient facts to hold Fleet Factors liable as a past owner or operator. From 1976 until SPW ceased operations in February 1981, Fleet Factors involvement with the site was within the parameters of the secured creditor exemption.[84] The court stated:

> During this period, Fleet regularly advanced funds to SPW against the assignment of SPW's accounts receivable, paid and arranged for security deposits for SPW's

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80. *Id.* at 1555-56.

81. 901 F.2d at 1557-58 (footnotes omitted).

82. *Id.* at 1558.

83. *Id.*

84. *Id.* at 1558-59.

> Georgia utility services, and informed SPW that it would not advance any more money when it determined that its advanced sums exceeded the value of SPW's accounts receivable.[85]

EPA claims that once SPW ceased operations at the plant in February 1981 and began to wind down its affairs, Fleet Factor's involvement with the site dramatically increased. EPA claimed that Fleet Factors did the following: (1) required SPW to seek its approval before shipping goods to customers; (2) established the price for excess inventory; (3) dictated when and to whom the furnished goods should be shipped; (4) determined when employees would be terminated; (5) supervised the activity of the office administrator; (6) processed SPW's employment and tax forms; (7) controlled access to the site; and (8) contracted with Baldwin Industrial Liquidators to dispose of the equipment and fixtures at the site. The Eleventh Circuit held that these facts, if proved, would be sufficient to remove Fleet Factors from the protection of the secured creditor exemption.[86]

The court concluded by stating:

> The scope of the secured creditor exemption is not determined by whether the creditor's activity was taken to protect its security interest. What is relevant is the nature and extent of the creditor's involvement with the facility, not its motive. To hold otherwise would enable secured creditors to take indifferent and irresponsible actions toward their debtors' hazardous wastes with impunity by incanting that they were protecting their security interest. Congress did not intend CERCLA to sanction such abdication of responsibility.[87]

Because there remained disputed issues of material fact, the case was remanded for future proceedings consistent with the opinion.[88] On remand, the trial court in a February 19, 1993 bench ruling, held that the secured creditor exemption did not protect Fleet Factors from liability. District Judge Dudley H. Bowen, Jr. likened the secured creditor's liquidator to a "Viking raiding party."[89]

Arguing that the Eleventh Circuit's decision and Ninth Circuit's decision in *In re Bergsoe Metal Corp.*,[90] discussed below, created a conflict among the federal circuit courts, Fleet

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85. *Id.* at 1559.

86. 901 F.2d at 1559.

87. *Id.* at 1560.

88. *Id.*

89. United States v. Fleet Factors Corp., No. 687-070 (D.C. Ga. Feb. 19, 1993); *see also Superfund: Government Proposes Global Settlement of Environmental Claims with Debtor LTV*, 23 Envt'l. Rep. (BNA) 2834-35 (Feb. 26, 1993).

90. 910 F.2d 668 (9th Cir. 1990).

Factors sought United States Supreme Court review.[91] On January 14, 1991, the Court denied certiorari.[92] Since the Ninth Circuit and the Eleventh Circuit articulated two different standards of lender liability, the Court unfortunately passed up an opportunity to decide one of the most hotly debated environmental law issues in recent years.[93]

While it is true that the *Fleet Factors* requires some active management participation to trigger liability, the Eleventh Circuit never sets forth the threshold level triggering liability. Does a telephone call from a bank's lending officer to a debtor in default "suggesting" a particular course of action as to environmental issues constitute "active management participation?" It is submitted that the practical realities of the situation dictate that liability may be imposed under *Fleet Factors'* "low" threshold standard.

The Eleventh Circuit's decision was greeted with a unanimous chorus of criticism from the financial community. These critics contend that the Eleventh Circuit's "capacity to influence" test may be construed as imposing lender liability only upon a showing that the mortgagee, through its loan documents, has the right to control operations in a post-default scenario. The cold, hard fact of the matter is that most, if not all, loan documents grant the lender broad powers to "control" the collateral, especially after default. Thus, a literal reading of *Fleet Factors* suggests that a financial institution may acquire potential CERCLA liability simply by showing up at the loan closing. Moreover, the practical realities of the vast majority of lender-borrower relationships dictate that lenders have considerable "capacity to influence."[94] Under *Fleet Factors*, a bank could arguably incur liability by having been in a position to control the debtor's environmental compliance matter, whether or not the secured creditor actually exercised control.[95]

The Eleventh Circuit justified its decision by stating that its new standard of liability would encourage potential lenders to investigate thoroughly the waste disposal practices and policies of potential mortgagees, thus encouraging safer waste disposal practices and fostering improved lending procedure.[96] In rejecting this rationale, one noted commentator has stated:

> This optimistic analysis seem somewhat naive and does not adequately account for the unpredictable and often enormous cost of hazardous waste cleanup. It is unlikely that lenders can accurately gauge the risks or charge high enough interest rates to cover the costs of potential hazardous waste cleanups. The most likely consequences of the *Fleet Factors* decision will be to make it difficult or impossible for companies

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91. 5 Toxics L. Rptr. (BNA) 950 (Jan. 2, 1991).

92. Fleet Factors Corp. v. United States, 111 S. Ct. 752 (1991).

93. Anhang, *supra* note 65, at 235.

94. Petition for Certiorari of Fleet Factors Corp. at 8-9, Fleet Factors Corp. v. United States, 111 St. Ct. 752 (No. 90-504).

95. Greenberg and Shaw, *supra* note 52, at 1212.

96. United States v. Fleet Factors Corp., 901 F.2d 1550, 1558 (11th Cir. 1990); *see also* Cornell, *supra* note 10, at 857-58.

> with existing or potential waste problems to borrow money. Lenders will refuse to become insurers. The inability of companies to obtain funds to finance remedial activities may well increase the number of orphan sites left for the government to clean up. The *Fleet Factors* decision could very well have the opposite effect of what the court intended and adversely impact the effort to clean up hazardous waste sites.[97]

Moreover, companies that use large quantities of hazardous substances, such as manufacturers, and small businesses that cannot afford a comprehensive environmental audit, may face problems in acquiring loans.[98]

On the other hand, one commentator suggested that *Fleet Factors* is in accordance with CERCLA's congressional intent and language, promotes the broad liability scheme of CERCLA whereby liability is imposed upon PRPs, and is consistent with the evolving case law in other CERCLA contexts, such as corporate officer liability. In addition to these factors, the Eleventh Circuits' standard, the commentator asserts, encourages mortgagees to require environmental audits and to require compliance with environmental standards prior to loan closing, preventing the creation of future Superfund sites.[99]

V. Fleet Factors' Confusing Aftermath

A. In re Bergsoe Metal Corp.

In *Bergsoe*, the Ninth Circuit faced the issue of the extent of the secured creditor exemption. Circuit Judge Kozinski initially observed that CERCLA provides that the owner of a contaminated facility is liable for the cleanup costs.[100] "It is left for the Courts, however, to clean up the mess left behind by complicated financial transactions. We search for the CERCLA owner."[101]

Bergsoe Metal Corporation (Bergsoe) was formed in 1978 for the purpose of conducting a lead recycling operation. In 1978, Bergsoe contacted the Port of St. Helens (Port), an Oregon municipal corporation organized and empowered to issue revenue bonds to promote industrial growth, to discuss the building of a lead recycling facility. Thereafter, the Port agreed to issue industrial revenue bonds to provide funds for the acquisition of land and the construction of the plant. In December 1979, the Port sold Bergsoe fifty acres of land on which to construct the plant. To complete the financing package for the recycling operation, Bergsoe and the Port entered into a complex sale-and-lease-back arrangement whereby the Port was the title owner to the property.

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97. Daniel J. Dunn, *The Black Hole of Lender Liability: United States v. Fleet Factors Corp.*, 1 ENVT'L LIAB. IN COM. TRANSACTIONS 3, 5 (1990).

98. Greenberg and Shaw, *supra* note 52, at 1258-62.

99. Burke, *supra* note 97, at 817-22.

100. In re Bergsoe Metal Corp., 910 F.2d 668, 669 (9th Cir. 1990).

101. *Id.*

When Bergsoe defaulted in the financial arrangement, the Port placed Bergsoe into involuntary bankruptcy under Chapter 11 of the Bankruptcy Code. By that time, the Oregon Department of Environmental Quality had determined that toxic substances had contaminated the plant site. In September 1987, the trustee in bankruptcy filed suit against East Asiatic Company, Ltd. (EAC), the sole stockholder of Bergsoe, requesting a declaration that EAC was liable for the cost of abating the pollution. EAC then filed a third-party claim against the Port.

While it was undisputed that the Port owned the property, the Port nonetheless maintained it was not a CERCLA owner because it fell within the security interest exemption. It was undisputed that the Port held the deed to the plant primarily to ensure that Bergsoe would meet its obligations under the lease and ultimately under the industrial revenue development bonds. In other words, the Port had a security interest in the property. The question then became whether the Port had participated in the management of the plant.[102] After noting the recent Eleventh Circuit decision, the court stated:

> We leave for another day the establishment of a Ninth Circuit rule on this difficult issue. It is clear from the statute that, whatever the precise parameters of "participation," there must be *some* actual management of the facility before a secured creditor will fall outside the exception. Here there was none, and we therefore need not engage in line drawing.[103]

EAC pointed out several facts that it claimed demonstrated that the Port participated in the management of the Bergsoe plant. First, it contended that the Port negotiated and encouraged the building of the plant. Circuit Judge Kozinski held that the secured creditor exemption would cease to have any meaning if that was sufficient to remove a creditor from the exemption.[104] The court stated:

> Creditors do not give their money blindly, particularly the large sums of money needed to build industrial facilities. Lenders normally extend credit only after gathering a great deal of information about the proposed project, and only when they have some degree of confidence that the project will be successful. A secured creditor will always have some input at the planning stages of any large-scale project and, by the extension of financing, will perforce encourage those projects it feels will be successful. If this were "management," no secured creditor would ever be protected.[105]

Second, EAC pointed out that the Port had certain rights under the lease, such as the right to inspect the premises and to reenter and take possession upon foreclosure. In rejecting this argument, the court noted that nearly all secured creditors have these rights. The CERCLA exemption uses the active "participating in management." A critical distinction is not what

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102. *Id.* at 669-72.

103. *Id.* at 672 (emphasis original).

104. *Id.*

105. 910 F.2d at 672 (footnote omitted).

rights the lender has, but what it does.[106] "Regardless of what rights the Port may have had, it cannot have participated in management if it never exercised them. And there is no evidence that the Port exercised any control over Bergsoe once the two parties signed the leases."[107]

In conclusion, the Port, the court stated, held indicia of ownership primarily to protect a security interest in the plant and did not participate in the management of the site. Therefore, the Port was not a CERCLA owner and not liable for cleanup costs.[108] It would seem that the *Bergsoe* court followed the *Mirabile* standard. However, the impact of the Ninth Circuit's decision will probably be limited as a result of the complex and peculiar facts of the case, as well as the unwillingness of the Ninth Circuit to articulate an appropriate standard of liability.

B. Resolution Trust Corp. v. Polmar Realty, Inc.

Fleet Factors received a more hospitable reception by the Southern District of New York. In *Resolution Trust Corp. v. Polmar Realty, Inc.*,[109] the Resolution Trust Corporation (RTC), in its capacity as conservator of a failed financial institution, moved for a preliminary injunction requiring the mortgagor/owner of certain Manhattan property and subject to a mortgage held by the RTC, to allow the RTC to enter such premises to conduct environmental assessment field studies. The purpose of the environmental studies was to determine whether toxic substances existed on the property.[110]

District Judge Lasker first noted, citing *Chase Lincoln First Bank, N.A. v. Kesselring-Dixon, Inc.*,[111] that under New York law, a mortgagee who is on notice that contamination of the property was a possibility, but who nevertheless completes a foreclosure on the property, may not undo the foreclosure later upon the discovery of toxic substances and seek damages from the former owners.[112] Second, citing *Fleet Factors*, the court noted that federal courts have also "held recently that secured creditors may be liable for environmental cleanups under CERCLA even prior to taking title if they have exercised a certain degree of control over the property."[113] Given the potential claims exposure of the RTC, the court allowed the RTC entry to the property to perform the environmental studies.[114] The fact that the influential Southern

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106. *Id.* at 672-73.

107. *Id.* at 673 (footnote omitted).

108. *Id.*

109. 34 Env't Rep. Cas. (BNA) 1361 (S.D.N.Y. Dec. 16, 1991).

110. *Id.* at 1361-62.

111. 554 N.Y.S.2d 379 (Sup. Ct. 1990).

112. 34 Env't Rep. Cas. (BNA) at 1362.

113. *Id.*

114. 34 Env't Rep. Cas. (BNA) at 1362-63.

District of New York cited *Fleet Factors*, without criticism, should be of concern to mortgagees.

C. *Grantors to the Silresim Site Trust v. State Street Bank & Trust Co.*

Customers of the Silresim Solvent and Recycling Site were sued as PRPs for the cost of cleaning up the facility.[115] Union National Bank (UNB), holder of the first, second, and third mortgages on the property, was sued as an owner/operator.

Plaintiffs argued that UNB was involved in the active management of the site, claiming that in lieu in foreclosing on its loan, it directed the site owners to hire a particular individual as the site manager. As alleged by the PRPs, the site manager's involvement in the site rendered him UNB's agent. UNB had sought to "bleed" money from the site prior to foreclosure and at the same time, the company continued to accumulate pollutants at the site.

The court concluded that the bank was not liable and had not engaged in site management. It held that the site manager was ultimately hired by the manager of the company and that at no time was UNB's agent. Judge Robert E. Keeton concluded that the bank had not engaged in management of the day-to-day activities of the site, allowing an escape from liability. The bank's demands with respect to the collateral were conducted consistently with the singular purpose of protecting its security interest and did not, at any time, constitute management of the toxic waste site. Judge Keeton specifically stated that he was "not rejecting any holding in *Fleet Factors*" and that he did not find "anything in . . . *Fleet Factors* that is inconsistent with my decision."[116] It is submitted that an aggressive application of the *Fleet Factors* rationale would have rendered UNB liable. These three cases clearly demonstrate the post-*Fleet Factors* disarray and the need for a uniform rule.

VI. Remedying Fleet Factors: The Legislative and Administrative Solutions

A. *Legislative Proposals*

The adverse comments by lending institutions of *Fleet Factors* and the subsequent pressure on Congress and EPA have resulted in legislative and administrative proposals being brought forward to cure the implications of the decision. During the 102d Congress, Senator Jake Garn (R-UT) and Frank R. Lautenberg (D-NJ) introduced legislation that would reject *Fleet Factors* and enlarge the secured creditor exemption. This legislation was adopted in the Senate as amendments to S. 2733,[117] a housing reform bill. While the Senate passed the bill on July 1, 1992, it failed to pass the House, as did much of the environmental legislative

115. Grantors to the Silersim Site Trust v. State Street Bank & Trust Co., No. 88-1324-K (D.C. Mass. Nov. 24, 1992).

116. *Id.*

117. S.2733, 102d Cong., 2d Sess. (1992).

proposals of the 102d Congress.[118] In environmental matters as well as other issues, the 102d Congress will be remembered as the "gridlock Congress."[119]

Such legislation faced considerable opposition from environmental groups; they charged that such legislation would create a major loophole in CERCLA, constituting a bailout for lenders for their bad business decisions. As evidenced by the prolix debate to amend the Clean Air Act and to enact SARA, the environmental legislative process is characterized by bitter discussion between environmental organizations and business groups. Given the political climate, Congress would rather "invade Russia in the winter" than revisit CERCLA. With the 1992 election fast approaching, this legislative proposal became mired in political controversy and died.[120] In any event, any lender liability legislation that may ultimately emerge from the legislative process in the future may be saddled with complex amendments, creating more problems than it solves.

B. EPA's Fix

In addition to a legislative fix, EPA on September 14, 1990, put forward an administrative rule styled "EPA Draft Proposal Defining Lender Liability Issues Under the Secured Creditor Exemption of CERCLA" (EPA Rule).[121] The EPA Rule was revised on June 24, 1991[122] and became final on April 29, 1992.[123] The EPA Rule seeks to reconcile the lender's need to manage loans with EPA's duty to abate environmental contamination at hazardous waste sites.[124]

Prior to the EPA Rule, the EPA was aggressive in seeking imposition of CERCLA liability on banks. As a result of political pressure from financial institutions and federal agencies, EPA bowed to the pressure and reversed its position.[125]

EPA's proposal received 350 comments[126] and underwent a lengthy regulatory review process at the Office of Management and Budget (OMB). Commentators noted two reasons for the failure by OMB to quickly approve the EPA Rule. First, in responding to comments

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118. James E. Satterfield, *A Tale of Sound and Fury: The Environmental Record of the 102d Congress*, 23 Envtl. L. Rep. (Envtl. L. Inst.) 10015 (January, 1993).

119. *Id.* at 10025.

120. *Id.* at 10015, 10025.

121. *EPA Draft Proposal Defining Lender Liability Issues Under the Secured Creditor Exemption of CERCLA (Sept. 14, 1990)*, 5 Toxics L. Rep. (BNA) 668 (Oct. 17, 1990).

122. 56 Fed. Reg. 28,798 (1991).

123. 40 C.F.R. § 300.1100 (1992).

124. *Id.*

125. Greenberg and Shaw, *supra* note 52, at 1239.

126. Jeffery M. Sharp, *The New EPA Lender Liability Rule: A Partial Solution*, 25 UCC L.J. 224, 226 (1993).

by the lending community, OMB was concerned that the lender liability rule did not go far enough in protecting banks. Second, several informed sources speculated that OMB was delaying action with the hope that Congress would pass legislation addressing this issue.

In addition to pressure from environmental and business groups, OMB's review was further slowed by lobbying from other federal agencies, especially the RTC and Federal Deposit Insurance Corporation (FDIC). These governmental agencies were increasingly concerned about the liability they may face when they assume control of a failed financial institution. After taking control of an insolvent financial institution, the RTC and FDIC may face CERCLA liability when coping with assumed loans in default. The RTC has identified 300 of its properties that pose potential environmental problems. Cleanup estimates for approximately 50 of these properties indicated that the costs may be more than three times the market value. For that reason, the RTC and FDIC, as well as other governmental entities, exerted considerable pressure on OMB for a broad rule exempting lenders from CERCLA liability.[127] Since EPA has spent the past ten years litigating to expand the scope of lender liability, it is ironic that its potential "victims" are now sister governmental agencies.

The EPA's Rule is prefaced by seventy pages of commentary which indicates the political sensitivity of this issue. The foundation of the EPA Rule is the definition of the term "participating in the management of a facility;" participation in the management of a facility means actual participation in the management or operational affairs of the facility by the mortgagee and does not include the mere capacity to influence or the ability to influence. It also does not include the unexercised right to control facility operations. While the borrower is still in possession of the facility encumbered by a security interest, a mortgagee is participating in the management only if he either (1) exercises decisionmaking control over the borrower's environmental compliance or (2) exercises control at a level comparable to that of a manager of the borrower's facility, such that the lender has assumed responsibility for overall management of the enterprises encompassing the day-to-day decisionmaking at the facility with respect to environmental compliance or all, or substantially all, of the operational aspects of the faciity other than environmental compliance.

With that definition in mind, the EPA Rule then focuses on the three stages of loan administration: inception of the loan, policing and workout, and foreclosure and post-foreclosure activities. Prior to loan closing, a prospective lender, who requires an environmental inspection of the facility, commands a prospective borrower to clean up the facility, or insists upon the borrower coming into compliance with environmental standards, is not by such action considered to be participating in the facilities management. Neither CERCLA nor the EPA Rule requires a prospective mortgagee to conduct an environmental audit at the facility to qualify for the lender exemption.

During the loan policing stage, a lender will remain within the exemption even though it requires the borrower to decontaminate the facility during the term of the security interest, mandates that the borrower comply with applicable environmental standards during the term of the security interest, exercises authority to monitor the facility or the borrower's business or financial condition during the term of the security interest, or takes other actions to adequately police the loan. At foreclosure, the secured creditor can maintain the exemption provided the holder undertakes to sell or otherwise divest himself of the property in a

127. INSIDE EPA WEEKLY REPORT 3 (Jan. 4, 1991); INSIDE EPA WEEKLY REPORT 3 (Mar. 8, 1991); INSIDE EPA WEEKLY REPORT 1, 5 (March 22, 1991); Kipnis, *supra* note 22, at 460.

reasonably expeditious manner, using normal commercial means that are relevant or appropriate; provided, however, that the mortgagee did not participate in management prior to foreclosure. For purposes of establishing that a lender is seeking to sell, a holder that outbids, rejects, or fails to act upon within 90 days of receipt of a written *bona fide* firm offer for fair consideration for the property, loses the exemption. Subsequent to foreclosure, while the mortgagee is holding the property for disposition and liquidation, the lender may liquidate, maintain business activities, wind up operations, perform environmental cleanup, and take measures to preserve, prepare, or protect the secured asset prior to sale. Furthermore, after foreclosure, a lender must within twelve months following foreclosure list the site for sale.[128] In short, the EPA Rule appears to be a return "full circle" to the *Mirabile* standard.

C. The EPA Rule's Flaws

From a mortgagee's perspective, the EPA Rule abrogates many of the unpleasant features of *Fleet Factors*, as well as *Maryland Bank & Trust Co.*. However, the EPA Rule is not without its shortcomings for it has four major problems. First, the EPA Rule lacks a shelter rule for subsequent purchasers to transfer the immunity enjoyed by lenders. Without such a rule, potential purchasers will be hesitant to purchase the site from the lender because to do so may expose them to CERCLA liability. In short, the "safe harbor" provision should be expanded down the chain of title.

Second, the EPA Rule is subject to fluctuating political considerations that created it. With the new administration now in office, a "correct" interpretation of the statutory exemption could be established by EPA, dominated by Clinton Administration appointees.

Third, the EPA Rule does not address federal environmental statutes, such as the Resource Conversation and Recovery Act, and state environmental laws that are similar to CERCLA. Finally, a major problem for the EPA Rule is that its binding effect remains unclear.[129] In fact, the Chemical Manufacturers Association and the Michigan Attorney General recently filed suit in the District of Columbia federal court, seeking the invalidation of the EPA Rule.[130] While CERCLA authorizes EPA to promulgate rules and regulations, it is arguable that CERCLA does not grant EPA the power to define substantially those parties that fall within CERCLA's liability scheme. If that is so, the EPA Rule cannot be regarded as binding and is, at best, only an articulation of EPA's enforcement policy. Accordingly, the EPA Rule might have little effect on private reimbursement and contribution actions.[131] It must be remembered that EPA has not sought the imposition of CERCLA liability on many financial institutions. However, since this is an "age whe[re] . . . law is dominated by the search for

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128. 40 C.F.R. § 300.100(d)(2)(i); *see also* Sharp, *supra* note 126, at 227-31.

129. Greenberg and Shaw, *supra* note 52, at 1247-48.

130. Chemical Mfrs. Ass'n v. EPA, No. 92-1314 (D.C. Cir. filed July 28, 1992); Michigan v. EPA, No. 92-1312 (D.C. Cir. filed July 28, 1992); Interview with John Byrne, Counsel, American Bankers Association, in Washington, D.C. (Sept. 17, 1992).

131. Greenberg and Shaw, *supra* note 52, at 1248-52.

the deep pocket,"[132] PRPs seeking contribution might be undeterred by the EPA Rule and aggressively seek to have CERCLA liability imposed upon mortgagees. In short, private party suits may not be governed by EPA's interpretation of the exemption's language.[133]

VII. *High Noon* For EPA's Rule

A. Ashland Oil, Inc. v. Sonford Products Corp.

To date, EPA's Rule has been treated with "Southern hospitality" by the federal judiciary. In *Ashland Oil, Inc. v. Sonford Products Corp.*,[134] Plaintiff Ashland Oil, Inc. (Ashland) leased land in St. Paul Park, Minnesota, for approximately 23 years to tenants who manufactured wood preservatives at the facility. Industry Financial Corporation's (IFC) predecessor Industry Capitol, Inc. loaned money to Sonford Products Corporation (Sonford), one of Ashland's tenants. As collateral for that loan, IFC took a security interest in Sonford's assets, including inventory and equipment.

In 1982, Sonford filed a petition for bankruptcy, wherein IFC, as a secured creditor, participated in the bankruptcy proceeding. In an attempt to recover the value of its loan to Sonford, IFC agreed to cooperate in a transaction that would effectively transfer Sonford's assets to Park Penta Corporation (Park Penta). Under the terms of the workout transaction, the Sonford bankruptcy trustee abandoned the Sonford assets in March 1983. Immediately afterword, IFC notified Sonford's creditors that Park Penta intended to acquire Sonford's former assets. In order to facilitate the transfer to Park Penta, IFC foreclosed its security interest in the abandoned assets and briefly held title to the assets in late March or early April 1983. On April 19, 1983, IFC sold the former Sonford assets to Park Penta.

In November 1981, Ashland brought this action against IFC and other defendants seeking to hold them liable for cost of cleaning up the property. Ashland first alleged that when IFC took title to Sonford's former assets, IFC became a owner/operator and subject to CERCLA liability. In their suit, Ashland alleged that during the time that Sonford conducted its operations on the lease property, the property became contaminated with toxic wastes.[135]

In "blessing" the EPA Rule, District Judge Magnuson stated:

> EPA's rule is consistent with the statutory language of CERCLA and the interpretation accorded that language by the majority of leading federal cases which have considered the question of CERCLA lender liability. EPA promulgated the rule after careful study and a full notice and comment procedure. Further, EPA's rule is entitled to deference because the President (vested by Congress with implementation authority) has assigned primary responsibility for CERCLA administration to the

132. Hixon v. Sherwin-Williams Co., 671 F.2d 1005, 1009 (7th Cir. 1982).

133. Greenberg and Shaw, *supra* note 52, at 1248-52.

134. 810 F. Supp. 1057 (D. Minn. 1993).

135. *Id.* at 1058-59.

agency. Therefore, the court will follow the EPA rule clarifying the scope of the lender safe harbor.[136]

EPA's "safe harbor" provision requires that a foreclosing mortgagee takes steps to sell the collateral swiftly, including listing the property for sale within twelve months. Judge Magnuson held that IFC held title to Sonford's former assets, including barrels and equipment that allegedly leaked pollutants, for only approximately 3-4 weeks.[137] Judge Magnuson stated: "IFC's brief holding of title thus falls squarely within the 'indicia of ownership to protect a security interest' safe harbor provided by statute and clarified by EPA's rule."[138]

Ashland also continued that IFC was liable as an owner/operator not only because it held title to the assets, but also because IFC participated in the management of the facility. A security interest holder, the court noted, is not exempt from liability under CERCLA if it participates in the management of the polluting facility. Under the EPA Rule, the agency defines participation in management of a facility as actual participation in the management of operational affairs of the facility by the holder; it does not include the mere capacity to influence, or ability to influence, or the unexercised right to control facility operations. The periodic review of the borrower's finances conducted by IFC were insufficient to constitute "participation in management," and thus IFC remains within the boundaries of the lender "safe harbor."[139]

B. Kelley v. Tiscornia

One day after the decision in *Ashland Oil, Inc.*, the Western District of Michigan announced its decision in *Kelley v. Tiscornia*.[140] In that action, the State of Michigan brought a CERCLA action seeking to recover cleanup costs at the Auto Specialties Manufacturing Company (AUSCO) facilities located in St. Joseph, Michigan and Benton Harbor, Michigan, alleging that Manufacturers National Bank of Detroit (MNB) operated the site during times when hazardous substances were released. MNB acted as a banker for AUSCO from 1964 to 1986.[141]

District Judge McKeague initially observed that under the EPA Rule, if the borrower was in possession of the facility during the period in question, it is in actual control only if it takes any of three actions. First, the lender will be deemed to be participating in management if he exercises decisionmaking control over the borrower's environmental standards compliance. Second, the lender will be deemed to be participating in management if it assumes or manifests responsibility for the overall management of the enterprise encompassing day-to-day

136. *Id.* at 1060 (citations omitted).

137. *Id.*

138. *Id.*

139. 810 F. Supp. at 1060.

140. 810 F. Supp. 901 (W.D. Mich. 1993).

141. *Id.* at 902-04.

decisionmaking of the facility with respect to environmental compliance. Third, the lender will be deemed to be participating in management if it assumes or manifests responsibility for the overall management of the facility encompassing day-to-day decisionmaking with respect to all or substantially all of the operational aspects of the facility other than environmental compliance, as opposed to financial or administrative aspects of the facility.[142]

The court considered MNB's relationship with the AUSCO facilities during two time periods. First, during the period from 1964 to August of 1986, the evidence indicated that MNB placed two of its officers on AUSCO's governing board and closely followed the financial condition of the borrower. Although MNB's officers served as directors, their status as director does not alone impose CERCLA liability. While the bank's officer were only on the full board of directors, those meetings occurred only once or twice a year and considered only pension and capital spending issues. The executive committee dealt with operational issues and environmental compliance, but neither of the bank officers sat on the executive board. The fact that the bank closely monitored AUSCO does not remove the bank from the "safe harbor" provision. As the EPA's Rule makes clear, influence alone does not incur liability; actual control is necessary. While the bank placed conditions upon AUSCO for continued financing, there was no evidence of actual decisionmaking by the bank as is needed to find CERCLA liability. Accordingly, the court found that from the period 1964 to August 1968, the bank was not liable.

The second period is from August 1986, through June 1988, during which the workout specialist recommended by MNB actually managed AUSCO. The bank's activities during the second period included obtaining personal guarantees from the shareholders, demanding that expenses be trimmed, and requiring that a turnaround specialist be retained to operate the company. These actions, the court held, indicated that the bank merely influenced, but did not control the decisionmaking at the facility.[143]

With respect to the workout specialists, the EPA Rule provides that a person who exerts influence over a facility manager, but who has no power to direct or implement operational decisions, is not ' participating in management' even if the level of influence exerted over the borrower is substantial.'"[144] While the bank's influence over the workout specialist was considerable, it remained only influence and did not constitute control. Moreover, MNB's continued monitoring reflects valid financial concerns, not operational concerns, and its actions did not exceed the scope of monitoring authorized in the loan document.[145] In noting the beneficial effect of EPA's Rule, the court stated:

> It appears ironic to this Court that the standard of liability the State [of Michigan] seeks to impose upon the lender in this case may well result in increasing the number of abandoned and inactive hazardous waste disposal sites. If banks are held liable under CERCLA for actions such as occurred in this case (i.e., suggesting or demanding new management, monitoring the borrower's financial health, and

142. *Id.* at 905-06.

143. *Id.* at 906-08.

144. *Id.* at 908 (quoting 57 Fed. Reg. 18,359).

145. 810 F. Supp. at 908.

consulting regularly with its customer), it is reasonable to assume that banks will quickly react to such judicial reasoning by refusing to extend additional credit or otherwise continue to work with troubled borrowers. Banks will insulate themselves from liability by calling loans rather than nursing troubled borrowers back to financial health. This anticipated response virtually guarantees an increase in the country's inventory of abandoned and inactive hazardous waste disposal sites.[146]

VIII. Avoiding Lender Liability

Considering the inconsistent case law, the uncertainty of the EPA's administrative fix, and the lack of a clear congressional mandate, it is obvious that mortgagees must continue to be sensitive to environmental issues in its lending practices. Four practical suggestions will alleviate much, if not all, of the exposure. First, a secured creditor can minimize its liability by making a thoughtful evaluation of the property to determine potential or actual toxic waste problems before taking a security interest in the land. This would include checking the chain of title, making a physical inspection of the property, checking with EPA and other governmental agencies for records of the site's environmental history, and utilizing environmental questionnaires and environmental liability checklists.[147]

Second, a mortgagee should consider having an independent environmental consultant conduct an audit of the property. This audit should be conducted before the loan transaction is made. Audits can assist in determining a plant's compliance with environmental standards and identify environmental hazards on the premises. For lenders with long-term mortgages, an estimate of the long-term effects of the hazardous substance at the facility should be made. Moreover, the loan document can require periodic audits during the life of the loan. However, if the transaction already is completed, an environmental audit should be conducted as a step in the process of deciding whether to foreclose on the land. If toxic waste are discovered during a pre-foreclosure audit, the secured creditor has two options: conclude that the remediation cost are small enough to justify foreclosure or write off the loan and walk away from the realty.[148]

Third, a mortgagee should require warranties and representations by the potential borrower that it has complied with all federal, state, and local environmental standards. These warranties should also clearly describe the condition of the land and address whether any releases of toxic waste are occurring or have occurred in the past.

Finally, the mortgagee should obtain an indemnification agreement in case the lender is held liable for cleanup costs. However, if the borrower goes into default, realistically this indemnification may be of limited use to the lender for he will be left with an insolvent debtor and contaminated property.[149]

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146. *Id.* at 909.

147. James Dragna, *Contaminated Collateral: How Lenders Can Reduce Their Environmental Exposure*, 10 L.A. Law 25, 30 (Jan. 1988). *See also* Quentel, *supra* note 23, at 183-84.

148. Corash and Behrendt, *supra* note 54, at 881; *see also* Quentel, *supra* note 23, at 183-84.

149. Quentel, *supra* note 23, at 183-85; *see also* Peck, *supra* note 25, at 106-26.

Once a borrower goes into default and the property is contaminated, the lender is then faced with a difficult choice. On the one hand, he can foreclose, comply with the EPA Rule, and hope that the EPA Rule will be upheld, exempting him from liability. On the other hand, fearing the application of the *Maryland Bank & Trust Co.* rule, a secured creditor may decide to abandon its collateral and waive foreclosure. Considering the possibility that the cleanup costs may be well in excess of the value of the collateral, as it did in *Maryland Bank & Trust Co.*,[150] a waiver of foreclosure could, in certain cases, be a prudent course of action, avoiding extensive cleanup costs, years of protracted litigation, and considerable transaction costs.

IX. Conclusion

To balance a bank's economic role and environmental role and to bring more confidence into the real estate marketplace, the need for carefully crafted and unambiguous legislation is clear. In the meantime, the EPA Rule is a positive development, a reasonable accommodation of the competing interests, and offers specific guidance to lenders providing them with considerable protection. However, considering the flux of this issue, a mortgagee must continue to evaluate environmental problems and to prudently act as an environmental *Godfather*, blessing certain loans and rejecting others. This quasi-governmental role supplements EPA's enforcement efforts and benefits society by preventing the creation of future toxic waste sites.

150. United States v. Maryland Bank and Trust Co., 632 F. Supp. 573, 574-79,(D. Md. 1986).