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# NEW EPA RULE CLARIFIES LENDER LIABILITY FOR RESPONSE COSTS UNDER CERCLA. BUT IS IT ENOUGH?

by JON D. PERKINS

Since the enactment in 1980 of the Comprehensive Environmental Response, Compensation, and Liability Act<sup>1</sup> ("CERCLA") — also known as "Superfund" — the issue of lender liability has been one of the statute's most worrisome aspects for the banking profession and businesses in general. The term "due diligence," already a household word in securities law, has become a household word in environmental law as well and has taken on great importance to bankers, their lawyers, and others concerned with secured loans.

With the issuance of its final rule on lender liability, "Lender Liability Under CERCLA," the Environmental Protection Agency ("EPA") attempted to lend clarity to this increasingly confusing area of CERCLA li-

ability.<sup>2</sup> This Comment will analyze the pre-ruling statutory and case law regarding lender liability under CERCLA, analyze the new rule, discuss cases that have applied the new rule, look at its implications, and finally provide some possible guidelines to lenders who may be affected by the new rule in light of recent decisions implementing the rule.

## PRE-RULING STATUTORY AND CASE LAW

Congress crafted CERCLA to empower the federal government with the necessary remedial power to cleanup existing facilities contaminated by hazardous substances.<sup>3</sup> Pursuant to CERCLA, the EPA has two methods to accomplish hazardous waste cleanup. First, the EPA may order the re-

sponsible parties to undertake the necessary remedial cleanup measures, provided the responsible parties possess the capacity to perform this task. Alternatively, the EPA may take action to cleanup contamination from hazardous substances and subsequently sue the responsible parties for the cleanup costs.<sup>4</sup> CERCLA established a Hazardous Substances Response Trust Fund ("Superfund") to finance the removal and remedial response costs.<sup>5</sup> To establish a prima facie case of CERCLA liability and recover Superfund outlays, the EPA must establish four facts: (1) that the site is a "facility;" (2) that a hazardous substance release occurred; (3) that the EPA incurred response costs; and (4) that the defendant is a responsible party.<sup>6</sup>

The lender liability problem has grown out of Superfund's broad liability and narrow exemption provisions. Four groups of defendants are potentially liable for response costs under CERCLA: (1) current owners and operators of waste facilities; (2) owners and operators at the time of waste disposal; (3) generators of hazardous waste; and (4) transporters of hazardous waste.<sup>7</sup>

Because CERCLA did not contain an explicit standard of liability and because the legislative history is relatively uninformative,<sup>8</sup> the task of fashioning CERCLA's liability policy fell to the courts. Courts have uniformly held that each of the four groups of potentially liable parties face strict, joint and several liability unless the environmental harm caused is divisible.<sup>9</sup>

1 Pub. L. No. 96-510, 94 Stat. 2767 (1980) (codified as amended at 42 U.S.C. §§ 9601-9657 (1988)). For a general legislative history of CERCLA, see Grad, *A Legislative History of the Comprehensive Environmental Response, Compensation and Liability ("Superfund") Act of 1980*, 8 COLUM. J. ENVTL. L. 1 (1982).

2 Lender Liability Under CERCLA, 57 Fed. Reg. 18,344 (1992) (codified at 40 C.F.R. §§ 300.1100 and 300.1105 (1992)). In addition, Missouri has enacted a state law which is almost identical to 40 C.F.R. § 300.1100. See Mo. Rev. Stat. Chapter 427. The federal rule occupies only four pages of the Federal Register — fairly brief as most important EPA regulations go. Its brevity may be the reason why the EPA's "Summary of the Proposed Rule" is about the same length as the final rule itself. 57 Fed. Reg. 18,344, 18346-18,348 (1992). The importance of the final rule may be appraised from the extent of the "Summary of Comments and Changes From the Proposed Rule," which spread over 26 Federal Register pages. More than 350 comments on the proposed rule came from representatives of banking, trade and industry associations, environmental groups, individual banks, lending institutions, and individuals. *Id.* at 18,348-18,374.

3 Congress' enactment of CERCLA occurred soon after the discovery of contamination at Love Canal and other sites and after the realization that existing environmental statutes were not equipped to handle these situations. H.R. Rep. No. 96-1016, Part I, 96 Cong., 2d Sess. (1980), reprinted in 1980 U.S.C.A.N. 6119, 6128. See also Comment, *The Liability of Financial Institutions for Hazardous Waste Cleanup Costs Under CERCLA*, 1988 Wis. L. Rev. 139, 141-142. The term "facility" is defined in 42 U.S.C. § 9601(9) (1988). The term "hazardous substance" is defined in 42 U.S.C. § 9601(14) (1988).

4 See 42 U.S.C. §§ 9604(a), 9606(a), and 9607(a) (1988). See also Susan M. King, *Lender's Liability for Cleanup Costs*, 18 ENVTL. L. REP. (ENVTL. L. INST.) 241, 249 (1988).

5 The terms "remove" and "removal" are defined in 42 U.S.C. § 9601(23) (1988). The terms "remedy" and "remedial action" are defined in 42 U.S.C. § 9601(24) (1988).

6 *U.S. v. Aceto Agric. Chem. Corp.*, 872 F.2d 1373, 1379 (8th Cir. 1989).

7 42 U.S.C. § 9607(a)(1)-(4) (1988). See *U.S. v. Maryland Bank & Trust Co.*, 632 F.Supp. 573, 577 (D.Md. 1986).

8 *U.S. v. Northeastern Pharm. & Chem. Co.*, 579 F.Supp. 823, 838 n.15 (W.D.Mo. 1984), *aff'd in part, rev'd in part*, 810 F.2d 726 (8th Cir. 1986), *cert. denied*, 484 U.S. 848 (1987).

9 For cases imposing strict liability, see e.g., *U.S. v. Monsanto Co.*, 858 F.2d 160, 167 (4th Cir. 1988), *cert. denied*, 490 U.S. 1106 (1989); *Tanglewood East Homeowners v. Charles-Thomas, Inc.*, 849 F.2d 1568, 1572 (5th Cir. 1988); *Levin Metals Corp. v. Parr-Richmond Terminal Co.*, 799 F.2d 1312, 1316 (9th Cir. 1986); *New York v. Shore Realty Corp.*, 759 F.2d 1032, 1042 (2d Cir. 1985). See also *U.S. v. Northeastern Pharm. & Chem. Co.*, 810 F.2d 726, 732 n.3 (8th Cir. 1986), *cert. denied*, 484 U.S. 848 (1987) (dictum). In addition, CERCLA was held to provide joint and several liability in *U.S. v. Chem-Dyne Corp.*, 572 F.Supp. 802, 810-811 (S.D. Ohio 1983) and *Monsanto*, 858 F.2d at 171.

The lender liability problem concerns only the first two categories of liable parties and is largely concerned with CERCLA's definition in § 101 of "owner or operator" in which the term "security interest" appears.<sup>10</sup> "Owner or operator" is defined in § 101(20)(A) as "any person owning or operating [a vessel or a] facility," but "does not include 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."<sup>11</sup>

In addition to the security interest exemption, CERCLA also has an "innocent landowner" defense to liability for someone who falls within the definition of an owner but had no involvement with the hazardous substances contaminating the site.<sup>12</sup> This defense arises when the release of hazardous substances at a facility results from "an act or omission of a third party other than an employee or agent of the defendant, or than one whose act or omission occurs in connection with a contractual relationship, existing directly or indirectly, with the defendant."<sup>13</sup> The party asserting the defense must establish, however, that he or she took "due care with respect to the hazardous substance concerned" and "took precautions against foreseeable acts or omissions of any such third party and the consequences that could foreseeably result from such acts or omissions."<sup>14</sup>

While the definition of "owner or operator" found in § 101(20)(A) does not use the term "control," to a great extent the lender liability debate has focused on the question of how much control is too much.<sup>15</sup> In its statement of the "background" of the final rule, the EPA noted that while case law existed with respect to defining how much control is too much, the language courts

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used to describe when control was too great tended to allow for a great deal of expansion, causing a small panic in the lending community.<sup>16</sup>

Perhaps foremost among the number of cases to which one might turn for guidance on this issue is *United States v. Fleet Factors Corp.*,<sup>17</sup> decided in 1990. Fleet Factors Corp., the creditor of a bankrupt company, foreclosed on the company's equipment and inventory after the company ceased operations.<sup>18</sup> The Eleventh Circuit Court of Appeals, in denying Fleet Factors'

motion for summary judgment, held that a secured creditor might be liable if it participated in the control of a facility "to a degree indicating a capacity to influence the corporation's treatment of hazardous wastes."<sup>19</sup>

In *In re Bergsoe*,<sup>20</sup> decided by the Ninth Circuit Court of Appeals in the same year, the court held that participation in management was not shown in a case in which a lender merely reserved the right to participate in management in order to protect its security interest.<sup>21</sup> In *Bergsoe*, the port of St. Helens, Oregon, had financed Bergsoe Metal Corp.'s construction of a lead recycling plant with municipal revenue bonds, pursuant to which a bank was the trustee for the bondholders.<sup>22</sup> The bank, which also had purchased the bonds, forced Bergsoe into Chapter 11 proceedings after Bergsoe had experienced financial problems. During this period, contamination was discovered at the plant.<sup>23</sup> The corporate holder of Bergsoe's capital stock unsuccessfully claimed that the port, which had not foreclosed but had appointed a manager of the plant and held rights of inspection and re-entry, thereby had participated in management.<sup>24</sup> The court stated: "What is critical is not the rights [the creditor] had, but what it did."<sup>25</sup>

Before *Fleet Factors* and *Bergsoe*, federal district courts had rendered varying holdings on the issue of lender liability. In

10 57 Fed. Reg. 18,344 (1992).

11 42 U.S.C. § 9601(20)(A) (1988) (emphasis added).

12 42 U.S.C. § 9607(b)(3) (1988). This defense was added to Superfund by the Superfund Amendment and Reauthorization Act ("SARA"). Superfund Amendment and Reauthorization Act of 1986, Pub.L. 99-499, 100 Stat. 1613 (1986). The amendment was introduced by then-Representative William H. Harsha, R.-Ohio, who stated: "This change is necessary because the original definition inadvertently subjected those who hold title to a ... facility, but do not participate in the management or operation and are not otherwise affiliated with the person leasing or operating the ... facility, to the liability provisions of the bill." Remarks of Rep. Harsha, reprinted in 2 Senate Comm. on Environmental and Public Works, 97th Cong., 2d Sess., 2 A Legislative History of CERCLA 945 (Comm. print 1983), quoted in *U.S. v. Fleet Factors Corp.*, 901 F.2d 1550, 1558 n.11 (11th Cir. 1990), cert. denied, 111 S.Ct. 752 (1991).

13 42 U.S.C. § 9607(b)(3) (1988).

14 *Id.*

15 See 57 Fed. Reg. 18,344 - 18,346 (1992).

16 *Id.*

17 901 F.2d 1550 (11th Cir. 1990) ("Fleet Factors II"), cert. denied, 111 S.Ct. 752 (1991). See also subsequent history *supra* at n.102 - 110.

18 *Id.* at 1552-1553.

19 *Id.* at 1557.

20 910 F.2d 668 (9th Cir. 1990).

21 *Id.* at 672.

22 *Id.* at 669.

23 *Id.*

24 *Id.* at 672-673.

25 *Id.* at 672.

*United States v. Mirabile*, the court held that foreclosure alone, without participation in a site's day-to-day operations, would not be enough to establish loss of the security interest exemption.<sup>26</sup> On the other hand, in *United States v. Maryland Bank & Trust Co.*<sup>27</sup> the court found that a bank had purchased property at foreclosure to protect its investment, not its security interest, thereby negating the bank's ability to claim the security interest exemption.<sup>28</sup>

In response to these cases construing "participation in management" in such ambiguous ways, the EPA established a general rule that "a holder's involvement in financially related matters — such as periodic monitoring or inspections of secured property, loan financing and restructuring, financial advice and similar activities — will not void the exemption."<sup>29</sup>

## ANALYSIS OF THE NEW RULE

It is impossible to discuss in any detail within the confines of this Comment each or even most of the EPA's summaries and explanations.<sup>30</sup> Instead, the text of the final rule itself can best serve as the basis of understanding it.

The first section of the rule, § 300.1100, "Security interest exemption," commences

by saying that one whose indicia of ownership are "primarily to protect a security interest in a vessel or facility, and who does not participate in the management of the vessel or facility, is not an owner or operator under CERCLA Section 107(a)(1) or (2)."<sup>31</sup> The burden of proof that "the defendant is liable as an owner or operator" is imposed on the plaintiff in an action brought under that section or under § 300.1105, "Involuntary acquisition of property by the government."<sup>32</sup>

The indicia of ownership of security interests include, but are not limited to, the standard legal instruments and "legal or equitable title" obtained pursuant to foreclosure.<sup>33</sup> Legal title to the security interest itself is not required.<sup>34</sup> A holder is a person who maintains indicia of ownership as defined in the rule; the definition includes the initial holder, a subsequent holder, and a receiver.<sup>35</sup>

The rule first defines when actions are taken "primarily to protect [a] security interest" by following the holding in *United States v. Maryland Bank & Trust Co.*: "[Securing] payment or performance of an obligation" does not give rise to CERCLA liability,<sup>36</sup> so long as it is the primary reason why any ownership indicia are held.<sup>37</sup> If the interest is held "primarily for investment" it fails to qualify for the exemption.<sup>38</sup>

The rule then defines the first of the key terms in § 101(20)(A) — "participating in the management of a vessel or facility" — by listing those actions that constitute such participation and those that do not.<sup>39</sup> Affirming *Bergsoe*, the rule states that "the mere capacity to influence, or the unexercised right to control facility operations," does not constitute participation.<sup>40</sup> Actual participation is required.<sup>41</sup> "[Decision-making] control over the borrower's environmental compliance" constitutes "participation in management"<sup>42</sup> as does "control at a level comparable to that of a manager ... encompassing the day-to-day decision making of the enterprise with respect to" the "[environmental] compliance"<sup>43</sup> or "[all], or substantially all"<sup>44</sup> of the operations. The rule distinguishes the operations from the "financial or administrative" aspects of the enterprise.<sup>45</sup> Excluded from participation in management are the lender's operations at the inception of the loan, policing and workout actions, policing the security interest or loan, and participating in the management of a facility by taking a response action under Section 107(a)(1) of CERCLA.<sup>46</sup>

The rule also supplies a useful definition of "workout." Under the rule, the term refers to "those actions by which a holder, at any

26 *U.S. v. Mirabile*, 15 ENVTL. L. REP. (ENVTL.L.INST.) 20,994 (E.D.Pa., Sept. 4, 1985).

27 632 F.Supp 573 (D.Md. 1986).

28 *Id.* at 579.

29 57 Fed. Reg. 18,344, 18,345 (1992).

30 The EPA published its proposed lender liability rule on June 24, 1991. The 350 comments that it received are discussed in the EPA's 266-page "Summary of Contents and Changes From the Proposed Rule," constituting Part III of its April 29, 1992, release. Among the more important subjects of these comments were "Application of the § 101(20)(A) Security Interest Exemption to Other Sections of CERCLA and Other Laws," "Definition of Covered Security Interests," "Definition of Participation in Management," "General Test of Participation in Management," "Foreclosure," "Post-Foreclosure 'Operation' of a Facility of a Holder," "Burden of Proof," and "Effect of [the] Final Rule on Holding in *U.S. v. Fleet Factors*." 57 Fed. Reg. 18,344, 18,348-18,374 (1992).

31 40 C.F.R. § 300.1100 (1992).

32 *Id.*

33 40 C.F.R. § 300.1100(a) (1992).

34 *Id.*

35 40 C.F.R. § 300.1100(a)(1) (1992).

36 40 C.F.R. § 300.1100(b) (1992).

37 40 C.F.R. § 300.1100(b)(2) (1992).

38 *Id.*

39 40 C.F.R. § 300.1100(c) (1992).

40 40 C.F.R. § 300.1100(c)(1) (1992).

41 *Id.*

42 40 C.F.R. § 300.1100(c)(1)(i) (1992).

43 40 C.F.R. § 300.1100(c)(1)(ii)(A) (1992).

44 40 C.F.R. § 300.1100(c)(1)(ii) (1992).

45 40 C.F.R. § 300.1100(c)(1)(ii)(B) (1992).

46 40 C.F.R. § 300.1100(c)(2) (1992).

47 40 C.F.R. § 300.1100(c)(2)(ii)(B) (1992).

48 40 C.F.R. § 300.1100(d) (1992).

time prior to foreclosure and its equivalents, seeks to prevent, cure, or mitigate a default by the borrower or obligor, or to preserve, or prevent the diminution of, the value of the security."<sup>47</sup>

The detailed treatment of "Foreclosure on Property and Post-Foreclosure Activities" also provides important clarification with respect to the scope of the security interest exemption.<sup>48</sup> One of the greatest problems for lenders has been what one should do after foreclosure to preserve the security interest exemption when the lender itself acquires the property.<sup>49</sup> The final rule provides that the indicia of ownership held after foreclosure will continue to be considered primarily as protection for a security interest provided that the holder undertakes to sell, re-lease property held pursuant to a lease financing transaction (whether by a new lease financing transaction or substitution of the lessee), or otherwise divest itself of the property in a reasonably expeditious manner, using whatever commercially reasonable means are relevant or appropriate with respect to the vessel or facility, taking all of the facts and circumstances into consideration, and provided that the holder did not participate in management (as defined in 40 C.F.R. § 300.1100(c)) prior to foreclosure or its equivalent.<sup>50</sup>

The final rule permits the holder to undertake any response action under CERCLA

and, subject to certain qualifications, to "take measures to preserve, protect or prepare the secured asset prior to sale or other disposition," without losing the protection from liability.<sup>51</sup> The holder is required, however, "within 12 months following foreclosure," to list the property for sale with a broker or agent who deals in the same type of property, or to advertise it monthly in a suitable real estate publication with a circulation of more than 10,000.<sup>52</sup> If a holder outbids or rejects "an offer of fair consideration," it establishes thereby that its ownership is not primarily intended to protect the security interest, unless such outbidding or rejection is required by law.<sup>53</sup>

The foregoing is a summary of what the final rule does. A brief examination of what it does not do is also in order. The final rule does not extend its definitions and clarifications beyond the sections of CERCLA that it addresses. The EPA specifically refused to extend the definitions of owner or operator of a facility under CERCLA's §§ 101(20) and 101(35) to address liability arising from loans to operators of underground storage tanks under the Resource Conservation and Recovery Act.<sup>54</sup> Nor does the rule pre-empt any other federal or state laws that may apply to the activities to which it is specifically directed.<sup>55</sup>

Furthermore, the rule does not apply to trustees and other fiduciaries. The EPA's

stated reason for this should give some reassurance to these individuals and their attorneys: "A trustee is not personally liable for CERCLA cleanup costs solely because a trust asset is contaminated by hazardous substances."<sup>56</sup>

The rule also does not require inspections of sites by holders of security interests; rather, the rule specifically provides that inspections shall not be considered evidence of management participation. "[A] decision to perform an environmental audit or inspection for the purpose of preserving the capacity to assert the 'innocent landowner' defense does not void or in any way compromise a holder's eligibility for the § 101(20)(A) exemption."<sup>57</sup> The rule also gives no significance to a holder's motivation in making such inspections.<sup>58</sup>

While the rule does not apply specifically to any private action, the EPA suggests that this regulation can have an effect in litigation to which the government is not a party.<sup>59</sup> The EPA argues that the rule is not merely an agency interpretation of Section 101(20)(A), but is a "legislative" or "substantive" rule that has undergone notice and comment pursuant to the Administrative Procedure Act and as such, it defines the liability of holders for CERCLA response costs in both litigation involving the United States and private party litigation.<sup>60</sup>

49 57 Fed. Reg. 18,344 - 18,346 (1992).

50 40 C.F.R. § 300.1100(d) (1992).

51 40 C.F.R. § 300.1100(d)(2) (1992).

52 40 C.F.R. § 300.1100(d)(2)(i) (1992).

53 40 C.F.R. § 300.1100(d)(2)(ii) (1992). Fair consideration for the value of the security interest is defined in 40 C.F.R. § 300.1100(d)(2)(ii)(A) (1992). In essence, the provision is designed to permit recovery of the amount owed on the loan, plus interest and costs to the lender incident to foreclosure, workout, and other measures. *Id.*

54 42 U.S.C. § 6991(a)-(i) (1988); 57 Fed. Reg. 18,344, 18,349 - 18,350 (1992). The EPA has issued financial responsibility requirements for local governmental owners and operators of underground storage tanks ("USTs") containing petroleum. Four alternative mechanisms may be used by local governments to demonstrate financial responsibility for taking corrective action and compensating third parties for bodily injury and property damage caused by accidental underground storage tank releases. See 58 Fed. Reg. 9,026 (1993).

55 57 Fed. Reg. 18,344, 18,350 (1992). In fact, CERCLA specifically provides that it is not pre-emptive. 42 U.S.C. § 9614(a) (1988).

56 57 Fed. Reg. 18,344, 18,349 (1992). *But see City of Phoenix v. Garbage Servs. Co.*, 816 F.Supp. 564 (D.Ariz. 1993) (holding that trustee was not "operator" of landfill for purposes of CERCLA liability, even though trustee had authority to control landfill, where trustee was not involved in day-to-day administration but that trustee was "owner" of landfill for purposes of CERCLA liability even though it held only bare legal title to the landfill).

57 *Id.* at 18,353.

58 *Id.* at 18,354. "Participation in management" is an objective, fact-based inquiry, and the legal consequence of the same actions undertaken by two different holders is not changed by differences in motivation. *Id.* Such motivation was also held to be irrelevant in *Bergsoe*, 901 F.2d at 1560 (9th Cir. 1990).

59 57 Fed. Reg. 18,344, 18,368 (1992).

60 *Id.* However, it is worth noting that many of those who commented on the final rule disagree with the EPA. *Id.*

## CASES THAT HAVE INTERPRETED THE NEW RULE

In *Ashland Oil, Inc. v. Sonford Prod. Corp.*, decided by the United States District Court for the District of Minnesota in January, 1993, the court ruled that a non-bank commercial lender was not liable under CERCLA.<sup>61</sup> The lender, Industry Financial Corp. ("IFC"), made secured loans to an Ashland tenant, Sonford Products Corp., which manufactured wood preservatives.<sup>62</sup> Sonford subsequently went bankrupt.<sup>63</sup> IFC held title to Sonford's assets for about a month, after which they were acquired by another company, Park Penta Corp.<sup>64</sup> Park Penta borrowed from IFC to make the acquisition with IFC taking a security interest in the assets.<sup>65</sup> A year later, Park Penta filed for bankruptcy.<sup>66</sup> IFC could not find another buyer for the assets and abandoned its security interest.<sup>67</sup> Ashland, faced later with cleanup costs on the land leased by Sonford and others, sued IFC and several other defendants, seeking to hold them liable for cleanup costs under CERCLA.<sup>68</sup>

Citing the EPA rule, the court determined that merely holding a security interest did not expose the lender to liability: "The undisputed evidence shows that [the lender] did not participate in the management of either Park Penta or Sonford or exercise any deci-

sion making control over environmental compliance decisions."<sup>69</sup> Likewise, the court ruled that temporarily holding title did not subject the lender to liability because the brief holding of the title "falls squarely within the 'indicia of ownership to protect a security interest' safe harbor provided by statute and clarified by the EPA's rule."<sup>70</sup>

The United States District Court for the Western District of Michigan in January 1993 decided a similar case involving a commercial bank in *Kelly v. Tiscornia*.<sup>71</sup>

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Manufacturers National Bank was a party to *Kelly* as a result of its long-standing credit relationship with Auto Specialties Manufacturing Co., owned by the Tiscornia family.<sup>72</sup> Furthermore, bank officers had served on the borrower's board for more than twenty years.<sup>73</sup> When the borrower encountered financial troubles, the bank provided additional credit, and insisted on increased monitoring of the borrower's finances.<sup>74</sup> Eventu-

ally the bank stated that it would only provide further credit if management changes were made.<sup>75</sup> It recommended two outside turnaround specialists,<sup>76</sup> one of whom was hired to serve as Chief Executive Officer but later was fired.<sup>77</sup> Throughout the relationship, the bank held a first mortgage on the borrower's property.<sup>78</sup>

The court ruled that Manufacturers National could not be held liable for environmental problems.<sup>79</sup> It cited the EPA rule's protections, noting that holding the first mortgage was not sufficient to prove liability.<sup>80</sup> It pointed out that the bank had exercised no control over the borrower's environmental compliance.<sup>81</sup> Although bank officers had served on the borrower's board, the court noted that the board met infrequently and only handled pension and capital spending issues.<sup>82</sup> Operational issues, including environmental compliance, were handled by an executive committee, which the bankers did not join.<sup>83</sup> The court also held that the bank's efforts to monitor and police its loans were protected by the EPA rule.<sup>84</sup> As for the turnaround specialist, the court held that "[t]he bank's insistence upon outside management under threat of calling the loan does not constitute impermissible control."<sup>85</sup> The court further stated that:

61 810 F.Supp. 1057 (D.Minn. 1993).

62 *Id.* at 1058.

63 *Id.*

64 *Id.* at 1058-1059.

65 *Id.* at 1059.

66 *Id.*

67 *Id.*

68 *Id.*

69 *Id.* at 1060.

70 *Id.* (referring to 42 U.S.C. § 9601(20)(A) and 40 C.F.R. § 300.1100(a)).

71 810 F.Supp. 901 (W.D.Mich. 1993).

72 *Id.* at 903.

73 *Id.*

74 *Id.*

75 *Id.*

76 *Id.* at 903-904.

77 *Id.* at 904.

78 *Id.* at 905.

79 *Id.* at 909.

80 *Id.* at 905.

81 *Id.* at 906.

82 *Id.*

83 *Id.*

84 *Id.* at 907.

85 *Id.* The borrower's eventual firing of the consultant was taken into account in reaching this holding. *Id.*

86 *Id.* at 909.

"[i]f 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 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 response virtually guarantees an increase in the country's inventory of abandoned and inactive hazardous waste disposal sites."<sup>86</sup>

In *Waterville Indus., Inc. v. Finance Auth. of Maine*, the First Circuit Court of Appeals held that a Maine government agency cannot be held liable as an "owner" under the Superfund law, even though it took title to land after the default of a mortgage it had guaranteed and permitted a polluter to occupy the land under a sale-leaseback arrangement.<sup>87</sup> In 1972, the Finance Authority of Maine's ("FAME") predecessor had guaranteed a loan taken out by a private corporation so that it could purchase and develop the Waterville property.<sup>88</sup> In 1980, the borrower defaulted and FAME made "substantial payments" to cure the default.<sup>89</sup> Immediately thereafter, FAME purchased the property from the borrower for \$1 and

leased it back to the company, giving it the option to purchase the site for \$1 at the end of the lease.<sup>90</sup> The agreement capped the total payments that FAME could receive at \$868,982 which corresponded to the amount of payments made by FAME to cure the debtor's default.<sup>91</sup> The agreement was in force for approximately two years, during which the borrower is believed to have deposited hazardous wastes on the site.<sup>92</sup> The borrower later declared bankruptcy.<sup>93</sup> FAME subsequently won a judgment that it held title to the land, but after a year, FAME sold the land.<sup>94</sup> The dispute began in 1983 when the corporate predecessor of Waterville Industries, Inc. purchased the property.<sup>95</sup> After discovering that the site was contaminated with hazardous wastes and executing a cleanup, Waterville sued FAME under CERCLA to recover its response costs, noting that FAME had held title to the property while the wastes were deposited.<sup>96</sup>

Relying solely on the language of CERCLA § 101(20)(A), the court rejected Waterville Industries' argument that through the sale-leaseback arrangement, FAME became the owner of the land, rather than just the holder of a security interest. The court concluded that when Congress wrote § 101(20)(A), it had in mind "not only the classic case of the bank mortgage but also equivalent devices serving the same function, such as lease-financing arrangements."<sup>97</sup> The court held that the limitation on payments under the lease created a "fair inference" that FAME was seeking only to recover payments it

made under the loan guarantee that it provided.<sup>98</sup> The court did acknowledge that, under principles of real estate law, FAME did become an owner of the Waterville site after the debtor declared bankruptcy but held that "such a maturation of ownership does not divest the owner of protection under CERCLA's security interest exemption so long as the owner proceeds within a reasonable time to divest itself of ownership."<sup>99</sup> Although CERCLA itself does not provide any period for divestiture after the collapse of a financing arrangement, the court held that such a "safety zone" was implicit in the statute.<sup>100</sup> The court concluded by noting that by providing a "safe harbor" of 12 months within which a security interest holder may offer property for sale without risking CERCLA liability in its new rule on lender liability, the EPA has "followed the same path."<sup>101</sup>

Most recently, in May 1993 the United States District Court for the Southern District of Georgia handed down its decision on remand from the Eleventh Circuit Court of Appeals in the *Fleet Factors* case ("*Fleet Factors IV*"). After denying both parties' motions for summary judgment in *Fleet Factors III*,<sup>102</sup> the court in *Fleet Factors IV* held that Fleet did not qualify for the secured creditor exemption because companies that it hired to prepare assets for auction mishandled hazardous wastes.<sup>103</sup> The court ruled that Fleet's own activities prior to foreclosure were not management and were consistent with activities permitted under the

87 984 F.2d 549 (1st Cir. 1993).

88 *Id.* at 550.

89 *Id.*

90 *Id.* at 550, 552.

91 *Id.* at 552.

92 *Id.* at 551.

93 *Id.*

94 *Id.*

95 *Id.*

96 *Id.*

97 *Id.* at 552.

98 *Id.*

99 *Id.* at 553.

100 *Id.*

101 *Id.*

102 *U.S. v. Fleet Factors Corp.*, No. CIV. A. CV687-070, 1993 WL 130539 (S.D.Ga. April 23, 1993)

103 *U.S. v. Fleet Factors Corp.*, No. CIV. A. CV687-070, 1993 WL 156633 (S.D.Ga. May 12, 1993)

EPA's rule defining the limits of the secured creditor exemption.<sup>104</sup> The court also held, however, that the post-foreclosure activities of liquidator and salvage crews hired by Fleet Factors failed to comport with Superfund regulations and aggravated environmental problems at the site.<sup>105</sup> Coupled with Fleet Factors' holding of a deed on the property to secure the borrower's debt, the court ruled that the agents' activities made Fleet liable as a facility owner under § 107(a)(2) of CERCLA.<sup>106</sup>

The court noted that the handling of hazardous waste substances indicates impermissible involvement in management unless done in accordance with CERCLA's National Contingency Plan ("NCP") or under the supervision of an NCP on-scene coordinator and that the actions by the agents in this case were indeed impermissible.<sup>107</sup> The court found that the actions of one agent in straightening up the site and grouping the items on the site for sale were protected activities under 40 C.F.R. § 300.1100(d)(2) of the EPA's lender liability rule.<sup>108</sup> The agent's actions in moving drums which contained hazardous substances, however, went beyond the activities protected under the rule.<sup>109</sup> The court also found that the actions of another agent who agreed to "broom clean" the site after retrieving unsold equipment and machinery, also voided Fleet's exemption. The court said that the second agent had handled the hazardous waste drums and removed asbestos insulation "with all the finesse of a Viking raiding party" and noted that the second agent "backed into and

crushed the drums with tractors, and scraped asbestos-laden insulation from the equipment."<sup>110</sup>

#### IMPLICATIONS OF THE NEW RULE

While the new rule is a step in the right direction in providing more meaningful safe harbors for lenders, certain important questions with which lenders have been grappling still remain unanswered. It is still unclear, and consequently left to the courts to decide, whether certain specific actions commonly pursued by lenders to protect their security interests will cause them to lose the security interest exemption.

For example, may a lender exercise control over certain distinct areas of the borrower or its business such as appointing a new manager, approving leases or establishing parameters regarding the approval of leases without being considered to be participating in management? Can the lender, prior to a foreclosure sale, become involved in managing the facility (directly as a mortgagee in possession, or indirectly through the appointment of a receiver), if the borrower has abandoned the property? The EPA's commentary to the rule sheds some light on, but does not directly answer, these questions. In the commentary, the EPA stated that a lender should be able to act in a manner consistent with normal lending practices,<sup>111</sup> but it also has stated that a lender cannot take control of a facility until after foreclosure.<sup>112</sup>

Another ambiguity concerns how contingent interests, shared-appreciation mort-

gages, or other participating interests will be treated. Will amounts due to lenders based on such participating interests be considered as part of the indebtedness due the lender and, consequently become part of the amount that is deemed as fair consideration for the property? In other words, can a lender, after foreclosure, reject a purchase offer that does not include this amount without losing the security interest exemption? Also, if the participating interest is recovered by the lender, will this be considered a "windfall" to the lender that the EPA can recover if the government has spent money to clean up the property?<sup>113</sup> Furthermore, would the presence of a significant participating interest cause the lender's "indicia of ownership" no longer to be primarily for protecting a security interest, but instead be deemed as primarily an investment, causing the lender to lose the security interest exemption?<sup>114</sup>

In addition to these ambiguities, lenders must be aware of certain limitations in relying on the rule. First, it is unclear whether the rule will be binding in a private-party action against a lender.<sup>115</sup> As mentioned earlier, the EPA asserts that it does have authority to issue a "legislative" or "substantive" rule that would be binding on private-party actions against lenders.<sup>116</sup> In support of this position, the EPA has stated that it issued the rule as a revision to the National Oil and Hazardous Substances Pollution Contingency Plan, under the authority of CERCLA §§ 105 and 115.<sup>117</sup> Further, as mentioned earlier, the rule has undergone notice and comment pursuant to the Administrative Procedure

104 In making this ruling, the court further noted that it was appropriate to ask whether a reasonable, similarly situated secured creditor acting primarily to protect its security interest would have engaged in the actions taken by the creditor and that even though neither the secured creditor exemption nor the EPA's rule expressly requires consideration of this factor, such consideration is warranted to ensure consistency between Congress' intent in creating the exemption and application of the exemption. 1993 WL 156633 at \*5.

105 1993 WL 156633 at \*4-10.

106 *Id.* at \*15. The court also ruled that although Fleet Factors "arranged for disposal" within the meaning of CERCLA § 107(a)(3), its holding title to the plant site precluded finding it liable under both § 107(a)(2) and (3). *Id.* at \*13-15.

107 *Id.* at \*8.

108 *Id.* at \*7-8.

109 *Id.* at \*8-9.

110 *Id.* at \*9.

111 57 Fed. Reg. 18,344, 18,357 (1992).

112 *Id.*

113 *See id.* at 18,365.

114 *See id.* at 18,354, 18,362.

115 *See infra* at n.128. The rule has been challenged by the Michigan attorney general and the Chemical Manufacturers Association as invalid based on the argument that the EPA exceeded its authority under CERCLA. *Michigan v. EPA*, C.A. No. 92-1312 (Pet. filed July 28, 1992); *Chemical Mfrs. Ass'n v. EPA*, CA No. 92-1314 (Pet. filed July 28, 1992). *See also* BNA, Environmental Reporter, Aug. 7, 1992, page 1142.

116 57 Fed. Reg. 18,344, 18,368 (1992).

117 *Id.*



Act and, consequently, according to the EPA is binding on private-party litigation as well as on government actions.<sup>118</sup>

Second, the rule only governs the security interest exemption to CERCLA liability that lenders would experience as an owner or operator. It does not cover other sources of strict liability faced by lenders under other federal statutes (such as the Resource Conservation & Recovery Act ("RCRA")), state or local statutes, or common law. The EPA has stated, however, that it is working on a rule to interpret the security interest exemption under RCRA that would be similar to the rule for CERCLA.<sup>119</sup>

Finally, as previously discussed, a lender could be liable under CERCLA as a generator or transporter if the lender arranges for the disposal of environmental contaminants on property it owns or in which it holds a security interest.<sup>120</sup>

## GUIDELINES TO LENDERS

### A. Environmental Audits

One of the best methods of reducing exposure to environmental liability is to obtain a thorough environmental assessment of the property before making a loan secured by such property. Then, update the audit before foreclosing or otherwise taking title to the property. The EPA notes that the rule confirms that while performing an audit is not necessary to keep the exemption, a lender can require a borrower to obtain an environmental audit and to comply with the recommendations in the audit without losing the security interest exemption.<sup>121</sup> In requiring such actions, however, the lender should be careful to leave the decision making in the hands of the borrower or the lender could lose the exemption. The rule also states that

even if a lender did not obtain an audit before it first loaned money to a borrower, if it obtains an audit prior to foreclosure, it can still maintain its entitlement to the innocent landowner defense.<sup>122</sup>

### B. Loan Documentation

The rule also confirms that a lender may obtain protections against environmental liabilities through indemnities, representations, warranties, and covenants from a borrower regarding the presence of hazardous materials and compliance with laws.<sup>123</sup> Loan documents, however, should be reviewed carefully with an eye toward eliminating or modifying any rights granted to the lenders that could be construed as the lender exercising control over the decision-making functions of the borrower with respect to the property. For example, loan documents should not permit a lender to appoint the manager of the property, especially prior to default, but instead provide criteria for approving or rejecting a manager proposed by the borrower. Similarly, the loan documents should provide leasing parameters and criteria for approving or rejecting leases rather than absolute discretion to the lender in approving or rejecting leases.

### C. Cleanup

If a cleanup is necessary while the borrower still has possession of the property, or if there are problems concerning operations on the property that require a loan workout, to the extent possible the lender should exercise all rights under the loan documents in a manner geared toward obtaining information, giving advice, and attempting to influence the borrower. The lender should not attempt to control the decision making of the borrower.

### D. Foreclosure and Resale of Property

The rule confirms that even though a lender can acquire property at foreclosure and still be entitled to the security interest exemption, the exemption is not assignable (although any person acting on behalf of or for the benefit of a lender is covered by the security interest exemption).<sup>124</sup> Furthermore, the lender must disclose to the purchaser any environmental information it has on the property it is trying to convey or else the lender will lose the innocent landowner defense.<sup>125</sup> Thus, ultimately, the liability for cleanup will affect the value of the property. Clearly, if the potential costs of cleanup to which the lender will be exposed exceed the value of the property, the lender should not bid on that property. Once a lender has decided to foreclose and is the successful bidder at the foreclosure sale, the rule requires the lender to follow specific procedures and deadlines for advertising and selling the property.<sup>126</sup> These include attempting to sell the property as soon as commercially possible after the foreclosure and not rejecting bids that equal or exceed the debt owed by the borrower.<sup>127</sup>

## CONCLUSION

As noted by the decisions rendered since the issuance of the rule, the rule already serves as a highly useful set of guidelines to lenders on what actions they can and should take to maintain the important security interest exemption.<sup>128</sup> Nonetheless, as noted in the previous discussion, the rule is not a panacea; lenders must proceed deliberately, purposefully, and with circumspection when making loans secured by property and when deciding how to protect their secured interest through workout or foreclosure.

118 *Id.*

119 *Id.* at 18,349.

120 *See supra* n.7.

121 57 Fed. Reg. 18,344, 18,347 (1992).

122 *Id.* at 18,353.

123 *Id.* at 18,377.

124 *Id.* at 18,360 - 18,364.

125 *See* 42 U.S.C. § 9607(b)(3) (1988).

126 40 C.F.R. § 300.1100(d)(2)(i) (1992).

127 40 C.F.R. § 300.1100(d)(2)(ii) (1992).

128 Even if not upheld in *Michigan v. EPA* or *Chemical Mfrs. Ass'n v. EPA* (see *supra* n.115), the rule still offers significant insight to lenders regarding the agency's interpretation of the exemption.