

# Lender Liability Under CERCLA — Past, Present and Future

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## I. INTRODUCTION

In the late 1970s, national public attention became focused on the severity and enormity of the problem of inactive and abandoned hazardous waste sites in the United States.<sup>1</sup> As a result, the Comprehensive Environmental Response, Compensation, and Liability

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1. In 1978, President Carter declared the Niagara Falls, New York community that was affected by the Love Canal debacle the site of a national emergency. BRUCE YAN-  
DLE, *THE POLITICAL LIMITS OF ENVIRONMENTAL REGULATION* 108 (1989). In 1979, the United States Environmental Protection Agency (“EPA”) estimated that between 30,000 and 50,000 inactive and uncontrolled hazardous waste sites existed in the United States. H.R. REP. NO. 1016, Part I, 96th Cong., 2d Sess. 18 (1980), *reprinted in* 1980 U.S.C.A.N. 6119, 6120.

Act of 1980 ("CERCLA")<sup>2</sup> was hurriedly enacted during the final days of the Ninety-Sixth Congress.<sup>3</sup> CERCLA was designed to supplant the inadequacy of existing law to control the widespread hazardous waste site problems that resulted from improper, negligent, and reckless hazardous waste disposal practices.<sup>4</sup>

The purpose of CERCLA is to effectuate the cleanup of hazardous waste sites. To accomplish that objective, the federal government<sup>5</sup> may use "Superfund"<sup>6</sup> resources to pay for the expense of cleanup when a quick response is necessary, or when the party or parties responsible for the hazardous waste are unknown, cannot be found or do not have the wherewithal to pay for the cleanup expense. When certain responsible parties are known and found, the government may compel them to pay for the cost of cleanup by ordering those parties either to have the site cleaned up or to reimburse the government if Superfund resources have already been used to pay for the cleanup.

Specifically excluded from the categories of persons who might otherwise be liable for CERCLA cleanup expenses are secured creditors, provided that certain conditions are met. This exclusion, which is idiomatically known as the secured creditor exemption or security interest exemption, shields lenders from CERCLA cleanup

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2. Pub. L. No. 96-510, 94 Stat. 2767 (1980) (codified as amended at 42 U.S.C. §§ 9601-9675 (1988 & Supp. I 1989)).

3. CERCLA has been described as "a hastily drawn piece of compromise legislation, marred by vague terminology and deleted provisions." *United States v. Northeastern Pharmaceutical & Chemical Co., Inc.*, 579 F.Supp 823, 838 n.15 (W.D. Mo. 1984), *aff'd in part and rev'd in part*, 810 F.2d 726 (8th Cir. 1986), *cert. denied*, 484 U.S. 848 (1987). See also Frank P. Grad, *A Legislative History of the Comprehensive Environmental Response, Compensation and Liability ("Superfund") Act of 1980*, 8 COLUM. J. ENVTL. L. 1 (1982).

4. H.R. REP. No. 1016, Part I, 96th Cong., 2d Sess. 17-18 (1980), *reprinted in* 1980 U.S.C.A.N. 6119, 6120.

5. The EPA has been delegated primary responsibility. Executive Order No. 12,316, 3 C.F.R. § 168 (1982).

6. CERCLA is commonly referred to as the "Superfund Act" or simply "Superfund" because one of its key features was the creation of a "Superfund" to pay for cleanup expenses relating to hazardous waste sites. From 1981 through 1985, the Superfund was a \$1.6 billion fund financed by taxes on petroleum, feedstock chemicals, and appropriated general revenues. 42 U.S.C. § 9631 (1982) *repealed by* Pub. L. No. 99-499, 100 Stat. 1613, 1774 (1986). The Superfund Amendments and Reauthorization Act of 1986 ("SARA") expanded and extended the Superfund by making an additional \$8.5 billion available through 1991 to clean up hazardous waste sites. Pub. L. No. 99-499, §§ 511-531, 100 Stat. 1613, 1760-1782 (1986)(codified as amended at 26 U.S.C. §§ 4611-4612, 4661-4662 (1988 & Supp. I 1989)). In 1990, the Superfund was again expanded and extended, this time by making an additional \$5.1 billion available through 1994. Pub. L. No. 101-508, § 6301, 104 Stat. 1388-1, 1388-319 (1990)(as codified at 42 U.S.C. § 9611 (1988 & Supp. II 1990)).

liability that might otherwise arise because of a borrower's hazardous waste disposal practices. However, shortly after CERCLA was enacted, lenders and their attorneys became plagued with uncertainty as to what activities could be undertaken by lenders without voiding the security interest exemption.

After giving an overview of CERCLA, this article will examine the few cases which have addressed the secured creditor exemption. A brief excursus will then follow on the potential CERCLA liability of shareholders, corporate officials and successor entities, as well as on certain bankruptcy issues. The article will then analyze recent regulations and proposed legislation designed to clear up the uncertainty surrounding the security interest exemption. Finally, it will discuss what lenders should consider doing in order to minimize their risk of becoming liable for cleanup expenses under CERCLA.

## II.

### OVERVIEW OF CERCLA

#### A. Remedial Nature of CERCLA

CERCLA's general scheme is to allow the federal government to take appropriate action whenever a hazardous substance<sup>7</sup> is released<sup>8</sup> into the environment<sup>9</sup> which may present an imminent and substantial danger to public health or welfare.<sup>10</sup> To respond<sup>11</sup>

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7. "Hazardous substance" means many materials regulated under other federal statutes, including, without limitation, substances regulated under the Federal Water Pollution Control Act at 33 U.S.C. § 1321(b)(2)(A) (1988 & Supp. II 1990), hazardous waste having the characteristics identified under or listed pursuant to section 3001 of the Solid Waste Disposal Act, 42 U.S.C. § 6921 (1988 & Supp. II 1990), toxic pollutants listed under section 307(a) of the Federal Water Pollution Control Act, 33 U.S.C. § 1317(a) (1988 & Supp. II 1990), hazardous air pollutants listed under section 112 of the Clean Air Act, 42 U.S.C. § 7412 (1988 & Supp. II 1990), and hazardous substances that are regulated under Section 7 of the Toxic Substances Control Act, 15 U.S.C. § 2606 (1982 & Supp. III 1991). The term does not include petroleum, including crude oil, not otherwise listed or designated as a hazardous substance pursuant to the foregoing, or natural gas, natural gas liquids, liquified natural gas, or synthetic gas usable for fuel. 42 U.S.C. § 9601(14) (1988 & Supp. II 1990).

8. "Release" means "any spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing into the environment (including the abandonment or discarding of barrels, containers, and other closed receptacles containing any hazardous substance or pollutant or contaminant) . . . ." 42 U.S.C. § 9601(22) (1988).

9. "Environment" means any water, land surface or air within the United States or under the jurisdiction of the United States. 42 U.S.C. § 9601(8) (1988).

10. 42 U.S.C. § 9604(a) (1988).

11. "Respond" or "response" means "remove, removal, remedy and remedial action." 42 U.S.C. § 9601(25) (1988). "Remove" or "removal" means generally the cleanup or removal of released hazardous substances from the environment and any

quickly without first attempting to locate the responsible parties, the government may use Superfund resources to clean up the site.<sup>12</sup> The government may then seek to recover the cleanup expense from certain categories of responsible parties.<sup>13</sup> Alternatively, the government may forego using Superfund money and simply order responsible parties to clean up the site at their expense.<sup>14</sup> Responsible parties are also liable for response costs incurred by private parties.<sup>15</sup>

The consequences of non-compliance with a cleanup order are not to be taken lightly. First, if Superfund resources are used for the cost of cleaning up a site, a statutory lien in favor of the government attaches to all real property and real property rights that are subject to or affected by the removal or remedial action.<sup>16</sup> Additionally, any person who is liable for a release of a hazardous substance, and who fails to perform removal or remedial action when ordered to do so, may be fined up to \$25,000.00 for each day of noncompliance,<sup>17</sup> and is liable for punitive damages equal to three times the amount of costs paid for by Superfund resources.<sup>18</sup>

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other actions that are necessary to prevent and mitigate damage to the public health or welfare or to the environment. 42 U.S.C. § 9601 (23) (1988). "Remedy" or "remedial action" means generally action of a more permanent nature than removal, taken instead of or in addition to removal to prevent and minimize the release of hazardous substances so that they do not migrate to cause substantial danger to present or future public health or welfare or to the environment. 42 U.S.C. § 9601 (24) (1988). A removal action is generally action taken to temporarily remedy the condition, and may involve something as simple as putting a fence around the property. A remedial action is designed to have a more long-term effect, such as putting a clay cap on top of the site.

12. 42 U.S.C. § 9611 (1988).

13. "[T]hose [parties who are] responsible for the problems caused by hazardous wastes were intended to bear the costs and responsibilities for remedying the condition." *United States v. Chem-Dyne Corp.*, 572 F. Supp. 802, 806 (S.D. Ohio 1983).

14. 42 U.S.C. § 9606(a) (1988).

15. 42 U.S.C. § 9607(a) (1988). Private parties may only sue responsible parties for reimbursement of response costs incurred by the private parties. Private parties may also use Superfund resources to pay for response costs relating to sites listed on the National Priorities List. 40 C.F.R. § 300.425 (b)(1) (1992). Currently, there are 1,188 sites on the national priorities list, and a proposal has been made by the EPA to add another 23 sites to the list. 56 Fed. Reg. 35840 (1991) (to be codified at 40 C.F.R. pt. 300)(proposed July 29, 1991).

16. 42 U.S.C. § 9607(l) (1988). However, in a recent case the Superfund lien was held to violate the due process clause of the Fifth Amendment of the Constitution because the lien provision in CERCLA "completely lacks procedural safeguards" to protect someone with a defense to the claim. *Reardon v. United States*, 947 F.2d 1509, 1523 (1st Cir. 1991).

17. 42 U.S.C. § 9606(b)(1) (1988).

18. 42 U.S.C. § 9607(c)(3) (1988).

### B. *Potentially Responsible Parties*

There are four classes of potentially responsible parties under CERCLA. They are: (a) current owners and operators of a facility;<sup>19</sup> (b) any person who owned or operated a facility at the time hazardous substances were disposed of at the facility; (c) any person who arranges for treatment or disposal of hazardous substances at a facility; and (d) transporters of hazardous substances who select the facility for the disposal of the hazardous substances.<sup>20</sup>

### C. *Retroactivity, and Joint, Several and Strict Liability*

The liability arm of CERCLA extends far and wide. CERCLA is retroactive, so parties may be liable for acts or omissions occurring before the date of CERCLA's enactment.<sup>21</sup> Moreover, strict liability applies under CERCLA.<sup>22</sup> Parties are also jointly and severally liable for the entire cleanup expense unless the costs are divisible.<sup>23</sup>

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19. "Facility" means:

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

42 U.S.C. § 9601(9) (1988). Liability under CERCLA also arises when, instead of a facility, a vessel is affected by hazardous substances. "Vessel" means "every description of watercraft or other artificial contrivance used, or capable of being used, as a means of transportation on water." 42 U.S.C. § 9601(28) (1988).

20. 42 U.S.C. § 9607(a) (1988).

21. *Kelley v. Thomas Solvent Co.*, 714 F. Supp. 1439, 1443 (W.D. Mich. 1989); *Am-land Properties Corp. v. Aluminum Co. of America*, 711 F. Supp. 784, 790 (D.N.J. 1989). Retroactive application of CERCLA does not violate due process. *United States v. Monsanto Co.*, 858 F.2d 160, 174 (4th Cir. 1988), *cert. denied*, 490 U.S. 1106 (1989); *United States v. Northeastern Pharmaceutical & Chem. Co.*, 810 F.2d 726, 734 (8th Cir. 1986), *cert. denied*, 484 U.S. 848 (1987).

22. *Monsanto*, 858 F.2d at 170; *see also* *United States v. Bliss*, 667 F. Supp. 1298, 1304 (E.D. Mo. 1987) (liability under CERCLA is strict, without regard to the liable party's fault or state of mind); *United States v. Dickerson*, 640 F. Supp. 448, 451 (D. Md. 1986). CERCLA itself shows the intent of Congress to hold parties strictly liable because the statute provides that liability under CERCLA "shall be construed to be the standard of liability" under section 311 of the Clean Water Act [Federal Water Pollution Control Act], 33 U.S.C. § 1321 [1988], which courts have held to be strict liability." *New York v. Shore Realty Corp.*, 759 F.2d 1032, 1042 (2nd Cir. 1985); *see also* *Steuart Trans. Co. v. Allied Towing Corp.*, 596 F.2d 609, 613 (4th Cir. 1979).

23. *Monsanto*, 858 F.2d at 171; *see also* *United States v. Bliss*, 667 F. Supp. at 1312 (E.D. Mo. 1987); *United States v. Stringfellow*, 661 F. Supp. 1053, 1060 (C.D. Cal. 1987). Although CERCLA does not mandate joint and several liability, it permits it. *Monsanto*, 858 F.2d at 171; *see also* *Shore Realty Corp.*, 759 F.2d at 1042 n.13; *United States v. Chem-Dyne Corp.*, 572 F. Supp. 802, 810 (S.D. Ohio 1983). If there is a reasonable basis for apportionment of damages resulting from divisible harm, each

However, the burden of proof of such apportionment is upon each potentially responsible party.<sup>24</sup> Moreover, indemnification, hold harmless, and similar agreements are ineffective to shield someone from CERCLA liability to the government.<sup>25</sup> Notably, the statute itself does not contain any provisions for retroactive application, or for joint, several or strict liability. Such applications came about jurisprudentially, illustrating the general view of the courts that when it comes to abandoned hazardous waste sites, the liability net is to be cast out as far as possible.

Still, though liability under CERCLA is strict, it is not absolute. There are three defenses. The first two are acts of war and acts of God.<sup>26</sup> The third defense, known as the innocent landowner defense, applies when damages resulting from a release of a hazardous substance are caused solely by someone other than the potentially responsible party. This defense requires that at the time the property was acquired, the potentially responsible party had no knowledge or reason to suspect that any hazardous substance was present on the property,<sup>27</sup> and further, that the party exercised due care with respect to the hazardous substance involved and took precautions against foreseeable acts or omissions of a third party and the consequences that could foreseeably result from such acts or omissions.

### III.

#### SECURED CREDITOR EXEMPTION

##### A. *In General*

The CERCLA definition of "owner or operator" is not coextensive with all possible uses of the term. Specifically excluded is "a

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party is liable only for the portion of the harm that he or she caused. *Chem-Dyne Corp.*, 572 F. Supp. at 811.

24. *Chem-Dyne Corp.*, 572 F. Supp. at 811.

25. 42 U.S.C. § 9607(e) (1988). However, such agreements may be binding between the parties to such an agreement. *Id.*

26. 42 U.S.C. § 9607(b)(1)&(2) (1988). "Act of God" means an "unanticipated grave natural disaster or other natural phenomenon of an exceptional, inevitable, and irresistible character, the effects of which could not have been prevented or avoided by the exercise of due care or foresight." 42 U.S.C. § 9601(1) (1988).

27. 42 U.S.C. §§ 9601(35)(A) and 9607(b)(3) (1988). A purchaser of property must make extensive inquiries in order to avail itself of the innocent landowner defense. See 42 U.S.C. § 9601 (35)(B) (1988). However, too much diligence may vitiate the defense because once a purchaser has knowledge of the presence of hazardous substances on the property the defense is no longer available. Roger D. Schwenke, *Environmental Liabilities Imposed on Landowners, Tenants and Lenders - How Far Can and Should They Extend?*, 18 *Env'tl. L. Rep.* (Env'tl. L. Inst.) 10,361, at 10,364 (1988).

person,<sup>28</sup> who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect a security interest in the vessel or facility.”<sup>29</sup> As the following discussion on the cases will show, the potential CERCLA liability of a secured lender hinges on the degree to which the lender involves itself in the management of its borrower’s business enterprise.

## B. Secured Creditor Exemption Cases

### 1. *United States v. Mirabile*

The first case to address the potential CERCLA liability of a secured creditor as an owner or operator of a facility was *United States v. Mirabile*.<sup>30</sup> In that case, suit was filed against the present owners of property to recover CERCLA cleanup expenses. The owners then filed a third-party claim against three creditors who provided financing to a corporation which operated a paint manufacturing business on the property when hazardous substances were released there.

Prior to the government filing suit, one of the creditors, American Bank and Trust Company, foreclosed on its mortgage and was the highest bidder at the foreclosure sale. However, the bank did not take title to the property. Instead, it continued to negotiate with third parties for a sale of the property. Four months later, the bank assigned its foreclosure sale bid to the Mirabiles who owned the property at the time the lawsuit was filed. During those four months, the bank sought to protect a building located on the property from vandalism by boarding up windows and changing locks. The bank also inquired about the cost of disposing of several drums of hazardous waste located on the property and visited the property several times in order to show it to prospective purchasers. All of the bank’s activities took place several months after the paint manufacturing business ceased operations at the site.

In rejecting to the government’s assertion that American Bank and Trust Company was liable for cleanup expenses as an owner or operator, the court held that a secured lender will not be liable for cleanup costs as long as the lender “does not become overly entan-

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28. “Person” means “an individual, firm, corporation, association, partnership, consortium, joint venture, commercial entity, United States Government, State, municipality, commission, political subdivision of a State, or any interstate body.” 42 U.S.C. § 9601(21) (1988).

29. 42 U.S.C. § 9601(20)(A) (1988).

30. 15 Env’tl. L. Rep. (Env’tl. L. Inst.) 20,994 (E.D. Pa. Sept. 4, 1985).

gled in the affairs of the actual owner or operator of a facility.”<sup>31</sup> The court explained:

The reference to management of the “facility,” as opposed to management of the affairs of the actual owner or operator of the facility, suggests once again that the participation which is critical is participation in operational, production, or waste disposal activities. Mere financial ability to control waste disposal practices of the sort possessed by the secured creditors in this case is not, in my view, sufficient for the imposition of liability.<sup>32</sup>

Congress’ intent in enacting CERCLA was “to impose liability upon those who were responsible for and profited from improper disposal practices.”<sup>33</sup> In *Mirabile* the actions taken by American Bank and Trust Company were efforts to protect its security interest in the property and did not constitute participation in the management of the facility.<sup>34</sup> The court held that CERCLA liability will not attach to a secured creditor who does not, at a minimum, participate in the “day-to-day operational aspects” of a site. Finding the bank’s actions to be “prudent and routine steps to secure the property against further depreciation,”<sup>35</sup> the court granted the bank’s motion for summary judgment.<sup>36</sup>

## 2. *United States v. Maryland Bank & Trust Co.*

The next case to address the issue of secured lender liability under CERCLA was *United States v. Maryland Bank & Trust Co.*<sup>37</sup> In that case, Maryland Bank & Trust had held a mortgage on property since 1980. In 1981, the bank instituted foreclosure proceedings and in 1982 purchased the property at a foreclosure sale. One year later, the Environmental Protection Agency (“EPA”) removed

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31. *Id.* at 20,995.

32. *Id.*

33. *Id.* at 20,966.

34. *Id.*

35. *Id.*; accord *United States v. Nicolet, Inc.*, 712 F. Supp. 1193, 1204-05 (E.D. Pa. 1989) (where the court, in ruling on the government’s motion for leave to file second amended complaint, said, “[e]xisting case law suggests that a mortgagee can be held liable under CERCLA only if the mortgagee participated in the managerial and operational aspects of the facility in question.” *Id.* at 1205).

36. Another creditor named as a defendant in the case was the Small Business Administration. However, because there was no evidence of any “day-to-day” management by the Small Business Administration, summary judgment was also entered in its favor. *Id.* at 20,997. The third creditor, Mellon Bank, was not able to prevail on its motion for summary judgment because genuine issues of fact existed as to whether Mellon Bank engaged in the sort of management participation activities that would make it liable as an owner or operator under CERCLA. *Id.*

37. 632 F. Supp. 573 (D. Md. 1986).

237 drums of hazardous waste and 1,180 tons of contaminated soil. The government then filed suit against the bank, as owner of the property, to recover the cleanup expenses.

The court rejected the bank's attempt to invoke the security interest exemption, saying:

The exemption of subsection (20)(A) [42 U.S.C. § 9601(20)(A) (1988)] covers only those persons who, at the time of the clean-up [sic], 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 [sic]. The mortgage held by [the bank] . . . terminated at the foreclosure sale . . .<sup>38</sup>

The court determined that the bank's purchase of the property at the foreclosure sale was done not to protect its security interest, but to protect its investment. Ruling that the security interest terminated as a result of the foreclosure sale, the court did not consider it possible for the bank to own the property to protect a security interest that no longer existed.<sup>39</sup>

Moreover, the court refused to allow a secured creditor to escape CERCLA liability by acquiring property at a foreclosure sale, as this would "convert CERCLA into an insurance scheme for financial institutions."<sup>40</sup> A secured lender could acquire property at a foreclosure sale without incurring CERCLA liability, have the property cleaned up at the government's expense, and then sell the property in its cleaned-up condition at a profit.<sup>41</sup>

Accordingly, the court granted the government's summary judgment motion finding the bank liable as an owner under CERCLA.<sup>42</sup> Once the bank acquired title to the property, the security interest was extinguished, and the secured creditor exemption no longer applied.<sup>43</sup>

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38. *Id.* at 579. In addition, the court said that an owner could not also be an operator, even though 42 U.S.C. § 9607(a)(1) (1988) provides that an owner *and* operator shall be liable for cleanup expenses. The court said that the legislative history of CERCLA indicates that Congress intended for owners and operators of facilities to be potentially liable, but, by definition, that the owner and operator could not be one and the same person. *Id.* at 578.

39. *Id.* at 579.

40. *Id.* at 580.

41. *Id.*

42. *Id.* at 582.

43. In distinguishing *United States v. Mirabile*, 15 *Envtl. L. Rep.* (Envtl. L. Inst.) 20, 994 (E.D. Pa. Sept. 4, 1985) from *Maryland Bank & Trust*, the court compared the fact that in *Mirabile* the security interest holder promptly assigned the property, while in *Maryland Bank & Trust* the bank held the property for nearly four years, and a full year before the EPA cleanup. *Id.* at 579. The court said it "need not consider the issue of

The court reasoned that lenders may protect themselves from the impact of losing the secured creditor exemption by investigating and discovering potential problems and "making prudent loans."<sup>44</sup> According to the court, mortgagees may insulate themselves from CERCLA liability by, for example, not foreclosing and not bidding at the foreclosure sale.<sup>45</sup> However, the court did not address how lenders may protect themselves in a situation where a debtor has insufficient assets other than the mortgaged property to pay the balance of the loan. If a lender in that situation neither foreclosed nor bid at a foreclosure sale, as the court recommends, the lender would effectively be relegated to the position of an unsecured creditor. On the other hand, if a creditor were to foreclose and purchase the property at a foreclosure sale, it would run the risk of becoming liable for CERCLA cleanup expenses. Moreover, making a "prudent loan," as the court suggests, is no guarantee that the property will not be affected by hazardous substances. It is quite possible that even the choicest of loans may involve property that, unbeknownst to either the lender or to the borrower, has been used for surreptitious dumping of hazardous waste by a trespasser. The court did not offer any guidance to lenders as to how they might protect themselves from CERCLA liability in that situation either.

### 3. *Guidice v. BFG Electroplating and Manufacturing Co.*

*Guidice v. BFG Electroplating and Manufacturing Co., Inc.*<sup>46</sup> involved a third-party action by current owners of property to recover CERCLA cleanup expenses from current and past owners of adjacent property. These included National Bank of the Commonwealth which had held title to the adjacent property for eight months following foreclosure on its mortgage. There were two issues relating to the bank's potential liability. One was whether certain actions taken by the bank during the existence of the mortgage, but prior to a foreclosure sale, voided the secured creditor exemption. The other issue was the bank's potential liability after acquiring title to the property.

The steps taken by the bank prior to the foreclosure sale consisted of meetings with officials of the mortgagor's business to discuss the

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whether a secured party which purchased the property at a foreclosure sale and then promptly resold it would be precluded from asserting the section 101(20)(A) exemption." *Id.* at 579 n.5.

44. *Id.* at 580.

45. *Id.* at n.6.

46. 732 F. Supp. 556 (W.D. Pa. 1989).

status of company accounts, personnel changes, and raw materials inventory. Bank officials also assisted the mortgagor in completing application forms that the company was submitting to the Small Business Administration for another loan. After business operations at the mortgagor's facility ceased, the bank met several times with company officials to discuss the possibility of restructuring the bank loan. The bank also referred a potential lessee of the property to the company's attorney.

The court held that the actions taken by the bank prior to purchasing the property at the foreclosure sale were insufficient to void the secured creditor exemption because there was no evidence to show that the bank "controlled operational, production, or waste disposal activities" at the facility.<sup>47</sup> Instead, the court concluded that the bank's actions were simply "prudent measures undertaken to protect its security interest in the property."<sup>48</sup> Explaining the exemption, the court said:

There are policy reasons for exemption of secured creditors . . . from CERCLA liability prior to the secured creditor's purchase of the property at foreclosure. A goal of CERCLA is safe handling and disposal of hazardous waste. To encourage banks to monitor a debtor's use of security property, a high liability threshold will enhance the dual purposes of protection of the bank's investments and promoting CERCLA's policy goals. Conversely, a low liability standard would encourage a lender to terminate its association with a financially troubled debtor and expedite loan payments in an effort to recover the debts.<sup>49</sup>

With regard to the bank's potential liability during the time it actually owned the property, the court examined the divergent results reached by the courts in *Mirabile* and *Maryland Bank & Trust* in light of the Superfund Amendments and Reauthorization Act ("SARA") amendments to CERCLA.<sup>50</sup> The court concluded that SARA supports the narrowness of the *Maryland Bank & Trust* holding. While SARA specifically excluded state and local governments from liability as an owner or operator when ownership or control of property is acquired involuntarily through bankruptcy, tax delinquency, abandonment or similar means,<sup>51</sup> it failed to exempt from liability secured creditors who acquire property through

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47. *Id.* at 562.

48. *Id.*

49. *Id.*

50. *See supra* note 6.

51. 42 U.S.C. § 9601(20)(D) (1988)(as amended by SARA, Pub. L. No. 99-499, § 101(b)(1)) In such a case, any person who owned, operated or controlled activities at

foreclosure. Noting the disparate treatment of these two types of owners, the court reasoned that Congress must have intended to hold secured creditor owners liable under CERCLA.<sup>52</sup>

#### 4. *United States v. Fleet Factors Corp.*

The uncertainty of potential lender liability under CERCLA was augmented by *United States v. Fleet Factors Corp.*<sup>53</sup> In that case, the government sought to recover response costs incurred in connection with the removal of hazardous waste from a site that contained 700 drums of toxic chemicals and forty-four truckloads of asbestos-containing materials. Among the potentially responsible parties was Fleet Factors Corporation ("Fleet"), which held a security interest in the contaminated property.

Pursuant to a 1976 factoring agreement, Fleet advanced funds to the owner of a cloth printing facility. The loan was secured by a security interest in the facility and all of the owner's equipment, inventory and fixtures. In 1979, the facility owner filed a petition for reorganization under the United States Bankruptcy Code.<sup>54</sup> In 1981, the owner discontinued operations and began liquidating its inventory. Later that same year, after the reorganization proceedings were converted to liquidation proceedings,<sup>55</sup> the owner of the facility was discharged from its debts and a trustee took title to the facility. In 1982, Fleet foreclosed on its security interest in the equipment, inventory and fixtures. In 1984, the EPA discovered the hazardous substances at the facility and incurred cleanup costs in the amount of \$400,000.00. In 1987, the facility was conveyed to Emanuel County, Georgia at a foreclosure sale resulting from unpaid state and county taxes.

The government later sued Fleet, among others, to recover the cost of cleaning up the hazardous waste. The government asserted that Fleet was liable for the response costs incurred by the government, either as a present owner and operator of the facility<sup>56</sup> or as the owner or operator of the facility at the time the hazardous substances were disposed of on the property.<sup>57</sup>

In determining whether Fleet was a present owner and operator,

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the facility "immediately beforehand" is held liable. *Guidice*, 732 F. Supp. at 563 (construing 42 U.S.C. § 9601 (20)(D) (West Supp. 1989)).

52. *Id.*

53. 901 F.2d 1550 (11th Cir. 1990), *cert. denied*, 111 S. Ct. 752 (1991).

54. 11 U.S.C. §§ 1101-1174 (1988 & Supp. II 1990).

55. 11 U.S.C. §§ 701-766 (1988 & Supp. II 1990).

56. 42 U.S.C. § 9607(a)(1) (1988).

57. 42 U.S.C. § 9607(a)(2) (1988).

the court construed the meaning of present owner and operator as the person owning or operating the facility at the time the plaintiff's lawsuit is filed.<sup>58</sup> When the lawsuit was filed against Fleet, the owner of the facility was not Fleet, but Emanuel County, Georgia. However, CERCLA exempts from liability, as an owner or operator, a unit of state or local government that involuntarily acquires title to a facility.<sup>59</sup> In such a case, the owner or operator is deemed to be the person who "owned, operated or otherwise controlled activities at such facility immediately beforehand."<sup>60</sup> The court said that because the bankruptcy trustee was the owner and operator of the facility immediately prior to the sale to Emanuel County, Fleet was not liable as a present owner or operator.<sup>61</sup> The court added that the phrase "immediately beforehand" means "without intervening ownership, operation, and control."<sup>62</sup> Fleet's involvement with the facility ended more than three years before the county acquired title.<sup>63</sup>

The question of Fleet's liability as an owner or operator of the facility at the time the hazardous substances were released was another matter. In that context, the court confronted the secured creditor exemption, and it was the first time a federal appellate court was presented with the issue.<sup>64</sup> In dicta, the court said:

[A.] secured creditor may incur section 9607(a)(2) liability [42 U.S.C. § 9607 (a)(2)(1988)], without being an operator, by participating in the financial management of a facility to a degree indicating a capac-

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58. 901 F.2d at 1554. The court also said that even though "owner and operator" as used in 42 U.S.C. § 9607(a)(1) (1988) is in the conjunctive, the legislative history and other cases indicate that the disjunctive should have been used. *Id.* at 1554 n.3; see *Guidice v. BFG Electroplating & Mfg. Co.*, 732 F. Supp. 556, 561 (W.D. Pa. 1989); *Artesian Water Co. v. New Castle County*, 659 F. Supp. 1269, 1280 (D. Del. 1987), *aff'd*, 851 F.2d 643 (3rd Cir. 1988); *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573, 577 (D. Md. 1986). Moreover, 42 U.S.C. § 9607(a)(2) (1988) is phrased with the disjunctive and there is no rational reason why liability should be imposed upon owners *or* operators under one section but only owners *and* operators under another section. *Fleet Factors*, 901 F.2d at 1554 n.3.

59. 42 U.S.C. § 9601(20)(D), *added by* Pub. L. No. 99-499, § 101(b)(1) (1988).

60. 42 U.S.C. § 9601(20)(A)(iii) *as amended by* Pub. L. No. 99-499, § 101(b)(2) (1988).

61. 901 F.2d at 1555.

62. *Id.*

63. *Id.*

64. Preliminarily, the court said, "[I]n order to achieve the 'overwhelmingly remedial' goal of the CERCLA statutory scheme, ambiguous statutory terms should be construed to favor liability for the costs incurred by the government in responding to the hazards at such facilities." 901 F.2d at 1557; see also *Florida Power & Light Co. v. Allis Chalmers Corp.*, 893 F.2d 1313, 1317 (11th Cir. 1990); *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573, 579 (D. Md. 1986).

ity 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*.<sup>65</sup>

However, the court did say that secured lenders are permitted to "monitor. . . any aspect of a debtor's business," and may also "become involved in occasional and discrete financial decisions relating to the protection of its security interest without incurring liability."<sup>66</sup>

The court recognized the concern that its interpretation of the secured creditor exemption would dissuade lenders from providing financial assistance to businesses with potential hazardous waste problems, and thereby perpetuate rather than resolve the problem of improper hazardous waste disposal. However, the court said that such a concern is unfounded, insisting that its ruling should instead encourage creditors "to monitor the hazardous waste treatment systems and policies of their debtors and insist upon compliance with acceptable treatment standards as a prerequisite to continued and future financial support."<sup>67</sup>

In finding Fleet liable as an owner or operator of a facility at the time hazardous substances were disposed of at the facility, the court considered significant the fact that after operations were discontinued at the facility and the owner began winding down its affairs, Fleet required the owner of the facility to obtain Fleet's approval prior to shipping goods to customers. Fleet also set prices for excess inventory, dictated when and to whom goods would be shipped, determined when employees would be laid off, supervised the office administrator's activities, received and processed the owner's employment and tax forms, controlled access to the facility and hired someone to dispose of fixtures and equipment at the facility.<sup>68</sup> If the government could prove the above facts, Fleet would

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65. 901 F.2d at 1557-58 (footnote omitted).

66. *Id.* at 1558.

67. *Id.*

68. *Id.* at 1559.

not be exempt from CERCLA liability.<sup>69</sup>

The court considered Fleet's financial management of the facility "pervasive, if not complete."<sup>70</sup> Moreover, a lender's ability to influence a borrower's hazardous waste disposal practices will be inferred from the extent of the lender's involvement in the financial management of a facility.<sup>71</sup>

##### 5. *In re Bergsoe Metal Corp.*

The most recent case to address the secured creditor exemption is *In re Bergsoe Metal Corp.*<sup>72</sup> In that case, the Port of St. Helens ("Port") issued bonds to finance the purchase of land and construction of a secondary lead recycling plant by Bergsoe Metals Corporation ("Bergsoe").

In a convoluted transaction, the Port first sold land to Bergsoe, which gave the Port a promissory note and mortgage on the property. Next, the bonds were issued, with the proceeds thereof going to Bergsoe, which was obligated to pay the money owed on the bonds to a bank which held the bonds in trust. A sale and lease-back transaction then took place, whereby Bergsoe sold the land to the Port, and the Port and Bergsoe entered into two leases, one a lease by the Port to Bergsoe of the land and the other a lease by the Port to Bergsoe of the recycling plant. Rent to be paid by Bergsoe was equal to the principal and interest due on the bonds, with the rent payments to be made directly to the bank holding the bonds in trust. Bergsoe also had an option to purchase the land and recycling plant back from the Port for one hundred dollars after the bonds had been paid in full. In connection with the issuance of the bonds, the Port mortgaged the lead recycling plant property to the bank which held the bonds in trust. The Port also assigned to the bank all of its rights under the Bergsoe leases. The bank agreed to collect rent under the leases and to apply them to the retirement of the bonds. Finally, the Port placed in escrow with the bank the deed to the property and related documents and instructed the bank to deliver the documents to Bergsoe when the option to purchase was exercised after retirement of the bonds.

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69. *Id.*

70. *Id.*

71. *Id.* at n.13. The inference, however, was not necessary in this case because there was evidence that Fleet actively controlled hazardous waste disposal practices at the facility by prohibiting the owner from selling barrels of chemicals to potential buyers. The barrels were still at the facility until EPA acted to remove them. *Id.*

72. 910 F.2d 668 (9th Cir. 1990).

Not long after beginning operations, Bergsoe had financial difficulties which eventually resulted in workout documents being signed by the bank, Bergsoe, the Port, and a management company that had been appointed by the bank to manage the property on behalf of Bergsoe. Shortly after the workout agreement, Bergsoe discontinued operations at the plant and the bank forced Bergsoe into involuntary reorganization proceedings in bankruptcy. Later, the Oregon Department of Environmental Quality discovered the presence of hazardous substances on the property.

Suit was filed by the bank and the bankruptcy trustee against Bergsoe's owners, not only to collect the outstanding debts of Bergsoe, but also to request a declaration that Bergsoe's owners were liable for the cost of cleaning up the property. A third-party claim was filed against the Port, alleging that the Port was liable under CERCLA for the cleanup costs.

After a determination that the Port had a security interest in the property,<sup>73</sup> the court considered the issue of the Port's "participation in management." After quoting the dicta in *Fleet Factors*, the court said:

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.<sup>74</sup>

Without enunciating the Ninth Circuit's position on the "participation in management" question, the court adopted the rule advanced in *Fleet Factors* that some degree of actual participation in management is necessary before the secured creditor exemption will be lost. In a footnote, the court said:

[The owner of Bergsoe's stock] generally errs in equating the power to manage with actual management. As did the Eleventh Circuit in *Fleet Factors*, we hold that a creditor must, as a threshold matter, exercise actual management authority before it can be held liable for action or inaction which results in the discharge of hazardous wastes. Merely having the power to get involved in management, but failing to exercise it, is not enough.<sup>75</sup>

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73. The court determined that the Port's ownership of the property was to "ensure that Bergsoe would meet its obligations under the leases and therefore under the bonds." *Id.* at 671.

74. *Id.* at 672.

75. *Id.* at 673 n.3.

The court did not consider the fact that the Port "negotiated and encouraged" the building of the plant to be participation in management at all;<sup>76</sup> to consider such activities sufficient to cause a creditor to lose the exemption would cause the exemption to "cease to have any meaning."<sup>77</sup> The court said, "[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."<sup>78</sup>

The court also rejected an argument that because the Port had certain rights under the leases, "such as the right to inspect the premises and to reenter and take possession upon foreclosure," the Port participated in management to a sufficient degree to void the exemption;<sup>79</sup> the fact that a secured creditor has certain rights does not necessarily mean it is participating in management. The court said, "[w]hat is critical is not what rights the Port had, but what it did. The CERCLA security interest exemption uses the active 'participating in management.' Regardless of what rights the Port may have had, it cannot have participated in management if it never exercised them."<sup>80</sup>

There was no evidence that the Port exercised any control over Bergsoe after the leases were signed. As a result, the granting of the Port's motion for summary judgment was affirmed.

### C. *Status of Secured Creditor Exemption*

The few cases which have dealt with lender liability under CERCLA show that the secured creditor exemption has evolved from one that remained intact as long as a secured lender did not, at a minimum, participate in the "day-to-day operational aspects" of a site,<sup>81</sup> to an exemption that did not apply when a lender's involvement in the management of a facility was broad enough to support an inference that the lender could, if it chose, affect hazardous waste disposal decisions.<sup>82</sup> The exemption also vanished as soon as

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76. *Id.* at 672.

77. *Id.*

78. *Id.*

79. *Id.*

80. *Id.* at 672-73.

81. *United States v. Mirabile*, 15 *Envtl. L. Rep.* (*Envtl. L. Inst.*) 20,994, 20,996 (E.D. Pa. Sept. 4, 1985).

82. *United States v. Fleet Factors Corp.*, 901 F.2d 1550 (11th Cir. 1990), *cert. denied*, 111 S. Ct. 752 (1991).

a secured lender took title to property through a foreclosure sale.<sup>83</sup> What is apparent from the cases, which is consistent with the secured creditor exemption contained in CERCLA, is that the more a lender involves itself in a borrower's business, the more likely it is that the secured creditor exemption will not apply. Moreover, the longer a lender owns property after foreclosing, the less likely it will be that a lender will be able to avoid CERCLA liability by relying on the secured creditor exemption.

#### IV.

#### POTENTIAL LIABILITY UNDER CERCLA OF SHAREHOLDERS, CORPORATE OFFICIALS AND SUCCESSOR ENTITIES

##### A. *Shareholder Liability*

Not only is it possible for a creditor to lose the protection of the CERCLA secured creditor exemption by participating in the management of its borrower's facility, the creditors' shareholders, including the parent corporation if the creditor is a subsidiary, may be liable for response costs along with the creditor under CERCLA. If a shareholder dominates a corporation or controls the management and operations of the corporation, the shareholder may also be held liable for response costs for which the corporation is liable.<sup>84</sup> CERCLA places no special significance on the corporate structure.<sup>85</sup>

In a recent case, however, the Fifth Circuit has said that CERCLA does not define owners or operators to include parent corporations, nor does the legislative history indicate Congress' intent to "alter so substantially a basic tenet of corporation law."<sup>86</sup> Moreover, the court said veil piercing should be limited to situations in which the corporate entity is used as a sham to perpetuate a fraud or avoid personal liability.<sup>87</sup>

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83. *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573 (D.Md. 1986).

84. *United States v. Kayser-Roth Corp.*, 724 F. Supp. 15, 20-21 (D.R.I. 1989), *aff'd*, 910 F.2d 24 (1st Cir. 1990), *cert. denied*, 111 S. Ct. 957 (1991); *see also Idaho v. Bunker Hill Co.*, 635 F. Supp. 665, 671-72 (D. Idaho 1986). Presumably, the liability would be joint and several. *See United States v. Monsanto Co.*, 858 F.2d 160, 171 (4th Cir. 1988), *cert. denied*, 490 U.S. 1106 (1989); *United States v. Bliss*, 667 F. Supp. 1298, 1312-13 (E.D. Mo. 1987); *United States v. Stringfellow*, 661 F. Supp. 1053, 1060 (C.D. Cal. 1987).

85. *Kayser-Roth Corp.*, 724 F. Supp. at 24.

86. *Joslyn Mfg. Co. v. T.L. James & Co.*, 893 F.2d 80, 82 (5th Cir. 1990), *cert. denied*, 111 S. Ct. 1017 (1991).

87. *Id.* at 83.

### B. *Liability of Corporate Officials*

In addition to shareholders, corporate officials may also be liable for the corporation's CERCLA liability. To the extent that such officials participate in the management of a facility, are responsible for day-to-day operations, or have control or authority over the activities of a facility from which hazardous substances are released, those persons may be liable for the cleanup costs the corporation is liable for under CERCLA.<sup>88</sup>

The possible liability of shareholders and corporate officials only makes matters worse for lenders already operating in an area with unknown boundaries. If a lender were to have title to foreclosed-upon property put in the name of a subsidiary, such as a corporation specifically created to own, manage and dispose of such property, and the secured creditor dominates that corporation, the secured creditor may find itself liable, along with its subsidiary, for CERCLA cleanup expenses. Moreover, if the subsidiary undertakes the cleanup of property acquired through or in lieu of foreclosure, and if while the subsidiary owns the property another release of hazardous substances occurs because the cleanup is not done properly, the corporate officials who manage and control the subsidiary may become personally liable for CERCLA response costs.

### C. *Liability of Successor Entities*

A successor entity is also potentially liable for response costs its predecessor was liable for under CERCLA. In *Smith Land & Improvement Corp. v. Celotex Corp.*,<sup>89</sup> the court said, "[O]ur study of CERCLA persuades us that Congress intended to impose successor liability on corporations which either have merged with or have consolidated with a corporation that is a responsible party as defined in . . . [CERCLA]."<sup>90</sup>

## V.

### BANKRUPTCY CONSIDERATIONS

The quandary in which secured creditors find themselves because of the secured creditor exemption uncertainty is aggravated even more when a borrower files for bankruptcy. CERCLA cleanup ex-

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88. *United States v. Carolawn Co.*, 14 *Env'tl. L. Rep.* (Env'tl. L. Inst.) 20,669, 20,700 (D.S.C. 1984).

89. 851 F.2d 86 (3d Cir. 1988), *cert. denied*, 488 U.S. 1029 (1989).

90. *Id.* at 92. *See also* *United States v. Distler*, 31 *Env't Rep. Cas.* (BNA) 1092, 1093-94 (W.D. Ky. 1990).

penses are administrative expenses to be paid before other creditors. As a result, secured lenders are relegated to being paid after CERCLA expenses are paid.<sup>91</sup> Thus, a creditor with a security interest in property owned by a debtor who files for bankruptcy may choose not to foreclose because of the risk of CERCLA liability as an owner. Yet this secured creditor also risks not being paid anything as an unsecured creditor either, because most, if not all, of the debtor's assets will likely be used to pay administrative priority expenses, the largest such expense probably being CERCLA response costs.<sup>92</sup>

## VI.

### EPA'S REGULATIONS

#### A. *In General*

In an attempt to clarify the uncertainty faced by lenders, the EPA recently promulgated regulations defining the secured creditor exemption by describing the range of activities that a secured lender may undertake without being deemed an owner or operator of a facility.<sup>93</sup> Included within the regulations are definitions of key terms. The regulations focus on the activities of lenders at three critical junctures, namely, before a loan is made, during loan administration, and after foreclosure.<sup>94</sup>

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91. *In re T.P. Long Chem., Inc.*, 45 B.R. 278, 286-87 (Bankr. N.D. Ohio 1985); see also *In re Wall Tube & Metal Prods. Co.*, 831 F.2d 118, 123-24 (6th Cir. 1987) (post petition response costs for the cleanup of prepetition pollution or prepetition hazardous waste accumulations held to be entitled to administrative expense priority). *But see In re Dant & Russell, Inc.*, 853 F.2d 700, 709 (9th Cir. 1988) (prepetition cleanup obligations are not entitled to administrative expense priority).

92. In 1989, the EPA estimated the average cost of cleaning up a hazardous waste site was \$25 million, with the average likely to increase. *Lender Liability under Federal and State Environmental Laws and EPA's Proposed Rule on Lender Liability under CERCLA, 1991: Hearings Before the Subcomm. on Policy, Research and Insurance of the House Comm. on Banking, Finance & Urban Affairs* (statement of Joseph P. Forte and Michael L. Graham, Section of Real Property, Probate & Trust Law, American Bar Association).

93. National Oil and Hazardous Substances Pollution Contingency Plan, 57 Fed. Reg. 18,344, 18,382 (1992) (to be codified at 40 C.F.R. pt. 300).

94. A shortcoming of the regulations is that they may only apply in actions by the government against potentially responsible parties, but not actions filed by third parties against lenders for reimbursement of response costs. In the preamble to the regulations, the EPA quite naturally insists that its regulations will apply even in cases in which the government is not a party. 57 Fed. Reg. 18,344, 18,368 (1992). However, for a different viewpoint, see *Lender Liability Issues Attract Attention at Annual American Bar Association Meeting*, 22 Env't Rep. (BNA), No. 17, at 1148 (August 23, 1991).

### B. "Indicia of Ownership"

The EPA's definition of "indicia of ownership" for purposes of the secured creditor exemption is "evidence of a security interest or evidence of an interest in a security interest in real or personal property securing a loan or other obligation, including any legal or equitable title to real or personal property acquired incident to foreclosure and its equivalents."<sup>95</sup> Provided that certain other conditions are satisfied, that definition will allow a secured lender to foreclose and take title to property without losing the secured creditor exemption, which would not be the result if the holding of *Maryland Bank & Trust Co.* were followed.<sup>96</sup>

### C. "Participation in Management"

In order for the secured creditor exemption to apply, a lender must still refrain from participating in the management of a facility. Participation in the management of a facility means "actual participation in the management or operational affairs," and does not include the "mere capacity to influence, or ability to influence, or the unexercised right to control facility operations."<sup>97</sup> Thus, the regulations seem to be an attempt to overrule administratively the dicta of *Fleet Factors*.<sup>98</sup>

EPA further expands this definition by developing a two-prong test to determine whether a holder of a security interest participated in the management of a facility.<sup>99</sup> Under the first prong of the test, a holder of a security interest is considered to have participated in management if it exercised decision-making control over the borrower's environmental compliance, including hazardous substance disposal or handling practices.<sup>100</sup> The secured lender need not have actually caused a release of a hazardous substance in order to lose the security interest exemption. Merely exercising decision-making control over the borrower's environmental compliance, even if a release does not occur, makes a lender liable as an owner or

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95. 57 Fed. Reg. 18,344, 18,382 (1992) (to be codified at 40 C.F.R. § 300.1100(a)). If the creditor claims the exemption, the plaintiff has the burden of proving that the defendant is liable as an owner or operator. *Id.*

96. *See supra* notes 37 to 45 and accompanying text.

97. 57 Fed. Reg. 18,344, 18,383 (1992)(to be codified at 40 C.F.R. § 300.1100(c)(1)).

98. In the preamble to the regulations, however, the EPA states that its rule does not administratively overrule *Fleet Factors*. Instead, the EPA maintains that its rule is actually consistent with *Fleet Factors* and clarifies the dicta of that case. 57 Fed. Reg. 18,344, 18,369 (1992).

99. 57 Fed. Reg. 18,344, 18,359 (1992).

100. *Id.*

operator.<sup>101</sup>

The second prong of the test will find participation in management where a holder of a security interest exercised "control at a level comparable to that of a manager of the borrower's enterprise," to the extent that the lender assumes or manifests responsibility for overall operational aspects of the enterprise, regardless of whether such day-to-day management encompassed decision-making control over the borrower's environmental compliance.<sup>102</sup> Operational aspects include functions such as facility manager, chief operating officer or chief executive officer. On the other hand, the function of credit manager, accounts receivable or accounts payable manager, personnel manager, controller or chief financial officer are deemed financial or administrative functions, rather than operational, and thus appear to be safe territory for lenders, provided that all other conditions of the exemption are met.<sup>103</sup>

#### D. *Permitted Actions Prior to Loan*

In order to provide some specific guidance to lenders, the EPA's regulations specify what actions may be taken by lenders at various stages of a loan without voiding the security interest exemption. Nothing that lenders do prior to holding a security interest will nullify the exemption. Specifically, lenders may, as a condition to making a loan, undertake or require an environmental inspection of the facility, or require prospective borrowers to clean up a facility or respond to an inspection by ensuring that the facility remains or is maintained in compliance with all applicable environmental requirements. However, the regulations do not require that an environmental inspection be conducted before a loan is made, and the liability of a lender will not be based on or affected by a failure to have such an inspection performed.<sup>104</sup>

#### E. *Permitted Actions During Loan Administration Stage*

While a loan remains outstanding, the regulations allow a lender to police the security interest or loan without being considered as participating in the management of a facility. This includes requiring the borrower to clean up the facility and to comply with all federal, state, and local environmental and other rules and regula-

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101. *Id.*

102. *Id.* at 18,383 (to be codified at 40 C.F.R. § 300.1100(c)(1)(ii)(B)).

103. *Id.*

104. 57 Fed. Reg. 18,344, 18,383 (1992)(to be codified at 40 C.F.R. § 300.1100(c)(2)(i)).

tions during the term of the loan. The lender may also periodically monitor or inspect the facility, or the borrower's business or financial condition, and impose upon the borrower such other requirements or conditions as are reasonably necessary for the lender to police the loan or security interest adequately.<sup>105</sup> Such requirements may be contained in loan or other relevant documents, which may also contain financial, environmental, and other warranties, covenants, and representations of the borrower.

The regulations also permit lenders to engage in workout activities that are taken in an effort to "prevent, cure, or mitigate a default," or to "prevent the diminution of the value of the security."<sup>106</sup> Specific examples of permitted workout activities cited in the regulations are restructuring or renegotiating the terms of the security interest, payment of additional interest, extension of payment period, providing specific or general financial or other advice, suggestions, counseling, or guidance.<sup>107</sup>

#### F. *Permitted Actions After Foreclosure*

A secured creditor who does not participate in the management of a facility prior to foreclosure may retain the secured creditor exemption after foreclosure. However, in acquiring the property at a foreclosure sale, the lender must not outbid any offers of "fair consideration" made at the foreclosure sale. After foreclosure, the lender must undertake to sell the property "in a reasonably expeditious manner, using whatever commercial means are relevant or appropriate."<sup>108</sup> In the preamble to the final regulations, EPA states that a holder of a security interest may conclusively establish that it is attempting to sell the property in a reasonably expeditious manner by, within twelve months following foreclosure, listing the property with a broker, dealer, or agent who deals with the type of property in question, or advertising at least monthly that the property is for sale in the area in which the property is located.<sup>109</sup> However, if at any time after six months following foreclosure the lender rejects a "written, bona fide, firm offer of fair consideration" for the property, or does not act within ninety days of receipt of such an offer, the exemption will be lost.<sup>110</sup> As long as the owner of the

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105. *Id.* (to be codified at 40 C.F.R. § 300.1100 (c)(2)(ii)).

106. *Id.*

107. *Id.*

108. *Id.* at 18,384 (to be codified at 40 C.F.R. § 300.1100(d)).

109. *Id.* at 18,362.

110. *Id.* at 18,384 (to be codified at 40 C.F.R. § 300.1100(d)(2)(ii)(B)).

property is able to satisfy the general requirement of attempting to sell the property in a "reasonably expeditious manner" and does not reject any "written, bona fide, firm offer of fair consideration," it is irrelevant how long a security interest holder owns the property before selling it.<sup>111</sup>

### G. *CERCLA Liability Exclusion for Federal Government*

While a state or local government which involuntarily acquires ownership or control of a facility by virtue of its function as a sovereign is not considered an owner or operator under CERCLA,<sup>112</sup> there is presently no comparable exclusion for the federal government. Entities of the federal government such as the Federal Deposit Insurance Corporation and the Resolution Trust Corporation have become increasingly likely to own or possess properties as a result of bank and savings and loan failures. The EPA regulations also address the potential liability of such entities.

Under the regulations, an entity of the federal government will not be deemed an owner or operator under CERCLA if ownership or possession of property is obtained involuntarily by virtue of its function as a sovereign.<sup>113</sup> Foreclosures are specifically listed as such involuntary acquisitions, as are any other means by which a federal governmental entity involuntarily acquires assets in the course of administering a governmental loan or loan guarantee program.<sup>114</sup>

## VII.

### THE FUTURE OF LENDER LIABILITY UNDER CERCLA

#### A. *"Fair Consideration"*

Under EPA's regulations, "fair consideration" is the value of the security interest, which, in the case of a senior security interest, is calculated as follows:

[A]n amount equal to or in excess of the sum of the outstanding principal . . . owed to the holder immediately preceding the acquisition of full title . . . pursuant to foreclosure and its equivalents, plus any unpaid interest, rent or penalties (whether arising before or after foreclosure and its equivalents), plus all reasonable and necessary costs, fees, or other charges incurred by the holder incident to work out, foreclo-

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111. *Id.* at 18,378.

112. 42 U.S.C. § 9601(20)(D) (1988).

113. 57 Fed. Reg. 18,344, 18,385 (1992)(to be codified at 40 C.F.R. § 300.1105).

114. *Id.*

sure and its equivalents, retention, maintaining the business activities of the enterprise, preserving, protecting and preparing the . . . facility prior to sale . . . or other disposition, plus response costs incurred under section 107(d)(1) of CERCLA or at the direction of an on-scene coordinator; less any amounts received by the holder in connection with any partial disposition of the property, net revenues received as a result of maintaining the business activities of the enterprise, and any amounts paid by the borrower subsequent to the acquisition of full title . . . pursuant to foreclosure and its equivalents.<sup>115</sup>

In the case of a junior security interest, fair consideration is equal to the value of all outstanding senior interests, plus the value of the junior security interest, calculated in the same manner as a senior security interest.<sup>116</sup>

It is possible, albeit perhaps not likely when contaminated property is involved, that the actual value of the property may be greater than the amount which the regulations define as "fair consideration," generally equivalent to all amounts outstanding on a loan. Normally a lender would not sell property for an amount that is significantly less than its fair market value.<sup>117</sup> However, the EPA regulations require lenders to do just that where fair market value exceeds the amount of the outstanding loan. An offer of fair consideration is a cash offer that does not contain unreasonable terms or conditions, presumably from the seller's standpoint. Yet EPA makes it clear that the only "relevant benchmark" is the amount outstanding on the loan.<sup>118</sup> As long as a cash offer is made that is at least equal to the outstanding loan amount, and the offer is not unreasonable in other respects, the lender must accept the offer in order to preserve protection from CERCLA liability. The market value of the property is irrelevant.

### B. *Foreclosure*

As long as a lender does not "participate in management" prior to foreclosure, the regulations allow a lender to foreclose, take title to the property and still retain the secured creditor exemption.

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115. 57 Fed. Reg. 18,344, 18,384 (1992)(to be codified 40 C.F.R. § 300.1100(d)(2)(ii)(A)).

116. *Id.*

117. In *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573 (D. Md. 1986), the court considered the purchase of property at a foreclosure sale by the foreclosing creditor as something that was done to protect the bank's investment, and not to protect the security interest which is what the secured creditor exemption requires. *Id.* at 579.

118. 57 Fed. Reg. 18,344, 18,365 (1992).

Moreover, following foreclosure the prohibition against participating in the management of a facility no longer applies. Therefore, as long as a foreclosing creditor does not participate in the management of a facility prior to foreclosure, and, following foreclosure, complies with the listing or advertising and acceptance of "fair consideration" requirements set forth in the regulations, the lender will be able to rely on the secured creditor exemption. This actually entitles a secured creditor to a benefit not available to anyone else. Any other purchaser of the property at a foreclosure sale would be liable as a current owner or operator. By contrast, even a secured creditor with actual knowledge that property is contaminated with hazardous substances will be immune from CERCLA liability, as long as the lender complies with all of the requirements set forth in the regulations regarding its actions both before and after the acquisition by foreclosure.

### C. *Other Causes of Liability*

Although EPA's regulations ensure that a secured creditor who forecloses on property in compliance with EPA's conditions will not become an "owner or operator" within the CERCLA meaning of those terms, the regulations will not shield a lender from CERCLA liability if it arranges for disposal or transport of hazardous substances from a site at which there is a release,<sup>119</sup> or transports hazardous substances to a facility selected by the lender from which there is a release.<sup>120</sup> Therefore, even though the regulations may make it easier for a creditor to avoid CERCLA liability as an owner or operator, once lenders acquire title to property they must be careful to refrain from activities that may make them liable for CERCLA response costs as a result of arranging for the treatment or disposal of hazardous substances or as a result of transporting hazardous substances. The regulations are emphatic in that respect.<sup>121</sup>

### D. *Effective Date of Regulations*

In the preamble to the regulations, the EPA states that the effective date of the regulations is the date of publication in the Federal Register, which was April 29, 1992.<sup>122</sup> However, the EPA also

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119. 42 U.S.C. § 9607(a)(3) (1988).

120. 42 U.S.C. § 9607(a)(4) (1988).

121. 57 Fed. Reg. 18,344, 18,384-85 (1992)(to be codified at 40 C.F.R. § 300.1100(d)(3)).

122. 57 Fed. Reg. 18,344, 18,374 (1992).

expects that the regulations "will provide appropriate guidance for evaluating the actions of a holder or government entity prior to the effective date."<sup>123</sup> As a result, while it is not clear whether courts will apply the regulations retroactively, the EPA will apparently be guided by the regulations even when a lender's actions in question occurred prior to the effective date of the regulations.

### VIII. CONGRESSIONAL ACTION

During the past several years, there have been attempts in Congress to define the secured creditor exemption more clearly. For example, in 1991 a bill was introduced to limit the liability of secured creditors under CERCLA.<sup>124</sup> The proposed amendment to CERCLA would define "participation in management" as being "actual, direct, and continual or recurrent exercise of managerial control by a person over the vessel or facility, . . . which managerial control materially divests the borrower . . . of such control."<sup>125</sup>

The bill would consider ownership of property acquired through foreclosure as an action undertaken primarily to protect a security interest, provided that the lender-turned-owner "diligently is proceeding to sell or convey title or the right to title on commercially reasonable terms at the earliest possible time while preserving the property in the interim."<sup>126</sup>

Moreover, any action taken to preserve and protect the value of a vessel or facility or to assist a borrower in winding down operations or activities related to the property would not be deemed participation in management under the proposed legislation. An environmental inspection consistent with commercial or customary practice by or for the creditor would be probative evidence that the creditor is acting to preserve and protect the property during the time the creditor has possession or control of the property.<sup>127</sup> However, a creditor would be liable for response costs if the creditor causes or exacerbates a release of a hazardous substance.

Congress adjourned while the House Bill was still being considered by the Energy and Commerce Committee. However, the secured creditor exemption was also addressed in each of the two

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123. *Id.*

124. H.R. 1450, 102d Cong., 1st Sess. (1991).

125. *Id.* at § 1(a)(iii).

126. *Id.* at § 1(a)(iv).

127. *Id.* at § 1(a)(v).

prior congressional sessions.<sup>128</sup> Therefore, future congressional action focusing on the problem seems likely.<sup>129</sup>

## IX.

### RISK-EVASIVE POLICIES AND PROCEDURES FOR LENDERS

#### A. *In General*

The uncertainty which has surrounded the secured creditor exemption since *United States v. Mirabile*<sup>130</sup> changed the way lenders do business.<sup>131</sup> With potential CERCLA liability present whenever virtually any commercial loan is made, and even when some residential loans are made, lenders should formulate risk-evasive measures and develop strategies for dealing with the potential liability. However, no procedures or policies are risk-free, and the best that lenders can hope for is risk-minimization.

#### B. *Prior to Making Loan*

Before making a commercial loan, the lender should require an environmental risk-assessment or, at a minimum, an environmental audit, just as an appraisal, a survey, and title insurance are usually required. Additionally, the lender should examine the property's history to determine who its former owners were and what the property was used for in the past. If the results of the environmental audit are not satisfactory, the lender should decide whether to refuse to make the loan at all, or do so only after the property is cleaned up.

Even if property is not contaminated at the time a loan is made, a lender should consider carefully what uses may be made of the property by the borrower. If the borrower intends to use the prop-

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128. Similar legislation was proposed in 1989 and 1990. See S. 2319, 101st Cong., 2d Sess. (1990); H.R. 4494, 101st Cong., 2d Sess. (1990); H.R. 2085, 101st Cong., 1st Sess. (1989). Moreover, a Senate Banking Committee counsel said recently that despite the EPA's new regulations, legislation is still needed to protect secured creditors, and that prospects for passage of such legislation are good. See *Current Developments*, 23 Env't Rep. (BNA) No. 3, at 315 (May 15, 1992).

129. The filing recently of two lawsuits challenging the EPA regulations may make Congress more resolute in its attempt to amend CERCLA. See *Michigan v. EPA*, filed No. 92-1312 (D.C. Cir. July 28, 1992); *Chemical Mfrs. Ass'n v. EPA*, filed No. 92-1314 (D.C. Cir. July 28, 1992).

130. 15 Env'tl. L. Rep. (Env'tl. L. Inst.) 20,994 (E.D. Pa. Sept. 4, 1985).

131. Eighty-eight percent of banks surveyed by the American Bankers Association said they have made changes to their lending procedures as a result of the potential for CERCLA liability. See Amy T. Phillips, *EPA's Lender Liability Rule: A Sweetheart Deal for Banker?*, 22 Env't Rep. (BNA) No. 17, at 1158 (August 23, 1991).

erty as the location for a paint manufacturing facility, for example, this should send a danger signal warning that hazardous waste problems may arise. In such a case the risk of potential CERCLA liability for the lender may so outweigh the benefits of making the loan that the loan will simply not be made. The potential for CERCLA liability may not be as apparent to a lender when, for example, the borrower is a hardware store owner. However, if such a borrower intends to sell paint, kerosene, turpentine, and a host of other hazardous substances, as many hardware stores do, improper handling and disposal of such products by the borrower may also result in a significant diminution in the value of the property, as well as CERCLA liability.

If the results of the environmental risk analysis indicate that the property securing the loan may be affected by hazardous substances, a lender should consider additional security from the borrower. The lender may require that certain individuals personally guarantee repayment of a loan made to a corporation or partnership, or that the borrower mortgage additional property to serve as additional collateral for the loan. With such precautions, if the borrower defaults on the loan, the lender may be able to foreclose on clean property that is not contaminated by hazardous substances, as well as pursue the personal guarantors. Otherwise, a lender may be effectively forced to treat any loan secured by property that becomes contaminated by hazardous substances as an unsecured loan.

### *C. Reviewing and Revising Existing Loan Documents*

The lender should also review existing loan documents to determine if they contain adequate environmental provisions. However, the time to evaluate the sufficiency of environmental provisions in loan documents is before a loan is made, not after discovering that the property is contaminated. Existing documents without adequate environmental provisions may leave the lender without recourse. Without a provision in the loan documents, for example, which gives the lender the right to accelerate maturity of a loan upon discovery of hazardous substances on the property, if the loan is not otherwise in default, a lender may be forced to sit idly by while the property becomes increasingly more contaminated, thereby greatly diminishing its value.

Even if loan documents give the lender the right to compel the borrower to clean up contamination on the mortgaged property, a lender should carefully consider the risk of doing so. The ability to demand that a borrower clean up such property may support an

inference that the lender could affect the borrower's hazardous waste disposal decisions if the lender so chose.<sup>132</sup> Although the dicta in *Fleet Factors* seems to contradict the position adopted by the EPA in its regulations, which position a court will take in a private party response cost recovery action is not yet known. A better remedy would be to accelerate maturity of the loan if the property becomes contaminated. In that way, the lender would either be repaid the loan at that time, or if the borrower does not repay the loan upon acceleration of maturity, the lender may be able to foreclose at a time before the contamination becomes too severe. Discovering the problem early and responding to it quickly are essential for a lender to be able to minimize its CERCLA liability exposure.

As further protection, the lender should incorporate into the loan documents an indemnity provision in favor of the lender for any CERCLA liability the lender may be faced with as a result of making the loan and holding a mortgage on the property. The borrower should also be required to sign representations and warranties that the property has never been used for any activities involving or resulting in the handling, storage or release of any hazardous substances, and that the property has never been the subject of any environmental compliance order, lawsuit or judgment.

In the loan documents, the borrower should also agree that he will not conduct, and will not allow anyone else to conduct, any activities on the property that involve the manufacture, use, handling, storage, treatment, or release of hazardous substances which could result in liability under CERCLA. Moreover, the borrower should promise to notify the lender's designated environmental committee or representative promptly in the event of any release or threatened release of hazardous substances on the property, and also in the event the borrower receives any notice, compliance order, or lawsuit relating to hazardous substances on the property. The borrower should further agree to pay promptly, and hold the lender harmless from, any amount claimed to be due as a result of the release or presence of hazardous substances on the property. Finally, the borrower should agree to comply with all environmental compliance orders and judgments relating to the property and hold harmless and indemnify the lender from and against all such orders and judgments.

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132. See *United States v. Fleet Factors Corp.*, 901 F.2d. 1550, 1557-58 (11th Cir. 1990), *cert. denied*, 111 S. Ct. 752 (1991).

#### D. *Loan Administration*

After a loan is made, certain internal control procedures should be followed. First, the lender should designate a person or a committee with *exclusive* responsibility for responding to all inquiries from a borrower concerning hazardous substances and other environmental issues. For example, all telephone calls and letters relating to environmental questions about a borrower's business should be handled by certain individuals who will not, in response to a question from a borrower about what to do about a chemical spill at the borrower's business, routinely say, "clean it up." Even such a seemingly innocuous reply may support an inference that the lender could affect hazardous waste disposal practices if it so chose,<sup>133</sup> or is exercising decision-making control over the borrower's environmental compliance.<sup>134</sup>

The lender should also prohibit any of its agents or representatives from participating in any way in the operational aspects of a borrower's business. If loan workout negotiations become necessary, discussions and activities should be limited solely to restructuring the financial aspects of the loan repayment. A loan workout may include extending the term of the loan, reducing the interest rate, either temporarily or throughout the remaining term of the loan, requiring additional security, or reamortizing the loan. However, under no circumstances should a lender involve itself in the operational management of a borrower's business.

#### E. *Foreclosure Considerations*

If a loan is in default and a loan workout is either not feasible or not advisable from a potential CERCLA liability standpoint, an additional risk-analysis should be made before foreclosing or taking title to the property in lieu of foreclosure. To make an effective analysis, another environmental audit should be performed at this stage. Although the property may have been free of hazardous substances at the time the loan was made, and the borrower's business may have been one involving minimum likelihood of hazardous substances being released on the property, it is still possible that, during the term of the loan, hazardous substances were surreptitiously put on the property. Even if someone used the property to dispose of hazardous substances without the borrower's or lender's

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133. *Id.*

134. See 57 Fed. Reg. 18,344, 18,383 (1992)(to be codified at 40 C.F.R. § 300.1100(c)(1)(i),(ii)).

knowledge, the borrower will still be liable as a current owner under CERCLA, and therefore the lender could likewise face potential liability. If a pre-foreclosure environmental audit discloses the presence or possibility of hazardous substances on the property, a lender may decide to forego foreclosing altogether. Again, it will depend upon a risk-analysis, weighing the potential CERCLA liability against the outstanding balance of the loan.

In order to be able to have a pre-foreclosure environmental audit performed, the loan documents should include a provision which expressly gives the lender the right to enter the property for the purpose of having an environmental audit of the property conducted at any time during the term of the loan. Without such a provision, the borrower may deny the lender access to the property.

Although this was not clear when EPA's regulations were proposed, the final secured creditor exemption rule and preamble specifically provide that not only will a lender holding a security interest be shielded from CERCLA liability if all conditions of the rule are satisfied, but any person acting on behalf of or for the benefit of a holder of a security interest is also covered by the rule.<sup>135</sup> This means that court-appointed receivers or keepers of property, as well as agents, affiliates, subsidiaries and other representatives of a holder of a security interest, will not be considered as owners or operators as long as they act on behalf or for the benefit of the security interest holder.<sup>136</sup>

#### F. *Existing Loans*

For existing loans, a lender should follow the same procedure and perform the same risk-assessment that should be made for new loans. However, if existing loan documents do not give the lender the right to enter the property to have an environmental audit conducted, the lender may have to decide whether or not to foreclose without knowing whether the mortgaged property contains hazardous substances. In any event, a review should be made of existing loans to determine if the lender previously participated in the management of any borrower's enterprise. For any loans where the lender has participated in the management of the borrower's enterprise, the lender should then determine which loans are secured by property that may contain hazardous substances, so that special at-

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135. *Id.* at 18,382 (to be codified at 40 C.F.R. § 300.1100(a)(1)).

136. *Id.* See also *id.* at 18,352-53.

tention will be given to such loans in an attempt to minimize the potential for CERCLA liability.

### G. *Settlement Possibilities*

Even with thorough risk-assessment policies and procedures and stringent internal control mechanisms, a lender may nevertheless find itself a potentially responsible party for response costs. However, before engaging in expensive and protracted litigation, settlement possibilities should be discussed with the government. Under certain conditions the federal government is authorized to settle with potentially responsible parties.<sup>137</sup>

CERCLA authorizes the government to enter into *de minimis* settlement agreements if the settlement relates to only a minor portion of the response costs. To be able to avail itself of the *de minimis* settlement provisions of CERCLA, one of two conditions must be met. One is that the party seeking a settlement must have contributed only minimally to the amount of hazardous substances at the facility and to the toxic or other hazardous effects of the hazardous substances at the facility.<sup>138</sup> The other condition is that the potentially responsible party (a) is the owner of the property; (b) did not have actual or constructive knowledge at the time the property was acquired that the facility had been used for the generation, transportation, storage, treatment or disposal of any hazardous substance; (c) did not conduct or permit the generation, transportation, storage, treatment or disposal of any hazardous substance at the facility; and (d) did not contribute to the release of a hazardous substance at the facility through any act or omission.<sup>139</sup>

## X.

### CONCLUSION

Potential CERCLA liability for lenders is lurking in virtually any commercial loan transaction. Because lenders had recently become more reluctant to foreclose on mortgages and deeds of trust, the very objective of CERCLA was being thwarted. Instead of lenders foreclosing and eventually putting property back into the stream of commerce, contaminated properties owned by impecunious borrowers, or by borrowers who could not be located, were either not getting cleaned up at all, or they were being cleaned up at the

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137. 42 U.S.C. § 9622 (1988).

138. 42 U.S.C. § 9622(g)(1)(A) (1988).

139. 42 U.S.C. § 9622(g)(1)(B) (1988).

government's expense. The few cases that have dealt with the issue of lender liability under CERCLA actually created more uncertainty for lenders, rather than eliminating or reducing it. EPA's regulations are a step in the right direction toward attempting to solve the problem. The regulations state more clearly for lenders what are permitted and prohibited activities. However, it appears that some uncertainty continues to linger, and legislation to amend CERCLA may be the only effective means to solve the problem fully.

