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## NOTES AND COMMENTS

### Sailing in Safe Harbors: Recent Developments Regarding Lender Liability Under CERCLA

RON BURKE

#### I. Introduction

Secured creditors seeking to provide financing to businesses, especially those that handle hazardous waste, have been operating in uncertain waters since the late 1980s. Through a series of judicial decisions, uncertainty developed over the scope of the safe harbor provision that exempts, under certain conditions, a secured creditor from liability as an "owner or operator" under the federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA).<sup>1</sup> The most significant case was *United States v. Fleet Factors Corporation*,<sup>2</sup> where the Eleventh Circuit opined, in dicta, that a secured creditor who participated in the financial management of the borrower could be held liable as an "operator" if that creditor had the capacity to control its borrower's operations, regardless of whether the secured creditor exercised that capacity to control.<sup>3</sup> *Fleet Factors'* capacity to control test created great uncertainty within the lending community because it suggested that lenders could be held liable, without actively participating in the management of the facility, for cleanup costs which might far exceed the value of the collateral obtained as security.

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1. CERCLA § 101(20)(A), 42 U.S.C. § 9601(20)(A) (1994).

2. 901 F.2d 1550 (11th Cir. 1990), *cert. denied*, 498 U.S. 1046 (1991).

3. *See id.* at 1157-58.

The United States Environmental Protection Agency (EPA), responding to the clamor created in large part by *Fleet Factors*, promulgated a regulation in 1992 which sought to clarify the scope of the exemption.<sup>4</sup> The rule, however, was quickly invalidated by the D.C. Circuit in *Kelley v. EPA*,<sup>5</sup> which held that EPA did not have the statutory authority to define a class of liable parties under CERCLA.<sup>6</sup> Congress reacted in 1996 by amending CERCLA to include many of the provisions contained in the 1992 EPA rule.<sup>7</sup>

This Comment describes the recent history of the treatment of the security interest exemption, and concludes with an analysis of how the 1996 CERCLA Amendments will affect the lending community. Part II of this Comment describes CERCLA's liability regime, the 1992 EPA rule, case law before and after the invalidation of the 1992 EPA rule, and the *Kelley* decision. The 1996 CERCLA Amendments clarifying the scope of the exemption are discussed in Part III. Case law decided after the 1996 CERCLA Amendments and an EPA enforcement policy statement issued in 1997 are presented in Part IV. Finally, Part V presents an analysis of the 1996 CERCLA Amendments, and Part VI is a conclusion, stating that the 1996 amendments provide important protection for secured creditors, yet statutory and non-statutory incentives remain for such parties to be wary of contaminated properties.

## II. Background

### A. CERCLA Liability

The 96<sup>th</sup> Congress enacted CERCLA in December 1980.<sup>8</sup> CERCLA applies "primarily to the cleanup of leaking inactive

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4. See National Oil and Hazardous Substances Pollution Contingency Plan; Lender Liability Under CERCLA, 57 Fed. Reg. 18,344 (1992) [hereinafter EPA Lender Rule].

5. 15 F.3d 1100 (D.C. Cir. 1994), *cert. denied sub nom* Am. Bankers Ass'n v. Kelley, 115 S. Ct. 900 (1995).

6. See *id.*

7. See Pub. L. No. 104-208, 110 Stat. 3009 (1996).

8. See CERCLA §§ 101-405, 42 U.S.C. §§ 9601-9675 (1994).

or abandoned sites and to emergency responses to spills.”<sup>9</sup> A central goal of CERCLA is to make those parties who caused environmental contamination pay for its cleanup, and courts have broadly interpreted CERCLA to achieve this goal.<sup>10</sup>

The enactment of CERCLA represented an “eleventh hour compromise” between the two houses of Congress.<sup>11</sup> The final bill was passed in “considerable haste.”<sup>12</sup> As a result, CERCLA is “not a paradigm of clarity or precision” as manifested, *inter alia*, in poorly defined terms,<sup>13</sup> and by “inconsistencies and redundancies.”<sup>14</sup>

Unlike the “cooperative federalism” of the Clean Air Act<sup>15</sup> and the Clean Water Act,<sup>16</sup> CERCLA provides the federal government with primary authority to implement a cleanup program.<sup>17</sup> Possible explanations for this non-deferential legislative approach include: i) unlike traditional pollution control (e.g., end-of-pipe) requirements, little ongoing oversight is required once a cleanup action has been completed, and ii) Congress believed, at the time CERCLA was enacted, that the federal government was best equipped to develop and transfer expertise from one site to another, and to address the complex issues posed by what was anticipated to be a relatively low number of sites.<sup>18</sup> Although EPA has traditionally initiated CERCLA actions, at least forty-five states have developed their own programs that parallel the federal CERCLA regime.<sup>19</sup> In several areas, state programs

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9. *New York v. Shore Realty Corp.*, 759 F.2d 1032, 1040 (2d Cir. 1985) (quoting F. ANDERSON, ET AL., ENVIRONMENTAL PROTECTION: LAW AND POLICY 568 (1984)).

10. *See, e.g.*, *B.F. Goodrich v. Murtha*, 958 F.2d 1192, 1198 (2d Cir. 1992).

11. *See Shore Realty Corp.*, 759 F.2d at 1040.

12. *See Exxon Corp. v. Hunt*, 475 U.S. 355, 368 (1986).

13. *Artesian Water Co. v. New Castle County*, 851 F.2d 643, 648 (3d Cir. 1988).

14. *United States v. Alcan Aluminum Corp.*, 964 F.2d 252, 258 (3d Cir. 1992).

15. CAA §§ 101-602(g), 42 U.S.C. §§ 7401-7671(g) (1997).

16. FWPCA §§ 101-607, 33 U.S.C. §§ 1251-1387 (1997).

17. *See Robert H. Abrams, Superfund and the Evolution of Brownfields*, 21 WM. & MARY ENVTL. L. & POL’Y REV. 265, 266-67 (1997).

18. *See id.* at 267.

19. *See id.* at 267-268. For example, New York’s counterpart to the federal CERCLA statute is found in Title 13 of N.Y. ENVTL. CONSERV. LAW § 27 (McKin-

are more proactive than CERCLA (e.g., no petroleum exclusion provision; former owner or operators are subject to liability regardless of whether the hazardous substance release occurred during their involvement with the site).<sup>20</sup>

Under CERCLA section 104, the President is authorized to undertake short-term "removal" actions to control immediate threats posed by releases or threatened releases of hazardous substances, and to conduct longer-term "remedial actions," consistent with the National Contingency Plan (NCP), to cleanup contaminated sites.<sup>21</sup> Congress directed the President to revise the NCP, which was originally promulgated for cleanups under section 311 of the Clean Water Act,<sup>22</sup> to "establish procedures and standards for responding to releases of hazardous substances" under CERCLA.<sup>23</sup>

EPA's removal and remedial actions are financed in part from the Hazardous Substance Trust Fund, commonly called the Superfund, which is funded in part from an excise tax on petroleum and certain other chemicals.<sup>24</sup> Superfund money may be spent to finance "government response[s]" and to pay any "claim[s] for necessary response costs incurred by any other person" under the NCP.<sup>25</sup>

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ney 1997); New Jersey's analog is the New Jersey Spill Compensation and Control Act found at N.J. STAT. ANN. § 58 (West 1997).

20. See Abrams, *supra* note 17, at 268. CERCLA establishes minimum requirements, and does not preempt state requirements that are more stringent. See *United States v. Akzo Coatings of America, Inc.*, 949 F.2d 1409, 1454 (6th Cir. 1991). States are precluded, however, from obtaining alternative remedies that conflict with the terms of a consent decree that has been entered by a federal court. See *id.* at 1454-55.

21. CERCLA § 104(a)(1), 42 U.S.C. § 9604(a)(1) (1997).

22. See FWPCA § 311, 33 U.S.C. § 1321 (1994).

23. CERCLA § 105(a), 42 U.S.C. § 9605(a). The President subsequently delegated these responsibilities to EPA. See Exec. Order No. 12,316, 46 Fed. Reg. 42,237 (1981).

24. See CERCLA § 107, 26 U.S.C. § 9507 (1997). See also, 26 U.S.C. § 4611 (1997).

25. CERCLA § 111, 42 U.S.C. § 9611(a). Limitations exist, however, to the government's use of the Superfund. For example, removal actions are generally limited to less than \$2 million and twelve months unless site-specific conditions warrant otherwise. See CERCLA § 104(c)(1), 42 U.S.C. § 9604(c)(1). Superfund monies may only be used for remedial actions if certain conditions are met. See CERCLA § 104(c)(3), 42 U.S.C. § 9604(c)(3). For example, the site must ulti-

CERCLA also authorizes the government to recover response costs from "responsible parties,"<sup>26</sup> which allows the government to "respond immediately while later trying to shift financial responsibility to others."<sup>27</sup> The charged party incurs liability under CERCLA section 107 if four conditions are met: i) the property is a "vessel or a facility,"<sup>28</sup> ii) there has been a "release" or "threatened release"<sup>29</sup> of any "hazardous substance,"<sup>30</sup> iii) "response"<sup>31</sup> costs have been incurred

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mately be placed on the National Priorities List (NPL), and the state wherein the site is located must contribute at least ten percent of the cleanup cost. See CERCLA § 104(c)(5)(A), 42 U.S.C. § 9604(c)(5)(A).

26. CERCLA § 107(a), 42 U.S.C. § 9607(a).

27. *Shore Realty Corp.*, 759 F.2d at 1041.

28. "Facility" includes:

(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.

CERCLA § 101(9), 42 U.S.C. § 9601(9). As such, "facility" refers to both real property and personal property that has been contaminated by hazardous substances. See CERCLA § 101(9), 42 U.S.C. § 9601(9).

29. A "release" is defined broadly to include any "spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing into the environment." See CERCLA § 101(22), 42 U.S.C. § 9601(22).

30. "Hazardous substances" is defined broadly to include:

(A) any substance designated pursuant to § 311(b)(2)(A) of the Federal Water Pollution Control Act, (B) any element, compound, mixture, solution or substance designated pursuant to § 102 of this Act, (C) any hazardous waste having the characteristics identified under or listed pursuant to § 3001 of the Solid Waste Disposal Act (but not including waste the regulation of which has been suspended by Act of Congress, (D) any toxic pollutant listed under § 307(a) of the Federal Water Pollution Control Act, (E) any hazardous air pollutant listed under § 112 of the Clean Air Act, and (F) any imminently hazardous chemical substance or mixture with respect to which the Administrator has taken action pursuant to § 7 of the Toxic Substances Control Act.

CERCLA § 101(14), 42 U.S.C. § 9601(14).

"The term hazardous substances [sic] excludes petroleum and natural gas, yet this exclusion does not apply to petroleum that has been mixed with hazardous substances otherwise regulated." Memorandum from Francis S. Blake, General Counsel, to J. Winston Porter, Assistant Administrator, *Office of Solid Waste and Emergency Response* (July 31, 1987).

as a result of the release or threatened release; and iv) the party charged falls within one of four classes of responsible parties under section 107(a).<sup>32</sup>

Responsible parties liable for response costs under section 107(a) consist of: 1) the "owner and operator" of a facility;<sup>33</sup> 2) any person<sup>34</sup> who "owned or operated" the facility during the time when hazardous substances were disposed of;<sup>35</sup> 3) any person who arranged for the disposal or treatment, or transportation for such disposal or treatment, of hazardous substances owned or possessed by that person (arrangers);<sup>36</sup> and 4) Any person who transports hazardous substances to a disposal or treatment facility selected by that person (transporters).<sup>37</sup>

Liable parties under section 107 are responsible for all costs incurred by government authorities for response actions that are "not inconsistent" with the NCP, other necessary response costs incurred by any other person that are consistent with the NCP, natural resource damages, and health assessment costs conducted under section 104(i).<sup>38</sup> A liable party is also subject to an administrative order under section 106 to address an "imminent and substantial endangerment" to public health and the environment.<sup>39</sup>

Liability under CERCLA "shall be construed to be the standard of liability" under section 311 of the federal Clean Water Act.<sup>40</sup> Courts have interpreted CERCLA section

31. The term "response" includes removal and remedial actions. *See* CERCLA § 101(25), 42 U.S.C. § 9601(25).

32. *See* CERCLA § 107(a), 42 U.S.C. § 9607(a).

33. *See* CERCLA § 107(a)(1), 42 U.S.C. § 9607(a)(1).

34. A "person" is 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." *See* CERCLA § 101(21), 42 U.S.C. § 9601(21).

35. *See* CERCLA § 107(a)(2), 42 U.S.C. § 9607(a)(2).

36. *See* CERCLA § 107(a)(3), 42 U.S.C. § 9607(a)(3).

37. *See* CERCLA § 107(a)(4), 42 U.S.C. § 9607(a)(4).

38. *See* CERCLA § 107(a)(4), 42 U.S.C. § 9607(a)(4).

39. *See* CERCLA § 106(a), 42 U.S.C. § 9606(a).

40. CERCLA § 101(32), 42 U.S.C. § 9601(32).

107(a) as imposing strict liability on responsible parties.<sup>41</sup> CERCLA liability is also joint and several when the harm is indivisible,<sup>42</sup> and is retroactive.<sup>43</sup>

Only three limited defenses exist for potentially liable parties under CERCLA.<sup>44</sup> No liability exists if the party can demonstrate that the release or threatened release of hazardous substances resulted from: i) an act of God, ii) an act of war, or iii) an act of a third party with whom the defendant had no direct or indirect "contractual relationship"<sup>45</sup> when the defendant exercised due care with respect to the site and took steps to prevent foreseeable consequences (commonly referred to as the innocent landowner defense).<sup>46</sup>

"Owner or operator" is defined, *inter alia*, as "any person owning or operating" a facility.<sup>47</sup> CERCLA's legislative his-

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41. See *United States v. Monsanto Co.*, 858 F.2d 160, 167 (4th Cir. 1988), *cert. denied*, 109 S. Ct. 3156 (1989); See also *J.V. Peters & Co. Inc. v. EPA*, 767 F.2d 263, 266 (6th Cir. 1985).

42. See *Monsanto Co.*, 858 F.2d at 171.

43. See, e.g., *United States v. Olin Corp.*, 107 F.3d 1506, 1513-14 (11th Cir. 1997) (holding that CERCLA's response cost liability scheme applies to releases of hazardous substances occurring before CERCLA's enactment).

44. See CERCLA § 107(b)(1)-(3), 42 U.S.C. § 9607(b)(1)-(3).

45. The term "contractual relationship" includes land contracts, deeds or other instruments transferring title or possession unless the real property was acquired by the defendant after the deposition of hazardous substances and the defendant, *inter alia*, at the time of acquisition, did not know or had "no reason to know" at the time of acquisition that the property was contaminated with hazardous substances. CERCLA § 101(35)(A), 42 U.S.C. § 9601(35)(A).

A defendant had "no reason to know" of the presence of hazardous substances if he/she undertook "all appropriate inquiry" into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability. CERCLA § 101(35)(B), 42 U.S.C. § 9601(35)(B). CERCLA does not define "all appropriate inquiry" or "good commercial or customary practice." CERCLA § 101 (35)(B), 42 U.S.C. § 9601 (35)(B). The American Society for Testing Materials has issued two standards for site assessments to provide guidance as to what constitutes this level of inspection: Transaction Screening Process (E 1528-93) and the Phase I Environmental Site Assessment Process (E 1527-93).

46. See CERCLA § 107(b)(1)-(3), 42 U.S.C. § 9607(b)(1)-(3). The innocent landowner defense is rarely available to a party who conducts "all appropriate inquiry" because the presence of significant contamination is unlikely to go undiscovered during such an investigation. See Robert S. Berger et al., *Recycling Industrial Sites in Erie County: Meeting the Challenge of Brownfield Redevelopment*, 3 BUFF. ENVTL. L.J. 69, 84-86 (1995).

47. CERCLA § 101(20)(A), 42 U.S.C. § 9601(20)(A).



tory does not provide much clarification by stating "in the case of a facility, an 'operator' is defined to be a person who is carrying out operational functions for the owner of the facility pursuant to an appropriate agreement."<sup>48</sup> An example of the quick legislative drafting of CERCLA is the conjunctive in the "owner *and* operator" language of section 107(a)(1), and the disjunctive in "owner *or* operator" which is contained in sections 101(20)(A) and 107(a)(2).<sup>49</sup> Notwithstanding this discrepancy, courts have not required a party to be both the owner and operator to incur liability under section 107(a).<sup>50</sup>

Excluded from the definition of "owner or operator" is a "person who, without participating in the management of a facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility."<sup>51</sup> This exemption is the subject of this Comment and is referred to as the Security Interest Exemption (SIE).<sup>52</sup> Parties who seek to rely on the SIE have the burden of proving that they qualify for that exemption.<sup>53</sup>

Three phrases in the SIE that have led to uncertainty are: i) "indicia of ownership," ii) "primarily to protect a security interest," and iii) "participating in the management."<sup>54</sup> For example, a lender will typically take certain actions prior to providing a loan, during the period when the loan is performing, during pre-foreclosure or workout actions, and/or during post-foreclosure.<sup>55</sup> Such actions might include monitoring facility performance, conducting environmental inves-

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48. *United States v. Mirabile*, 15 Env'tl. L. Rep. (Env'tl. L. Inst.) 20,994, 20,996 (E.D. Pa. Sept. 4, 1985) (referencing H.R. REP. NO. 172, 96<sup>th</sup> Cong., 2d Sess. 1980, reprinted in 1980 U.S.C.C.A.N., 6160, 6180).

49. *See Redwing Carriers Inc. v. Saraland Apartments*, 94 F.3d 1489, 1497-98 (11th Cir. 1996) (emphasis added).

50. *See id.*

51. CERCLA § 101(20)(A), 42 U.S.C. § 9601(20)(A).

52. The Resource Conservation and Recovery Act (RCRA) contains a similar security interest exemption for an "owner" of a petroleum underground storage tank (UST) who is not otherwise engaged in petroleum production, refining, and marketing. *See* SWDA § 9003(h)(9), 42 U.S.C. § 6991b(h)(9).

53. *See United States v. First City Nat'l Bank of Houston*, 386 U.S. 361, 366 (1967).

54. *See EPA Lender Rule*, *supra* note 4, at 18,374.

55. *See id.* at 18,376-77.

tigations, requiring compliance or cleanup activities, refinancing or undertaking loan workouts, or providing financial advice.<sup>56</sup> Uncertainty regarding the SIE, especially prior to the CERCLA Amendments in 1996, includes the extent to which these activities constitute participation in the management of the debtor.<sup>57</sup>

Moreover, uncertainty regarding the scope of the SIE provides a disincentive for lenders to become involved in the redevelopment of brownfields. Brownfields are “abandoned, idled or underused industrial and commercial facilities where expansion or redevelopment is complicated by real or perceived environmental contamination.”<sup>58</sup> The number of brownfield sites in the United States ranges from tens of thousands to 450,000 sites.<sup>59</sup> Redevelopment of brownfields is hindered by: i) potential liability under CERCLA or other environmental laws, ii) technical difficulties related to defining the full extent of contamination and the necessary extent of remediation, iii) uncertainty regarding total cleanup costs, iv) community concerns regarding health risks from the presence of contamination and cleanup remedy selected, and v) non-environmental barriers (e.g., obsolete infrastructure, limited access, crime, congestion).<sup>60</sup>

EPA’s Brownfields Economic Redevelopment Initiative is intended to facilitate the redevelopment of brownfields.<sup>61</sup> The four “cornerstones” of EPA’s initiative consist of brownfields demonstration pilot projects, clarification of liability issues (e.g., lender liability), partnerships with other stakeholders to coordinate redevelopment efforts, and

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56. See *id.* at 18,345.

57. See *id.* at 18,376.

58. U.S. EPA, *Brownfields Glossary of Terms* (last modified September 30, 1997) <<http://www.epa.gov/swerosps/bf/glossary.htm#brow>>.

59. See *State of the States on Brownfields: Programs for Cleanup and Reuse of Contaminated Sites*, Office of Technology Assessment, June 1995, 4 (OTA-BP-ETI-153).

60. See *id.* at 5-10.

61. See U.S. EPA, *Brownfields Economic Redevelopment Initiative* (last modified March 1998) <<http://www.epa.gov/swerosps/bf/html-doc/econinit.htm>>.

"workforce development" efforts in brownfields communities.<sup>62</sup>

Forty-six states have some form of initiative underway for brownfields redevelopment.<sup>63</sup> The state-by-state mix of initiatives varies and includes funding of brownfields projects, providing incentives (e.g., tax) to attract private investment, and offering comfort letters (e.g., no further action letters, covenants not to sue) for cleanup actions.<sup>64</sup>

## B. Case Law Prior to 1992 EPA Rule

In *United States v. Mirabile*,<sup>65</sup> the district court denied Mellon Bank's (Mellon) motion for summary judgment<sup>66</sup> because a genuine issue of material fact existed<sup>67</sup> as to whether Mellon, as a secured creditor, had participated in the borrower's day-to-day nonfinancial management decisions to an extent that violated the SIE.<sup>68</sup> Mellon had provided working capital financing, secured by current assets, to Turco Coatings, Inc. (Turco).<sup>69</sup> Mellon's summary judgment motion, claiming protection under the SIE, was denied because of the current property owners' allegations that, prior to Turco ceasing operations, Mellon representatives visited the site fre-

62. See *id.* EPA submitted a brownfields budget request of \$91 million for fiscal year 1999, relative to the fiscal 1998 budget of \$87 million. *Air Quality, Hazardous Waste Cleanup Highlighted in Fiscal 1999 Funding Request*, 28 Env't Rep. (BNA) 2015 (Feb. 6, 1998).

63. See *State-by-State Brownfields Report Prepared by Northeast-Midwest Institute* (Jan. 28, 1998), 28 Env't Rep. (BNA) 2086 (Feb. 6, 1998).

64. See *id.*

65. 15 Env'tl. L. Rep. (Env'tl. L. Inst.) 20,994 (E.D. Pa. Sept. 4, 1985).

66. Federal Rule of Civil Procedure 56(c) authorizes the court to render summary judgment "forthwith if the pleadings, depositions, answers to interrogatories and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." FED. R. CIV. P. 56(c).

67. "The mere existence of some alleged factual dispute between the parties will not defeat the otherwise properly supported motion for summary judgment; the requirement is that there be no genuine issue of material fact." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247-48 (1986).

68. See *Mirabile*, 15 Env'tl. L. Rep. (Env'tl. L. Inst.) at 20,996.

69. See *id.*

quently and insisted on certain manufacturing changes and reassignment of personnel.<sup>70</sup>

EPA sought to recover its response costs from the site owners, Anna and Thomas Mirabile.<sup>71</sup> The Mirabiles joined two of three lenders (i.e., Mellon, and American Bank and Trust Company (ABT)), who had previously provided financing to Turco, as third-party defendants on grounds that the lenders were liable as former owner and operators.<sup>72</sup>

The district court in *Mirabile* held that, in order to lose the protection of the SIE, a secured creditor "must, at a minimum, participate in the day-to-day operational aspects" of the facility.<sup>73</sup> On this basis, the court found that ABT acted within the scope of the SIE.<sup>74</sup> ABT's actions included successfully bidding at the sheriff's sale, taking measures to secure the site against vandalism after all operations had ceased, and then assigning its bid to a third party.<sup>75</sup> The court held these activities by ABT were permissible as they were "prudent and routine steps" undertaken merely to protect its security interest after all operations had ceased.<sup>76</sup>

A narrower interpretation of the SIE was made by the district court for Maryland in *United States v. Maryland Bank & Trust Co.*,<sup>77</sup> where the SIE was voided by a mortgagee who foreclosed on a property and held title to that property for four years.<sup>78</sup> The secured creditor, Maryland Bank & Trust Co. (MB&T), took title at a foreclosure sale in 1982 to a property which had been used by MB&T's borrower as a haz-

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70. *See id.*

71. *See id.* at 20,994.

72. *See Mirabile*, 15 Env'tl. L. Rep. (Env'tl. L. Inst.) at 20,995. Mellon and ABT then counterclaimed against the United States alleging that if their activities resulted in CERCLA liability, then the Small Business Administration (SBA), the third lender, should be liable as well. *See id.* The SBA loan agreement with Turco included certain restrictions on Turco's finances but the court found that this involvement in the financial aspects of Turco's operations was insufficient to void the SIE for the SBA. *See id.* at 20,997.

73. *Id.* at 20,996.

74. *See id.* at 20,997.

75. *See id.* at 20,996.

76. *See Mirabile*, 15 Env'tl. L. Rep. (Env'tl. L. Inst.) at 20,996.

77. 632 F. Supp. 573 (D. Md. 1986).

78. *See id.*

ardous waste dump.<sup>79</sup> EPA subsequently removed contaminated soils and drums from the site, and sought to recover its response action costs from MB&T.<sup>80</sup> At the time of the court's decision, MB&T still held title to the property,<sup>81</sup> but disclaimed liability on the basis of the SIE.<sup>82</sup> The court, however, found that MB&T was liable as an owner because the SIE includes only "those persons who, at the time of the cleanup, hold indicia of ownership to protect a then-held security interest in the land."<sup>83</sup> The court decided that MB&T lost the exemption when it foreclosed on the property because it purchased the property "not to protect its security interest, but to protect its investment."<sup>84</sup> The court reasoned that MB&T's position would violate a fundamental tenet of CERCLA which is that responsible parties, and not the government, should bear the costs of cleanup.<sup>85</sup> If MB&T were to avoid liability, then MB&T would benefit from the increased value of the property because of the cleanup done at the government's expense.<sup>86</sup> The court did not address whether a lender who promptly sells a parcel of land after foreclosure, unlike MB&T, remains within the SIE.<sup>87</sup>

In *Guidice v. BFG Electroplating and Manufacturing Company, Inc.*,<sup>88</sup> the western Pennsylvania district court followed this narrow interpretation, holding that the National Bank of Commonwealth (National Bank), which purchased the subject property at a foreclosure sale, should be liable to the "same extent as any other bidder would have been."<sup>89</sup> National Bank had received a third-party complaint seeking contribution for response costs as a former owner and operator during the eight-month period that National Bank held

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79. See *id.* at 575.

80. See *id.* at 576.

81. See *id.* at 575.

82. See *id.* at 577.

83. *Maryland Bank & Trust Co.*, 632 F. Supp. at 579.

84. *Id.*

85. See *id.* at 580.

86. See *id.*

87. See *id.* at 579.

88. 732 F. Supp. 556 (W.D. Pa. 1989).

89. *Id.* at 563.

title to the property.<sup>90</sup> The court, in denying National Bank's motion for summary judgment, held that the SIE did not apply to the time that National Bank owned title to the property, and genuine issues of fact existed regarding whether hazardous substances were released during National Bank's ownership period.<sup>91</sup>

A secured creditor's motion to dismiss on grounds of the SIE was denied in *United States v. Nicolet, Inc.*,<sup>92</sup> because a genuine issue of material fact existed as to whether that secured creditor participated in the management of the facility.<sup>93</sup> EPA filed suit against Nicolet, Inc. (Nicolet) claiming that Nicolet, as the current owner of a manufacturing site in Pennsylvania, was liable for over \$2.5 million in EPA response costs related to the cleanup of an area where asbestos-containing waste material had been dumped.<sup>94</sup> T & N Public Limited Company (T&N) held a mortgage on the property, and owned all of the stock of Keasbey & Mattison Company (Keasbey) which operated the site prior to Nicolet.<sup>95</sup> EPA amended its complaint to add T&N as a defendant, alleging that T&N was liable for its response costs under five theories of liability, including that T&N was liable as a former owner or operator because T&N held a mortgage on property and actively participated in the facility's management.<sup>96</sup> The dis-

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90. *See id.* at 557.

91. *See id.* at 563-64.

92. 712 F. Supp. 1193 (E.D. Pa. 1989).

93. *See id.* at 1204.

94. *See id.* at 1195-96.

95. *See id.*

96. *See id.* at 1196-97. The government's other theories included that T&N: i) was the alter ego of Keasbey because T&N had "both a substantial ownership interest and exercised substantial involvement in Keasbey," and, as such, the corporate veil between T&N and Keasbey should be pierced; ii) was the alter ego of Keasbey in that T&N dominated Keasbey's policies operations and management, and that the corporate form of Keasbey served to "defeat public convenience, protect fraud, or defend crime;" iii) actively participated as sole shareholder in Keasbey's management during the time that asbestos disposal occurred on site and thus was liable section 107(a)(2); iv) was liable as a former owner and operator because it was "familiar [as the parent corporation] with Keasbey's waste disposal practices and had the capacity to abate environmental harm caused by such activities." *Id.*

trict court, following the holdings in *Maryland Bank*,<sup>97</sup> *Mirabile*,<sup>98</sup> and *Fleet Factors*,<sup>99</sup> agreed with the government's position that a mortgagee incurs CERCLA liability "only if the mortgagee participated in the managerial and operational aspects of the facility."<sup>100</sup> As such, the court denied the defendant's motion to dismiss the government's complaint because the government had alleged facts sufficient to raise a question as to T&N's liability.<sup>101</sup>

The case creating the greatest clamor was *United States v. Fleet Factors Corporation*,<sup>102</sup> in which the Eleventh Circuit affirmed the district court's denial of Fleet Factors Corporation's (Fleet) summary judgment motion when Fleet asserted the SIE.<sup>103</sup> In 1976, Fleet had entered into a "factoring" arrangement with Swainsboro Print Works, Inc. (SPW) where Fleet advanced funds, secured by SPW's accounts receivable, and Fleet obtained a security interest in the remaining plant, property and equipment.<sup>104</sup> In 1979, SPW filed for Chapter 11 protection and, with court approval, the factoring arrangement with Fleet continued.<sup>105</sup> In late 1981, after Fleet stopped advancing funds because of SPW's deteriorating financial condition, SPW's bankruptcy proceeding was converted to Chapter 7 liquidation and a trustee was assigned to the facility.<sup>106</sup>

In May 1982, after obtaining bankruptcy court approval, Fleet foreclosed on its security interest in certain of SPW's inventory and equipment, and contracted with Baldwin Industrial Liquidators, Inc. (Baldwin) to auction these materi-

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97. See *Maryland Bank & Trust Co.*, 632 F. Supp. at 573.

98. See *Mirabile*, 15 Env'tl. L. Rep. (Env'tl. L. Inst.) at 20,994.

99. See *United States v. Fleet Factors Corp.*, 901 F.2d 1550 (11th Cir. 1990), *affg* 724 F. Supp 955 (S.D. Ga. 1988), *cert. denied*, 498 U.S. 1046 (1991).

100. *Nicolet*, 712 F. Supp at 1205.

101. See *id.*

102. See *Fleet Factors Corp.*, 901 F. 2d at 1550.

103. See *id.*

104. See *id.* at 1550.

105. See *id.*

106. See *id.*

als.<sup>107</sup> Fleet never foreclosed on the real property.<sup>108</sup> In August 1982, Fleet entered into an agreement with Nix Riggers (Nix) where Nix had up to 180 days to remove the inventory and equipment left unsold from Baldwin's auction.<sup>109</sup> The government alleged that i) Baldwin moved several hundred leaking drums of chemicals away from the planned auction area to a different on-site area, and ii) asbestos pipe insulation on the equipment was disturbed by Nix and/or the parties who purchased the equipment at the auction.<sup>110</sup> In January 1984, EPA removed 700 fifty-five gallon drums and forty-four truckloads of asbestos-containing materials.<sup>111</sup> Three years later, Emanuel County acquired the site at a foreclosure sale due to SPW's failure to pay taxes.<sup>112</sup>

The United States then sued the former principal officers of SPW and Fleet to recover its cleanup costs.<sup>113</sup> Fleet was granted interlocutory appeal to the Eleventh Circuit after its motion for summary judgment was denied by the district court.<sup>114</sup>

The Eleventh Circuit affirmed the district court's denial of Fleet's summary judgment motion because of Fleet's actions after SPW had ceased operations.<sup>115</sup> The court reasoned that Fleet's actions which voided the SIE included: i) requiring SPW to obtain Fleet's approval prior to shipping its products to customers, ii) setting the price for excess inventory, iii) deciding when employees should be fired, iv) contracting with Baldwin and Nix to remove the equipment and inventory, and v) prohibiting SPW from selling certain chemical drums which remained at the site until they were ulti-

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107. See *Fleet Factors Corp.*, 901 F.2d at 1552. Some of the materials were sold at an auction with the buyers removing the items on an "as is" and "in place" basis. See *id.* at 1552.

108. See *id.* at 1555.

109. See *United States v. Fleet Factors Corp.*, 724 F. Supp 955, 958 (S.D. Ga. 1988).

110. See *id.*

111. See *Fleet Factors Corp.*, 901 F.2d at 1553.

112. See *id.*

113. See *id.*

114. See *id.*

115. See *id.* at 1560.



mately removed by EPA.<sup>116</sup> The Eleventh Circuit held that these actions, if proven true, would remove Fleet from the scope of the SIE because they constituted participation in the financial and operational management of SPW.<sup>117</sup>

The Eleventh Circuit then defined, in dicta, a narrow scope of the SIE which created great uncertainty in the lending community: a secured creditor may face section 107(a) owner or operator liability if it "participat[ed] in the financial management of a facility to a degree indicating a capacity to influence" the facility's hazardous waste management practices.<sup>118</sup> Moreover, a secured creditor would be similarly 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."<sup>119</sup> As such, the Eleventh Circuit rejected the *Mirabile*<sup>120</sup> court's interpretation of the SIE which required day-to-day participation in the management or operation of the facility to void the exemption.<sup>121</sup>

The Eleventh Circuit foresaw some of the negative reaction that would be created by its decision and sought to rebuke such criticism.<sup>122</sup> The court dismissed concerns that such a narrow interpretation would create disincentives for creditors to provide loans to businesses that are perceived to present increased hazardous waste liability.<sup>123</sup> The court believed that a narrow interpretation would create incentives for i) lenders to conduct careful pre-loan due diligence investigations regarding a potential debtor's hazardous waste management practices, ii) debtors to better manage their

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116. See *Fleet Factors Corp.*, 901 F.2d at 1559.

117. See *id.*

118. *Id.* at 1557.

119. *Id.* at 1558.

120. See *Mirabile*, 15 Env'tl. L. Rep. (Env'tl. L. Inst.) at 20,996.

121. See *id.*

122. See *Fleet Factors Corp.*, 901 F.2d at 1558.

123. See *id.* A 1991 American Bankers Association survey reported that sixty-two percent of banks had declined to provide a loan because of environmental liability concerns. See *Court Rejects Lender Shield*, ENGINEERING NEWS-REC., Feb. 21, 1994, at 24.

hazardous wastes, and iii) lenders to ensure that the debtor follows proper waste management practices.<sup>124</sup>

Subsequent cases generally did not follow *Fleet Factors'* narrow interpretation of the SIE. In *Bergsoe Metal Corporation v. Eastern Asiatic Company*,<sup>125</sup> the Ninth Circuit affirmed the granting of the Port of St. Helens' (Port) motion for summary judgment on the grounds that the Port was exempt from CERCLA liability because it held title to property in order to protect its security interest, and its unexercised rights as a lessor of the property (i.e., right to inspect the property and retake possession upon foreclosure) did not constitute participation in the management of the facility.<sup>126</sup> The Port issued industrial development revenue bonds for the construction of a secondary lead recycling plant in St. Helens, then sold the land to Bergsoe Metal Corporation (Bergsoe) for construction of the recycling plant.<sup>127</sup> The Port subsequently took back the deed under a sale-and-leaseback provision.<sup>128</sup> The Port then mortgaged the property, assigned the leases, and sold the revenue bonds to the United States National Bank of Oregon (Bank of Oregon).<sup>129</sup> Four years after beginning operations, Bergsoe filed for involuntary bankruptcy under Chapter 11.<sup>130</sup> The Bank of Oregon and the trustee filed suit against the corporate owners of Bergsoe's stock, East Asiatic Company Ltd. (EAC), to collect on Bergsoe's debts and to seek a declaration that EAC was liable for contamination discovered on the property by the Oregon Department of Environmental Quality.<sup>131</sup> EAC filed a third-party complaint against the Port and counterclaim against the Bank of Oregon, alleging that they were liable under CER-

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124. See *Fleet Factors Corp.*, 901 F.2d at 1558.

125. 910 F.2d 668 (9th Cir. 1990).

126. See *id.* at 673.

127. See *id.* at 669.

128. See *id.* at 669-70.

129. See *id.* at 670.

130. See *Bergsoe Metal Corporation*, 910 F.2d at 670.

131. See *id.*

CLA.<sup>132</sup> The Port filed a motion for summary judgment claiming that it was exempt from liability under the SIE.<sup>133</sup>

The Ninth Circuit held that even though the Port held title to the property, this ownership was for the purpose of protecting the Port's security interest.<sup>134</sup> The court reasoned that the "lease" between Bergsoe and the Port was similar to a security agreement in substance because the lease payments, which were equal to the bond's principal and interest amounts and were to be paid directly to the Bank of Oregon, terminated when the bonds were paid off.<sup>135</sup> Moreover, Bergsoe retained typical indicia of ownership, such as responsibility for payment of taxes and insurance and risk of loss from property damage.<sup>136</sup>

In holding that the Port did not participate in the management of Bergsoe, the Ninth Circuit opined that "[w]hat is critical is not what rights the Port had, but what it did."<sup>137</sup> The court, however, declined to specify what level of participation would void the SIE.<sup>138</sup>

### C. The EPA Lender Rule

EPA promulgated a rule on April 29, 1992, (EPA Lender Rule) to clarify the scope of the SIE.<sup>139</sup> EPA considered this a legislative or substantive rule, and stated in preamble language that it was to apply not only in litigation involving the government but also litigation between private parties.<sup>140</sup> Due to the questions raised by the *Fleet Factors*' dicta,<sup>141</sup> EPA noted in the preamble that impermissible "management participation does not include the unexercised right to be-

132. *See id.*

133. *See id.* at 670-71.

134. *See id.* at 673.

135. *See id.* at 671.

136. *See Bergsoe Metal Corp.*, 910 F.2d at 671. The court also noted that the deeds were placed in escrow with the Bank of Oregon, and Bergsoe could purchase the property for \$100 when the bonds were paid off. *See id.*

137. *Id.* at 672.

138. *See id.*

139. *See EPA Lender Rule*, *supra* note 4.

140. *See id.* at 18,368.

141. *See Fleet Factors Corp.*, 901 F.2d at 1557.

come involved in operational facility decisionmaking."<sup>142</sup> EPA maintained, however, that the rule was otherwise consistent with the Eleventh Circuit's holding.<sup>143</sup>

EPA set out a two-prong general test to determine whether a security interest holder has impermissibly participated in the management of a facility.<sup>144</sup> Under the first prong, management participation is indicated by the holder having "exercised decisionmaking control over the borrower's environmental compliance" activities.<sup>145</sup> Under the second-prong, the test looks to the actual level of involvement by the holder in the overall management of the day-to-day operations, regardless of whether control over the borrower's environmental compliance activities has been assumed or not.<sup>146</sup> The second prong was meant in part to guard against a holder "carving out" environmental matters from its control of the facility in an effort to protect itself from liability.<sup>147</sup>

EPA described, in the preamble, which actions taken by a person who holds "indicia of ownership"<sup>148</sup> would and would not constitute participation in the management of the borrower.<sup>149</sup> For example, impermissible actions included "actual participation in the management or operational affairs of the vessel or facility," and "decisionmaking control over the borrower's environmental compliance" matters.<sup>150</sup> Participation in the management also included assuming responsibility for day-to-day decisionmaking regarding: a) the environmental compliance matters of the borrower's facility, or b) all

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142. EPA Lender Rule, *supra* note 4 at 18,379.

143. *See id.* at 18,369.

144. *See id.* at 18,359.

145. *Id.*

146. *See* EPA Lender Rule, *supra* note 4 at 18,359-60.

147. *See id.* at 18,360.

148. *Id.* at 18,374. EPA defined indicia of ownership as "evidence of interests in real or personal property" and provided examples including a "mortgage, deed of trust, or legal or equitable title obtained pursuant to foreclosure or its equivalents, a surety bond, guarantee of an obligation, title held pursuant to a lease financing transaction in which the lessor does not select initially the leased property, or an assignment, lien, pledge, or other right to or form of encumbrance against the property." *Id.*

149. *See id.* at 18,373-80.

150. *Id.* at 18,383.

or nearly all of the non-environmental operational (but not financial or administrative) matters of the facility.<sup>151</sup>

Permissible actions related to environmental matters that do not rise to participation in management included: i) conducting environmental inspections of the subject property,<sup>152</sup> ii) requiring a prospective borrower to take certain cleanup actions or other actions to achieve compliance with applicable environmental laws, and iii) conducting response actions under section 107(d)(1) of CERCLA or under the direction of a NCP on-scene coordinator.<sup>153</sup>

Regarding workout activities, actions under the EPA Lender Rule that would not void the SIE, as long as those actions do not involve participation in management, included: i) restructuring the terms of the security interest, ii) requiring additional rent or interest, iii) providing specific or general financial advice, and iv) exercising rights under an escrow agreement.<sup>154</sup> EPA defined "workout" as those "actions by which a holder, at any time prior to foreclosure or 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>155</sup>

Finally, EPA stated in the preamble to the EPA Lender Rule that mere foreclosure did not, contrary to *Maryland Bank*,<sup>156</sup> convert an indicia of ownership into actual ownership.<sup>157</sup> Indicia of ownership held to protect a security interest was defined in the EPA Lender Rule to include "legal or equitable title acquired through or incident to foreclosure and its equivalents."<sup>158</sup> In order to obtain such post-foreclosure

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151. See EPA Lender Rule, *supra* note 4 at 18,383.

152. See *id.* at 18,376-77. EPA noted in the preamble that liability of a security interest holder under the SIE should not be affected by whether or not the holder conducted an environmental inspection in connection with obtaining the security interest, nor should the holder's liability be affected by the results of any such inspection. See *id.*

153. See *id.* at 18,383.

154. See *id.* at 18,383.

155. *Id.*

156. 632 F. Supp. 573 (D. Md. 1986).

157. See EPA Lender Rule, *supra* note 4, at 18,377.

158. *Id.* at 18,383-84.

protection, the security holder must not have participated in the management of the facility prior to foreclosure and must undertake to divest itself of the property in a "reasonably expeditious manner."<sup>159</sup> No time limit was set by EPA as to when a lender must divest its title, although the Rule did provide that a lender holding title is deemed to be doing so to protect its security interest if the lender lists the facility for sale within twelve months following foreclosure,<sup>160</sup> while a holder who "outbids, rejects or fails to act upon an offer of fair consideration" for the property is not considered to hold indicia of ownership primarily to protect a security interest.<sup>161</sup>

The SIE only applies to potential owner or operator liability under CERCLA sections 107(a)(1) and (a)(2). The EPA Lender Rule expressly stated that a lender acting within the exemption would nonetheless be potentially liable as an "arranger" or "transporter" under CERCLA section 107(a)(3) and (a)(4), respectively.<sup>162</sup>

#### D. Case Law Subsequent to Promulgation of EPA Lender Rule

In *Waterville Industries, Inc. v. Finance Authority of Maine (Waterville)*,<sup>163</sup> the First Circuit held that one of the goals of the SIE was to protect those lenders holding title to property as security for debt, and that Congress intended for this protection to include lease financing arrangements.<sup>164</sup> The court opined that Congress' intention was to avoid disrupting avenues of credit and to limit the wide breadth of CERCLA liability to those owners who "had the real equity interest in the property."<sup>165</sup> The court noted that this finding was consistent with the Ninth Circuit's holding in *Bergsoe*

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159. *Id.* at 18,384.

160. *See id.* at 18,384.

161. *Id.*

162. *See id.* at 18,385.

163. 984 F.2d 549 (1st Cir. 1993).

164. *See id.* at 552.

165. *Id.* at 552.

*Metal Corporation*,<sup>166</sup> which stated that a lease financing arrangement qualifies as a security interest under CERCLA.<sup>167</sup>

In *Waterville*, a textile manufacturer defaulted on construction loans for a textile mill; the Finance Authority of Maine (FAME) was the guarantor of the loans and accepted a deed in lieu of foreclosure.<sup>168</sup> FAME immediately leased the property to the First Hartford Corporation (FHC) to allow the mill to continue operations.<sup>169</sup> Hazardous wastes were released into two wastewater lagoons during the time that FAME was the lessor.<sup>170</sup> When FHC subsequently filed for Chapter 11 bankruptcy protection, the bankruptcy court recognized FAME as the title holder of the property.<sup>171</sup> After FHC's unsuccessful attempt to sell the property, FAME conveyed the site within eight months to the predecessor of Waterville Industries.<sup>172</sup> Waterville Industries remediated the wastewater lagoons, as directed by an EPA administrative order, and then filed a contribution action<sup>173</sup> against FAME alleging that FAME was liable as a former owner of the property.<sup>174</sup>

The First Circuit held that FAME's nominal ownership did not void the SIE because FAME successfully reconveyed the property within a reasonable time period.<sup>175</sup> The court held, consistent with the EPA Lender Rule, that the SIE applies to a "lender-lessor" as long as that party makes a reasonably prompt effort to divest itself of the property once the lease arrangement is terminated.<sup>176</sup> Moreover, the court found that Congress intended the SIE to protect from liability

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166. See 910 F.2d at 668.

167. See *Waterville Indus., Inc.*, 984 F.2d at 553; see generally, *Bergsoe*, 910 F.2d at 668.

168. See *Waterville Indus., Inc.*, 984 F.2d at 550.

169. See *id.*

170. See *id.*

171. See *id.* at 551.

172. See *id.*

173. See CERCLA § 113(f)(1), 42 U.S.C. § 9613(f)(1) (allowing a person to seek contribution, for response costs incurred, from any other person who is potentially liable under § 9607(a)).

174. See *Waterville Indus., Inc.*, 984 F.2d at 551.

175. See *id.* at 552.

176. See *id.* at 553.

those “‘owners’ who are in essence lenders holding title to the property as security for the debt.”<sup>177</sup>

The First Circuit followed this reasoning in *Northeast Doran, Inc. v. Key Bank of Maine*,<sup>178</sup> where it affirmed the dismissal of a complaint against a mortgagee because the mortgagee’s divestiture of a property, less than six months after acquiring a judgment of foreclosure, was reasonably prompt and within the bounds of the SIE.<sup>179</sup> Key Bank of Maine (Key), the mortgagee, sold the property at an auction to Northeast Doran, Inc.<sup>180</sup> The court also held that Key’s interest in the property was to protect its security interest.<sup>181</sup> Key retained an independent consultant to conduct an environmental assessment of the property which found possible contamination; the court, consistent with the EPA Lender Rule, held that this action did not remove Key from the protection of the SIE.<sup>182</sup>

On *Fleet Factors*’ remand from the Eleventh Circuit,<sup>183</sup> the federal District Court for the Southern District of Georgia applied the EPA Lender Rule.<sup>184</sup> The court held that Fleet Factors Corporation (Fleet) was liable as a former owner and operator because its agents (i.e., Baldwin, Nix)<sup>185</sup> voided the SIE after Fleet’s foreclosure on certain personal property.<sup>186</sup> However, prior to the time it foreclosed on the inventory, machinery and equipment, Fleet did not violate the EPA Lender Rule’s two-prong participation in management test because

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177. *Id.* at 552.

178. 15 F.3d 1, 3 (1st Cir. 1994).

179. *See id.* at 3.

180. *See id.* at 2.

181. *See id.* at 3.

182. *See id.*

183. *See generally, Fleet Factors Corp.*, 901 F.2d 1550.

184. *See United States v. Fleet Factors Corp.*, 821 F. Supp. 707 (S.D. Ga. 1993) [hereinafter *Fleet Factors Remand*].

185. *See supra* notes 99-113 and accompanying text for a description of the underlying facts regarding the *Fleet Factors* case. Fleet did not dispute that a principal-agent relationship existed with respect to the actions of Baldwin and Nix at the SPW site. *See Fleet Factors Remand, supra* note 184, at 714.

186. *See Fleet Factors Remand, supra* note 184, at 710.



its actions were "consistent with those a reasonable, similarly situated secured creditor probably would have taken."<sup>187</sup>

During the post-foreclosure period, Baldwin impermissibly participated in the management by relocating on the property "several hundred damaged, corroded and leaking drums" so they would not interfere with the planned auction.<sup>188</sup> The court noted that "mere incidental handling" of hazardous substances by a lender after foreclosure would not void the SIE.<sup>189</sup> The drums in this instance, however, posed an "apparent and serious" environmental threat and Baldwin's actions were more than incidental handling.<sup>190</sup> Baldwin's actions voided the SIE because they were not conducted under the direction of an NCP on-scene coordinator or were otherwise consistent with the NCP, as required by the EPA Lender Rule.<sup>191</sup>

For the same reasons that made Baldwin liable, Nix's actions in salvaging property unsold from Baldwin's auction violated the EPA Lender Rule because Nix improperly handled hazardous substances in a manner that aggravated a serious environmental threat, and Nix's actions represented impermissible day-to-day decisionmaking control over environmental matters at the facility.<sup>192</sup> In addition, Nix's eighteen-month presence on the site was not "reasonably expeditious" as required by the EPA Lender Rule for post-foreclosure divestiture.<sup>193</sup>

Finally, the court noted that Baldwin's and Nix's actions resulted in hazardous substance releases (e.g., spills from the drums).<sup>194</sup> These releases, coupled with the forfeiture of the

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187. *Id.* at 716.

188. *Id.* at 718.

189. *Id.* at 719.

190. *See id.*

191. *See Fleet Factors Remand*, *supra* note 184, at 710.

192. *See id.* at 718. The court noted that Nix's actions were conducted with "all the finesse of a Viking raiding party." *Id.* at 720. Such actions included "shov[ing] chemical drums about the site to [prepare for] salvage operations, back[ing] into and crush[ing] the drums with tractors, scrap[ing] (and chopp[ing] with hatchets) asbestos-laden insulation from equipment and machinery" and allowing that material to accumulate on the floor. *Id.*

193. *See id.* at 721.

194. *See id.* at 721.

SIE, resulted in Fleet's liability under CERCLA section 107(a)(2) as a former owner or operator during the time of disposal of hazardous substances.<sup>195</sup>

### E. Kelley Decision Vacating EPA Lender Rule

In *Kelley v. EPA*,<sup>196</sup> the State of Michigan and the Chemical Manufacturers Association promptly challenged the EPA Lender Rule in the D.C. Circuit Court of Appeals. The court vacated the rule on grounds that Congress intended the judicial system, rather than EPA, to determine the scope of liability under section 107 of CERCLA.<sup>197</sup>

EPA made several arguments that Congress had provided it with specific authority to issue substantive regulations. First, EPA claimed that CERCLA section 105, which authorized EPA to develop the NCP and to "reflect and effectuate the responsibilities and powers created by this chapter," included a delegation of power to decide the liability of parties under section 107 because section 107 liability is one such "responsibility and power."<sup>198</sup> Although recognizing that section 105 does "provide the EPA with broad rulemaking authority to craft the NCP,"<sup>199</sup> the court held that section 105 did not provide EPA with authority to define liability under section 107 but only to "limit the level of damages recoverable by the prevailing party."<sup>200</sup>

EPA claimed that CERCLA section 115 provides the agency with general authority to issue any rule that is reasonably related to the statute's goal.<sup>201</sup> The D.C. Circuit re-

195. See *Fleet Factors Remand*, *supra* note 184, at 723-24.

196. 15 F.3d at 1100. CERCLA provides the D.C. Circuit Court of Appeals with exclusive jurisdiction to review agency regulations promulgated under CERCLA. See CERCLA § 113(a), 42 U.S.C. § 9613(a).

197. See *Kelley*, 15 F.3d at 1107. The EPA Lender Rule was removed from the Code of Federal Regulations on June 29, 1995. See 60 Fed. Reg. 33,912-13 (1995).

198. *Kelley*, 15 F.3d at 1105.

199. *Id.* (quoting *Ohio v. EPA*, 838 F.2d 1325, 1331 (D.C. Cir. 1988)).

200. *Id.*

201. See *id.* CERCLA provides the President with authority to "delegate and assign any duties or powers imposed upon or assigned to him and to promulgate any regulations necessary to carry out the provisions of this subchapter." CERCLA § 115, 42 U.S.C. § 9615.

jected this argument because the Agency did not demonstrate either "explicit or implicit evidence of congressional intent to delegate interpretive authority" for defining classes of liability.<sup>202</sup>

EPA also argued that since section 107(a)(4)(A) allows it to bring an enforcement action against a potentially responsible party to recover response costs incurred by EPA, then EPA must first necessarily determine whether that party is liable under section 107.<sup>203</sup> The court rejected this argument by reasoning that the final determination of a party's liability is made by the courts, even though EPA, like any government prosecutor, must initially exercise judgment in determining whether to bring a civil action against a party who is potentially liable.<sup>204</sup>

Similarly, the court noted that the ultimate determination of liability under section 106 is made by the courts after a party's compliance with an administrative order issued by EPA to respond to an imminent and substantial endangerment.<sup>205</sup> As such, CERCLA requires parties to "shoot first (clean up) and ask questions (determine who bears the ultimate liability) later."<sup>206</sup>

CERCLA section 106(b)(2) allows a party who has complied with such an administrative order to petition EPA for reimbursement of reasonable costs incurred if that party believes that it is not liable under section 107.<sup>207</sup> If EPA denies the request for reimbursement, then the party may bring an action in federal district court and obtain reimbursement if it can show by a "preponderance of the evidence" that it is not a liable party under section 107.<sup>208</sup> EPA argued that it must

202. *Kelley*, 15 F.3d at 1106.

203. *See id.* at 1107.

204. *See id.* at 1105.

205. *See id.*

206. *Id.*

207. *See* CERCLA § 106(b)(2)(A), 42 U.S.C. § 9606(b)(2)(A).

208. *See* CERCLA § 106(b)(2)(C), 42 U.S.C. § 9606(b)(2)(C). A party who is liable under section 107(a) may nonetheless obtain reimbursement if it can demonstrate that the response action ordered by EPA was "arbitrary and capricious or was otherwise not in accordance with law." CERCLA § 106(b)(2)(D), 42 U.S.C. § 9606(b)(2)(D).

decide a party's liability under section 107 when determining whether to reimburse that party under section 106(b)(2).<sup>209</sup> The court disagreed and noted that if a party brings an action against EPA for reimbursement, then EPA is a defendant whose preliminary judgment as to the plaintiff's liability is entitled to "no consideration, let alone the deference afforded to the typical administrative adjudication."<sup>210</sup> Moreover, since private parties can bring actions under various provisions of CERCLA<sup>211</sup> without the government's involvement, the court reasoned that this provided further evidence of congressional intent to have courts, rather than EPA, determine the scope of liability under section 107.<sup>212</sup>

EPA asserted in the preamble to the EPA Lender Rule that, even if not a legislative rule, the Rule should receive substantial deference as an interpretive rule.<sup>213</sup> The court disagreed and rejected the EPA Lender Rule as an interpretive rule on the same grounds that disqualified it as a substantive rule. The court reasoned that since Congress did not intend for EPA to decide the liability of parties, then EPA's interpretation of the scope of liability deserves no *Chevron* deference.<sup>214</sup> Additionally, the court reasoned that no deference was warranted because i) an independent cause of action existed for private parties in federal court to decide the liability issue which courts should adjudge without the cloud of EPA's interpretive view, and ii) the agency's only statutory

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209. See *Kelley*, 15 F.3d at 1106.

210. *Id.* at 1107.

211. For example, CERCLA provides that a responsible party, who has incurred CERCLA response costs, may seek contribution from other responsible parties potentially liable under section 107(a), and the court will use "such equitable factors as the court determines appropriate" in allocating response costs. CERCLA § 113(f)(1), 42 U.S.C. § 9613(f)(1). Even if EPA were to reimburse the party, the court noted that EPA's determination of liability would not be binding in federal court in a subsequent contribution action brought by a third party against the reimbursed party. See *Kelley*, 15 F.3d at 1108.

212. *Kelley*, 15 F.3d at 1108.

213. See EPA Lender Rule, *supra* note 4, at 18,368.

214. See *Kelley*, 15 F.3d at 1108. The *Chevron* doctrine provides that if congressional intent on the statutory interpretation at issue is either ambiguous or absent, a court should defer to an agency's interpretation if that interpretation is based on a "permissible construction" of the statute. *Chevron, U.S.A., Inc. v. Nat. Resources Def. Council, Inc.*, 467 U.S. 837, 843 (1984).

authority regarding liability issues is to bring the issue to federal court as a prosecutor.<sup>215</sup>

#### F. EPA's 1995 Enforcement Policy Statement

EPA and the U.S. Department of Justice (DOJ) responded to the *Kelley* decision by issuing a policy statement on September 22, 1995, which stated that EPA and DOJ would apply, as an enforcement guidance policy for CERCLA actions, the provisions of the vacated EPA Lender Rule against lenders and government entities that acquire property involuntarily (1995 Enforcement Policy).<sup>216</sup> EPA did not raise the validity of the EPA Lender Rule as an enforcement policy in *Kelley v. EPA*, and the court there left open this option for EPA to pursue.<sup>217</sup> The 1995 Enforcement Policy instructed EPA and DOJ personnel, when exercising their enforcement discretion, to consult the regulatory text and preamble language contained in the vacated EPA Lender Rule so as to endorse the "interpretations and rationales" contained in that Rule.<sup>218</sup> The 1995 Enforcement Policy was limited for use by EPA and DOJ employees and was intended neither to represent a rulemaking nor to create any substantive or procedural rights in any person.<sup>219</sup>

In December 1995, EPA issued a fact sheet, for use by EPA employees, that summarized the 1995 Enforcement Policy and provided answers to common questions regarding the effect of the policy on government entities that involuntarily

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215. See *Kelley*, 15 F.3d at 1108-09.

216. CERCLA Enforcement Against Lenders and Government Entities that Acquire Property Involuntarily, 60 Fed. Reg. 63,517 (1995) [hereinafter Enforcement Policy]. Examples provided in the EPA Lender Rule of involuntary property acquisitions by the government include acquisitions by or transfers to a government entity: (i) "pursuant to seizure or forfeiture authority," (ii) "pursuant to abandonment proceedings, or as the result of tax delinquency" or other instances when a government entity involuntarily "obtains ownership or control of property by virtue of its function as a sovereign." See EPA Lender Rule, *supra* note 4, at 18,385.

217. See *Kelley*, 15 F.3d at 1109.

218. See Enforcement Policy, *supra* note 216 at 63,517-18. As in the EPA Lender Rule, the guidance policy was limited to CERCLA applications and did not apply to liability issues under RCRA. See *id.* at 63,518.

219. See *id.* at 63,519.

acquire contaminated property.<sup>220</sup> On August 20, 1996, EPA issued a similar fact sheet regarding the effect of the SIE on lenders (EPA Lender Fact Sheet).<sup>221</sup> In this latter fact sheet, EPA stated that: i) the 1995 Enforcement Policy was issued as part of EPA's Brownfields Economic Redevelopment Initiative, ii) the 1995 Enforcement Policy did not apply to cleanup enforcement actions initiated by state authorities, and iii) a lender who leases or re-leases property subsequent to foreclosure would likely not be protected by the SIE unless that lender held title to the property in a lease financing arrangement prior to foreclosure.<sup>222</sup>

### G. Case Law After Kelley Decision

The *Kelley* decision restored the uncertainty created by the *Fleet Factors* dicta.<sup>223</sup> Subsequent cases, however, tended to expressly or implicitly follow the principles of the vacated EPA Lender Rule.

In *Z & Z Leasing, Inc. v. Graying Reel, Inc.*,<sup>224</sup> a federal district court in Michigan explicitly rejected the *Fleet Factors* test because it would "largely eviscerate the exemption Congress intended to afford secured creditors," although the court declined to establish a bright line test for CERCLA operator liability.<sup>225</sup> The court granted Comerica Bank's (Comerica) motion for summary judgment on grounds that the SIE protected it from CERCLA liability.<sup>226</sup>

Manufacturers National Bank of Detroit (Detroit Bank) held a security interest in Z & Z Leasing, Inc.'s (Z & Z) per-

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220. See U.S. EPA, *Fact Sheet: The Effect of Superfund on Involuntary Acquisitions of Contaminated Property by Government Entities* (last modified February 13, 1998) <<http://es.epa.gov/oeca/osre/951200.html>>.

221. See U.S. EPA, *Fact Sheet on the Effect of Superfund on Lenders that Hold Security Interests in Contaminated Property* (last modified February 13, 1998) <<http://es.epa.gov/oeca/osre/960820.html>>.

222. See *id.*

223. See generally, *Kelley*, 15 F.3d at 1100; see also *Fleet Factors*, 901 F.2d at 1557.

224. 873 F. Supp. 51 (E.D. Mich. 1995).

225. *Id.* at 55.

226. See *id.* at 56.

sonal and real property.<sup>227</sup> Plaintiff Z & Z claimed that Comerica, as successor to Detroit Bank, was liable as an operator because it: i) obtained covenants requiring Z & Z to comply with all applicable environmental laws, ii) obtained negative covenants regarding financial matters of Z & Z, iii) conducted an environmental investigation of the property six years after obtaining the first mortgage during which it sampled hazardous substances contained within an abandoned UST, and iv) reported a release of hazardous substances from the UST to the State of Michigan.<sup>228</sup> The court rejected Z & Z's claims and held that Comerica was not an operator under CERCLA because the actions that it took (e.g., requiring compliance with laws, investigating the property for contamination) were "prudent and routine steps" to protect its security interest.<sup>229</sup>

In *Kemp Industries, Inc. v. Safety Light Corp.*,<sup>230</sup> a federal district court in New Jersey held that Prudential Insurance Company (Prudential), which financed the development of a property through a sale and leaseback mechanism, was not liable as an owner or operator even though it held title to the property as lessor for fourteen years.<sup>231</sup> As in *Bergsoe Metal Corporation*,<sup>232</sup> the court looked to the underlying reason as to why Prudential held title to the property and not merely the fact that it did so.<sup>233</sup> Prudential financed the construction of a phosphor production operation by purchasing the facility and immediately leasing the property back to the operator.<sup>234</sup> After considering various factors,<sup>235</sup> the court

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227. See *id.* at 52. Comerica was successor to Manufacturers National Bank of Detroit. See *id.*

228. See *id.* at 54-55.

229. 873 F. Supp. at 55. The court also rejected Z & Z's claim that Comerica was an owner because Comerica never foreclosed on the real property, and Michigan followed the lien theory of mortgage law where title does not pass automatically to the mortgagee upon the granting of a mortgage. See *id.* at 54.

230. 857 F. Supp. 373 (D.N.J. 1994).

231. See *Kemp Indus.*, 873 F. Supp. at 379, 383, 395.

232. 910 F.2d at 668 (9<sup>th</sup> Cir. 1990).

233. See *Kemp Indus.*, 873 F. Supp. at 390.

234. See *id.* at 378-79.

235. Consistent with New Jersey case law, factors considered by the court to indicate that a lease is in the form of a security arrangement included whether:

found that Prudential acquired title to the property as part of a security agreement to finance the development of the site and the lessee retained the benefits and risks typically associated with property ownership.<sup>236</sup>

### III. Lender Liability Act

On September 30, 1996, the President signed an omnibus appropriations bill which included the Asset Conservation, Lender Liability, and Deposit Insurance Protection Act of 1996 (Lender Liability Act) which amended section 101(20) and section 107 of CERCLA to clarify the scope of the SIE.<sup>237</sup>

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i) the lessee was required to maintain insurance against casualty loss, ii) the lessee was required to be fully responsible for casualty loss without any relief from the lease payment obligations, iii) the lessee was required to indemnify the lessor from all claims related to use of the equipment, iv) the lessee was required to pay all taxes related to the equipment, v) the lessee was required to pay a "substantial deposit" upon acceptance of the lease, vi) the contract included an accelerated rent provision in the event of default, and vii) the equipment was purchased by the lessor for the lessee as evidenced by a contract provision identifying the equipment supplier. *See id.* at 388-389.

236. *See Kemp Indus.*, 873 F. Supp. at 394. The court noted that the "totality of the facts surrounding the transaction" is determinative, rather than the "fulfillment of a list of elements." *Id.* As such, the court discounted the marginal ownership benefits retained by Prudential (e.g., right to depreciate the property; absence of a repurchase option in the contract). *See id.* at 393-94.

The plaintiffs claim that Prudential was an operator because it participated in the management of the facility was rejected by the court because no supporting evidence was submitted. *See id.* at 395. In fact, long-time employees at the manufacturing plant testified that they never saw a Prudential employee at the site or knew of any connection between Prudential and the facility. *Id.*

237. *See* Pub. L. 104-208, 110 Stat. 3009 (1996) (codified as amended at 42 U.S.C. 9601 *et seq.*) [hereinafter Lender Liability Act].

The Act also amends section 107 of CERCLA to limit fiduciary liability to the value of assets held in the fiduciary capacity. *See* Lender Liability Act. It also provides a safe harbor for certain fiduciary actions such as undertaking a response action under the NCP, terminating the fiduciary relationship, monitoring or inspecting the property, and placing environmental covenants or warranties within the fiduciary agreement. *See id.* These protections are lost, however, if the fiduciary's negligence causes or contributes to the release of hazardous substances. *See id.*

Unlike the EPA Lender Rule which only addressed CERCLA actions, the Lender Liability Act amended RCRA's security interest exemption for owners and operators of USTs containing petroleum to i) validate an EPA Rule promulgated in 1995, codified in 40 C.F.R. § 280.200, regarding the petroleum UST security interest exemption (EPA UST Lender Rule), and ii) apply the amended



The Act was the first substantive change to CERCLA in a decade since the Superfund Amendments and Reauthorization Act of 1986.<sup>238</sup> The constitutionality of substantive legislation in an appropriations bill has been upheld.<sup>239</sup>

The Lender Liability Act rejects the *Fleet Factors* dicta by defining impermissible participation in management as actual involvement with the management or operation of the facility, and not “merely having the capacity to influence, or the unexercised right to control” facility operations.<sup>240</sup> While the borrower remains in possession of the facility, a security interest holder will be deemed to have impermissibly participated in management only when the holder: i) exercises decisionmaking control over the environmental compliance matters of the facility to the extent that the security holder has assumed responsibility for hazardous substance management, or ii) exercises control similar to that of a facility manager over a) “day-to-day” environmental compliance decisionmaking, or b) “all or substantially all of the [facility’s] operational functions (as distinguished from financial or administrative functions)” other than those related to environmental compliance.<sup>241</sup>

Other actions by a security interest holder that would not be considered participation in management include: i) acting prior to the time a security interest is obtained (e.g., conducting an environmental investigation of the property),<sup>242</sup> ii) holding, abandoning or releasing of a security interest,<sup>243</sup> and iii) providing “financial or other advice” to remedy or prevent “diminution in the value of the . . . facil-

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CERCLA SIE provisions to RCRA UST liability issues to the extent there is not a conflict with the EPA UST Lender Rule. *See id.* § 2503 (codified as amended at 42 U.S.C. § 6691(b)(h)(9)); *cf.* EPA Lender Rule, *supra* note 4.

238. Superfund Amendments and Reauthorization Act of 1986, Pub. L. No. 99-499, 100 Stat. 1613 (codified as amended at 42 U.S.C. §§ 9601-9075 (1986)).

239. *See, e.g.,* *Robertson v. Seattle Audubon Soc’y*, 503 U.S. 429, 440 (1992).

240. *See* Lender Liability Act, *supra* note 237, § 2502(b) (codified as amended at 42 U.S.C. § 9601(20)(F)(i)).

241. *Id.* (codified as amended at 42 U.S.C. § 9601(20)(F)(ii)).

242. *See id.* (codified as amended at 42 U.S.C. § 9601(20)(F)(iii)).

243. *See id.* (codified as amended at 42 U.S.C. § 9601(20)(F)(iv)(I)).

ity.”<sup>244</sup> Finally, neither the restructuring nor otherwise altering of contractual terms and conditions of the security agreement,<sup>245</sup> nor the “exercising [of] other remedies” under applicable law for a breach of the security agreement would rise to the level of impermissible participation in management.<sup>246</sup>

Regarding the environmental matters of the facility, permissible actions by a lender that do not constitute participation in management include: i) “response actions under [CERCLA] section 107(d) or under the direction of an [NCP] on-scene coordinator,”<sup>247</sup> ii) inclusion of environmental compliance terms or conditions (e.g., covenants, warranties) in the security agreement and monitoring or enforcing such terms or conditions,<sup>248</sup> and iii) requiring a “response action or other lawful means of addressing the release or threatened release of a hazardous substance.”<sup>249</sup>

Provided that a lender acted within the SIE prior to foreclosure, a lender may continue to receive such protection notwithstanding the fact that the lender forecloses on the property, and then continues the business operations, sells or liquidates the business, or re-leases the property where a lease finance transaction is involved.<sup>250</sup> In addition, after foreclosure, a lender may perform a section 107(d)(1) response action or a response action as directed by an on-scene NCP coordinator; or, “take[ ] any other measure to preserve, protect or prepare” the facility for sale or disposition.<sup>251</sup> This protection is qualified on the lender seeking to sell or re-lease the facility at the “earliest practicable, commercially reason-

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244. *Id.* (codified as amended at 42 U.S.C. § 9601(20)(F)(iv)(VI)).

245. *See* Lender Liability Act, *supra* note 237, § 2502(b) (codified as amended at 42 U.S.C. § 9601(20)(F)(iv)(VII)).

246. *See* Lender Liability Act, *supra* note 237, § 2502(b) (codified as amended at 42 U.S.C. § 9601(20)(F)(iv)(VIII)).

247. *Id.* (codified as amended at 42 U.S.C. § 9601(20)(F)(iv)(IX)).

248. *See id.* (codified as amended at 42 U.S.C. § 9601(20)(F)(iv)(II-III)).

249. *Id.* (codified as amended at 42 U.S.C. § 9601(20)(F)(iv)(V)).

250. *See id.* (codified as amended at 42 U.S.C. § 9601(20)(E)(ii)(II)).

251. *Id.* § 2502(b) (codified as amended at 42 U.S.C. § 9601(20)(E)(ii)(II)).

able time, on commercially reasonable terms taking into account market conditions.”<sup>252</sup>

The Lender Liability Act provides definitions of “security interest,”<sup>253</sup> and “foreclosure.”<sup>254</sup> The Act similarly provides a broad definition of lender that includes private lenders, insured depository institutions and credit unions, and entities such as the Federal National Mortgage Association.<sup>255</sup>

Finally, the Lender Liability Act expressly restores the portion of the EPA Lender Rule that expanded the list of state or local government entities that involuntarily acquire ownership or control of property and that are exempt from the term owner or operator under section 9601(20)(D).<sup>256</sup> Such examples provided in the EPA Lender Rule include acquisitions by a government agency or agent (i) acting as a conservator or receiver, (ii) administering a governmental loan program, and (iii) acting through its seizure or forfeiture authority.<sup>257</sup> The Lender Liability Act declared that this reinstated portion of the EPA Lender Rule was not subject to judicial review.<sup>258</sup>

252. Lender Liability Act, *supra* note 237, § 2502(b).

253. The term security interest means “a right under a mortgage, deed of trust, assignment, judgment lien, pledge, security agreement, factoring agreement, or lease and any other right accruing to a person to secure the repayment of money, the performance of a duty, or any other obligation by a nonaffiliated person.” *Id.* § 2502(b) (codified as amended at 42 U.S.C. § 9601(20)(G)(vi)).

254. “Foreclosure” includes, *inter alia*, acquiring a facility through a deed in lieu of foreclosure, the termination of a lease agreement, the purchase at a judicial or nonjudicial foreclosure sale, or “any other formal or informal manner by which the person acquires, for subsequent disposition, title to or possession of a . . . facility” to protect that person’s security interest. *Id.* (codified as amended at 42 U.S.C. § 9601(G)(iii)).

255. *See id.* (codified as amended at 42 U.S.C. § 9601(G)(iv)).

256. *See id.* at § 2504. This exclusion for government entities involuntarily acquiring property is not available if those entities have “caused or contributed to the release or threatened release” of hazardous substances. CERCLA § 101(20)(D), 42 U.S.C. § 9601(20)(D).

257. *See* EPA Lender Rule, *supra* note 4, at 18,385. This exclusion for government entities involuntarily acquiring property exists provided that those entities have not “caused or contributed to the release or threatened release” of hazardous substances. *See id.*

258. *See* Pub. L. No. 104-208 § 2504(b).

## IV. Developments Subsequent to Lender Liability Act

## A. Case Law

In *Kelley v. Tiscornia*,<sup>259</sup> the Sixth Circuit affirmed the lower court's grant of summary judgment in favor of Manufacturers National Bank of Detroit (Detroit Bank) on the grounds that the Detroit Bank did not participate in the management of the borrower Auto Specialties Manufacturing Company (AUSCO), as that term was defined by the Lender Liability Act.<sup>260</sup> The court reasoned that there was no evidence that Detroit Bank had participated in the operation of the facility rather than merely in the financial and administrative aspects of the business.<sup>261</sup> Although the lower court's January 1993 holding was based on the EPA Lender Rule, the Sixth Circuit found that the Lender Liability Act essentially codified the EPA Lender Rule, and that the Act governed disputes that had not been finally adjudicated at the time of enactment.<sup>262</sup>

The State of Michigan claimed that Detroit Bank was liable for on-site contamination as a CERCLA owner or operator during either of two time periods: (i) when Detroit Bank representatives served on AUSCO's board of directors, and (ii) when a turnaround specialist, recommended by Detroit Bank as a condition to continued financing, was hired by AUSCO to manage the business.<sup>263</sup> During the first time period, the lower court found that Detroit Bank acted within the SIE during its twenty-two year participation on AUSCO's board and close monitoring of AUSCO's performance because its actions were limited to AUSCO's financial aspects (e.g. pension and capital spending issues, borrowing issues with another lender, financial impacts of labor disputes) rather than actual control over day-to-day operational (e.g., environmental compliance) matters.<sup>264</sup>

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259. No. 94-1403, 1996 WL 732323, at \*2 (6th Cir. Dec. 19, 1996).

260. *See id.*

261. *See id.*

262. *See id.*

263. *See Kelley v. Tiscornia*, 810 F. Supp. 901, 905 (W.D. Mich. 1993).

264. *See id.* at 906-07.

Regarding the second time period in question, Detroit Bank acted within the scope of the safe harbor provision by avoiding actual control of AUSCO's decisionmaking.<sup>265</sup> The court found that: i) AUSCO was free to ignore Detroit Bank's condition that the workout specialist be hired which only evidenced permissible influence (even if substantial) but not actual control by Detroit Bank, and ii) regular communication between the workout specialist and Detroit Bank was consistent with the Detroit Bank's valid monitoring of AUSCO's financial matters and such communication was within the limits set by the loan agreement.<sup>266</sup> Moreover, the lower court opined that agreeing with the State's argument would likely result in a denial of further funding to debtors who owned contaminated property since CERCLA risks would attach to lenders.<sup>267</sup>

In *F.P. Woll & Co. v. Fifth and Mitchell Street Corp.*,<sup>268</sup> the plaintiff alleged that Philadelphia National Bank (PNB) was a former CERCLA operator of a dry cleaning compound manufacturing facility because it actively managed that facility during the time hazardous substances were released, including the period after PNB foreclosed on the assets of that facility until it "promptly" resold those assets to a third party. PNB moved for dismissal for failure to state a claim on grounds that it was protected from liability under the SIE, as amended by the Lender Liability Act.<sup>269</sup> The court declined to grant PNB's motion because of the plaintiff's allegation that PNB operated the facility when hazardous substance releases occurred.<sup>270</sup>

In *Canadyne-Georgia Corp. v. Nationsbank, N.A.*,<sup>271</sup> a testator created a trust, with a bank appointed as co-trustee, to continue the operations of an agricultural chemical company. Canadyne-Georgia Corporation, a subsequent property

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265. See *id.* at 907-08.

266. See *id.*

267. See *id.* at 909.

268. No. CIV.A. 96-5973, 1997 WL 535936 at \*1-2 (E.D. Pa. July 31, 1997).

269. See *id.* at \*1.

270. See *id.* at \*2.

271. 982 F. Supp. 886 (M.D. Ga. 1997).

owner, claimed that the bank was liable under CERCLA section 107 as a former owner or operator at the time when hazardous substances were released.<sup>272</sup> The court granted the bank's motion to dismiss for failure to state a claim on grounds that: i) the bank was not a covered person under CERCLA because, even though the bank held title to the real property as a tenant in common in the trust, Georgia trust law imposed liability only on the trust res for tort wrongs committed by an executor "empowered and directed by the will to conduct and continue the business of the testator,"<sup>273</sup> and ii) the alleged facts were insufficient to state a claim that the bank was an operator under CERCLA.<sup>274</sup> As the bank was not a covered person under CERCLA, the court did not address the bank's second defense that it was protected by the SIE as amended by the Lender Liability Act.<sup>275</sup>

In *United States v. Pesses*,<sup>276</sup> a magistrate for a federal district court in Pennsylvania granted Dollar Savings Association's (Dollar Savings) motion for summary judgment because Dollar Savings qualified for the SIE as that exemption was defined by the Lender Liability Act.<sup>277</sup> Following an auction of inventory and equipment arranged by a Chapter 7 bankruptcy trustee after the borrower defaulted on loan payments, Dollar Savings took control of the facility for nearly three years before returning control to the trustee.<sup>278</sup> Dollar Savings' actions during this period included retaining secur-

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272. *See id.* at 887.

273. *Id.* at 889 (quoting *Fife v. Richardson*, 77 Ga. App. 698, 699, 495 S.E.2d. 772, 773 (1948)).

274. *See id.* at 891.

275. *See id.* at 888.

276. Civ. A. No. 90-0654, 1998 U.S. Dist. LEXIS 7902, at \*1 (W.D. Pa. May 6, 1998).

277. *See id.* at \* 62.

278. *See* Civ. A. No. 90-654, 1996 WL 143,875, at \*3 (W.D. Pa. Feb. 14, 1996). The borrower, Marvin Pesses, operated a scrap processing facility under a fifteen-year lease arrangement with the local industrial development authority who retained title to the property. Civ. A. No. 90-0654, 1998 U.S. Dist. LEXIS 7902, at \*64-65. Under this arrangement, Dollar Savings issued loan proceeds to the facility by way of the development authority and in return received rental payments from the facility and obtained a security interest in the personal and real property. *See id.* at \*65.

ity personnel, leasing a portion of the site for storage of sailboats, communicating with the state environmental agency and a consulting firm regarding an environmental investigation at the site, and contracting with a person who successfully located buyers for equipment and scrap material remaining at the site.<sup>279</sup> Dollar Savings never foreclosed on the real estate.<sup>280</sup> Dollar Savings was unsuccessful in finding a buyer to purchase its security interest partly because estimated cleanup costs exceeded the value of the property, and as a result, Dollar Savings mailed the facility's keys to the bankruptcy trustee.<sup>281</sup> The court, in granting Dollar Savings' motion for summary judgment, found that Dollar Savings satisfied the SIE because: i) it was undisputed that Dollar Savings did not participate in the management of the facility during the period the borrower operated the site as a metal processing facility, and ii) Dollar Savings made "commercially reasonable efforts, as soon as practicable" to sell the property.<sup>282</sup>

#### B. Revised EPA Enforcement Policy

In 1997, EPA revised its 1995 Enforcement Policy to account for the enactment of the Lender Liability Act regarding government entities and lenders that acquire property involuntarily (1997 Enforcement Policy).<sup>283</sup> EPA noted that because of the substantial similarities between the Lender Liability Act and the EPA Lender Rule, EPA would use the EPA Lender Rule's preamble as guidance when interpreting provisions of the SIE.<sup>284</sup> For example, EPA will assess whether a lender has divested itself of a property after foreclosure at the "earliest practicable, commercially reasonable time" and on "commercially reasonable terms" by referring to

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279. *See id.* at \*3-4.

280. *See id.* at \*3.

281. *See Pesses*, Civ. A. No. 90-0654, 1998 U.S. Dist. Lexis 7902, at \*69-70.

282. *Id.* at \*62, 65-66.

283. Policy on Interpreting CERCLA Provisions Addressing Lenders and Involuntary Acquisitions by Government Entities, 62 Fed. Reg. 36,424 (1997).

284. *See id.* EPA stated that its 1997 Enforcement Policy was intended "solely as guidance" for EPA employees. *See id.*

the preamble language in EPA Lender Rule regarding how a lender may establish that it has divested itself of a foreclosed property "in a reasonably expeditious manner."<sup>285</sup> Regarding involuntary acquisitions by government entities, EPA noted that the Lender Liability Act validated those provisions of the EPA Lender Rule and, as such, EPA would look to the corresponding preamble language as "authoritative guidance" when interpreting provisions of the SIE on this issue.<sup>286</sup> For example, EPA will refer to the preamble's definition of "involuntary acquisition or transfer" to interpret that term.<sup>287</sup>

## V. Analysis of Lender Liability Act

The Lender Liability Act<sup>288</sup> clarifies the parameters of the SIE. The Act is generally favorable to secured creditors and fiduciaries, as it rejects and puts to an end the *Fleet Factors*<sup>289</sup> "capacity to control" test, and restores the notion that secured creditors must actually "participate in the management" of a facility before incurring liability.

The Act, however, does not offer absolute protection. As such, incentives continue to exist for lenders to evaluate the condition of property contemplated as collateral security, and to carefully assess the nature and extent of any pre- and post-foreclosure actions, as described below.

### A. Lender Liability Act Represents Correct Public Policy Choice

To the extent that the Lender Liability Act protects secured creditors from CERCLA liability for contamination that they neither contributed to nor caused, the Act reflects the correct public policy choice. Providing resolution to the amorphous boundaries of permissible SIE actions removes the disincentive for lenders to avoid financing "dirty" businesses, and removes the disincentive for lenders to walk away from a

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285. *Id.*

286. *See id.*

287. *Id.*

288. *See* Lender Liability Act, *supra* note 237 and accompanying text.

289. *See Fleet Factors Corp.*, 901 F.2d at 1550.



property rather than foreclose on a contaminated site and risk potential liability.

For example, contrary to what the Eleventh Circuit opined in *Fleet Factors*, one result of that decision was a diversion of financing away from businesses that were perceived as presenting an excessive risk of cleanup liability because their operations involve large quantities of hazardous substances. Regardless of whether the site proved clean at the inception of the loan, there could be no guarantee that the site would remain clean in the future when foreclosure may be contemplated. The potential liability, under the *Fleet Factors* dicta, could easily exceed the relatively low loan value often provided to these businesses. Small and mid-sized businesses, which are often undercapitalized and incur relatively greater difficulty and costs in obtaining capital, were particularly affected. These businesses include such establishments as dry cleaners, automobile repair shops, gasoline stations and other businesses which handle significant quantities of hazardous substances.

Potential CERCLA liability creates an incentive for lenders to undertake comprehensive environmental inspections of properties prior to the inception of the loan. An unreasonable risk of incurring cleanup liability, however, will create an incentive for a lender to decline providing a loan to a prospective borrower if significant contamination is found. Similarly, with businesses perceived as "dirty," unreasonable risks of cleanup liability may cause the lender to reject any financing at the outset without conducting an environmental site assessment of the property because of the likelihood that significant contamination exists or may exist in the future.

Moreover, the fear of incurring unlimited environmental liability provides an incentive for a lender to avoid foreclosing or otherwise taking control of the property, effectively abandoning its interest in the site. As such, a financially distressed borrower may be unable to obtain needed financing to continue operations, and ultimately may be forced to close the facility. The result would be an increase in the number of abandoned hazardous waste sites in the country, a situation that CERCLA was intended to correct.

Redevelopment of brownfields and decreased development of greenfield locations will also be facilitated to the extent that the Lender Liability Act restores certainty about which acts by lenders will result in liability. Lender liability is but one of many barriers to redevelopment of brownfields. This mix of environmental and non-environmental obstacles makes it likely that lenders will continue to be concerned about providing financing on brownfields. Additional measures offered by government regulators, such as covenants not to sue, will complement the limited incentive offered by the Lender Liability Act.

Protection afforded lenders in the Act helps to refocus liability, consistent with CERCLA's goal that the "polluter pays" for cleanup, on those parties who have actual and meaningful involvement with site operations or ownership. Otherwise, lenders can expect to receive claims for recovery of response costs merely because they may be the only party with some connection to the site who has deep pockets to pay for the cleanup. If lenders do become actively involved with facility operations, then the protection of the SIE will be lost and they will incur liability under section 107(a)(1) and (a)(2) as would other owners or operators.

The Lender Liability Act properly confirms that lease financing transactions can qualify as protected security interests under the SIE. Where lenders take title to property as passive finance lessors and, *inter alia*, do not retain other indices of property ownership, they should receive the same limited protection as other secured creditors. Similarly, the Lender Liability Act, like the EPA Lender Rule, properly recognizes that indicia of ownership to protect a security interest includes lenders who hold title to property after foreclosure.

#### B. Secured Creditors Must Still Be Wary About Potential Environmental Statutory Liability

Incentives remain for lenders to be concerned about foreclosing on contaminated property or accepting it as collateral security. Lenders will not only need to ensure that their activities fall within the scope of protection provided by the

SIE, but also be concerned about potential liability under other federal statutory provisions. Moreover, unless states modify their own Superfund programs to offer similar protection as the federal Lender Liability Act, secured creditors will face potentially greater and more uncertain liability at the state level.

Pre-loan activities by lenders are well-defined, limited, and clearly protected by the Lender Liability Act which provides that participation in management does not include acting or failing to act prior to obtaining a security interest. Typical pre-loan activities include conducting environmental inspections, requiring compliance or cleanup measures in response to those inspections, and obtaining contractual provisions (e.g., representations, warranties, covenants) in the security agreement.

Although protection offered by the SIE is not contingent on the lender conducting an environmental site assessment or investigation of the property, a lender nonetheless has a regulatory incentive to conduct such an inspection in an effort to qualify for CERCLA's innocent landowner defense. While the innocent landowner defense is limited and rarely successful, undertaking "all appropriate inquiry" through "commercial or customary practice" at a minimum includes conducting a site investigation. Neither the courts nor EPA have established how extensive and comprehensive an investigation must be to qualify as "all appropriate inquiry."

During the period when a loan is performing, the Lender Liability Act provides numerous examples of what participation in management does not include. Most notably, participation in management does not include the capacity to influence or the unexercised right to control facility operations. Other actions not rising to the level of participation in management include: i) inspecting the facility, ii) providing financial advice, iii) restructuring the agreement, iv) and conducting an environmental response action under section 107(d) or under the direction of an on-scene NCP coordinator. Cleanup actions taken outside these constraints will not be protected from liability.

The Lender Liability Act, however, provides less clarity as to what actions will be considered participation in management. The extent to which a lender “exercises decisionmaking control” over environmental compliance matters, or assumes responsibility over substantially all of the facility’s operational functions, is not clear. The risks of acting outside the protection of the SIE are even greater for lenders during “workout” type activities where more involvement with the troubled borrower occurs than during the period when the loan is performing. The boundaries of permissible actions in these circumstances will be clarified through case law.

Moreover, creditors face even more uncertainty about what post-foreclosure actions constitute “participation in management.” A secured creditor will only receive the protection of the SIE if it avoided participation in management prior to foreclosure, and after foreclosure it must divest the property at the “earliest practicable, commercially reasonable time” given market conditions. Although the EPA Rule created a presumption of twelve months after foreclosure for when a lender was acting in a reasonable expeditious manner to divest a property, the Lender Liability Act includes no such presumption. Not including a fixed time limit provides the regulated community with needed flexibility and allows for fact-specific circumstances to dictate what is reasonable divestiture period for a particular property. Yet the downside of flexibility is less clarity as to when the holding of title will be deemed to be for investment purposes rather than merely for protecting a security interest.

After foreclosure, secured creditors who operate the business will be exposed to potential environmental liability even if they remain within the SIE. The Lender Liability Act offers limited protection against owner and operator liability under CERCLA and Subtitle I of RCRA. Lenders will still face exposure under other provisions of federal and state law. For example, a lender operating a business after foreclosure will be liable for ongoing compliance with existing or future operating permits and for hazardous substance releases from waste management units. Secured creditors transporting hazardous substances off-site for treatment or disposal will

incur exposure to CERCLA liability as arrangers or transporters.

The Lender Liability Act offers protection to a lender that forecloses on a property, but that protection does not extend to a subsequent purchaser of the property. Extending such protection to subsequent purchasers would overly broaden the SIE to parties who did not originally have a security interest in the property. The lack of such protection may hinder transfer of contaminated properties and affect the ability to sell the property within a commercially reasonable period. A prospective purchaser of contaminated property will typically expect to pay a price discounted for the presence of contamination, and/or receive contractual protection from the seller for any liability resulting from that contamination. The contractual protection would include an indemnification from the seller for future claims related to on-site contamination; the willingness of the buyer to rely on such an indemnification will rest in part on the creditworthiness of the seller. Transferring an environmentally impaired property may be problematic unless the lender is willing to offer such contractual protection and/or to discount the purchase price, neither of which are attractive options for the seller.

### C. Secured Creditors Also Have Non-Regulatory Incentives to be Aware of Environmental Matters

Non-regulatory incentives exist for secured creditors to evaluate the environmental condition of properties being considered as collateral security. A typical appraisal of the market value of a property does not take into account the effect of contamination on property value, unless that contamination is obvious and well known. For example, friable asbestos-containing building materials may be present throughout an older structure. The cost to abate or remove the asbestos, if necessary, may be greater than the apparent market value of the property received from an appraisal that did not inspect for or otherwise take notice of the asbestos. A latent defect in the property, which is more likely to go unnoticed during a market appraisal, is ground-water contamination. When en-

vironmental site conditions are properly assessed by a lender prior to financing, a more accurate picture of property and collateral value emerges, resulting in more informed and predictable lending decisions.

If contamination is well-defined and manageable (e.g., a small area of soil contamination), the lender may require that the borrower conduct a cleanup as a condition to receiving funding. Occasionally, however, the contamination is widespread, significant, and difficult if not impossible to remediate in a timely manner (e.g., ground water contaminated with dense non-aqueous phase liquids such as chlorinated solvents). In these instances, the net collateral value of the property may be negative, and the lender may decline to lend on the property regardless of the potential for the lender to incur cleanup liability.

Environmental investigations also allow for a determination whether environmental costs may negatively affect the ability of the borrower to meet loan payments. For example, the borrower's ability to repay the loan may be affected by new regulatory requirements that may become effective and require a significant capital outlay (e.g., for pollution control technology) to maintain compliance. In the worst case, the new regulatory requirements may raise operational costs to a prohibitive level, resulting in a shut-down of the facility. Similarly, an investigation may reveal existing compliance deficiencies that require significant capital outlays to resolve, or the presence of an imminent regulatory order to remediate contamination on the subject property. Assessing these matters prior to the inception of the loan provides non-regulatory benefits to lenders in addition to the evaluation of the potential for incurring CERCLA liability.

## VI. Conclusion

The Lender Liability Act provides important protection for lenders by clarifying the scope of the SIE and removing the uncertainty created by judicial decisions such as *Fleet Factors*. Questions remain regarding the scope of the SIE, especially with respect to what actions represent participa-

tion in management. Future case law will further define the boundaries of permissible actions. Nonetheless, lenders will continue to have incentives, as standard commercial practice, to evaluate the condition of potential borrower's properties considered for collateral security and to re-evaluate such conditions prior to undertaking a foreclosure action. A lender will follow these measures regardless of SIE considerations because of the potential impact on the borrower's cash flow and on the collateral value of the property.