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NOTES

CERCLA's Web of Liability Ensnarers Secured Lenders: The Scope and Application of CERCLA's Security Interest Exception

INTRODUCTION

In the wake of the twentieth anniversary of Earth Day and the "greening" of America, the American public has become aware of the threat to its health¹ and environment caused by the unsafe disposal of hazardous wastes.² In the zeal to correct society's numerous environmental problems, secured lenders are increasingly incurring liability for clean-up costs associated with their borrowers' contaminated property. In the past, secured lenders could avoid environmental liability by not participating in the management of a borrower's daily operations and by not acquiring title to contaminated property upon foreclosure. Recently, however, the Eleventh Circuit Court of Appeals delineated a new liability trap by ruling that secured lenders may incur liability by merely exhibiting the capacity to influence a borrower's hazardous waste disposal decisions.³ This decision has been challenged by other courts,⁴ and it is now unclear

1. Note, *Toxic Waste Litigation, Developments in the Law*, 99 HARV. L. REV. 1458, 1462 (1986) [hereinafter Note, *Toxic Waste Litigation*]. "Exposure to hazardous wastes can cause cancer, genetic mutation, birth defects, miscarriages, and damage to lungs, liver, kidneys, or nervous system." *Id.* "Evidence has established a causal link between toxic chemical exposure and . . . personality disorders." Burkhart, *Lender/Owner's and CERCLA: Title and Liability*, 25 HARV. J. ON LEGIS. 317, 317 (1988).

2. This Note uses the terms "hazardous waste," "hazardous substance," and "toxic waste" to mean "hazardous substance" according to the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), Pub. L. No. 96-510, 94 Stat. 2767 (1980) (codified in part as amended at 42 U.S.C. §§ 9601-75 (1988)). See *infra* note 27 and accompanying text.

3. *United States v. Fleet Factors Corp.*, 901 F.2d 1550 (11th Cir. 1990).

4. See *infra* note 89.

what actions by secured lenders will lead to environmental liability.

Although American industry has generated hazardous substances as products and by-products of manufacturing for years, the amount of hazardous substances generated has increased tremendously. American industry generated approximately 150 million metric tons of hazardous waste in 1981. This figure rose to an estimated 266 million metric tons per year by 1986.⁵ This increase is not surprising because the Environmental Protection Agency (EPA) has identified more than 4,000 types of businesses and industries that generate hazardous wastes.⁶

As the amount of hazardous waste generated in this country has increased, so have the costs involved with its clean-up and proper disposal.⁷ The United States General Accounting Office has acknowledged that there are as many as 425,380 potential Superfund sites in the United States.⁸ The estimated response costs for the worst 2,500 of these could amount to more than \$22 billion,⁹ while the average clean-up costs for the other sites could range from \$10-\$12 million per site.¹⁰

In 1980, as a response to public concern over the problem of improper hazardous waste disposal, Congress hastily¹¹ passed the Comprehensive

5. Comment, *Lender Liability for Hazardous Waste Cleanup*, 1988 WIS. L. REV. 139, 140. Most hazardous substances are not destroyed, but are stored perpetually at hazardous waste sites. The process of storing hazardous wastes consists of sealing the waste in drums and burying it in clay-lined dumps. Of the hazardous dumps in existence, 74% use containers, 54% use tanks, 17% use surface impoundments, 6% incinerate wastes, and 5% use landfills. Note, *Toxic Waste Litigation*, *supra* note 1, at 1462.

6. See Burkhart, *supra* note 1, at 320 n.4. The EPA's list of sources potentially generating hazardous waste includes: automobiles; banking, aircraft, aerospace, communications, and public utility industries; electronic, furniture, textile, food, beverage, and grocery manufacturers; and optical, paper, packing, and rubber products.

7. For example, nearly 230 families were forced to evacuate from Love Canal, New York because their homes were built around an abandoned chemical dump containing 350 million pounds of industrial waste. H.R. REP. NO. 1016, 96th Cong., 2d Sess., pt. 1, reprinted in 1980 U.S. CODE CONG. & ADMIN. NEWS 6119, 6121-22. By 1980, more than \$27 million had been spent in response costs. *Id.* Union Carbide Corporation recently agreed to pay at least \$40 million for clean-up of a Colorado hazardous waste site. Wall St. J., Nov. 3, 1986, at 47, col. 1. The EPA has estimated the response costs of the Stringfellow Acid Pits hazardous waste site to be \$40 million. Wall St. J., Sept. 25, 1986, at 23, col. 1. See also Comment, *supra* note 5, at 140-41 nn.3 & 10. The United States government also intends to spend \$33 million to buy back all of the homes in Times Beach, Missouri, a town contaminated by dioxin sprayed on its streets a decade earlier. See Burkhart, *supra* note 1, at 318 n.2.

8. See 18 Env't Rep. (BNA) 2043 (Jan. 22, 1988).

9. *Id.*

10. Burkhart, *supra* note 1, at 318 n.3.

11. CERCLA was adopted during the final days of the 96th Congress just prior to the inauguration of the Reagan administration. The legislation was adopted under a special suspension of rules which precluded any amendments. There was not even a

Environmental, Response, Compensation and Liability Act (CERCLA).¹² In 1986 Congress also passed the Superfund Amendments and Reauthorization Act (SARA).¹³ CERCLA, unlike previous environmental legislation,¹⁴ vested federal and state governments with the authority to respond promptly to releases¹⁵ or threatened releases of hazardous substances from sites existing both prior to and after the statute's enactment.¹⁶ CERCLA authorizes the EPA to target specific waste sites across the nation and to rank the sites through a National Priority List (NPL) which determines the order in which the sites will be cleaned up.¹⁷

CERCLA initially created a trust fund, often referred to as the "Superfund," which provides funds to be used specifically for the clean-up of hazardous waste sites on the NPL.¹⁸ Although the primary responsibility for utilizing Superfund finances for clean-up operations rests with the EPA, state and local governments may also tap the Superfund to finance their own clean-up efforts.¹⁹

conference held on the measure, and no report was issued on the legislation as enacted. For a discussion of CERCLA's legislative history, see Grad, *A Legislative History of the Comprehensive Environmental Response, Compensation and Liability ("Superfund") Act of 1980*, 8 COLUM. J. ENVTL. L. 1 (1982).

12. 42 U.S.C. §§ 9601-75 (1988).

13. In October 1986, Congress passed SARA, which extended the funding for the trust fund for an additional five years. SARA also increased CERCLA funding from \$1.6 billion for the first five years to \$8.5 billion for the five years following SARA's enactment. *Id.* § 9611.

14. Congress initially attempted to address the environmental problem by enacting the Resource, Conservation and Recovery Act (RCRA), which regulates hazardous waste from its generation to its disposal. Pub. L. No. 94-580, 90 Stat. 2795 (1976) (codified as amended at 42 U.S.C. §§ 6901-87 (1988)). RCRA has some deficiencies, however, because it "is of no help if a financially responsible owner of the site cannot be located." H.R. REP. NO. 1016, 96th Cong., 2d Sess., pt. 1, *reprinted in* 1980 U.S. CODE CONG. & ADMIN. NEWS 6119, 6125. Furthermore, RCRA does not provide for site clean-up "when the owner is unknown, is not responsible, or is financially unable to pay for these costs." *Id.* Finally, RCRA "applies to past sites only to the extent that they are posing an imminent hazard." *Id.* See also Note, *The Toxic Mortgage, CERCLA Seeps into the Commercial Lending Industry*, 63 ST. JOHN'S L. REV. 839, 841-43 (1989).

15. The term "release" is generally defined in CERCLA as "any spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing into the environment (including the abandonment or discarding of barrels, containers, and other closed receptacles containing any hazardous substances or pollutant or contaminant)." 42 U.S.C. § 9601(22) (1988).

16. CERCLA applies retroactively to all responsible parties and hazardous waste sites. See *infra* notes 54-55 and accompanying text.

17. 42 U.S.C. § 9605(c) (1988).

18. Pub. L. No. 96-510, § 221, 94 Stat. 2801 (1980), *repealed by* Pub. L. No. 99-499, Title V, § 517(c)(1), 100 Stat. 1774 (1986). Currently, the fund is labeled the "Hazardous Substance Superfund." 42 U.S.C. § 9601(11) (1988).

19. 42 U.S.C. § 9604(d) (1988).

CERCLA provides three mechanisms to initiate the clean-up of hazardous waste that responsible parties fail to clean-up. First, the EPA is empowered to issue an administrative order directing responsible parties to engage in clean-up efforts.²⁰ To enforce these orders, the EPA has the authority to levy fines up to \$25,000 a day.²¹ Second, the EPA can request an injunction in federal court requiring the responsible party to clean-up or abate the release of hazardous substances.²² Third, the government may choose to clean-up the site itself using Superfund money.²³ Under this remedy, CERCLA requires the EPA to sue the responsible parties to reimburse the fund.²⁴ To recover its response costs in such a suit, the government must prove that:

- (1) the site is a "facility"²⁵ for purposes of CERCLA;
- (2) a release²⁶ or threatened release of any hazardous substance²⁷ from the site has occurred;
- (3) the release or threatened release has caused the federal government to incur response costs; and
- (4) the defendant is one of the persons designated as a party liable for costs under CERCLA.²⁸

When CERCLA was enacted, Congress attempted to place the responsibility for hazardous waste clean-up on all parties even remotely

20. *Id.* § 9606(a), (b).

21. *Id.*

22. *Id.* § 9606(a).

23. *Id.* § 9604.

24. *Id.* § 9607(a).

25. The term "facility" means "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 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." *Id.* § 9601(9). The courts have interpreted "facility" liberally in favor of evoking CERCLA guidelines. *See, e.g.*, *United States v. Bliss*, 667 F. Supp. 1298, 1305 (E.D. Mo. 1987); *United States v. Conservation Chem. Co.*, 619 F. Supp. 162, 184-85 (W.D. Mo. 1985).

26. *See supra* note 15 and accompanying text.

27. CERCLA applies to all hazardous substances even if they are not hazardous "wastes." Under CERCLA, a hazardous substance means a substance that has been identified as such in other environmental statutes. 42 U.S.C. § 9601(14) (1988). Furthermore, the EPA is authorized to classify any additional substance as "hazardous" if it "may present a substantial danger to the public health or welfare of the environment." *Id.* § 9602(A). For example, asbestos has been deemed a hazardous substance for purposes of CERCLA. *United States v. Nicolet*, 712 F. Supp. 1205, 1207 (E.D. Pa. 1989).

28. *United States v. Bliss*, 667 F. Supp. 1298, 1304 (E.D. Mo. 1987); *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573, 576 (D. Md. 1986); *United States v. Wade*, 577 F. Supp. 1326, 1333 (E.D. Pa. 1983).

responsible for creating the problem.²⁹ The four classes or categories of potentially responsible parties (PRPs) who may be liable under CERCLA include:

- (1) the current owners or operators of a hazardous waste facility;³⁰
- (2) the former owners or operators of the facility at the time of any waste disposal;
- (3) the generators of the hazardous waste; or
- (4) the transporters of the hazardous substances.³¹

Although CERCLA's list of PRPs is expansive, its definition of "owner or operator" specifically excludes any person "who, *without participating in the management* of a [hazardous waste facility], holds indicia of ownership primarily to protect his security interest."³² It appears that this exclusion from liability, known as the "security interest exception," was

29. H.R. REP. NO. 1016, 96th Cong., 2d Sess., pt. 1, *reprinted in* 1980 U.S. CODE CONG. & ADMIN. NEWS 6136.

30. Courts have construed "owner and operator" under § 107(a)(1) to mean "owner or operator" because such a construction is in accord with legislative intent. *See* Burkhardt, *supra* note 1, at 332-33. *See also* Guidice v. BFG Electroplating & Mfg. Co., 732 F. Supp. 566, 577-78 (W.D. Pa. 1989); Artisan Water Co. v. New Castle County, 659 F. Supp. 1269, 1280 (D. Del. 1987), *aff'd*, 851 F.2d 643 (3d Cir. 1988); *Maryland Bank & Trust Co.*, 632 F. Supp. at 577-78.

31. CERCLA § 107(a) states:

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

(A) all costs of removal or remediation action incurred by the United States Government or a state or an Indian tribe not inconsistent with the national contingency plan;

(B) any other necessary costs of response incurred by any other person consistent with the national contingency plan;

(C) damages for injury to, destruction of, or loss of natural resources, including the reasonable costs of assessing such injury, destruction, or loss resulting from such a release; and

(D) the costs of any health assessment or health effects study carried out under § 9604(i) of this title.

42 U.S.C. § 9607(a) (1988).

32. *Id.* § 9601(20)(A) (emphasis added).

intended to protect lenders holding a security interest in property from being classified as CERCLA PRPs.

The primary impetus for the passage of CERCLA was to provide an effective legal mechanism for imposing liability for the clean-up of unsafe hazardous waste sites on solvent parties connected to the environmental problem.³³ During the last five years, however, secured lenders who were not responsible for the problem have found themselves ensnared in CERCLA's web of liability. This has occurred as a result of a series of judicial decisions narrowing the scope of the security interest exception. These decisions have expanded the definition of "owner or operator" of a hazardous waste site to include lending institutions in some situations.³⁴ Until recently, secured lenders that did not foreclose and did not participate in the operational decisions of a borrower were exempt from liability under CERCLA because they fell under the security interest exception.³⁵ In *United States v. Fleet Factors Corp.*,³⁶ however, the Eleventh Circuit Court of Appeals established an expanded theory of secured lender liability for a borrower's environmental problems. The court held that a secured lender is removed from the protection of the security interest exception if it is shown that the lender merely had the ability to influence a borrower's hazardous waste decision if it so chose.³⁷

This Note focuses on the interpretation and application of CERCLA's security interest exception as it applies to secured lenders. Section I discusses the overall structure of CERCLA and specifically focuses on its liability and defense provisions. Section II examines the developing liability of lenders as "owners or operators" and the applicability of the security interest exception. Section III focuses on the future of lender liability under CERCLA. Finally, Section IV outlines measures secured lenders may follow in order to minimize their risk of liability under CERCLA.

I. THE STRUCTURE OF CERCLA

A. *Scope of Liability*

CERCLA's primary liability provision is section 107(a).³⁸ This section allows government agencies to sue PRPs³⁹ for remov-

33. Klotz & Kane, *Environmental Liability Concerns for the Secured Lender* 1, 1-2 (unpublished manuscript on file in the office of the Indiana Law Review).

34. See *United States v. Fleet Factors Corp.*, 901 F.2d 1550 (11th Cir. 1990); *Guidice v. BFG Electroplating & Mfg. Co.*, 732 F. Supp. 556 (W.D. Pa. 1989); *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573 (D. Md. 1986); *United States v. Mirabile*, 15 *Envtl. L. Rep.* (Envtl. L. Inst.) 20992 (E.D. Pa. Sept. 4, 1985).

35. *Fleet Factors*, 901 F.2d at 1550.

36. *Id.*

37. *Id.* at 1558.

38. 42 U.S.C. § 9607(a). (1988). For the full text of § 107(a), see *supra* note 31.

39. 42 U.S.C. § 9607(a) (1988).

al⁴⁰ and remedial⁴¹ costs as well as damages for the destruction or loss of natural resources due to the release of hazardous substances.⁴²

The initial flurry of CERCLA litigation focused on holding PRPs liable pursuant to their status as hazardous waste “generators.”⁴³ During the past five years, however, this focus has shifted. Courts have with increasing regularity imposed liability on PRPs based on their status as “owners or operators” of a hazardous waste facility.⁴⁴ In imposing such liability, courts have greatly broadened the definition of an “owner or operator,” so that more classes of PRPs are subject to CERCLA’s web. Courts have held lessors,⁴⁵ lessees,⁴⁶ corporate officers,⁴⁷ corporation stockholders,⁴⁸ parent corporations,⁴⁹ temporary owners and brokers,⁵⁰

40. A removal action is essentially a clean-up activity which includes studies to monitor and evaluate the release of hazardous substances. *Id.* § 9604(a).

41. A remedial action includes more long-term and permanent responses and includes confinement, ditching, trenching, recycling, segregation, and relocation of endangered residents. *Id.*

42. *Id.* §§ 9604, 9605.

43. See Comment, *CERCLA Litigation Update: The Emerging Law of Generator Liability*, 14 ENVTL. L. REP. (Envtl. L. Inst.) 10224 (June, 1984).

44. See *infra* notes 45-53 and accompanying text.

45. A passive lessor of a site is liable for response costs even if the lessor was in no way connected with the lessee’s activities. *United States v. Monsanto Co.*, 858 F.2d 160 (4th Cir. 1988); *United States v. Argent Corp.*, 21 Env’t Rep. Cas. (BNA) 1354 (N.D. Pa. 1984); *United States v. South Carolina Recycling & Disposal, Inc.*, 21 Env’t Rep. Cas. (BNA) 1577 (D.S.C. 1984).

46. Lessees who actually cause the contamination are liable. *Caldwell v. Gurley Ref. Co.*, 755 F.2d 645 (8th Cir. 1985); *South Carolina Recycling & Disposal, Inc.*, 21 Env’t Rep. Cas. (BNA) 1577 (D.S.C. 1984).

47. A corporate officer who managed the corporation’s disposal activities may be personally liable for clean-up costs. *United States v. Carolawn Co.*, 21 Env’t Rep. Cas. (BNA) 2124 (D.S.C. 1984); *United States v. Mottolo*, 22 Env’t Rep. Cas. (BNA) 1026 (D.N.H. 1984); *United States v. Wade*, 577 F. Supp. 1326 (E.D. Pa. 1983).

48. Shareholders of a corporation are personally liable if they participate in making decisions with respect to hazardous waste disposal. *Quadrion Corp. v. Mache*, 738 F. Supp. 270 (N.D. Ill. 1990); *Kelley v. Thomas Solvent Co.*, 727 F. Supp. 1532 (W.D. Mich. 1989); *United States v. Carolawn Co.*, 21 Env’t Rep. Cas. (BNA) 2124 (D.S.C. 1984).

49. In the following cases the parent corporation was liable because it had the capacity to control and manage the disposal practices of the subsidiary corporation: *State v. Bunker Hill*, 635 F. Supp. 665 (D. Idaho 1986); *Wehner v. Syntex Agribusiness, Inc.*, 616 F. Supp. 27 (E.D. Mo. 1985). See also *United States v. Stringfellow*, 661 F. Supp. 1053 (C.D. Cal. 1987) (parent corporation that merged with a wholly owned subsidiary was liable for the clean-up obligations of the subsidiary corporation). *But see Joslyn Mfg. Co. v. T. L. James & Co.*, 20 Env’t L. Rep. (Envtl. L. Inst.) 20382 (5th Cir. Jan. 29, 1990) (disagreeing with the Second Circuit Court of Appeals and holding that parent corporations are not liable under CERCLA for the violations of their wholly owned subsidiaries).

50. *United States v. Bliss*, 667 F. Supp. 1298 (E.D. Mo. 1987) (company which acted as a broker between chemical manufacturer and disposal company was liable for response costs); *United States v. Carolawn Co.*, 21 Env’t Rep. Cas. (BNA) 2124 (D.S.C. 1984) (chemical company that held title for merely one hour could be liable for clean-up costs).

present owners who did not contribute to contamination,⁵¹ lenders actively involved in a polluter's activities,⁵² and lenders who foreclosed and purchased property⁵³ to be potentially liable owners or operators under CERCLA. Courts have also held that liability under CERCLA may be applied retroactively.⁵⁴ Thus, a PRP may be liable for clean-up costs incurred prior to CERCLA's enactment.⁵⁵ In some cases, these pre-enactment costs have been substantial and have therefore imposed a great burden on the responsible party.⁵⁶

Liability under CERCLA can be enormous.⁵⁷ Responsible parties may be liable for up to \$50 million for damages to natural resources.⁵⁸ Furthermore, no ceiling on liability exists when the release or threatened release of a hazardous substance is a result of willful misconduct, willful negligence, or a refusal on the part of the disposer to provide reasonable cooperation and assistance in response activities.⁵⁹ Finally, CERCLA empowers the federal government to obtain treble damages from responsible parties who "fail without sufficient cause" to comply with clean-up plans.⁶⁰ This treble damages clause has withstood constitutional challenge⁶¹ and has been interpreted to allow treble damages when a PRP's defense is brought "in bad faith"⁶² or "without an objectively reasonable basis."⁶³

B. *The Security Interest Exception*

Although the scope of liability is encompassing, Congress sought to provide a degree of protection from liability for secured lenders through

51. *State v. Shore Realty Corp.*, 759 F.2d 1032 (2d Cir. 1985); *United States v. Tyson*, 25 Env't Rep. Cas. (BNA) 1897 (E.D. Pa. 1986); *United States v. Cauffman*, 21 Env't Rep. Cas. (BNA) 2167 (C.D. Cal. 1984).

52. *United States v. Mirabile*, 15 Env'tl. L. Rep. (Env'tl. L. Inst.) 20994 (E.D. Pa. Sept. 4, 1985).

53. Secured lenders who foreclose and purchase the site are liable as owners or operators under CERCLA. *Guidice v. BFG Electroplating & Mfg. Co.*, 732 F. Supp. 556 (W.D. Pa. 1989); *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573 (D. Md. 1986).

54. *United States v. Northeastern Pharmaceutical Chem. Co.*, 810 F.2d 726, 733-35 (8th Cir. 1986); *United States v. Tyson*, 25 Env't Rep. Cas. (BNA) 1897, 1907-08 (E.D. Pa. 1986); *United States v. Shell Oil Co.*, 605 F. Supp. 1064, 1079 (D. Cal. 1985); *United States v. Ottoli & Goss, Inc.*, 630 F. Supp. 1361, 1398 (D.N.H. 1985).

55. *Northeastern Pharmaceutical Chem. Co.*, 810 F.2d at 737.

56. *See supra* note 54 and accompanying text.

57. *See supra* note 7 and accompanying text.

58. 42 U.S.C. § 9607(c)(1) (1988).

59. *Id.* § 9607(c)(2).

60. *Id.* § 9607(c)(3).

61. *Aminoil, Inc. v. United States*, 646 F. Supp. 294, 299 (C.D. Cal. 1986).

62. *Id.*

63. *Solid State Circuits, Inc. v. United States Env'tl. Protection Agency*, 812 F.2d 383, 391 (8th Cir. 1987).

the "security interest exception" to CERCLA's definition of an "owner or operator." Specifically, the security interest exception provides that:

Such term [owner or operator] does not include a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility.⁶⁴

Substantial litigation has occurred over the meaning of this exclusionary provision.⁶⁵ Of critical importance to financial institutions is the question of when lenders will be included in this sanctuary. In past cases, a secured lender that did not foreclose on a borrower's property and did not participate in the debtor's daily operational decisions was held to be exempt from liability under the security interest exception.⁶⁶ Recent rulings, however, have placed these decisions in doubt.

In *United States v. Fleet Factors Corp.*⁶⁷ the Eleventh Circuit Court of Appeals held that a secured lender may be liable as a "de facto owner" of a contaminated facility if the lender participated in the financial management of the facility to an extent indicating the lender's capacity to influence the borrower's disposal decisions if it so chose.⁶⁸ This decision significantly narrowed the scope of the security interest exception so that the extent of the future application of this provision is now unclear.

C. Standard of Liability Under CERCLA

Although CERCLA did not specifically indicate the standard of liability imposed upon responsible parties, courts have consistently interpreted the Act to provide that responsible parties are subject to a strict liability standard.⁶⁹ Courts have reasoned that such an interpretation

64. 42 U.S.C. § 9601(20)(A) (1988).

65. See generally *United States v. Fleet Factors*, 901 F.2d 1550 (11th Cir. 1990); *Guidice v. BFG Electroplating & Mfg. Co.*, 732 F. Supp. 556 (W.D. Pa. 1989); *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573 (D. Md. 1986); *In re T.P. Long Chem., Inc.*, 45 Bankr. 278 (N.D. Ohio 1985); *United States v. Mirabile*, 15 *Env'tl. L. Rep.* (Env'tl. L. Inst.) 20992 (E.D. Pa. Sept. 4, 1985).

66. *Guidice*, 732 F. Supp. at 556; *United States v. New Castle County*, 727 F. Supp. 854 (D. Del. 1989); *Rockwell Int'l v. I.U. Int'l Corp.*, 702 F. Supp. 1384 (N.D. Ill. 1988).

67. 901 F.2d 1550 (11th Cir. 1990); *Maryland Bank & Trust Co.*, 632 F. Supp. at 573.

68. *Fleet Factors*, 901 F.2d at 1558.

69. E.g., *United States v. Monsanto Co.*, 858 F.2d 160, 167 (4th Cir. 1988); *United States v. Northeastern Pharmaceutical Chem. Co.*, 810 F.2d 726, 743 (8th Cir. 1986); *Kelley v. Thomas Solvent Co.*, 727 F. Supp. 1532, 1541 (W.D. Mich. 1989); *Maryland Bank & Trust Co.*, 632 F. Supp. at 576; *United States v. Dickerson*, 640 F. Supp. 448, 451 (D. Md. 1986); *United States v. Ward*, 618 F. Supp. 884, 893 (E.D.N.C. 1985); *City of Philadelphia v. Stepan Chem. Co.*, 544 F. Supp. 1135, 1148 (E.D. Pa. 1982).

is consistent with the Act's legislative intent.⁷⁰ As a result, a party may be liable under CERCLA even though its actions were neither intentional nor negligent.

Several courts have also interpreted CERCLA to impose liability without proof of causation between a hazardous waste generator's conduct and the release or threatened release of hazardous waste.⁷¹ In *United States v. Wade*,⁷² the court stated:

[T]o require a plaintiff under CERCLA to "fingerprint" wastes is to eviscerate the statute . . . The only required nexus between the defendant and the site is that the defendant has dumped his waste there and the [type of] hazardous substances found in the defendant's waste are also found at the site.⁷³

Consequently, unless the defendant can prove that he falls under one of CERCLA's narrow defenses,⁷⁴ the defendant will be liable if the disposed waste is of the type involved in the pollution of the site.⁷⁵

D. Apportionment of Liability

CERCLA does not mention whether responsible parties are subject to joint and several liability. Although early versions of the legislation provided that defendants would be jointly and severally liable for clean-up costs, the final version of the bill deleted that provision.⁷⁶ Courts nonetheless, have held that PRPs may be held jointly and severally liable under CERCLA.⁷⁷ Courts have reasoned that this interpretation comports with CERCLA's intended purpose because it allows the government better flexibility in recovering hazardous waste response costs.⁷⁸ Con-

70. *United States v. Price*, 577 F. Supp. 1103, 1114 (D.N.J. 1983).

71. *Monsanto*, 858 F.2d at 169-70; *State v. Shore Realty Corp.*, 759 F.2d 1032, 1044-45 (2d Cir. 1985); *United States v. Ottali & Goss, Inc.*, 630 F. Supp. 1361, 1402 (D.N.H. 1985); *United States v. Conservation Chem. Co.*, 619 F. Supp. 162, 236 (W.D. Mo. 1985); *United States v. Wade*, 577 F. Supp. 1326 (E.D. Pa. 1983).

72. 577 F. Supp. 1326 (E.D. Pa. 1983).

73. *Id.* at 1332-33.

74. For a discussion of the affirmative defenses available under CERCLA, see *infra* notes 83-86 and accompanying text.

75. See Klotz & Kane, *supra* note 33, at 9.

76. *United States v. Chem-Dyne Corp.*, 572 F. Supp. 802, 807 (S.D. Ohio 1983).

77. *United States v. Monsanto Corp.*, 858 F.2d 160, 167 (4th Cir. 1988); *Kelley v. Thomas Solvent Co.*, 727 F. Supp. 1532, 1552 (W.D. Mich. 1989); *United States v. Stringfellow*, 661 F. Supp. 1053, 1061 (C.D. Cal. 1987); *State v. Bunker Hill Co.*, 635 F. Supp. 665, 676 (D. Idaho 1986); *United States v. A & F Materials*, 578 F. Supp. 1249, 1254-55 (S.D. Ill. 1984); *Chem-Dyne Corp.*, 572 F. Supp. at 807-08.

78. *A & F Materials*, 578 F. Supp. at 1253-55; *Chem-Dyne Corp.*, 572 F. Supp. at 807-08.

sequently, courts will impose joint and several liability on defendants unless the harm is shown to be divisible.⁷⁹

As originally enacted, CERCLA was also silent concerning whether responsible parties have a right to contribution. Courts nonetheless determined that based upon common-law principles, a party who has incurred disproportionate liability under CERCLA has a right to contribution against other responsible parties.⁸⁰ In 1986, SARA codified this right to contribution.⁸¹ At least one court has held that a PRP may sue for contribution for necessary clean-up costs *before* the federal or state government decides to commence an action against a responsible parties.⁸²

E. Affirmative Defenses Under CERCLA

Three meager defenses are available to persons falling under CERCLA's broad liability scheme. Section 107(b) exculpates a person otherwise liable under CERCLA who can demonstrate that the release or threatened release of hazardous substances was caused solely by: (1) an act of God; (2) an act of war; or (3) an act of a third party having no contractual relation to the person.⁸³ Courts have construed these

79. *Monsanto*, 858 F.2d at 167; *Kelley*, 727 F. Supp. at 1552; *Stringfellow*, 661 F. Supp. at 1061.

80. *Caldwell v. Gurley Ref. Co.*, 755 F.2d 645, 651-52 (8th Cir. 1985); *State v. ASARCO, Inc.*, 608 F. Supp. 1484, 1491 (D. Col. 1985).

81. 42 U.S.C. § 9607(e)(2) (1988).

82. *Versatile Metals, Inc. v. Union Corp.*, 693 F. Supp. 1563, 1571 (E.D. Pa. 1988).

83. 42 U.S.C. § 9607(b) states:

There shall be no liability under subsection (a) of this section for a person otherwise liable who can establish by a preponderance of the evidence that the release or threat of release of a hazardous substance and the damages resulting therefrom were caused solely by—

(1) an act of God;

(2) an act of war;

(3) an act or omission of a third-party other than an employee or agent of the defendant, or than one whose act or omission occurs in connection with a contractual relationship, existing directly or indirectly, with a defendant (except where the sole contractual arrangement arises from a published tariff and acceptance for carriage by a common carrier by rail), if the defendant establishes by a preponderance of the evidence that (a) he exercised due care with respect to the hazardous substance concerned, taking into consideration the characteristics of such hazardous substance, in light of all relevant facts and circumstances, and (b) he took precautions against foreseeable acts or omissions of any such third party and the consequences that could foreseeably result from such acts or omissions; or

(4) any combination of the foregoing paragraphs.

defenses narrowly and have seldom allowed parties to successfully invoke these provisions.⁸⁴

The third party defense is the most frequently asserted affirmative defense. In 1986, SARA slightly broadened this defense by providing a detailed definition of what constitutes a "contractual relationship" for purposes of section 107(b)(3).⁸⁵ This amendment essentially provides that before a landowner can utilize the third party defense, he must be able to demonstrate that he made all reasonable inquiries into the previous activities on the property and had "no reason to know" that any hazardous substances were disposed of at the site.⁸⁶ In reality, this "innocent landowner defense" is also extremely limited in its scope because the defendant must show that he had neither actual nor constructive knowledge of any hazardous waste threat at the time the property was acquired.

II. THE DEVELOPMENT OF LENDER LIABILITY UNDER CERCLA

When CERCLA was enacted, the security interest exception⁸⁷ seemed to afford lenders a safe harbor from being ensnared in the Act's web of liability. This provision excludes from liability a secured creditor who "without participating in the management" of the facility "holds indicia of ownership primarily to protect his security interests."⁸⁸ Judicial in-

84. *United States v. Monsanto Corp.*, 858 F.2d 160, 168-69 (4th Cir. 1988); *United States v. Stringfellow*, 661 F. Supp. 1053, 1061 (C.D. Cal. 1989); *United States v. Argent Corp.*, 21 Env't Rep. Cas. (BNA) 1354, 1356 (N.D. Pa. 1984).

85. 42 U.S.C. § 9601(35)(A) (1988) states:

The term "contractual relationship," for the purpose of section 9607(b)(3) of this title, includes, but is not limited to, land contracts, deeds or other instruments transferring title or possession, unless the real property on which the facility concerned is located was acquired by the defendant after the disposal or placement of the hazardous substance on, in, or at the facility, and one or more of the circumstances described in clause (i), (ii), or (iii) is also established by the defendant by a preponderance of the evidence:

(i) At the time the defendant acquired the facility the defendant did not know and had no reason to know that any hazardous substance which is the subject of the release or threatened release was disposed of on, in, or at the facility.

(ii) The defendant is a government entity which acquired the facility by escheat, or through any other involuntary transfer or acquisition, or through the exercise of eminent domain authority by purchase or condemnation.

(iii) The defendant acquired the facility by inheritance or bequest.

In addition to the foregoing, the defendant must establish that he has satisfied the requirements of § 9607(b)(3)(a) and (b) of this title.

86. 42 U.S.C. § 9601(35)(A)(i) (1988).

87. *Id.* § 9601(20)(A).

88. *Id.*

terpretation of the secured interest exception, however, has had a checkered history and result. Courts disagree as to when and if this exception applies to a foreclosing lender who acquires ownership of the property to satisfy a secured debt.⁸⁹ In addition, courts have established conflicting standards of what constitutes impermissible participation in a debtor's management to nullify the security interest exception.⁹⁰ Unfortunately, Congress has provided no guidance in resolving these issues, and the CERCLA and SARA provisions do not address these interpretation concerns.

A. *United States v. Mirabile*

*United States v. Mirabile*⁹¹ was the first case to specifically interpret the scope of the security interest exception. In *Mirabile*, the United States brought suit against the Mirabiles, the current owners and operators of a site containing hazardous waste, to recover clean-up costs associated with the removal of hazardous substances. The Mirabiles then joined, among others, American Bank & Trust Company (ABT) and Mellon Bank National Association (Mellon Bank). Both of these banks made secured loans to the site's former owners.

In 1973, ABT loaned money to Mangels Industries, a paint manufacturing company. The note was secured in part by a mortgage on the property. In 1976, Turco Coatings, Inc. acquired Mangels Industries and borrowed money from Girard Bank, the predecessor in interest of Mellon Bank. This loan was secured by Turco's assets and inventory. Turco generated and deposited hazardous wastes at the site until 1980 when it ceased its operations due to financial difficulties.

In 1981, ABT foreclosed on the Turco property. It was then the highest bidder at the sheriff's sale and subsequently notified the sheriff that it intended to take title to the property. In December, 1981, however, ABT assigned its bid to the Mirabiles who accepted title to the property.

When sued by the EPA, the Mirabiles joined ABT and Mellon Bank as third party defendants, claiming that the banks were also PRPs under

89. See *In re Bergsoe Metal Corp.*, 910 F.2d 668 (9th Cir. 1990); *United States v. Fleet Factors Corp.*, 901 F.2d 1550 (11th Cir. 1990); *Guidice v. BFG Electroplating Mfg. Co.*, 732 F. Supp. 556 (W.D. Pa. 1989); *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573 (D. Md. 1986); *United States v. Mirabile*, 15 Env'tl. L. Rep. (Env'tl. L. Inst.) 20992 (E.D. Pa. Sept. 4, 1985); *In re T. P. Long Chem., Inc.*, 45 Bankr. 278 (N.D. Ohio 1985).

90. See *supra* note 89.

91. 15 Env'tl. L. Rep. (Env'tl. L. Inst.) 20992 (E.D. Pa. Sept. 4, 1985).

CERCLA as a result of their activities concerning the Turco Site. ABT and Mellon Bank then counterclaimed against the United States based upon the involvement of the Small Business Administration (SBA) in the site.⁹² ABT, Mellon Bank, and the SBA moved for summary judgment claiming nonliability based upon the security interest exception.

1. ABT's Motion for Summary Judgment.—ABT moved for summary judgment on two grounds. First, it contended that under Pennsylvania law, its successful bid at the sheriff's sale gave it only equitable title to the property which never evolved into legal title because it subsequently assigned its bid to the Mirabiles. Second, ABT asserted that its activities at the site were undertaken merely to protect its security interest in the Turco Site and that it never "participated in the management" of that site.⁹³

The court agreed with ABT's first argument and held that the passage of either legal or equitable title was irrelevant to the applicability of the security interest exception. The court stated that:

[It] need not resolve the issue of whether, under Pennsylvania law, ABT's successful bid at the Sheriff's sale technically vested ABT with ownership as defined by the statute. Regardless of the nature of the title received by ABT, its actions with respect to the foreclosure were plainly undertaken in an effort to protect its security interest in the property.⁹⁴

Therefore, the court concluded that ABT's foreclosure did not nullify its status under the security interest exception.

The court also agreed with ABT's second contention and held that the limited actions taken by ABT after foreclosure did not constitute "participation in the management of the site."⁹⁵ The court opined that, "it would appear that before a secured creditor such as ABT may be held liable, it must, at a minimum, participate in the day-to-day operational aspects of the site."⁹⁶ ABT's only actions with reference to the Turco Site were securing it against vandalism, inquiring as to clean-up costs, and showing the site to prospective buyers. The court found that these actions were only routine steps designed to prevent further depreciation of the property and could not be deemed participation in

92. In July of 1979, the SBA loaned \$150,000 to Turco which was to be applied to specific debts. The loan was secured by a second lien security interest in Turco machinery, equipment, inventory, accounts receivable, and property.

93. *United States v. Mirabile*, 15 *Env'tl. L. Rep.* (Env'tl. L. Inst.) 20992, 20996 (E.D. Pa. Sept. 4, 1985).

94. *Id.*

95. *Id.*

96. *Id.*

the day-to-day activities of the site.⁹⁷ Consequently, ABT's motion for summary judgment was granted, and ABT was not deemed a PRP.⁹⁸

2. *SBA's Motion for Summary Judgment.*—Although the SBA took neither legal nor equitable title to the Turco Site, the loan agreement allowed the SBA to participate in some of the financial management decisions of Turco. The Mirabiles contended that because the SBA was empowered to place restrictions on loan proceeds, the SBA may have prevented Turco from properly disposing of the hazardous wastes on the site.

The court rejected the Mirabiles' argument on two grounds. First, the court noted that there was no evidence that the SBA actually chose to assert its financial power over Turco.⁹⁹ Second, the court noted that participation in purely *financial* aspects of an operation is not sufficient to bring a lender within the scope of CERCLA liability.¹⁰⁰ Because the SBA's influence was limited to financial matters, the court granted its motion for summary judgment.¹⁰¹

3. *Mellon Bank's Motion for Summary Judgment.*—In contrast to the ABT and SBA motions, the court found itself faced with a "cloudier situation" when it considered Mellon Bank's motion for summary judgment.¹⁰² Mellon Bank, through its predecessor in interest, Girard Bank, held a security interest in Turco's inventory and assets. After Turco defaulted on its loan, Girard became involved in Turco's operations. Initially, it placed one of its loan officers on an advisory board established to oversee Turco's operations. Later, the Bank became more involved by making weekly visits and instructing the company on manufacturing, personnel, and sales matters.

The Mirabiles asserted that Mellon Bank's involvement with Turco brought it within the scope of CERCLA liability. The court agreed with the Mirabiles and held that although "[t]he reed upon which the Mirabiles seek to impose liability . . . is slender indeed,"¹⁰³ a genuine issue of fact was presented as to whether Mellon Bank, through its predecessor Girard Bank, engaged in the sort of *participation in management* which would bring a secured creditor within the scope of CERCLA liability.¹⁰⁴ Therefore, the court denied Mellon Bank's motion for summary judgment.¹⁰⁵

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.* at 20997.

103. *Id.*

104. *Id.*

105. *Id.*

The court's decision was a bittersweet result for the lending industry. On one hand, the court held that mere participation in the *financial* aspects of a borrower's waste disposal practices is not sufficient for the imposition of CERCLA liability.¹⁰⁶ Additionally, the court noted that a lender's foreclosure and subsequent acquisition of property will not necessarily remove it from the safe harbor afforded by the security interest exception.¹⁰⁷ On the other hand, lenders must be aware that they may incur liability under CERCLA if they become actively involved in a borrower's operations in order to protect a secured interest.

B. *United States v. Maryland Bank & Trust Company*

Shortly after *Mirabile*, the issue of lender liability was again addressed in *United States v. Maryland Bank & Trust Co.*¹⁰⁸ Contrary to *Mirabile*, the court in *Maryland Bank* held that the security interest exception does not protect a mortgagee who forecloses and subsequently takes title to the property.¹⁰⁹

In 1980, Maryland Bank & Trust Company (MBT) made a secured loan to Mark McCleod, the owner and operator of the California Maryland Drum (CMD) site. In 1981, after McCleod failed to make payments, MBT foreclosed on the CMD site and purchased the property at the foreclosure sale. In 1983, the EPA found that hazardous wastes were improperly disposed of at the CMD site. After the MBT refused the EPA's order to clean up the site, the EPA proceeded to clean the site itself at a cost of over \$550,000. The EPA then sued MBT for payment claiming that it was liable under CERCLA as the present owner and operator of the facility.

MBT's primary defense was that it was not liable to the EPA because it was protected by CERCLA's security interest exception.¹¹⁰ In its summary judgment motion, MBT asserted that it was not liable as a present owner or operator of the CMD site because it had foreclosed and took title to the property merely to protect its security interests. The United States contended, however, that MBT was liable as a present owner and operator of the site, and it was not entitled to any exemption because it no longer held a security interest in the property.

The court agreed with the Government's position and held that MBT was liable as a responsible party under CERCLA.¹¹¹ The court supported

106. *Id.*

107. *Id.*

108. 632 F. Supp. 573 (D. Md. 1986).

109. *Id.* at 579-80.

110. *Id.* at 579.

111. *Id.*

its finding by utilizing a literal reading of the security interest exception. It stated that the "verb tense of the security interest exception is critical. The security interest must exist *at the time* of the clean-up" in order to afford a lender any protection.¹¹² The court consequently ruled that the security interest exception terminates upon a lender's foreclosure and subsequent purchase of the property because the security interest is destroyed as the lender's interest ripens into full title.¹¹³

Next, the court asserted that policy considerations played a role in its determination of liability. The court reasoned that:

Under the scenario put forward by the bank, the federal government would alone shoulder the cost of cleaning up the site, while the former mortgagee-turned-owner, would benefit from the clean-up by the increased value of the now unpolluted land. At the foreclosure, the mortgagee could acquire the property cheaply. All other prospective purchasers would be faced with potential CERCLA liability, and would shy away from the sale. Yet once the property has been cleared at the taxpayers' expense and becomes marketable, the mortgagee-turned-owner would be in a position to sell the site at a profit.

In essence, the [bank's] position would convert CERCLA into an insurance scheme for financial institutions, protecting them against possible losses due to the security of loans with polluted properties.¹¹⁴

The court further noted that lenders were not without protection under such a liability scheme. It stated that banks could protect themselves by conducting an environmental audit before lending any money. Based upon these findings, the court granted the Government's motion for summary judgment pertaining to MBT's liability under section 107(a)(1).¹¹⁵

C. *Guidice v. BFG Electroplating & Manufacturing Company*

In *Guidice v. BFG Electroplating & Manufacturing Co.*,¹¹⁶ the District Court for the Western District of Pennsylvania was faced with essentially the same interpretation issues involving the security interest exception that were examined in *Mirabile*. Contrary to the *Mirabile* decision, however, *Guidice* interpreted the security interest exception somewhat narrowly.

112. *Id.* (emphasis in original).

113. *Id.*

114. *Id.* at 580.

115. *Id.* at 582.

116. 732 F. Supp. 556 (W.D. Pa. 1989).

In *Guidice*, the National Bank of the Commonwealth issued a secured loan to Berlin Metal Polishers (Berlin Metal) in 1975. After Berlin Metal defaulted on its obligation to the Bank in 1980, the Bank sent representatives to tour the Berlin Metal plant and to meet with officials to discuss management. The Bank was informed of the number of work shifts, the status of Berlin Metal's accounts, the composition of management, and the presence of raw materials. At the meeting, the Bank suggested that the company take out a loan guaranteed by the SBA to pay off the monies that Berlin Metal owed the Bank. The Bank subsequently submitted the SBA loan application on behalf of Berlin Metal and recommended its approval, but the loan was refused.

A few months later, a Bank officer was contacted by a prospective purchaser of the Berlin Metal site. The Bank officer independently discussed the matter with city officials. The sale was never made, however, and, in 1981, Berlin ceased operations. At this time, a Bank officer was again sent to Berlin Metal to discuss restructuring the loan. Finally, in June, 1981, the Bank foreclosed on the property. The Bank subsequently bought the Berlin Metal facility at the sheriff's sale in 1982 and sold the property eight months later. In 1986, local residents sued BFG (the present property owner) and alleged that contamination from the Berlin Metal site was causing personal injuries. BFG then filed a third party complaint against the Bank alleging that the Bank was liable for response costs as a former "owner or operator" of the Berlin Metal site.

It was necessary for the court to address two separate arguments in order to render a decision on the Bank's motion for summary judgment. First, BFG contended that the Bank was liable as an owner or operator *before* it foreclosed on the Berlin Metal property. The Bank responded that it was immune from liability, however, because it fell under the security interest exception. At issue was whether the Bank's "participation in the management" of Berlin Metal was sufficient to remove it from the security interest exception.

The court chose to espouse the narrow interpretation of "participating in management" previously outlined in *Mirabile*. The court held that a secured creditor may provide financial assistance and may even provide isolated instances of specific management advice to its debtors without risking CERCLA liability.¹¹⁷ Applying this standard, the court found that the Bank's activities prior to foreclosure were insufficient to nullify the security interest exception.¹¹⁸ The court reasoned that none of the

117. *Id.* at 561. See also *United States v. Mirabile*, 15 Env'tl. L. Rep. (Env'tl. L. Inst.) 20992 (E.D. Pa. Sept. 4, 1985).

118. *Guidice v. BFG Electroplating & Mfg. Co.*, 732 F. Supp. 556, 562 (W.D. Pa. 1989).

Bank's activities concerning the Berlin property suggested that the Bank "controlled operational, production, or waste disposal activities" of the facility.¹¹⁹

Addressing the second issue, the court found that although the Bank could claim protection under the security interest exception with respect to its actions *before* foreclosure, the Bank could not claim protection under the security interest exception with respect to its activities *after* it foreclosed on the Berlin property.¹²⁰ Recognizing a divergence in case law, the court chose to adopt the position expressed in *United States v. Maryland Bank & Trust Co.*, rather than that established in *United States v. Mirabile*. Consequently, the court held that "when a lender is the successful purchaser at a foreclosure sale, the lender should be liable to the same extent as any other bidder at the sale would have been."¹²¹

The court supported its conclusion by pointing to the amendments to CERCLA in 1986. The court found that while Congress excluded other entities from CERCLA liability through the amendments, it did not "simultaneously amend the statute to exclude from liability lenders who acquired property through foreclosure."¹²² The court opined that this indicated a congressional intent to hold those lenders liable as owners.¹²³ In applying its interpretation to the case at hand, the court found that because the Bank purchased the Berlin property at the foreclosure sale, it was removed from the protection of the security interest exception.¹²⁴ Therefore, the court held that the third party defendant could proceed with its cause of action against the Bank for the period that the Bank had record title of the property.¹²⁵

D. *United States v. Fleet Factors Corporation*

*United States v. Fleet Factors Corp.*¹²⁶ is the most recent decision specifically construing the security interest exception's participation in management clause. In *Fleet Factors*, the Eleventh Circuit Court of Appeals held that a secured lender may incur CERCLA liability as a *de facto* owner if the lender participates in the borrower's financial management to an extent that indicates an ability to influence the borrower's hazardous waste disposal decisions.¹²⁷

119. *Id.*

120. *Id.* at 563.

121. *Id.*

122. *Id.*

123. *Id.*

124. *Id.*

125. *Id.* at 564.

126. 901 F.2d 1550 (11th Cir. 1990).

127. *Id.* at 1558.

From 1963 until 1981, Swainsboro Print Works, Inc. (SPW) or its predecessor in interest operated a cloth printing facility. In 1976, SPW and the Fleet Factors Corporation (Fleet Factors) entered into a factoring agreement in which Fleet Factors agreed to advance funds against the assignment of SPW's accounts receivable. As collateral for these advances, Fleet Factors obtained a security interest in all of SPW's equipment, inventory, and fixtures. In addition, Fleet Factors was granted a security interest in the SPW plant and property. In early 1981, Fleet Factors ceased advancing funds to SPW because SPW's debt to Fleet Factors exceeded the value of its accounts receivable. On February 27, 1981, SPW ceased operations and began to liquidate its inventory. By December 1981, SPW was adjudicated a bankrupt under Chapter 7, and a trustee assumed title and control of the facility.

After obtaining court approval in 1982, Fleet Factors foreclosed on its security interest in some of SPW's inventory and equipment¹²⁸ and contracted with Baldwin Industrial Liquidators (Baldwin) to conduct an auction of the collateral. Fleet Factors also contracted with Nix Riggers (Nix) to remove the unsold equipment from the SPW facility. Nix left the facility by the end of 1983.

Upon discovering that the SPW site was contaminated with hazardous substances, in 1984, the EPA cleaned up the facility at a cost of nearly \$400,000. In 1987, the facility was conveyed to Emanuel County, Georgia at a foreclosure sale resulting from SPW's failure to pay taxes. The United States subsequently sued Fleet Factors, among others, to recover the response costs incurred in cleaning up the SPW facility.

On appeal, the Eleventh Circuit addressed the issue of whether Fleet Factors's participation in the management of the SPW site caused it to incur liability as a past owner or operator of the site under CERCLA section 107(a)(2).¹²⁹ It was undisputed that Fleet Factors had a security interest in the SPW facility. What was in dispute, however, was whether Fleet Factors was exempt from liability because of its status under the security interest exception. The Government argued that Fleet Factors's activities at SPW nullified its status under the security interest exception

128. Fleet Factors never foreclosed on its security interest in the SPW plant and property, however.

129. The district court, in ruling on the Government's and Fleet Factors's Cross Motions for summary judgment, held that: (1) Fleet Factors's activities *before* February 27, 1981 at the SPW facility did not rise to the level of "participation in management" sufficient to incur liability as a past owner or operator under CERCLA § 107(a)(2), and (2) a genuine dispute existed as to whether Fleet Factors's activities *after* February 27, 1981 at the facility rose to a level of "participation in management" sufficient to incur liability as a past owner or operator under CERCLA. *United States v. Fleet Factors Corp.*, 724 F. Supp. 955, 960-61 (S.D. Ga. 1988), *aff'd*, 901 F.2d 1550 (11th Cir. 1990).

because Fleet Factors “participated in the management” of the facility.

The Government urged the court to adopt a narrow and strict interpretation of the security interest exception “that excludes from its protection any secured creditor that participates in *any* manner in the management of the facility.”¹³⁰ The court quickly rejected this argument and stated that such an interpretation would “largely eviscerate the exemption Congress intended to afford secured creditors.”¹³¹ Fleet Factors in turn suggested that the court adopt an interpretation similar to the one espoused in *United States v. Mirabile* which delineated between permissible participation in the financial management of a facility and impermissible management in the day-to-day operational management of a facility.¹³²

The court of appeals chose to reject both of the proposed definitions and instead, delineated one of its own. The court of appeals found the *Mirabile* construction of the security interest exception “too permissive” toward secured creditors.¹³³ The court reasoned that the *Mirabile* court’s broad interpretation would essentially require a secured creditor to be involved in the daily operations of a facility before it would incur any liability.¹³⁴ The court opined that such a construction would essentially render the security interest exception meaningless because persons whose activities rose to such a level were already liable as “operators” under section 9607(a)(2).¹³⁵ The court of appeals advocated the following standard:

[A] secured creditor may incur Section 9607(a)(2) liability, without being an operator, by participating in the *financial* [or operational] management of a facility to a degree indicating a capacity to influence the [borrower’s] treatment of hazardous wastes. It is not necessary for the secured creditor actually to involve itself in the day-to-day operations of the facility in order to be liable . . . [n]or is it necessary for the secured creditor to participate in management decisions related to hazardous waste. Rather, a

130. *United States v. Fleet Factors, Corp.*, 901 F.2d 1550, 1556 (11th Cir. 1990).

131. *Id.*

132. The district court in *Fleet Factors* chose to adopt such an interpretation by relying on the holding in *Mirabile*. The district court interpreted the statutory language to permit secured creditors to “provide financial assistance in general, and even isolated instances of specific, management advice to its debtors without risking CERCLA liability if the secured creditor does not participate in the day-to-day management of the business or facility either before or after the business ceases operations.” *United States v. Fleet Factors, Corp.*, 724 F. Supp. 955, 960 (S.D. Ga. 1988), *aff’d*, 901 F.2d 1550 (11th Cir. 1990).

133. *United States v. Fleet Factors, Inc.*, 901 F.2d 1550, 1557 (11th Cir. 1990).

134. *Id.*

135. *Id.*

secured creditor will be liable if its involvement with the management of the facility is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose.¹³⁶

The court listed several policy interests furthered by its interpretation of the security interest exception. First, it stated that lenders could still monitor any aspect of a debtor's business and become occasionally involved in financial decisions relating to the protection of their security interests without incurring liability.¹³⁷ Second, the court suggested that its ruling would encourage potential creditors to investigate thoroughly the waste treatment operations of potential debtors before making any loans and would provide powerful incentives for potential debtors to improve their handling of hazardous waste.¹³⁸ Finally, the court asserted that awareness of potential CERCLA liability will encourage creditors to continually monitor the existing operations of debtors and insist upon compliance with acceptable disposal procedures.¹³⁹ The court stated that society will benefit from such a result.¹⁴⁰

The court next applied its interpretation of the security interest exception to the factual situation at hand. First, the court agreed with the court below and found that Fleet Factors's involvement with the facility before February 27, 1981 was within the bounds of the security interest exception.¹⁴¹ The court also held, however, that Fleet Factors's alleged activities after February 27, 1981, if proven, would be sufficient to remove it from the protection of the security interest exception.¹⁴² The Government alleged that after this date, Fleet Factors required SPW to seek its approval before shipping inventory, established prices for excess inventory, stipulated when and to whom inventory would be shipped, determined when employees would be laid off, supervised administrative activities, received and processed SPW tax forms, controlled access to the facility, and contracted with Baldwin to dispose of SPW's fixtures and equipment. The court found that these activities removed Fleet Factors from the security interest exception.¹⁴³ After its lengthy analysis, the court denied Fleet Factors's summary judgment motion as

136. *Id.* at 1557-58 (emphasis added).

137. *Id.* at 1558.

138. *Id.*

139. *Id.*

140. *Id.*

141. SPW ceased operations and began to liquidate its inventory on February 27, 1981.

142. *United States v. Fleet Factors, Corp.*, 901 F.2d 1550, 1559 (11th Cir. 1990).

143. *Id.*

to its liability as a past owner or operator under CERCLA.¹⁴⁴ The court then remanded the case for further proceedings because disputed issues of material fact remained which had to be resolved and applied to the new interpretation of the security interest exception.¹⁴⁵

E. In re Bergsoe Metal Corporation

Only three months after the *Fleet Factors* decision, another United States Court of Appeals had the opportunity to interpret the “participating in management” clause of CERCLA’s security interest exception. In *In re Bergsoe Metal Corp.*,¹⁴⁶ the Ninth Circuit Court of Appeals implicitly rejected the interpretation of the security interest exception outlined in *Fleet Factors*. The court side-stepped the opportunity to delineate its own interpretation of the clause, however.

In 1978, Bergsoe Metals, a lead recycling corporation, contacted the Port of St. Helens (Port), a municipal corporation, to discuss the building of a lead recycling facility in St. Helens. In 1979, the Port agreed to issue bonds and sell Bergsoe fifty acres of land on which to construct the plant. In exchange, the Port received a promissory note for \$400,000 and a mortgage on the property.

Through a series of interlocking transactions after the initial agreement, Bergsoe, the Port, and the United States National Bank of Oregon completed the arrangement. At the center of this financing scheme were the revenue bonds issued by the Port. The Bank held these bonds in trust for the bondholders, and Bergsoe was required to pay the money owed on the bonds to the Bank rather than the Port. Although the Port was technically the owner of the property, the Bank held the deed in escrow so that Bergsoe had the right to repurchase the property for \$100 once the bonds were paid in full.

Soon after the Bergsoe plant began its operations in 1982, it began experiencing financial difficulties. In September of 1983, the Bank declared Bergsoe to be in default. Subsequently, the Bank and Bergsoe agreed to a “workout arrangement” in which Front Street Management Corporation would manage the facility. After the plant fared no better under new management, it was forced into bankruptcy in 1986. By that time, hazardous substances were discovered to have contaminated the facility.

In 1987, the Bank filed suit against East Asiatic Company (EAC), the company that owned Bergsoe, to collect on its debts. The Bank also sought a declaratory judgment that EAC was liable for the costs of

144. *Id.* at 1560.

145. *Id.*

146. 910 F.2d 668 (9th Cir. 1990).

cleaning up the plant. Bergsoe and EAC counterclaimed and brought third party actions against the Bank and the Port, arguing that they were liable for the clean-up costs under CERCLA. The Port moved for summary judgment, claiming that it was not liable for any response costs because it fell under the protection of CERCLA's security interest exception. The bankruptcy court granted the Port's motion and the district court affirmed. The EAC then appealed.

On appeal, the Ninth Circuit Court of Appeals first ruled that even though the Port was "technically" the owner of the Bergsoe property, it could claim protection under the security interest exception because it acted as a secured creditor rather than as an owner.¹⁴⁷ In so ruling, the court ignored previous decisions that strictly interpreted CERCLA and imposed liability upon parties who were merely temporary owners or brokers of a polluted property.¹⁴⁸ The court supported its finding by noting that the Bank "essentially financed" the Bergsoe plant while the Port's "only involvement was to give its approval to the project and to issue the bonds that served as the vehicle for the financing."¹⁴⁹ It further noted that the Port only received the warranty deed as part of a transaction in which the sole purpose was to provide financing for the plant.¹⁵⁰

Next, the court addressed whether the Port sufficiently participated in the management of the Bergsoe facility to remove it from the security interest exception. Although the court had the opportunity to define the "participating in management" phrase, it chose not to do so because it was clear that the Port fell within the boundaries of the security interest exception. The court stated:

We leave for another day the establishment of a Ninth Circuit rule on this difficult issue. It is clear from the statute that, whatever the precise parameters of "participation," there must be *some* actual management of the facility before a secured creditor will fall outside the exception. Here there was none, and we therefore need not engage in line drawing.¹⁵¹

The court supported its conclusion by pointing out that there was no evidence that the Port participated in any of Bergsoe's management.¹⁵²

147. *Id.* at 671.

148. *United States v. Bliss*, 667 F. Supp. 1298 (E.D. Mo. 1989) (company which acted as a broker between chemical manufacturer and disposal company was liable for response costs); *United States v. Carolawn Co.*, 21 Env't Rep. Cas. (BNA) 2124 (D.S.C. 1984) (chemical company that held title for merely one hour could be liable for clean-up costs).

149. *In re Bergsoe Metal Corp.*, 910 F.2d 668, 671 (9th Cir. 1990).

150. *Id.*

151. *Id.* at 672.

152. *Id.* at 673.

The court first asserted that the Port's involvement in the deal's "negotiations" did not constitute management participation.¹⁵³ The court reasoned that to hold the Port liable for its involvement in the negotiations would render the security interest exception meaningless because secured creditors always have some input on the planning stages of a project.¹⁵⁴ Similarly, the court concluded that the Port's right to inspect and re-enter the Bergsoe property could not be classified as management participation.¹⁵⁵ The court opined that "what is critical is not what rights the Port had, but what it did."¹⁵⁶ Because the Port never chose to exercise its rights, it could not be deemed to have actively participated in Bergsoe's management decisions.¹⁵⁷ Finally, the court noted that no evidence existed that the Port participated in the decision to hire Front Street Management Corporation to manage the facility.¹⁵⁸ Those negotiations were entirely between the Bank, Bergsoe, and Front Street. Finding that the Port had no actual participation in the Bergsoe facility, the court granted the Port's motion for summary judgment and held that it was not liable for clean-up costs as an owner or operator under CERCLA.¹⁵⁹

III. THE FUTURE OF LENDER LIABILITY

A. *Lenders Who Foreclose And Acquire Title*

It is clear that the *Mirabile* court on the one hand and the *Maryland Bank* and *Guidice* courts on the other, approached the issue of lender liability for foreclosing lenders from opposite directions. In *Mirabile*, the court held that if a lender did not actively participate in the borrower's operations, it would not be liable for clean-up costs even if it foreclosed and acquired title.¹⁶⁰ The *Mirabile* court was primarily concerned with recognizing the role of the security interest exception in protecting secured creditors. This concern, however, caused the court to ignore the fact that the bank had acquired full legal title and not just a security interest. Instead, the court focused on whether the bank sufficiently participated in the management of the facility to remove it from the exception.¹⁶¹

153. *Id.*

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.*

158. *Id.*

159. *Id.*

160. *United States v. Mirabile*, 15 *Env'tl. L. Rep.* (Env'tl. L. Inst.) 20992, 20996 (E.D. Pa. Sept. 4, 1985).

161. *Id.*

The *Mirabile* court probably did not even consider the policy implications of its holding. In effect, the court's decision placed lenders in a more advantageous position at a sheriff's sale than other potential buyers.

The courts in *Maryland Bank* and *Guidice* approached the issue differently. These courts held that when a lender forecloses and acquires full title, it is removed from the security interest exception. The *Maryland Bank* court recognized the public policy ramifications of the *Mirabile* decision and stated that the *Mirabile* standard would allow foreclosing lenders to be unjustly enriched. For example, when a bank forecloses on a polluted property, it would be the only bidder at the sheriff's sale who could take title without being liable for the site's clean-up costs.¹⁶² Other potential buyers of the property would shy away from purchasing the contaminated property because they would incur liability for the clean-up costs of the property when they took title. Thus, the bank could purchase the property at a lower price, wait until the property has been cleaned up at the taxpayers' expense, and then sell the property at a significant profit once it becomes marketable.¹⁶³ The *Maryland Bank* court refused to approve of such a result. Instead, it held that when a lender forecloses and acquires title to property, it should be treated like any other bidder at the sheriff's sale and should incur liability the same as any other PRP.¹⁶⁴

The *Maryland Bank* position is and should be the dominant view espoused. As courts have recognized, both the public policy and structure of CERCLA support removing a mortgagee-turned-owner from the protection of the security interest exception. CERCLA was never intended to allow banks to profit from government funded clean-ups of contaminated property. To treat any subsequent purchaser of contaminated property differently under CERCLA is simply inequitable.

Legislative intent supporting this narrow interpretation of the security interest exception is evidenced by several factors. First, Congress allowed liability under CERCLA to be extremely widespread. This is evidenced by Congress imposing liability on four broadly defined classes of persons.¹⁶⁵ Second, Congress provided for only three meager defenses that are available to PRPs.¹⁶⁶ Finally, when Congress amended CERCLA in 1986, it did not significantly narrow any of CERCLA's liability provisions and did not alter any previous court interpretations of its provisions.¹⁶⁷

162. *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573, 580 (D. Md. 1986).

163. *Id.*

164. *Id.*

165. *See supra* note 31 and accompanying text.

166. *See supra* note 83 and accompanying text.

167. *See supra* note 13 and accompanying text.

Even under the *Maryland Bank* view, lenders have an adequate means of protecting themselves from CERCLA liability. Financial institutions are in a position to investigate and discover potential environmental problems on their secured properties.¹⁶⁸ Additionally, banks can protect themselves by conducting reasonable investigations of potential borrowers' environmental situations *before* they lend money.

Recently, the *Guidice* court followed the *Maryland Bank* court's decision and entrenched its interpretation of the security interest exception into modern case law. It seems likely that the *Maryland Bank* position is now the dominant view because only one court has followed the *Mirabile* position after CERCLA was amended in 1986.¹⁶⁹

As a result of the *Maryland Bank* and *Guidice* decisions, lenders should be more cautious about foreclosing on their secured interests. In order to protect themselves, lenders must educate themselves about the hazardous waste disposal practices of their potential borrowers, conduct environmental inspections *before* making loans, and monitor the borrower's activities *during* the period of the loan. If after such investigation, a lender finds that a defaulting borrower has improperly disposed of hazardous substances on the property, the lender may be presented with a dilemma. The lender will have to decide: (1) if it is more cost effective to foreclose, purchase the property, pay for the clean-up, and resell the property or (2) if it is more cost effective to simply write-off the loan. Because of the staggering costs of environmental clean-up, lenders in many cases will find that it is better to simply write-off the loan.¹⁷⁰

B. Lenders Participating In A Borrower's Management

When Congress drafted the security interest exception, it did not define what actions constitute "participating in management." Consequently, this definition was left to judicial interpretation. Although substantial litigation has attempted to define the participation in management term, no clear standard or definition has emerged to provide

168. *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573, 580 (D. Md. 1986).

169. *Coastal Casting Serv., Inc. v. Aron*, No. 86-4463, 1988 WL 35012 (S.D. Tex. Apr. 8, 1988) (foreclosing on property is not enough in itself to find the lender liable as an owner).

170. In a recent survey of 2000 banks conducted by the American Banking Association, 15% of the banks reported that they had abandoned property held as collateral on loans, rather than foreclose upon it. *The Financial Times Ltd., Banks Criticize Proposed Lender Liability Rule*, WORLD INS. REP. (July 19, 1991). See also *Chemical Waste Complicates Many Land Sales, Financing*, Wall St. Journal, Nov. 5, 1986, at 39, col. 1 (lender decided not to foreclose on a \$200,000 loan upon learning that the land was contaminated with a hazardous substance and clean-up costs could amount to \$2.5 million).

guidance to lenders. Instead, there are two contrasting definitions of what constitutes permissible participation in a borrower's affairs before a lender is removed from the security interest exception. Under one view, courts have made a distinction between a lender's participation in the general financial management of a borrower's activities and a lender's impermissible participation in the day-to-day management of a borrower's production, operational, or waste disposal activities. This view was first outlined in *United States v. Mirabile* and has subsequently been followed by a line of district court opinions.¹⁷¹ This interpretation permits a lender to provide general *financial* advice and isolated instances of specific operational advice to a debtor without incurring CERCLA liability as long as a lender does not participate in the *day-to-day operational* aspects of the facility.¹⁷²

Although no appellate court has specifically espoused the *Mirabile* position, the Ninth Circuit in *In re Bergsoe Metal Corp.* seemed to implicitly adopt this view by holding that as a threshold matter, a lender must exercise *actual management authority* before it can be held liable for action or inaction that results in the discharge of hazardous wastes.¹⁷³ Furthermore, the court stated that a lender "[m]erely having the power to get involved in management, but failing to exercise it, is not enough" to subject it to liability.¹⁷⁴ This dicta should be interpreted as implicitly rejecting the *Fleet Factors* view which imposes liability on a lender whose actions merely indicate its *capacity* to become involved in a debtor's disposal decisions. Significantly, the *Bergsoe* court's treatment of the Port as a "secured lender" rather than an "owner" for purposes of CERCLA is also more consistent with the *Mirabile* position. Although the Port was the "technical owner" of the contaminated property, the *Bergsoe* court dismissed this fact and allowed the Port to claim protection under the security interest exception because it *acted* as a secured lender.¹⁷⁵

Contrary to the interpretation outlined in *Mirabile*, the Eleventh Circuit in *United States v. Fleet Factors Corp.* advocated a more encompassing definition of what activities may be classified as "participating in management" of a facility. In *Fleet Factors*, the court shifted the

171. See *United States v. Nicolet, Inc.*, 712 F. Supp. 1193, 1204-05 (E.D. Pa. 1989); *United States v. New Castle County*, 727 F. Supp. 854, 866 (D. Del. 1989); *Guidice v. BFG Electroplating & Mfg. Co.*, 732 F. Supp. 556, 561-62 (W.D. Pa. 1989); *Rockwell Int'l Corp. v. I.U. Int'l Corp.*, 702 F. Supp. 1384, 1390 (N.D. Ill. 1988); *United States v. Fleet Factors Corp.*, 724 F. Supp. 955, 960 (S.D. Ga. 1988), *aff'd on other grounds*, 901 F.2d 1550 (11th Cir. 1990).

172. See *supra* note 171.

173. *In re Bergsoe Metal Corp.*, 910 F.2d 668, 673 n.3 (9th Cir. 1990).

174. *Id.*

175. *Id.* at 671.

focus of its examination from the *type* of lender involvement (*i.e.*, financial or operational) to the *degree* of lender involvement, regardless of its type. Consequently, the court held that a lender will be removed from the security interest exception by participating in the financial or operational management of a facility to a degree indicating its capacity to influence the debtor's hazardous waste disposal decisions if it chose to do so.¹⁷⁶

The *Fleet Factors* decision established a third category of lender liability under CERCLA. Previously, lenders who foreclosed and acquired a facility or participated in the day-to-day operational management of a facility were subject to liability.¹⁷⁷ After *Fleet Factors*, secured lenders who merely have the capacity to influence a debtor's hazardous waste disposal decision are also potentially liable parties.

The *Fleet Factors* standard clearly narrows the scope of the security interest exception. It is relatively unclear, however, what lender management activities are permissible under *Fleet Factors*. The court offered some guidance by stating that lenders could still "monitor" any aspect of a debtor's business without incurring liability.¹⁷⁸ Furthermore, the court remarked that a lender "can become involved in occasional and discrete financial decisions relating to the protection of its security interest without incurring liability."¹⁷⁹ Lenders, however, should not heavily rely upon these gratuitous remarks. The consequences are severe for misjudging whether a certain action falls into one of these exceptions.

After examining the two differing interpretations of the security interest exception, it is suggested that the interpretation of "participating in management" advocated by *Mirabile* and several other courts better comports with the purpose and intent of CERCLA than the one proposed in *Fleet Factors*. First, the vagueness of the legal standard proffered by the *Fleet Factors* interpretation poses a significant problem for the lending community. The *Fleet Factors* standard imposes liability based on the *degree* of a lender's participation in a borrower's affairs. The court offered virtually no guidance as to what amount of participation is permissible. It only remarked that lenders could monitor any aspect of a borrower's financial situation and could become involved in "occasional and discrete financial decisions relating to the protection of its security interest."¹⁸⁰ This standard will result in lenders becoming overly cautious

176. *United States v. Fleet Factors Corp.*, 901 F.2d 1150, 1557-58 (11th Cir. 1990).

177. *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 578, 580 (D. Md. 1986). See *supra* note 171 and accompanying text.

178. *Fleet Factors*, 901 F.2d at 1558.

179. *Id.*

180. *Id.*

in making loans or engaging in loan workouts.¹⁸¹ In turn, this may cause a significant decrease in the availability of affordable credit to both small businesses and home purchasers whose property is environmentally active or near environmentally active property.¹⁸²

Furthermore, under the *Fleet Factors* standard, a lender may have no refuge from CERCLA liability if it conducts its business prudently and takes reasonable measures to protect its security interests. Virtually all lenders have the "capacity to influence," a borrower's business by the very terms of typical loan documents, security agreements, and mortgages. Without this "capacity to influence," a lender has no way to protect its collateral without incurring environmental liability. Therefore, by imposing liability on secured lenders who merely have the capacity to influence the environmental decisions of debtors, the *Fleet Factors* standard essentially eviscerates CERCLA's security interest exception.

Contrary to the *Fleet Factors* standard, the *Mirabile* standard imposes a palpable and discernable interpretation of the security interest exception. The *Mirabile* interpretation imposes liability based on a lender's *type* of participation (*i.e.*, financial or operational involvement), not its *degree* of participation. Although in some cases determining whether a lender is participating in the financial management or the operational management of a debtor may be difficult, the *Mirabile* standard provides lenders with predictability. Because of this increased predictability, this standard will not inhibit financial transactions unnecessarily, but will instead encourage responsible behavior and reasonable precautionary measures by lenders.

Second, the *Fleet Factors* interpretation is deficient because it ignores the fact that lenders often take actions to protect a security interest in a debtor's personal property as well as its real property. Under the *Fleet Factors* standard, a lender who does not have a secured interest in a borrower's real property may incur liability by merely becoming too involved in protecting an interest in a borrower's *personal* property. Lenders seldom conduct costly environmental investigations before mak-

181. In a recent survey of 2000 banks conducted by the American Banking Association, 63% of the banks reported that they had rejected loan applications because of possible environmental liability. Nearly 45% of the banks also reported that they had stopped lending to certain types of businesses, such as gasoline stations, because of potential environmental liability. The Financial Times Ltd., *Banks Criticize Proposed Lender Liability Rule*, WORLD INS. REP. (July 19, 1991).

182. Note, *Lender Liability for Hazardous Waste: An Economic and Legal Analysis*, 59 U. COLO. L. REV. 659, 669 (1988) [hereinafter Note, *Lender Liability*]. See also Leland, *Lender Liability and Cleanups Present Workout Dilemma*, AM. BANKER, June 20, 1990, at 4.

ing loans which are only secured by a borrower's accounts receivable, equipment, and inventory. The *Fleet Factors* interpretation, however, will force lenders to conduct these environmental audits on loans which are only secured by personal property.

Consequently, in order to protect themselves, lenders will need to conduct expensive environmental audits before making *any* type of secured loan. Small businesses seeking loans are hurt by such a result because the debtor must ultimately pay for the costs of these environmental audits. For example, a small business applying for a \$200,000 loan cannot afford to pay a \$10,000 to \$20,000 environmental audit fee.¹⁸³

Third, the *Fleet Factors* interpretation increases the likelihood that lenders will deny credit to businesses that either use hazardous substances or are located in areas of possible contamination. Already, small businesses such as dry cleaners, printers, pest control firms, agribusiness, and real estate developers are experiencing a credit crunch resulting from the lending community's attempts to avoid environmental liability.¹⁸⁴ Furthermore, besides tightening the availability of credit for developers and small businesses, the *Fleet Factors* standard will also make available credit more expensive.¹⁸⁵ This result will unduly burden many smaller businesses which depend upon the availability of affordable credit for their existence.¹⁸⁶ Finally, potential home purchasers will be denied credit merely because their property is located near an environmentally active facility.¹⁸⁷ CERCLA was not designed to chill responsible lending to potential home purchasers and environmentally active businesses.

Contrary to the *Fleet Factors* standard, the *Mirabile* standard effectuates a result in which lenders are not as prone to deny credit to businesses solely because of a business's affiliation with hazardous substances. Banks are better able to protect themselves from incurring liability under the lower and more predictable *Mirabile* standard. Consequently, the *Mirabile* interpretation is less burdensome on responsible parties seeking credit than the *Fleet Factors* interpretation.

183. Note, *Lender Liability*, *supra* note 182, at 669.

184. *FDIC, RTC Claim Federal Liability Laws Hamper Selling Insolvent Institutions*, 56 Banking Report (BNA) No. 15, at 685 (Apr. 15, 1991).

185. *Bankers, Lawyers, Business Endorse LaFalce CERCLA Lender Liability Bill*, 54 Banking Report (BNA) No. 23, at 986 (June 11, 1990) (testimony of Robert Clark, counsel for Associated Builders & Contractors, Inc. of Indiana, before the House of Representatives Small Business Committee). See also Note, *Lender Liability*, *supra* note 182, at 669.

186. Testimony of Lee Schroeder, President of First National Bank of Dana, Indiana, before the House of Representatives Small Business Committee (June 7, 1990) (unpublished) (on file in the office of the Indiana Law Review).

187. *Id.*

Finally, the *Fleet Factors* court asserted that its interpretation encourages lenders to monitor closely the hazardous waste policies and disposal practices of their debtors and requires their compliance with acceptable treatment standards as a prerequisite for continued financial support.¹⁸⁸ Facially, this seems to be a logical proposition. In reality, however, the *Fleet Factors* standard places lenders squarely on the horns of a dilemma. For example, if despite its previous investigations, a secured lender discovers a hazardous waste disposal problem on a defaulting debtor's site, the lender is faced with three options.

First, the lender may opt to foreclose. This is not usually a viable option, however, because the contaminated property will clearly not draw a good price at the foreclosure sale when any prospective purchaser (either a third party or the lender) will be subject to full liability upon acquiring title.

Second, upon the debtor's default, the lender may choose to call the entire loan due, obtain what money it can from the debtor, and then write-off the remaining loss. In doing so, the lender will only minimally inform the debtor of its financial situation because the lender will not want its actions to be misconstrued so that it becomes ensnared in the *Fleet Factors* web of liability. This result defeats the purposes of CERCLA. CERCLA's liability scheme was designed not only to impose liability upon responsible parties, but also to *encourage* activities that lead to safe hazardous waste disposal practices. In this situation, the *Fleet Factors* standard actually *discourages* responsible activities because it gives lenders incentives to terminate rather than to continue their association with a financially troubled debtor.¹⁸⁹ This termination will often cause the debtor to become insolvent. Thus, the government will in many cases be left with the responsibility to clean-up the contaminated site because the property will be virtually unmarketable.

Third, as the court in *Fleet Factors* suggested, a lender may attempt to engage in an active workout agreement with a defaulting debtor that attempts to address the hazardous waste disposal problems at the facility. In doing so, however, a lender probably subjects itself to liability under the *Fleet Factors* standard because its actions may be deemed of a sufficient degree to support the inference that it could have an effect on hazardous waste disposal decisions if it so chose. Because lenders may be held liable regardless of the success of their efforts, lenders will be more apt *not* to engage in active workout arrangements with debtors. Again, this is an undesirable result because it discourages good faith

188. *United States v. Fleet Factors Corp.*, 901 F.2d 1550, 1558-59 (11th Cir. 1990).

189. *Guidice v. BFG Electroplating & Mfg. Co.*, 732 F. Supp. 556, 562 (W.D. Pa. 1989).

workout arrangements designed to address environmental problems.

Under the *Mirabile* standard, lenders are not discouraged, but rather are encouraged to engage in good faith workout arrangements designed to address a borrower's environmental problems. The *Mirabile* interpretation allows secured lenders to participate in a debtor's management decisions without incurring liability as long as the secured lender does not participate in the day-to-day operational decisions of the company. By encouraging structured workout arrangements, this standard increases the likelihood that borrowers will remain solvent and will consequently be able to undertake, fund, and remedy part, if not all, of their environmental problems.

Furthermore, the *Mirabile* standard encourages potential borrowers to engage in environmentally safe practices before they apply for loans. Borrowers will engage in such practices because they know that lenders will conduct environmental audits and will structure the loan agreement terms according to the environmental liability risks present. Thus, both lenders and borrowers have incentives to require and promote environmentally safe practices. The *Guidice* court summarized the policy ramifications of the two competing standards by stating:

A goal of CERCLA is safe handling and disposal of hazardous waste. To encourage banks to monitor a debtor's use of security property, a high liability threshold [such as the *Mirabile* position] will enhance the dual purposes of protection of the banks' investments in promoting CERCLA's policy goals. Conversely, a low liability standard [such as the *Fleet Factors* position] would encourage a lender to terminate its association with a financially troubled debtor and expedite loan payments in an effort to recover the debts.¹⁹⁰

The reasoning in *Guidice* is sound, and its holding should be espoused by other courts. The *Mirabile* standard best comports with the purpose, intent, and underlying policy interests of CERCLA.

To the extent that the *Fleet Factors* decision is cited to establish a new standard of lender liability, it should be viewed as an aberration that will be rejected by other courts that are more concerned with the public policy ramifications of this issue. To the extent that *Fleet Factors* is limited to its facts, however, the decision is entirely consistent with the trend of authority. In *Fleet Factors*, there was sufficient active involvement in the day-to-day operational management of the debtor's facility so that the lender would probably be held liable under either the *Fleet Factors* or *Mirabile* standards of liability. Consequently, courts

190. *Id.* (citations omitted).

can and should distinguish the *Fleet Factors* decision on the basis of its facts and refuse to follow its holding. Courts should instead espouse the *Mirabile* standard because it comports with both the policies and intent of CERCLA.

C. Proposed EPA Rule Interpreting The Security Interest Exception

In response to the clamor of uncertainty caused by the expansive liability standard set forth in the *Fleet Factors* decision, the EPA recently promulgated proposed regulations which seek to provide secured lenders with a safe harbor from CERCLA liability.¹⁹¹ These regulations are designed to specify actions that lenders may take while making loans, during the life of loans, during workouts, and upon foreclosure, while still remaining within the bounds of the security interest exception. If these regulations become effective, however, they will provide little relief to foreclosing lenders and lenders who would otherwise incur liability under the *Fleet Factors* standard.

After its first draft rule was widely criticized, the EPA submitted a second draft rule to the Office of Management and Budget for review.¹⁹² This rule can essentially be divided into two main components. First, the proposed rule addresses lender activity that constitutes "participation in management" for purposes of applying the security interest exception.¹⁹³ The draft rule states that a lender has "participated in management" only if, while the borrower was still in possession, the secured lender "materially divested the borrower of decision making control over vessel or facility operations, particularly with respect to the hazardous substance present at the vessel or facility."¹⁹⁴ Significantly, the proposed rule also attempts to regulate the *Fleet Factors* standard out of existence by stating that "participation in management . . . does not include the mere unexercised capacity or ability to influence vessel or facility operations."¹⁹⁵

In addressing the permissible scope of a lender's activities, the proposed rule allows lenders to protect secured interests by policing loans or by undertaking financial workouts with borrowers when its security interests are threatened. The rule also provides a list of examples and

191. National Oil and Hazardous Substances Pollution Contingency Plan; Lender Liability under CERCLA, 56 Fed. Reg. 28798-28810 (1991) (to be codified at 40 C.F.R. § 300.1100).

192. *Id.* At the time of publication, the EPA proposed rule was undergoing public comment and judicial review. The proposed rule becomes effective in October 1991 if it satisfactorily completes this process.

193. *Id.* at 28809 (to be codified at 40 C.F.R. § 300.1100(c)(1)).

194. *Id.*

195. *Id.*

illustrations of activities that a lender may undertake without losing the security interest exemption provided that the actions are necessary to protect the security interest.¹⁹⁶ Specifically, the rule provides that a secured creditor may:

1. Require clean-up of a facility before granting a loan or during the life of a loan;
2. Require the facility owner or operator to give assurances of compliance with applicable environmental laws;
3. Periodically inspect or regularly monitor the facility and the owner or operator's business or financial condition;
4. Require or conduct environmental audits prior to or during the period of the loan;
5. Provide periodic financial advice to a debtor;
6. Engage in loan workout activities, including restructuring or renegotiating the loan, requiring payment of additional interest, extending the payment period, exercising forbearance or providing advice, or take other action that is necessary to protect the security interest;
7. Wind up operations, liquidate assets or otherwise act to recover the value of the collateral in a manner consistent with good commercial and environmental practice; and
8. Impose other requirements reasonably necessary for the lender to police the loan adequately or to comply with legal requirements.¹⁹⁷

The EPA expressly considers these activities to be consistent with the security interest exception and does not consider them to constitute "participation in management" for purposes of the security interest exception. The EPA's proposed rule requires lenders to duly consider and account for the hazardous substances known to be present at a facility. Lenders who act or fail to act in a way that causes or contributes to contamination will be excluded from the security interest exception.¹⁹⁸

The second component of the proposed EPA rule deals with secured lenders that foreclose and acquire title to an interest.¹⁹⁹ The draft regulation will allow secured lenders to foreclose and acquire title without incurring environmental liability as long as the lender disposes of the property within a reasonable period of time.²⁰⁰ If the lender divests the foreclosed property within six months of taking title, the lender is

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

197. *Id.* (to be codified at 40 C.F.R. §§ 300.1100(b)(1)-(c)(2)).

198. *Id.* (to be codified at 40 C.F.R. § 300.1100(c)(1)).

199. *Id.* at 28808-09 (to be codified at 40 C.F.R. § 300.1100(b)(1)).

200. *Id.* at 28809 (to be codified at 40 C.F.R. § 300.1100(b)(1)(ii)).

presumed to fall under the protection of the security interest exception.²⁰¹ If the lender does not divest itself of the property within the six month time frame, then the burden shifts to the lender to demonstrate that its actions were designed primarily to protect the security interest and were not designed for investment purposes.²⁰² This component of the rule seeks to nullify the holdings in *Guidice* and *Maryland Bank* that lenders who foreclose and acquire title become PRPs and incur CERCLA liability.

Although the EPA proposed rule places welcome limits on the government's efforts to impose liability on secured lenders, it does not apply to third party contribution actions against secured creditors.²⁰³ When the EPA is a plaintiff in an environmental lawsuit, the proposed EPA rule will be predictive of the agency's actions and how the EPA will view the actions of secured lenders. In private third party contribution lawsuits in which the secured creditor is the defendant, however, the proposed EPA rule will not provide protection to the secured lender because it is merely an interpretive rule which is not judicially binding.²⁰⁴

Because the proposed rule is not judicially binding, it offers virtually no protection to secured creditors. In nearly all CERCLA cases, there are multiple PRPs for every site. Thus, even if the EPA does not file suit against a secured creditor because it is following the EPA rule, one of the other PRP defendants (usually the present owner or operator of the facility) will bring a third party contribution action against the secured lender.²⁰⁵ The EPA rule will not apply to this third party action, however, and a court will be free to apply the *Mirabile* standard, the *Fleet Factors* standard, or some other liability standard in its examination of the lender's activities. If this occurs, lenders may incur liability despite the existence of the EPA rule. Consequently, although the EPA's proposed rule may be useful for secured lenders in direct actions brought by the EPA, it provides little or no assistance to secured lenders in third party contribution actions when the secured creditor is the defendant.

201. *Id.*

202. The proposed rule does not apply the six month limitation to government lenders and institutions that foreclose on property. These entities are presumed to be holding foreclosed property primarily to protect a security interest and for investment purposes. *Id.*

203. National Oil and Hazardous Substances Pollution Contingency Plan; Lender Liability Under CERCLA, 56 Fed. Reg. 28798-28810 (1990) (to be codified at 40 C.F.R. § 300.1100).

204. Because the EPA rule is interpretive in nature and is a significant departure from past EPA policy, courts will generally hold that such an interpretation should be given less deference than a relatively consistent line of court decisions.

205. For example, the following cases each consisted of third party suits against secured lenders: *In re Bergsøe Metal Corp.*, 910 F.2d 668 (9th Cir. 1990); *Guidice v. BFG Electroplating & Mfg. Co.*, 732 F. Supp. 556 (W.D. Pa. 1989); *United States v. Mirabile*, 15 Env'tl. L. Rep. (Env'tl. L. Inst.) 20992 (E.D. Pa. Sept. 4, 1985).

IV. PRECAUTIONARY MEASURES FOR LENDERS

Lenders should not wait until a borrower defaults on a loan before taking measures to prevent the imposition of liability costs under CERCLA. Instead, lenders must anticipate environmental problems that may arise under CERCLA and institute policies and procedures which address the potential risks of environmental liability.

First, the lender can protect itself from liability by insisting that the mortgagor obtain Environmental Impairment Liability (EIL) Insurance.²⁰⁶ EIL policies are designed to cover claims arising from environmental damage to the covered property. Although these policies may afford lenders some protection, lenders should not rely solely on EIL policies for protection. Currently, no EIL policy completely covers a lender's potential CERCLA exposure.²⁰⁷ In addition, mortgagors who have defaulted on their loans are also likely to forego payments on their EIL policies. This will cause the policies to lapse, and lenders will lose their protection.

Second, a lender should conduct an environmental audit and risk assessment on the potential debtor's property *before* making loans. Environmental audits are the best way that lenders can minimize CERCLA liability risks. It is recommended that an environmental investigation consist of a two-phase approach which includes: (1) a review of readily ascertainable environmental information concerning the property and (2) a scientifically conducted environmental audit to detect hazardous waste contamination on the property.²⁰⁸

In phase one, the lender should review state and federal government records of the particular property to ascertain whether the present or prior owners have violated any environmental laws, permits, or other requirements. In addition, lenders may use CERCLIS, the Superfund Data Base, to find out whether a secured property is located within a one mile radius of a potentially dangerous hazardous waste site.²⁰⁹ Because phase one activities do not require special skills, the investigation can be conducted by bank personnel inexpensively.²¹⁰

In phase two, a specialist should be hired to investigate both the surface and subsurface of the property. This audit should cover the

206. See Gieser, *Federal and State Environmental Law: A Trap for the Unwary Lender*, 1988 B.Y.U. L. REV. 643, 694.

207. *Id.*

208. The two-step technique was developed by the Federal National Mortgage Association. See Comment, *Buying into Trouble—Lender Liability under CERCLA and SARA*, 14 S. ILL. L.J. 319, 336 (1990).

209. *Id.* at 337.

210. The cost for a typical phase one audit can range from \$1500 to \$7500. *Id.* at 337 n.128.

property's soil and water samples, machinery, inventory, electrical systems, and construction materials. Phase two audits can be costly,²¹¹ but the cost of these audits is small compared to a potential multimillion dollar clean-up liability.

Third, the lender should require the borrower to declare that no past or current user of the property has created conditions which may give rise to environmental liabilities and that no enforcement actions are pending. In addition, to the extent that any environmental problems are discovered during the audit, those problems should be addressed *prior* to closing. The mortgagor should be required to clean-up any environmental hazards and comply with all present and future environmental laws.²¹²

Fourth, lenders should include an indemnity clause in loan agreements in which the mortgagor is required to indemnify the lender for clean-up costs upon the discovery of environmental contamination. Indemnity agreements have substantial problems, however. An indemnity agreement is only useful if the borrower is solvent, and in most cases, mortgagors in default will not be solvent. Additionally, indemnity agreements do not protect lenders from liability under CERCLA, but only provide a means for lenders to recoup their response costs from the mortgagor.²¹³

Fifth, lenders can minimize their potential liability by using contractual clauses that require a borrower's environmental compliance. Loan agreements should allow the lender to closely monitor the borrower's compliance with its environmental covenants. Additionally, a provision should be added requiring the borrower to notify the lender of any environmental problems. It is suggested that these provisions be tailored to closely follow the provisions of the EPA draft rule, especially with respect to the lender's ability to participate in management. It is also important that the lender include an acceleration clause that allows the lender to call the entire note due when the borrower fails to comply with the other covenants. This provision may allow the lender to recoup its loan proceeds before any serious environmental liability risks develop.²¹⁴

Sixth, lenders must be extremely careful not to become overly involved in a debtor's financial or operational management. Although isolated and discrete involvement may be safe, lengthy negotiations and enforcement steps designed to bring a borrower into compliance with loan provisions may remove the lender from the security interest exception

211. See Gieser, *supra* note 206, at 699 n.248. Environmental testing can cost up to \$20,000-\$30,000. *Id.*

212. *Id.* at 700.

213. 42 U.S.C. § 9607(e) (1988).

214. See Klotz & Kane, *supra* note 33, at 37-38.

and expose it to significant liability. Consequently, lenders should not engage in active workout arrangements with defaulting debtors unless the potential clean-up costs are low.

Seventh, lenders should weigh foreclosing decisions carefully. Put simply, if a high risk of incurring significant liability costs upon the acquisition of title exists, a lender should not foreclose. Instead, the lender should write-off the loan or engage in a workout arrangement in which the lender has only limited involvement with the borrower's management.

Finally, lenders should closely monitor the developments in both state and federal laws. Currently, several states have adopted "superlien" statutes which allow the imposition of priority liens on polluted properties.²¹⁵ In addition, Congress is presently considering bills that will provide different types of exemptions from CERCLA liability to lending institutions.²¹⁶ If passed, these bills will effectively nullify the results reached in *Fleet Factors*, *Guidice*, and *Maryland Bank*.

V. CONCLUSION

Judicial interpretation of CERCLA's security interest exception has had a checkered history and result. Although courts seem to agree that lenders who acquire title through foreclosure of a secured interest are subject to liability, there are conflicting standards as to what activities remove lenders from the protection of the security interest exception.

Under the line of district court cases espousing the *Mirabile* standard, a lender is subject to liability only through its participation in a borrower's day-to-day operational activities. This standard encourages a lender to monitor a borrower's activities and to become involved in the debtor's financial management in order to protect its security interest. By encouraging workout arrangements, this standard promotes CERCLA's goals by reducing the probability that borrowers will become insolvent and leave the government with enormous response costs.

215. Note, *Connecticut Lender Liability under Federal and State Environmental Law*, 9 BRIDGEPORT L. REV. 175, 176-77 (1988).

216. H.R. 1450, 102d Cong., 1st Sess., 137 CONG. REC. 987 (1991). This bill provides that a secured lender's participation in a company must be concrete in order for the lender to be liable for contamination. Lenders are also excluded from liability during a workout or foreclosure. Lenders would still incur liability if they caused or added to the environmental problem, however. *Id.* See also S. 651, 102d Cong., 1st Sess., 137 CONG. REC. 3457 (1991). This bill would place a cap on liability for insured depository institutions for environmental contamination in cases in which the lending institution was not at fault. The liability limit would not apply to lending institutions that cause or add to the environmental problem, however. S. 651, 102d Cong., 1st Sess., 137 CONG. REC. 3457 (1991).

The *Fleet Factors* standard on the other hand, is an aberration in the judicial interpretation of the security interest exception. Under this standard, a lender may incur liability merely by becoming overly active in the borrower's financial or operational management. This standard is not only vague and unpredictable, but is also contrary to CERCLA's purpose. In reality, this standard encourages lenders to terminate their relationship with defaulting debtors who possess contaminated properties, rather than engage in active workout arrangements designed to alleviate the problems. Consequently, courts should limit the *Fleet Factors* decision to its facts and espouse the *Mirabile* standard.

Clearly, lenders can take affirmative steps to protect themselves from CERCLA liability. Lenders should conduct environmental audits and include provisions in loan agreements allowing them to monitor a borrower's compliance with accepted environmental standards. If, despite all due diligence, a secured lender discovers that the borrower's property is contaminated, only with great caution should the lender exert any significant control over the debtor's financial or operational decisions regarding the facility.

Regardless of whether courts adopt the *Mirabile* or *Fleet Factors* interpretation of the security interest exception, one thing is clear. Lenders now are faced with three concerns: credit, collateral, and clean-up.

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