INTRODUCTION

In 1980, Congress enacted the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)\(^1\) to deal with the improper disposal of hazardous waste. Under CERCLA, the Environmental Protection Agency (EPA) is primarily responsible for cleaning up hazardous substance releases.\(^2\) Whether EPA chooses to clean up the release itself\(^3\) or to oversee a cleanup by responsible parties,\(^4\) the ultimate liability for cleanup generally falls not on the EPA but on any number of "potentially responsible parties" (PRPs).\(^5\) These PRPs include "the owner and operator of a vessel or facility"\(^6\) and "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."\(^7\) A complex and troubling question is whether a lender who takes on ownership or management of property in order to preserve a security interest is an "owner" or "operator" as contemplated by the statute, thereby incurring liability for CERCLA damages.

The statute attempts to answer this question in its definition of the term "owner or operator," which carves out an exception for the secured lender who "without participating in the management of a vessel or facility... holds indicia

---

\(^*\)Associate; Day, Berry & Howard, Hartford, Connecticut. The author would like to thank Kurt Strasser for his extremely insightful comments and guidance and James T. Shearin, Jane L. Scarpellino, Louise M. Goodwin, and Mikal J. Apenes for their thoughtful and fastidious review of this article.

6. 42 U.S.C. § 9607(a)(1). Facility is defined broadly to include:

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

42 U.S.C. § 9601(q).
7. 42 U.S.C. § 9607(a)(2). Other potentially liable parties include those who arrange for transport, disposal, or treatment of hazardous waste and any person who accepts any hazardous substance for transport to a site they choose for treatment or disposal. Id. at §§ 9607(a)(3)–(4).
of ownership primarily to protect his security interest." Though the language of this secured creditor exemption appears to be quite certain, courts have both construed and applied the exemption differently. This has created significant confusion as to when a lender may be held liable for CERCLA cleanup costs. This confusion prompted the EPA to release a rule interpreting the lender liability exemption. In a recent decision, however, the United States Circuit Court for the District of Columbia held that EPA was not empowered to issue the rule. The decision not only reinvigorates the earlier judge-made lender liability standards but further injects another standard, that of the rule, into the lender liability debate.

In an attempt to frame the upcoming debates which will be certain to follow the Kelley decision in both Congress and the courts, this article will analyze the competing lender liability standards and interpretations, focusing on the regulatory response contained in the EPA's recent rule. In particular the article will venerate how any liability scheme which allows lenders to foreclose without incurring liability undercuts numerous incentives to monitor and police environmental compliance. Finally, the article will propose two different solutions to the lender liability problem. These solutions, while imperfect, represent alternatives which should be considered before accepting any of the present standards.

I. Case Law Considering the Scope of Lender Liability Under CERCLA

Two different lines of legal reasoning have shaped the scope of lender liability as it exists under CERCLA. The first line of reasoning emphasized

10. See Kelley v. EPA, 15 F.3d 1100 (D.C. Cir. 1994).
11. The Kelley court determined that EPA had acted ultra vires when it promulgated the rule because Congress had not delegated to EPA the responsibility for issuing lender liability standards. Id. at 1105-08. As of Spring, 1994, Congress is moving rapidly to remedy this perceived lack of delegation. Sections of the CERCLA reauthorization bills recently introduced in Congress explicitly allow EPA to issue regulations on the lender liability issue. Quick Action on Administration's Proposals Said "Imperative" After Lender Liability Ruling, 24 Env't Rep. (BNA) 1890 (Mar. 14, 1994). Even if CERCLA reauthorization is not enacted this year, congressional aides have stated that Congress would take up the lender liability delegation separately before the end of the session. See, e.g., Congress Will Act on Lender Liability Even if Reauthorization Fails, Aide Predicts, 24 Env't Rep. 2068-69 (Apr. 8, 1994) (quoting Roger Goodman, chief of staff for Rep. Rick Boucher (D-Va.)).

Even if Congress delays in giving EPA express authorization for reissuing lender liability rules, it would be absurd to suggest that because of Kelley the rule will have no import on the issue of lender liability. First, it is likely EPA will use the rule as the standard it will follow when identifying PRPs for its own contribution actions. Second, the rule is the compromise product of a long, comprehensive process and will thus likely have significant impact on judicial interpretations of the lender liability issue in general and on analysis of the environmental and economic impacts of certain decisions in particular, regardless of Kelley.
actual participation in “day-to-day” management decisions. Later decisions, however, have led courts to a new standard. These decisions, starting with the infamous Fleet Factors case, abandoned the earlier focus on actual management participation and now focus on whether the lender’s position or status enable it to affect management decisions.

A. Day-to-Day Operations and the Conflict on Post-Foreclosure Liability

In United States v. Mirabile, the District Court for the Eastern District of Pennsylvania became the first court to consider the question of lender liability under CERCLA. In Mirabile, the court considered the liability of two different banks involved in the financing of a paint manufacturing company (Turco). American Bank and Trust Company (American) loaned Turco money in 1973, and secured its loan in part with the property. American foreclosed on its mortgage in 1981 and was the highest bidder at the sheriff’s sale of the property. Four months later American assigned its bid to the Mirabiles, the defendants who had purchased the property. In the time between the sheriff’s sale and assignment of their bid, American secured the building against vandalism, inquired about the cost of disposing various drums on the property, and showed the property to prospective purchasers.

The second bank was Mellon Bank (Mellon). In 1976, its predecessor in interest, Girard Bank, entered into a financing agreement with Turco secured by Turco’s inventory and assets. Some time thereafter, Turco created an advisory board to oversee the company’s operations and a loan officer from Mellon was appointed to serve on that board. After Turco’s bankruptcy, Mellon appointed a new representative to the Turco board and increased its monitoring of Turco’s financial condition.

Both banks filed motions for summary judgment based on the secured lender exemption. The District Court determined that “before a secured creditor . . . may be held liable, it must, at a minimum, participate in the day-to-day operational aspects of the site.” The court noted both statutory and policy reasons for this conclusion. The statutory argument focused on

12. See infra Part I(A).
15. Actually, American had loaned the money to Turco’s predecessor, Mangels. When Turco took control of Mangels they also took responsibility for Mangel’s debt to American. Id. at *4.
16. Id.
17. Id. at *5.
18. Id.
19. Id.
20. Id.
21. Actually, Girard, the predecessor of Mellon, increased the monitoring at this time. Id.
22. Id. at *6.
CERCLA's exemption for secured creditors who do not participate in the management of a facility.\textsuperscript{23} The district court, interpreting the statute, stated, "The reference to management of the 'facility,' as opposed to management of the affairs of the actual owner or operator of the facility, suggests once again that the participation which is critical is participation in operational, production, or waste disposal activities."\textsuperscript{24} The court thus narrowed the realm of activities that might incur liability to those activities that affect actual facility activity.

The court also noted CERCLA policy in making its determination. It turned to an earlier decision by the District Court of Missouri,\textsuperscript{25} in which that court gleaned from the statutory scheme and legislative history an intent to impose cleanup costs on those who bore the fruits of hazardous waste disposal and who were involved in the planning and implementation of the disposal practices.\textsuperscript{26} The day-to-day management standard satisfied the court's analysis. Under that standard, lenders were liable only when they participated in the planning and implementation of industrial activity to the extent that such practice affected the day-to-day operation of the facility and, therefore, decisions regarding use and disposal of hazardous substances.

Application of the day-to-day management standard yielded opposite results for the two banks in Mirabile. The court described American's actions simply as foreclosing and taking prudent steps to protect the bank's security interest in the property and secure against depreciation.\textsuperscript{27} These activities, the court concluded, did not rise to the level of influencing day-to-day operational management. Mellon Bank, on the other hand, was denied summary judgment. Peter McWilliams, Mellon's representative on the Turco board,\textsuperscript{28} testified that "he became involved with Turco because his superiors at Mellon wanted him to have 'more day-to-day hands-on involvement.'"\textsuperscript{29} Based on this testimony, the court denied summary judgment in order to get a clearer picture of McWilliams' participation on the board.\textsuperscript{30} The distinction in treatment thus rested on the characterization of each bank's participation in Turco's management.

A stricter view of the secured lender exemption was espoused by the next court to deal with the problem of lender liability under CERCLA. In United States v. Maryland Bank and Trust,\textsuperscript{31} the District Court for the District of

\begin{footnotesize}
\begin{itemize}
\item 24. Mirabile, 1985 WL 97 at *4.
\item 26. Mirabile, 1985 WL 97 at *10.
\item 27. Id. at *6.
\item 28. Id. at *7.
\item 29. Id. at *8.
\item 30. Id. at *9.
\end{itemize}
\end{footnotesize}
Maryland rejected the *Mirabile* day-to-day management standard and announced that CERCLA liability attaches to any secured lender who forecloses on contaminated property. Maryland Bank and Trust (MBT) foreclosed on property in 1981, and purchased the property at the foreclosure sale in 1982.\(^{32}\) In 1983, MBT refused to honor EPA's request to clean up hazardous waste on the property. Thereafter, EPA cleaned the property and initiated suit to recover its costs.\(^{33}\) At the time the case came before the Maryland Court, MBT still owned the property.\(^{34}\)

The Maryland court developed a different analysis of the statutory exemption for secured lenders. First, it noted that once a party qualified as an owner/operator under section 107(a)(1) (which MBT did), the burden switched to the defendant to prove it was entitled to the exemption.\(^{35}\) The court then invoked congressional intent and public policy in determining that the exemption is lost upon foreclosure.

The court first noted that the purpose for the statutory exemption was limited to protecting lenders in states where title passes to mortgagees:

> Congress intended by this exception to exclude these common law title mortgages from the definition of "owner" since title was in their hands only by operation of the common law. The exclusion does not apply to former mortgagees currently holding title after purchasing the property at a foreclosure sale.\(^{36}\)

The court then noted that where, as here, the lender had actually taken further action to gain title in the property, allowing the exemption would work to enrich a secured creditor who purchased it at the foreclosure sale.

> At the foreclosure sale, the mortgagee could acquire the property cheaply. All the 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.\(^{37}\)

This is especially true considering the fact the exempted lender, as owner of the property, would not be subject to any existing federal lien which might encumber a site that the taxpayers have paid to clean.\(^{38}\) If the lender is not

\(^{32}\) Id. at 575.

\(^{33}\) Id. at 576–77.

\(^{34}\) Id. at 578.

\(^{35}\) Id.

\(^{36}\) Id. at 579. The court noted that this was particularly true where the former mortgagee had held title to the property for a significant period of time prior to the cleanup. Id. Notably, the court withheld its opinion as to the liability of a lender who purchased and promptly resold the property. See id. at 579 n.5.

\(^{37}\) Id. at 580. See also infra Part II.A.

\(^{38}\) At present the only lien established in CERCLA is the federal lien provision of section 107. See 42 U.S.C. § 9607(l). This lien would not attach to property owned by secured lenders.
liable, it would reap a windfall at taxpayer's expense. The court thus held that, after its foreclosure on the property, MBT was liable under CERCLA.

MBT and Mirabile, read together, create confusion over the proper standard of liability for lenders who foreclose on their security. The decisions do not directly conflict in situations where there has been no foreclosure because the MBT Court was not directly concerned with this question. The Mirabile day-to-day standard thus seems most applicable to these circumstances. Where a secured lender has foreclosed, however, the different theories may lead to different results. Confronted with the possible application of two different standards, a lender would be unsure of whether it could realize the security on its property by foreclosing without risking extremely large cleanup costs.

The next District Court to consider lender liability was confronted with the choice of applying either the Mirabile or the MBT reasoning to a lender who foreclosed on its security. In Guidice v. BFG Electroplating and Manufacturing Co., the District Court for the Western District of Pennsylvania resolved the issue by applying the Mirabile standard prior to foreclosure and the MBT standard after foreclosure. The Court clearly articulated its belief that there should be an exemption for secured lenders prior to foreclosure:

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

Applying the above reasoning, the court found the day-to-day standard of liability applicable to pre-foreclosure lending. The court also accepted the MBT court's reasoning and standard concerning post-foreclosure activity. As developed in Guidice, therefore, the early trend in the district courts was to judge a lender by a day-to-day operation standard prior to foreclosure and a

for a few reasons. First, the lien can only attach based on a party's status as a potentially responsible party under section 107(a), which lenders will be exempted from. Second, the lien will only run until the lender's liability is satisfied. This is simply a corollary to the first requirement and makes a lien against a lender's property valid only if the lender is liable in the first place.

39. MBT's failure to consider what type of pre-foreclosure lender activity would incur liability will be important for later discussion of the shortcomings of the different standards. See infra Part II.


41. Id. at 562.

42. Id. at 563.
LENDER LIABILITY

standard of strict liability upon foreclosure. This trend was disregarded, however, by the first appellate court to consider lender liability in a CERCLA cleanup case.

B. Fleet Factors

In *United States v. Fleet Factors Corp.*, the Eleventh Circuit considered an interlocutory appeal by Fleet Factors, a lending institution, from the trial court’s denial of its motion for summary judgment. The basis of Fleet’s motion centered on the relationship between it and Swainsboro Print Works (SPW), a cloth printing facility. In 1976, Fleet entered a factoring agreement with SPW in which Fleet advanced SPW funds against their accounts receivable. Although SPW initially filed for bankruptcy in 1979, the bankruptcy court allowed Fleet to maintain its factoring agreement with the cloth company. Finally, in 1981, when the amount owed to Fleet exceeded its secured interest, Fleet stopped advancing money and SPW declared bankruptcy under Chapter VII.

Fleet hired two contractors to help it recoup its investment. The first contractor was hired to conduct an auction in June, 1982, to sell inventory and equipment. Fleet then hired another contractor to remove any unsold equipment and leave the premises in “broom clean” condition. Fleet never, however, foreclosed on its interest in the SPW facility. Upon inspection of the SPW plant in 1984, the EPA found and disposed of approximately 700 drums of hazardous waste and forty-four truckloads of material containing asbestos. The agency initiated suit against Fleet in the District Court for the Southern District of Georgia to recover its clean-up costs. The District Court adopted the *Mirabile* standard, focusing on two distinct periods of the relationship between Fleet and SPW. Without explaining what factors it actually considered, the District Court held as a matter of law that Fleet’s activity in the period prior to the entrance of either contractor upon the premises did not rise to the level of liability. It then looked at the period after the contractors entered the premises. Noting that the contractors may have caused further hazardous waste releases during this time, the court found that it could not grant summary judgment based on these and other disputed

---

44. Note as well that as further security Fleet took an interest in the facility and some of its equipment, inventory and fixtures. *Id.* at 1552.
45. *Id.*
46. *Id.* at 1553.
47. *Id.*
48. *Id.* at 1553.
The Appellate Court agreed with the District Court's ruling that summary judgment was not proper in this situation. However, the Appellate Court expressly disagreed with the District Court's use of the *Mirabile* standard to reach this conclusion. The Appellate Court found the *Mirabile* standard too permissive. It reasoned that a lender who actually participates in day-to-day management would already be liable as an owner/operator and that the standard of management required by the secured creditor exemption must be different, otherwise it would be meaningless. Instead, the court determined that "a secured creditor will be liable if its involvement with the management of the facility is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose." The Appellate Court's new standard did not require actual involvement in the facility's management or hazardous substance control management, but rather financial participation indicating a "capacity to influence" the facility's hazardous waste practices would be sufficient to incur liability.

The Appellate Court found support for this standard in CERCLA's legislative history and in a public policy rationale. In considering CERCLA's policy, the Appellate Court acknowledged criticisms that its theory of attaching liability to such a broad range of practices would not only discourage lending to companies with potential hazardous waste problems, but encourage lenders to distance themselves from the hazardous substance control practices of all its debtors. It responded by suggesting that its standard would do just the opposite. The court noted that creditors, fearing liability, would be inspired to investigate their potential debtors' hazardous substance practices, and to factor all possible risks into their loan agreement. Conversely, the Court reasoned, potential borrowers would understand that improper hazardous waste management adversely would affect their ability to obtain financing, and would therefore act more responsibly. Furthermore, the specter of potential liability creates an incentive for secured lenders to monitor facility practices after the loan is made.

Applying this new standard to Fleet, the Appellate Court found ample reason to deny summary judgment. The court split Fleet's involvement with the facts.

---

50. See id. at 961.
51. *Fleet*, 901 F.2d at 1557.
52. Id. at 1558.
53. Id. at 1557.
54. See id. at 1558 n.11 (noting that legislative history considered lenders who were "not otherwise affiliated" to be free from liability, and concluding that liability based on "affiliation" was triggered by involvement more peripheral than that used in *Mirabile's* day-to-day operations standard).
55. Id. at 1558.
56. Id.
57. Id.
58. Id.
property into three distinct periods. It found that the activity for the first period, ranging from the beginning of the financial relationship to the winding down of the bankrupt company in 1981, was insufficient to rise to the level of incurring liability. Fleet’s activity during the period from the winding down to the auction in June 1982, however, included a substantial degree of control over SPW’s shipping, pricing, employment practices, and plant administration. The Court found these activities and the cleanup attempts of Fleet’s contractors in the post-auction third period to be clearly within CERCLA’s reach. Thus, the first circuit court to analyze the scope of lender liability under CERCLA applied an extremely strict standard to the lender liability issue, and exposed a significantly large group of lenders to CERCLA’s liability scheme.

In its first decision on lender liability, the Ninth Circuit eased away from the relatively high standard of liability established by the Fleet court. In Bergsoe, the Ninth Circuit was faced with a non-foreclosing lender that held title to the contaminated property “merely [as] part of the financing arrangement.” Although the court declined to address the issue of a liability standard directly, it did determine that the secured creditor exemption requires at least “some actual management... before a secured creditor will fall outside the exception.” With this decision, the Ninth Circuit diverged from the decision in Fleet, which indicated that liability would attach even without actual management as long as there was “capacity to influence” hazardous waste decisions. The Ninth Circuit Court was not swayed by the Fleet court’s reasoning and, like earlier District Court decisions, required some activity to be taken by lenders in order to create CERCLA liability.

The Bergsoe decision thus varies with the Fleet standard by requiring some participation in management. Together, the remains of the day-to-day operations standard and automatic foreclosure liability, the Fleet and Bergsoe standards, and the standard of EPA’s rule (considered in Part III), create a morass of different standards which might be applied to determine lender liability under CERCLA.

59. Id. at 1559.

60. It is arguable that Fleet’s activities in the second and third period would have incurred liability if the court applied the Mirabile standard instead of creating a new one. This has led some parties, including the EPA, to characterize the Fleet court’s new standard as dicta. See infra note 89.

61. Fleet, 901 F.2d at 1559–60.

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

63. Id. at 671.

64. Id. at 672 (emphasis in original).
II. CRITICISMS OF THE DIFFERENT STANDARDS

A. Criticism of the Day-to-Day Operations Standard

Both courts and commentators have leveled criticisms at the day-to-day operations standard. Of all the critiques, probably the most pointed has been the MBT court's conclusion that the day-to-day operations standard improperly exempts a lender from liability even after it has foreclosed on a piece of property. The exempted lender will be able to pay more for "tainted" property at a foreclosure sale than other bidders because clean-up costs will not factor into its long-term expected return on the property. And if the property is cleaned by the government, the lender can sell the property at a substantial profit. Succinctly put, allowing the secured creditor an exemption from CERCLA liability after it forecloses on contaminated property creates a windfall for the lender-turned-owner. In such situations application of the day-to-day standard would certainly be improper.

The second critique of Mirabile comes from the Fleet court and focuses on the definition of owner/operator under CERCLA. The Fleet court rejected the Mirabile standard as so narrow that it "would essentially require a secured creditor to be involved in the operations of a facility in order to incur liability." This standard, the court noted, would render the secured lender exemption ineffective since involvement in operations of a facility would already create liability as an operator. In addition, the Fleet court presented

---

65. Note that in this context the day-to-day standard refers to the standard and reasoning of the district court in Mirabile. Though the MBT decision can certainly be considered an alternative path to liability after foreclosure, this paper chooses not to consider the MBT standard as a separate standard because it is limited in application to foreclosure situations. See supra text accompanying note 39.

66. See supra text accompanying notes 51-52.

67. This critique has itself been questioned. It has been pointed out, for example, that such enrichment occurs only if foreclosure comes before remediation; otherwise, increased value belongs to the owner of the property and not the secured lender. Bruce P. Howard & Melissa K. Gerard, Lender Liability Under CERCLA: Sorting out the Mixed Signals, 64 S. Cal. L. Rev. 1187, 1202-03 (1991). Another commentator has pointed out that the MBT Court itself was not sure that liability should attach in all cases of foreclosure, James B. Lowrey, Comment, Don't Get Involved!—How Unsuspecting Secured Creditors May Incur Liability Under CERCLA by "Participating in the Management" of a Debtor's "Facility," 56 Mo. L. Rev. 295, 321-22 (1991). Finally, one other writer has argued that liability under the MBT standard does not attach at foreclosure but only when the mortgagor purchases the mortgaged property. Scott Wilsdon, Note, When a Security Becomes a Liability: Claims Against Lenders in Hazardous Waste Cleanup, 38 Hastings L.J. 1261, 1288 (1987). Perhaps most significant is the fact that, in a practical sense, this windfall will be limited or, perhaps, never occur. For example, it is unlikely that the government will clean up a property immediately. Until that cleanup is accomplished the lender-turned-owner will be paying significant carrying costs on the property.

68. Fleet, 901 F.2d at 1557.

69. Id.
a policy analysis that supported its textual interpretation. According to that
analysis, a broad exemption for foreclosing mortgagors would be inconsistent
with Congress’ recognition in CERCLA of the seriousness of the hazardous
waste problems and its unwillingness to make the public pay for cleanup.

One final critic notes problems created by an ambiguous standard for
lender liability. Starting with the presumption that monitoring hazardous
waste disposal is of high priority, the writer argues that because of their
expertise in monitoring the economic health of their debtors, and because of
their ability to spread the costs of clean-up, banks should be encouraged to
monitor their client’s environmental activities. Thus, since “clarity of legal
standards is one factor that affects a lender’s decision to extend credit and to
monitor,” and because a bank will not monitor if it fears such activity might
incur liability, only a narrow standard with a high predictability of liability
would encourage such activity. The day-to-day standard focuses on the
individual acts of lenders in individual factual situations. Because it does not
delineate enough specific actions that can clearly be taken without incurring
liability, it limits a lender’s ability to lend to and monitor clients that use
hazardous substances. The standard is insufficient because it unjustly enriches
foreclosing lenders, doesn’t correlate with the statutory structure of CERCLA,
and may deter lending by its ambiguity.

B. Fleet Factors: A Hobson’s Choice

The Fleet court’s reasoning has frequently been criticized as creating a
Hobson’s choice. By choosing a standard that found liability when a creditor
was in a position to affect hazardous waste disposal practices, the court created
incentives for secured lenders to investigate and continually monitor the

---

70. See Wilsdon, supra note 67, at 1261.
71. See id. at 1293.
72. Roslyn Tom, Note, Interpreting the Meaning of Lender Management Participation under
73. Id. at 931–33.
74. Id. at 934 n.52 (emphasis in original omitted). Tom also notes that magnitude of liability
is another factor that affects lender decisions. Id. Altering the magnitude of liability for lenders
would, however, alter a fundamental principle of CERCLA liability: Once liable, a PRP is
responsible for the full cost of the problem. This straightforward nature of liability under
CERCLA is one of the statute’s great strengths, and altering liability standards would threaten
that underlying structure too greatly. The best approach to influencing lender decisions,
therefore, is to alter the clarity of the standards governing who is liable. This focus on changing
the clarity of the standard rather than the magnitude of liability is the approach taken by this
article as well as most other discussions of lender liability standards.
75. Id. at 931 nn.33, 35. The author accompanies the need for predictability with a high
threshold of liability (i.e., a narrow standard) because a low threshold would encourage banks to
sever their relationships with clients early (to the extent that a bank might actually force a client
into bankruptcy instead of working out a loan). In contrast, a high threshold of liability will allow
banks to both monitor and assist clients with problems, thus possibly benefiting society by
preventing future environmental harm.
hazardous waste disposal practices of its borrowers. Once a loan is made and a bank is in a position of liability, it will monitor disposal to protect its interest. But when confronted with a nebulous liability standard and the substantial costs of an average environmental cleanup, lenders might not make loans.

Banks profit from the accrued interest on loans. As one commentator has noted, "The huge potential environmental liabilities will often reduce the profit potential of making loans to such a degree that lenders simply will choose not to lend." They would instead opt for more conservative investments. Restricting available credit might, therefore, exacerbate the exact environmental problems that monitoring tries to prevent. "Without capital, business cannot afford to implement the waste reduction practices necessary to protect the public health and the environment." Furthermore, a sharp decrease in lending to companies with potential or identified hazardous waste risks will undercut CERCLA's goal of making such parties do the cleanup work themselves. In other words, the Fleet standard creates a Hobson's choice for the lender. A financial institution that conducts environmental audits prior to lending exposes itself to a significant amount of liability, while a bank that blindly lends money without audits creates a great risk that it will have to sustain losses in a write-off if a hazardous release occurs. Neither option is acceptable. The result could very well be a lack of lending to clients that create and use hazardous substances.

76. Fleet, 901 F.2d at 1558.
77. Id. at 1559.
78. Lowrey, supra note 67, at 325.
79. Id. at 326.
80. The Fleet court, in partial response to this criticism, suggests that banks that do lend money in these circumstances would be able to internalize the extra risk in the form of extra interest on loans to companies that deal with hazardous substances. Fleet, 901 F.2d at 1558. At least two commentators have noted the problems with this view. The first points out that some companies that deal with hazardous waste might not be able to afford the higher interest. These companies are a high risk for leaving a potential hazard uncleaned. This hazard would ultimately be cleaned with government funds. Lowrey, supra note 67, at 327. Perhaps the more damaging critique, however, suggests that any belief that a lender "can adequately protect itself by weighing and incorporating the risks associated with the negative results of [environmental due diligence] into the terms of its loan documents is . . . naive. Rarely can such risks be quantified with any degree of certainty or comfort, especially when the contours of environmental liability are subject to the vagaries of judicial interpreters." Timothy R. Zinnecker, Lender Liability Under CERCLA and the Fleet-ing Protection of the Secured Creditor Exemption, 44 Sw. L. J. 1449, 1470 (1991) (citations omitted). These critiques again suggest that banks would prefer making more conservative loans to taking such high risks.
81. Lowrey, supra note 67, at 295 n.195.
82. Id. at 326 n.197.
83. Id. at 327-28.
III. THE RULE

To address the confusion created by the conflicting lender liability standards, the EPA developed its own standard for lender liability under CERCLA. Released in April, 1992, the final rule is organized around the definition of three terms found in Section 101(20)(A) of CERCLA: “indicia of ownership,” “primarily to protect the security interest,” and, most importantly, “participating in the management of a facility.”

The bulk of the rule focuses on the most disputed part of the secured lender exemption: the definition of “participation in the management of a facility.” This part of the rule starts with a qualification, stating that any determination of what constitutes “participation in the management is fact sensitive.” It then creates a laundry list of activities that are covered by the secured lender exemption. For activities that are not included in the laundry list, the rule creates a general definition of participation in management which considers activities according to where they fall at different times along the life of the loan, to wit: actions at the inception of the loan, policing the security interest, loan workout, foreclosure and holding property for disposition, and liquidation.

The rule responds to criticisms of earlier court decisions in two important ways. First, it sets a high standard of liability for creditors to avoid deterring initial lending. The rule chooses an actual participation standard, rather than the Fleet standard, for determining which activities involve participation in the management of a facility. It provides: “Participation in the management of a facility means, for the purpose of Section 101(20)(A), actual participation in the management or operational affairs by the holder and does not include the mere capacity, or ability to influence, or the unexercised right to control, facility

84. See 57 Fed. Reg. 18,344 (1992) (codified at 40 C.F.R. pt. 300 (1993)). The vast majority of the EPA's publication is the preamble explaining the background of the rule and explaining its effect. Most of the references to the rule will be to this text. The rule, though recently vacated, will continue to play a significant role in the lender liability debate. See supra notes 10 and 11.

85. The first two terms, "indicia of ownership" and "primarily to protect the security interest" are dealt with summarily. The rule treats "indicia of ownership" broadly, defining the interest simply as an "interest in real or personal property securing a loan or other obligation." 40 C.F.R. § 300.1100(a)(1). The rule also does little to help further define what "primarily to protect the security interest" means. It simply notes that, in general, a security interest provides the holder with recourse against real or personal property of the person pledging the security if an obligation to pay money is not met, and then goes on to list certain recognized forms of security interests. 40 C.F.R. § 300.1100(b). It further states that protecting the security interest means holding ownership as a means of protecting a security interest and not as an investment. 40 C.F.R. § 300.1100(b)(2). Such definitions add little to one's understanding of the secured lender exemption.

86. 40 C.F.R. § 300.1100(c).
87. See 40 C.F.R. §300.1100(c)(2).
88. See 40 C.F.R. § 300.1100(c)-(d).
Thus, the rule accepts a narrow reading of the term "participation in the management," freeing lenders at least from the initial Hobson's choice created by Fleet. Under this rule, lenders could extend credit without fear that their purely financial relationship with a borrower would make them susceptible to CERCLA liability.

The second way the rule responds to earlier decisions is found in its attempts to alleviate the ambiguity of the participation in management standards. It does this by delineating specific activities that lenders may undertake without fear of liability. For example, the rule allows banks to inspect and monitor their security interest. It also allows lenders in the context of a loan workout to take action "with respect to the facility to secure or safeguard the security interest from loss." To maintain exemption coverage, however, these actions must be limited to protecting and preserving the security interest. Thus, the rule gives lenders a broad, but somewhat qualified, leeway of activity, which would allow them to properly protect and maintain their security without fear of incurring severe environmental liability.

The single most important activity which the rule would allow lenders to undertake is foreclosure. Contrary to the MBT court's decision, the rule states that foreclosure would not void the secured lender exemption as long as it is reasonably necessary to ensure satisfaction or performance of the

89. 40 C.F.R. § 300.1100(c)(1). Note that it would be misleading to say the rulemakers believed there were two standards from which to "choose." Rather the rulemakers chose to characterize the actual participation standard as applied uniformly by all courts—relegating the Fleet court standard to the realm of dicta. Thus, the preamble states that though the Fleet court suggested that a capacity to influence management might be enough to incur liability, the Fleet court held that some degree of actual participation was required. 57 Fed. Reg. at 18,345.

90. Id.
91. 40 C.F.R. §300.1100(c)(2).
92. The preamble treats inspection and monitoring separately. Inspection is treated under the title of actions at the "Inception of the Loan." The rule expressly provides that this action is not required to maintain exemption coverage. It states: "Neither the statute nor this regulation requires a holder to conduct or require an inspection to qualify for the exemption." 40 C.F.R. § 300.1100(c)(2)(i). Monitoring is treated under the title of "Policing the Security Interest." While the rulemakers note their appreciation of such activity, they, again, do not require it. The applicable text states: "A holder who engages in policing activities prior to foreclosure will remain within the exemption provided that the holder does not by such actions participate in the management of the vessel or facility . . . . Such actions include, but are not limited to, . . . taking other actions to adequately police the loan or security interest (such as requiring a borrower to comply with any warranties, covenants, conditions, representations or promises from the borrower)." 40 C.F.R. § 300.1100(c)(2)(ii)(A).
93. 40 C.F.R. § 300.1100 (c)(2)(ii)(B).
94. Id. The exact amount of leeway to actually participate in management during workout is unpredictable. See 57 Fed. Reg. 18,355 (acknowledging that some commentators have suggested that the general rule is both imprecise and unclear because it contains new definitions).
95. See supra notes 31-38 and accompanying text. See also 57 Fed. Reg. 18,361 (attempting to reconcile the rule with the MBT court's reasoning).
LENDER LIABILITY

underlying obligation. Furthermore, the rule also allows the lender to do anything necessary to preserve the value of the collateral—including taking steps to prevent or minimize the risk of a release of hazardous substances—without voiding the exemption. Also, the lender-turned-owner would be allowed to hold and maintain the premises indefinitely, as long as it advertised the property for sale and did not reject an offer for “fair consideration.”

Thus, the rule attempts to clarify activities that can be taken during all phases of the life of a loan without incurring liability. This, accompanied by a more definite liability standard, is an important attempt to deal with major problems raised by earlier judicial decisions. It is, however, important to view the rule in the context of its policy and practical effects before judging its efficacy.

IV. EFFECTS OF THE RULE

As previously mentioned, the rule responds to certain criticisms of the Fleet and Mirabile standards by choosing a high threshold of liability and creating a “laundry list” of activities a secured creditor can undertake without incurring liability. Certainly, the creation of a definite and high liability threshold is a positive change suggested by the rule. Under the rule’s standard, banks could, generally, lend more freely because they would not fear that CERCLA liability would attach immediately or shortly after the loan is made. Encouraging the availability of loans is still, of course, a priority. It remains to be seen, however, whether the rule’s specific exemptions would allow banks the freedom to lend while creating an incentive for secured lenders to help monitor and control hazardous substances.

A. Incentive Problems

The rule’s exemptions for secured lenders are too broad. As a result, it sacrifices incentives to properly handle hazardous substances. For example, the rule gives lenders freedom to inspect and monitor their borrower’s disposal and control practices without sacrificing their exemption. Otherwise, the rule reasons, banks would be deterred from monitoring and inspecting their security.

96. 40 C.F.R. § 300.1100(d).
97. 40 C.F.R. § 300.1100(d)(2). An interesting addition to this view of lenders as owners after foreclosure is the preamble comment that “if the release [or threat of release of hazardous substances] occurred in connection with activities undertaken at the direction of an on-scene coordinator (under § 107(d)(1) of CERCLA), then evidence of a release is not relevant to the issue of whether the holder has participated in management.” 57 Fed. Reg. 18,355. Thus, the rule hints that the rulemakers do not desire to insert lending institutions into the CERCLA liability scheme, but that they view lenders as outside parties who voluntarily clean hazardous releases on the site of their security.
The rule, however, does not require banks to monitor and inspect their security and, as will be shown hereafter, the market incentives for such types of activity are wholly inadequate. 100

1. Monitoring and Inspection

Most proponents of the rule argue that a lender's desire to ensure the value of its security will provide an incentive to monitor and inspect. This argument, however, misses two important considerations. First, a lender will not conduct the same amount of inspection and monitoring to protect the value of its security as it would to protect itself against extensive CERCLA liability. Most releases will occur (or be discovered) substantially into the life of a loan, and therefore lenders will rarely have to worry about recovering their entire security value. 101 Because the magnitude of a lender's incentive to ensure the value of its security is only commensurate with the outstanding debt, the typical incentive to monitor will be minor when compared with possible CERCLA liability, especially where the secured value is relatively small to start with. It follows that lenders subject to cleanup liability would have a much greater incentive to inspect and monitor to prevent releases than would lenders exempt from that liability.

Second, it is unnecessary to consider the above argument under EPA's rule because the present exemption for foreclosure removes almost any existing incentive to preserve security value. The rule allows the lender/owner to sell the property after a strict foreclosure and EPA cleanup. In such cases, the lender can take any value equal to or above the amount secured by the property. 102 Thus, the foreclosure exemption removes the original impetus for lenders to inspect or monitor by assuring them that they will be able to recoup the entire value 103 (or more) of their security whether environmentally contaminated or not.

2. Working Out the Loan

Another incentive problem arises with workout situations. The rule's treatment of this issue is ambiguous, but suggests that banks can do many

---

99. See supra note 92 and accompanying text.
100. It is also important to consider that under the standard of liability itself, which requires active participation in management, monitoring and inspection activity would rarely rise to the level of incurring liability. Thus the exemption seems to be only for those cases where monitoring and inspection are so profuse that they actually affect the way business deals with hazardous substances on a day-to-day basis.
101. This does not apply to revolving credit situations.
102. 40 C.F.R. § 300.1100(d).
103. Admittedly, the lender will expend significant sums in maintaining the improvement prior to cleanup. It is not clear, however, whether this cost could be recovered as part of the debt pursuant to a note or mortgage.
things other parties would not be allowed to do without incurring liability. Such an exemption would allow, though not require, banks to take any action necessary to work out a loan with a business without being deterred by fear of liability. Allowing the lender this latitude without creating environmental liability may create disincentives to manage an industry safely.

In many workout situations, lenders do not get their money back by taking the security. Instead, they rely on creating income for the company to repay the loan. This need to create income may very well directly conflict with any interest in maintaining hazardous substance programs, because banks will want to limit any such costs in favor of allocating more money to pay their note. This is particularly unfortunate because in a workout situation, where the borrower is seeking to appease the lender, banks are particularly well positioned to influence the environmental policies of borrowers. Absent the incentive provided by the threat of liability, lenders may forgo opportunities to protect the environment in an effort to extract as much income from the company as possible.

Backers of the rule might respond that the incentive to clean exists in the desire to preserve the equity in the security interest, just in case the need to foreclose on the security interest arises, and because any hazardous release problem will greatly decrease the available cash to pay off any loan at all. These arguments, however, are susceptible to similar criticisms as the arguments for monitoring considered above. At present, the foreclosure exemption serves to remove much of the incentive lenders would have to maintain their security.

3. Foreclosure

As has been pointed out in the two previous sections, the foreclosure loophole presently contained in the rule creates tremendous disincentives for any lender to spend money to monitor, inspect, or clean up property. This loophole, in addition to the previously mentioned exemptions, must be reconsidered by rulemakers, legislators, and courts.

The rule still suffers from the same problem originally described by the MBT Court. As the exception presently stands, a lender can foreclose on property and purchase it at the foreclosure sale for lower cost than potential buyers faced with CERCLA liability. These lenders can then sell the property after government clean up. While the rule does require a lender to consider any offer on the property that equals the amount owed them, it does not preclude the lender from accepting offers above the fair market price.

104. See supra note 86.
105. In this regard one must also remember that bank officers are often remunerated according to the money they can salvage through loan workout arrangements. This provides tremendous incentive to squeeze income out of an industry to the exclusion of environmental concerns.
106. See supra notes 31–38 and accompanying text.
107. See supra note 98.
108. Drafters of the rule attempted to respond to this argument by suggesting that foreclosure
Thus, lenders are virtually assured of recovering their security and possibly of making substantial profit from it. In this case such an exemption might enrich a lender who already made money (in the form of interest) from the same industry that created an environmental release.

B. Correlation With CERCLA

Another problem with the secured lender exemption is that it ignores the essence of CERCLA policy and effectiveness: the threat of liability. A potentially responsible party is jointly and severally liable for the entire cleanup cost which can run into millions of dollars. The statutory scheme creates incentives to properly handle hazardous substances based on this fear of substantial liability. Exempting lenders from the scheme, especially considering their ability to influence the disposal of hazardous substance, substantially interferes with the basic functioning of the statute. In addition, CERCLA’s scheme intends that those who profit from the creation or use of hazardous substances should be the ones liable for cleaning it up. Lenders make money by lending to industry, and, occasionally, by running it. As a result, they should not be completely exempt from liability. These considerations suggest that CERCLA standards should create liability for secured lenders.

V. POSSIBLE RESPONSES

I suggest in this section two possible responses to the current lender liability problem. The first incorporates various changes to CERCLA’s lender liability standard. This response, however, would require a substantial commitment of resources, and it would further complicate an already heavily regulated area of the law. The second suggestion is much simpler. This approach would not solve every contingency which arises with lender liability, but it would require a much smaller capital outlay. Both solutions incorporate considerations which should be taken into account in order to move the law in an environmentally and economically responsible direction.

A. A Statutory Change

As earlier analysis showed, one of the problems with the EPA’s rule on lender liability is that it removes incentives for lenders to take environmentally responsible actions in loan transactions. To solve this problem, CERCLA itself must be changed to require lenders to take specific actions to preserve their

---

law does not generally result in such an allocation and that, should a lender gain a windfall, the EPA would bring suit based on that lender’s unjust enrichment. 57 Fed. Reg. at 18,361. This suggestion, however, is simply improper, as foreclosure law would generally result in just such an allocation.
statutory exemption. For example, during the life of a loan, lenders would be in the best position to ensure that borrowers comply with hazardous substance monitoring, inspection, and control measures outlined by the EPA for the industry of each borrower. Under this sort of scheme, a supervising lender would incur liability for a release if the borrower deviates from the proper control measures. Thus, lenders would not be fearful of lending, working out loans, or any other activity they would undertake as a secured lender because they would be exempt as long as they followed certain guidelines as to monitoring, inspecting and controlling hazardous substances.\footnote{109}{The concept of requiring such activity by lenders is by no means farfetched. The first two versions of the rule on lender liability actually contained a requirement for inspection and monitoring. Citing a fear of overburdening lenders, the OMB had this requirement removed from the final rule.}

It would be relatively simple to overcome various practical difficulties with this statutory scheme. The extra cost of these environmental precautions, which might be considered a disincentive to lending in the first instance, could easily be covered by minimally increasing the interest rate of all loans made to debtors with a high risk of hazardous waste contamination. Higher interest rates would have the advantage of internalizing the cost of environmental hazards for companies borrowing money. As for enforcement, lenders would be required to show that they have taken all designated steps for ensuring compliance with any particular borrower. If such a showing was made, the lender would not be liable as a matter of law. Where they do not act in an environmentally responsible manner, banks would remain jointly and severally liable for cleanup costs.

A statutory scheme such as this achieves many of the results desired by both lenders and environmentalists; not only would banks be secure in their interests, but hazardous substances would be more effectively controlled in borrowing industries, thus minimizing hazardous substance releases in the future. While this new scheme would not comport with the current "participation in the management standard," it would still correspond to the overall spirit of CERCLA. Banks would not be immediately susceptible to CERCLA's strict liability scheme (such immediate liability would seriously limit initial lending), but they would nonetheless have to bear some of the burden of overseeing environmental compliance. Only an approach like this can ensure that banks take the responsibility for encouraging and perhaps requiring measures to ensure environmental protection.

This type of broad regulatory scheme would, admittedly, be resource intensive. It would require the creation of standards for control of hazardous substances, as well as for the proper amount of monitoring and inspection for every type of industry.\footnote{110}{An analogous program does exist in the present Clean Water Act. \textit{See} Federal Water Pollution Prevention and Control Act, 33 U.S.C. §§ 1251–1387 (1988). This program requires the EPA to establish Best Management Practices (BMP's) for different types of industry on how to...} Furthermore, such a system would be extremely
complex. Lenders would face an increasing number of regulatory requirements, further straining an already heavily regulated banking system. The burdens, however, may be worth the cost if they exist within a program for dealing with hazardous substances that is both environmentally and commercially sound.

B. New Standard

A more direct and less resource-intensive approach to this problem of lender liability would be the adoption of a standard that would create lender liability as soon as the lender enters the workout stage with a borrower or forecloses on a property.111 Because the standard still creates a high threshold of liability, it will not deter initial lending, except in extreme circumstances. Creditors should thus be able to lend without fear of liability attaching automatically. Furthermore, the standard would also create incentives for lenders to substantially inspect and monitor the industry to which they lend. In this way the lender will reduce the risk of environmental problems to a minimum should the contingency of loan workout or foreclosure arise.

When property is clean and properly run, banks will certainly have incentive to enter workout arrangements with the borrower; the alternative is to lose any value that they retain in the property. Furthermore, once a bank enters workout with a borrower, it will have the added control necessary to ensure that no hazardous release occurs. The workout standard should thus create incentives to keep business clean while not substantially deterring lending or workout opportunities.

This liability standard should also internalize the costs of clean up should a release occur during or after loan workout. First, the standard of liability would be predictable enough for banks to be able to internalize costs. Secondly, the fear that lenders will not be able to estimate costs of clean up will also be circumscribed by the limited number of cleanups lenders will have to undertake. Thus, lenders will have added some certainty to their ability to quantify risk, allowing them to pass on cleanup costs to industry that uses hazardous materials in the form of higher interest rates. In summation, the "workout liability standard" is a definite standard and creates a high enough threshold of liability that lending should not be deterred.

As for borrowers that are known to have a high risk of environmental problems, banks will be free to decide whether they should lend and what premium should attach. They will also know whether they should enter workout agreements with, or foreclose on, a business if they know that they will

remove pollutants from waste water. *Id.* at § 1329(b)(2)(A). Best management standards for hazardous material control could follow a similar development plan.

111. This "workout" standard will probably result in liability for lenders at a similar stage in the lender-borrower relationship as the "participation in the management" standard. That is, a lender does not usually assert the kind of control that would rise to a level of participation in management until a loan needs to be worked out. The decided advantage to a "workout" standard, however, is that it provides certainty as to when liability will attach to lenders.
incur substantial liability for doing so. The result, of course, is that those businesses that are likely to have environmental problems will sit uncleaned and the bank will not get its money through either workout payments or foreclosure. This extra risk, however, will be passed on to industry in the form of interest, while the lenders themselves will not be liable for clean up costs. Perhaps applying a rule creating a trade off between the EPA and lending institutions, as outlined in the previous section, would create viable results. In such a situation, the lender would have to satisfy criteria that showed the borrower was not financially able to pay for clean up. After satisfying these criteria the lender would be exempted from liability but required to administer a clean up of the hazardous release before it could collect its money.112 Admittedly, a program such as this would be a compromise, but in such cases, compromise might be expedient.

VI. CONCLUSION

The cases considering lender liability under CERCLA have created different standards of liability, and the EPA has attempted to provide an overarching rule to address problems with those standards. Unfortunately, these standards have consistently bypassed better solutions. EPA’s standard, for example, would give too much to lenders. By exempting foreclosing lenders, it would sacrifice the opportunity to offer numerous incentives that would encourage lenders to inspect, monitor, and otherwise promote environmentally responsible activity by its borrowers. These lost opportunities invite such standards to be completely rethought. While there might not be any perfect solution to the lender liability problem, there are certainly ways in which the current standards can be made substantially better.

112. The idea embodied in some state statutes of limiting a lender who forecloses on (or in this case works out) a loan to the value of the property might also be adaptable to this situation.