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LENDER LIABILITY/FIDUCIARY ISSUES ADDRESSED IN THE SUPERFUND REAUTHORIZATION†

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THUS far we have been discussing the broader aspects of Superfund[1] and Superfund Reauthorization.[2] I will discuss Superfund and Superfund Reauthorization from the more focussed viewpoint of lenders. I would like first to talk about what lender liability is: what we by "lender liability" and, frankly, what we do not mean. Second, I will like to review how lenders can be held liable; where the case law has taken us; and where EPA, in its attempts to clarify the area, has taken us. Finally, I will examine what the proposed Reauthorization Bill will do, and what it will not do to clarify the uncertainty of lender liability under CERCLA.

The first question, what is lender liability and what is it not, helps to establish the boundaries of this discussion. CERCLA[3] creates essentially three risks to lenders. The first risk is a basic credit problem. If a borrower's property is contaminated and the borrower is spending enormous amounts of money to clean it up, the borrower may not have enough money to pay back the loan. However, such a credit risk is not "lender liability," as that term is used here. It is a risk that CERCLA imposes on lenders, but it is not a risk of direct liability. The second risk occurs when a lender has a security interest in real property If that real property turns out to be contaminated, what was earlier thought to be a piece of collateral with positive value may turn out to have a negative value, because under CERCLA it is not uncommon for the clean-up costs to exceed the value of the property. The loss of value, or "impairment of collateral" is a risk CERCLA imposes on lenders, but it is not direct lender liability as we are using the term here.[4]

The risk that lenders are most concerned with, and the one that lenders hope will be adequately addressed in Reauthorization is the

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1. Superfund Amendments and Reauthorization Act of 1986, Pub. L. No. 99-499, 100 Stat. 1613 (1986) [hereinafter Superfund]. Superfund amended the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, 42 U.S.C. §§ 9601-9675 (1988 & Supp. 1992) [hereinafter CERCLA].

2. Superfund Reform Act of 1994, S. 1834, 103d Cong., 1st Sess. (1994).

3. 42 U.S.C. §§ 9601-9675 (1988).

4. *Special Report*, INSIDE EPA'S SUPERFUND REPORT, Jan. 14, 1993, at 1, 5.

risk imposed by direct lender liability.[5] This liability is created where a lender, by virtue of the fact that it has a security interest in property, and "participates in the management of property," however that phrase may be defined, may be held liable for the direct clean-up cost of that property, regardless of whether the lender caused the contamination.[6] Let me give you an example. A lender may have a million dollar loan outstanding, but under the statute could become liable for a $10 million clean-up. It is this direct liability of lenders for clean-up costs that lenders are most concerned with, and the problem that we hope Reauthorization will address.

To understand how a lender might be held liable, one must understand how CERCLA works.[7] Under CERCLA, liability is determined not only by virtue of actions or wrongdoing, but in many instances, merely by status.[8] "Owners and operators" of facilities are deemed liable for any contamination of the property[9] Prior owners and operators of the facility are liable for hazardous substances or hazardous waste that were disposed of at the time that they owned or operated the facility.[10]

What is an "owner" and "operator"? CERCLA includes a long list of definitions at the beginning of the statute and it defines "owner" and "operator" as follows: "the term 'owner or operator' means . . . in the case of a . . facility, any person owning or operating such facility . . . "[11] The definition is circular. This lack of clarity goes back to what Bill White was talking about in terms of how quickly CERCLA was enacted,[12] and in my opinion, in some instances, how poorly it was drafted.

Although the statute does not define what an owner and operator is, it does define what an owner and operator is not. The Statute does so through CERCLA's secured creditor exemption.[13]

Through that exemption, Congress carved out an exemption for "a person, who, without participating in the management of a . . . facility, holds [indicia of ownership] primarily to protect a security interest in

5. *Id.*
6. *Id.*
7 42 U.S.C. §§ 9601-75 (1988).
8. 42 U.S.C. § 9607(a) (1988).
9. 42 U.S.C. § 9607(a)(1) (1988).
10. 42 U.S.C. § 9607(a)(2) (1988).
11. 42 U.S.C. § 9601(20)(A)(ii) (1988).
12. William A. White, *Reauthorization Overview: EPA's Perspective*, 5 FORDHAM ENVTL. L.J. 299 (1994). *See also* Exxon Corp. v. Hunt, 475 U.S. 355, 363 (1986)(CERCLA is "not a model of legislative draftsmanship."); U.S. v. Alcan Aluminum Corp., 964 F.2d 252, 258 n.5 (3d Cir. 1992) ("The Statute is riddled with inconsistencies and redundancies."); Artesian Water Co. v. New Castle City, 851 F.2d 643, 648 (3d Cir. 1988) ("CERCLA is not a paradigm of clarity or precision. Problems of interpretation have arisen from the Act's use of inadequately defined terms, a difficulty particularly apparent in the response costs area.").
13. 42 U.S.C. § 9601(20)(A)(iii) (1988).

that facility."[14] It is not a particularly clear exemption. Apparently, Congress was looking to the courts to clarify the exemption through case law

Early cases after CERCLA enactment grappled with many issues. Those issues included, for example, whether foreclosing on property voids the exemption. Other issues included such questions as what factors determine participation in management? Does it mean participating in the financial management of a company, something that banks get involved with from time-to-time? Particularly in "work-out" situations? Or does it require something more than that? Does "participation in management" require actual participation in the operations of the facility? Or must the lender become involved in the day-to-day operations of the facility? What about "mere ability to control" the operations of the borrower, is that sufficient?

The results of cases decided through 1990 were not consistent. In 1990, the infamous *Fleet Factors* case was decided.[15] *Fleet Factors* was an example of a case where bad facts make bad law. Based on the facts of *Fleet Factors*, it is understandable why the court held the bank liable for contamination on the property. However, the decision of the Eleventh Circuit Court of Appeals is poorly worded. There is a great deal of ambiguity in the language. Different commentators have read the decision to mean different things. Some courts have read it to mean that actions prior to foreclosure can trigger lender liability Other commentators have read the decision to mean that mere participation in the financial affairs of a borrower (something a lender might do in a work-out) can be deemed "participation in management," and trigger lender liability.[16]

Some commentators have read *Fleet Factors* as even more troubling, pointing to language in the case that implies that the mere "capacity to control" the hazardous waste practices of the borrower can trigger lender liability.[17] In reality, of course, nearly any lender has the ability to control a borrower, or its hazardous waste decisions. Any loan can be premised and conditioned on certain practices by the

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14. *Id.*

15. United States v. Fleet Factors Corp., 901 F.2d 1550 (11th Cir. 1990), *cert. denied*, 498 U.S. 1046 (1991).

16. The speaker later provided additional insight into the circumstances leading to this situation:

> The lenders are in a kind of Catch 22. When the borrower begins to exhibit financial instability, lenders may assist the borrower to meet payments by becoming more involved in financial issues. To the extent that this happens, at least in some circuits, they take the risk of crossing the line and becoming liable for environmental impairment.
>
> Certainly the *Fleet Factors* case is probably the most important case that has been read to hold that participation in financial management is sufficient to void the secured creditor exemption. Again, the facts in *Fleet Factors* showed more than participation in financial management.

17. *Fleet Factors*, 901 F.2d at 1556-58.

borrower. In fact, most loan agreements with commercial or industrial establishments today require the borrower to comply in all respects with environmental laws; for example, they are required to dispose of its hazardous waste appropriately, etc. According to some commentators who read *Fleet Factors* broadly, if a bank has that control, it may be enough to trigger lender liability[18]

After *Fleet Factors*, significant efforts were made to clarify this very ambiguous area of CERCLA liability. Whether one agrees that these differing interpretations of *Fleet Factors* are warranted, it is clear that the ruling and language of the case created a great deal of uncertainty. Uncertainty is not something bankers like. Bankers are a conservative lot: they tend to dress conservatively, and they think conservatively Bankers, as most businesspersons, do not like uncertainty.

Bills were introduced in Congress. Rather than support Congressional action, however, EPA stepped in and through its rulemaking authority, attempted to eliminate some of the uncertainties. During a one and one half to two year period, EPA prepared and circulated various drafts of what became known as the EPA Lender Liability Rule.[19] Ultimately, in the spring of 1992, EPA issued its final Lender Liability Rule.[20]

The rule was intended to provide a safe harbor for banks. It set forth the actions a secured creditor could take and could not take during the different stages of the borrowing relationship — from the stage prior to making the loan to foreclosure after default.[21] For example, it explained whether or not the lender could "police" the hazardous waste practices of its borrower.[22] The rule attempted to clarify the actions a lender could and could not take during "work-out" — when the loan relationship has gone bad and loan payments are no longer being made.[23] The rule even determined what a bank could and could not do even after foreclosure and whether a lender could foreclose on property without triggering lender liability.[24]

Shortly after its final promulgation, the rule was challenged in the D.C. Circuit Court of Appeals. In early February of this year, the Court of Appeals, in *Kelley ex rel. Michigan v. EPA*,[25] vacated the lender liability rule, because, according to the court, EPA lacked au-

18. *See generally* Michael I. Greenberg & David M. Shaw, *To Lend or Not to Lend - That Should Not Be the Question: The Uncertainty of Lender Liability Under CERCLA*, 41 DUKE L.J. 1211, 1225 (1992).

19. EPA Lender Liability Rule, 40 C.F.R. § 300.1100 (1992).

20. 57 Fed. Reg. 18,382 (1992)(codified as 40 C.F.R. § 300.1100 (1992)).

21. 40 C.F.R. § 300.1100(c)(1)-(2) (1992).

22. 40 C.F.R. § 300.1100(c)(2)(ii)(A) (1992).

23. 40 C.F.R. § 300.1100(c)(2)(ii)(B) (1992).

24. 40 C.F.R. § 300.1100(d)(1)-(3) (1992).

25. Kelley *ex rel.* Michigan v. EPA, Nos. 92-1312, 92-1314, 1994 U.S. App. LEXIS 1715 (D.C. Cir. Feb. 4, 1994).

thority to issue the rule.[26] The court suggested that if lenders or EPA wanted the relief provided by the rule, they should look to Congress.[27] Ironically, the case came down one day after the Administration Superfund Reauthorization Bill was submitted.

Where do lenders go from here? Certainly, in the courts, lenders and EPA will likely seek rehearing, possibly rehearing *en banc*, before the District of Columbia Circuit Court of Appeals. More importantly, lenders will look more seriously to Congress for clarification through the Reauthorization Bill.[28]

In fact, the Reauthorization Bill does address the lender liability issue. The Bill does not provide much detail, at least the version of the Bill that was presented on February 4th. It states only that "authority to promulgate regulations to define the terms of this Act (CERCLA) as they apply to lenders and other financial services providers and other fiduciaries," etc., is confirmed by the section.[29] In other words, the Reauthorization Bill attempts to provide EPA with the authority to promulgate regulations that the District of Columbia Circuit Court of Appeals said it lacked authority to promulgate. That is, to define the specific terms of CERCLA (the term "owner-operator"), and thereby clarify the secured creditor exemption.[30]

Will the language in the Administration's Bill be sufficient? I do not believe so. A careful reading of *Kelley* reveals that the court believed EPA was doing more than merely defining the terms of the statute. What EPA was attempting to do, according to the court, was to define *liability*, and to expand or contract the scope of the statute and its liability scheme.[31] That, according to the court, is not EPA's responsibility. It is the responsibility of Congress.[32]

EPA does not define statutory terms, "but rather takes off from those terms, and devises a comprehensive regulatory regime to address the liability problems facing secured creditors."[33] This is an extensive quasi-legislative effort and not merely the construction of statutory phrases that the court noted in other cases.[34]

According to the court then, it may not be enough for Congress, through Reauthorization, to reiterate EPA's authority to define the terms of the statute.

26. *Id.* at *2.
27 *Id.*
28. S. 1834.
29. *Id.* § 407.
30. *See id.*
31. *Kelley*, 1994 U.S. App. LEXIS 1715, at *23-25.
32. *Id.*
33. *Id.* at *24.
34. *Id.*, *citing* National Family Planning & Reproductive Health Ass'n, Inc. v. Sullivan, 979 F.2d 227, 237 (D.C. Cir. 1992); Chamber of Commerce v. OSHA, 636 F.2d 464, 469 (D.C. Cir. 1980).

What impact does the uncertainty have, not just on lenders, but on the rest of us? Certainly there is a greater hesitancy on the part of lenders to extend credit to borrowers who have serious risks of environmental contamination. The uncertainty has also added to the transaction costs, particularly for industrial property.

In addition, the potential liability exacerbates the problem noted by Bill White:[35] the tendency of the present CERCLA liability scheme to drive industry away from potentially contaminated property. Some of the properties are not really a threat to human health and safety. Rather, it is the fear of the unknown that will drive lenders away from making loans on urban sites that may be contaminated.

Where does the law stand without the EPA rule? Lenders must look to existing case law In the Eleventh Circuit, *Fleet Factors* is still the rule. In the Ninth Circuit, the cases are a little bit better, and there is better clarification. The First Circuit has good clarification. In many other circuits, however, the liability issues have not been addressed. Lawyers advising lenders must look at the law and determine how to advise the lender about the liability in a particular district, in a particular circuit. Oftentimes, the answers are unclear; sometimes there is no case law guidance.

Just a brief word on fiduciary liability Typically fiduciary liability arises where you have a trustee. This is very similar to lender liability. A trustee, in most states, by operation of law, is required to hold title to the property as opposed to the trust itself. If the trustee holds title to the property for the benefit of the trust, or for the benefit of the beneficiary, can that trustee or the financial institution be deemed an "owner"?

The secured creditor exemption generally would not apply because typically a trustee does not hold its indicia of ownership to protect a security interest. The trustee holds title because as a trustee, title is held for the benefit of the beneficiary.

Although the case law in this area is sparse, it makes clear that in many cases a trustee will be considered an owner. Then the question becomes, if a trustee is an owner, can the trustee be held liable to an amount greater than the trust assets? There are cases, particularly the *Phoenix* case, decided in the district of Arizona,[36] which say that under certain circumstances, a trustee, a fiduciary, can be deemed liable, and that liability can exceed the value of the trust assets.[37]

The Reauthorization proposal does address the issue of fiduciary liability.[38] The proposal attempts to fix this problem the same way Congress initially fixed the issue concerning lenders. The proposal states that an owner and operator does not include a trustee who

35. White, *supra* note 12, at 307.
36. City of Phoenix v. Garbage Servs. Co., 827 F Supp. 600 (D. Ariz. 1993).
37. *Id.* at 605.
38. S. 1834 § 605(d)(4)(E)(i)-(ii).

holds title solely in a capacity as a fiduciary, providing the trustee does not participate in the management of the vessel or facility.

If the Reauthorization "fix" is ultimately enacted, fiduciaries will be in the same position that lenders were several years ago. The same question will arise: what does it mean to participate in the management of a facility? Does that mean, for example, the mere ability to participate? Where is the line that a trustee cannot cross? This concludes my discussion on lender and fiduciary issues. I thank you for your time.