EXPANSION OF CERCLA PROTECTION FOR LENDERS

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After a series of federal court decisions that have broadened the potential liability lenders may face under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA),[1] financial institutions finally received good news when the U.S. Court of Appeals for the Ninth Circuit refused to hold a lender liable in *In re Bergsoe Metal Corporation.*[2] Coming just two months after a federal appellate court had dramatically expanded the liability of lenders, the *Bergsoe* case may have slowed or halted the trend toward expanded lender liability for environmental cleanups.

LENDER LIABILITY PRIOR TO *BERGSOE*

Under CERCLA, the owners and operators of a facility or vessel (e.g., equipment, containers) may be strictly and jointly liable for cleanup costs associated with the discharge of hazardous substances. This liability extends to current owners and operators of a site as well as past owners and operators who were responsible for the release of the hazardous substances. CERCLA contains an exemption for a lender who "without participating in the management of . . . a facility, holds indicia of ownership primarily to protect" a security interest in property contaminated with hazardous substances. However, secured creditors may lose their immunity for at least a portion of their borrowers' cleanup obligations if they acquire title to the contaminated property through foreclosure, or if they become too involved in the day-to-day management of their borrowers' operations.

Prior to *Bergsoe,* four federal district courts and one appellate court had examined the scope of the secured creditor's exemption. These decisions generally fall into one of two lines of authority on the issue of whether a secured creditor loses its immunity when it forecloses on contaminated property. One view, espoused in *United States v. Mirabile,*[3] broadly construes the exemption and views the acquisition of title at foreclosure as merely incidental to protecting a security interest that should not subject a lender to CERCLA liability. The other line of cases, exemplified by *United States v. Maryland Bank and Trust Company (MBT)*[4] and *Guidice v. BFG Electroplating & Manufacturing Company, Inc.* (*Guidice*),[5] has adopted a narrow construction of the secured creditor's exemption, and holds that a lender will be liable if it forecloses on property, regardless of the motive or the length of time it is in the chain of title.

On the issue that is most important to lenders—namely, what constitutes the kind of control that will be considered "participation in the management" of a facility—the cases have failed to establish precisely the boundary between prudent oversight of a borrower's operation and excessive involvement in its daily affairs. The most onerous ruling to date on this issue was the recent decision in *United States v. Fleet Factors.*[6] In that case, the federal Court of Appeals for the Eleventh Circuit dramatically broadened the liability that lenders may face under CERCLA by expanding the types of action that could constitute "participation in the management" of a facility. The court held that a lender could be liable if it merely had the ability to influence or control the operations of its borrower. In essence, the court seemed to create a new category of liable parties just for lenders, in which they can be liable even if they do not qualify as statutory operators of the facility. As a result, the court found that Fleet's post-foreclosure actions were sufficient to expose it to liability under CERCLA.

The court also placed lenders in an untenable position in

1. 42 U.S.C. 9601 et seq.
2. 910 F.2d 668 (9th Cir. 1990).
3. 15 Envtl. L. Rep. (Envtl. L. Inst.) 20994; (E.D. Pa. No. 84-2280, Sept. 4, 1985).
4. 632 F.Supp. 573 (D. Md. 1986).
5. No. 86-2093 (W.D. Pa., Sept. 1, 1989).
6. 901 F.2d 1550 (11th Cir. 1990).

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that, on the one hand, the court said that lenders should monitor the hazardous waste treatment practices of their borrowers and insist that they comply with applicable requirements as a condition to continued financing, yet, on the other hand, such involvement could render the lender liable under the court's interpretation of the secured creditor's exemption.

FACTUAL BACKGROUND OF *BERGSOE*

Bergsoe Metals Corporation ("Bergsoe") operated a lead recycling facility in St. Helens, Oregon. In 1978, the Port of St. Helens (the "port") agreed to issue industrial development revenue and pollution control revenue bonds in order to finance the construction of a lead-recycling facility and the acquisition of the site upon which the plant was to be built. After acquiring the site, the port sold Bergsoe 50 acres and took back a $400,000 promissory note secured by a mortgage. A series of interlocking transactions ensued among Bergsoe, the port, and the National Bank of Oregon (the "bank") that resulted in the issuance of revenue bonds to finance the recycling operation. The first transaction was a sale and leaseback in which Bergsoe reconveyed the 50 acres back to the port by a warranty deed that was followed by the execution of two leases for the site and the recycling plant. Bergsoe agreed to construct the plant and to pay rent equal to the principal and interest under revenue bonds directly to the bank. The leases gave Bergsoe an option to purchase the entire facility once the bonds were paid in full.

In the second transaction, the port agreed to issue revenue bonds that were purchased and held by the bank as trustee for the bondholders. The bank took back, as trustee, a mortgage from the port on the land and the facility. The port also assigned all of its rights under the leases to the bank, and subordinated its rights under the prior mortgage. Finally, the warranty deeds, bill of sale, and UCC releases were placed in escrow by the port until Bergsoe exercised its option to purchase the facility.

Shortly after commencing operation, Bergsoe encountered financial difficulties and was declared in default of its leases by the bank. A workout arrangement was negotiated in which the bank appointed a management company to operate the facility. However, Bergsoe continued to perform poorly, and in 1986 was placed in an involuntary Chapter 11 bankruptcy proceeding by the bank.

Shortly before the commencement of the bankruptcy proceedings, the Oregon Department of Environmental Quality ("DEQ") determined that the site was contaminated with hazardous substances. In 1987 the bank and the bankruptcy trustee filed suit against the shareholders of Bergsoe, the East Asiatic Company, Ltd., The East Asiatic Company, Inc., and Heidelberg Eastern, Inc. (collectively "EAC"), seeking to recoup the debts of Bergsoe as well as a declaration that EAC was liable for the cleanup costs of the site. EAC, in turn, filed a counterclaim against the bank and a third-party complaint against the port alleging that they were liable as owners for the cleanup costs. On the grounds that it could not be liable under CERCLA because it was not the owner of the facility, the port moved for summary judgment, which was granted by the bankruptcy court and affirmed by a federal district court. EAC then appealed the decision dismissing the port.

THE NINTH CIRCUIT'S RULING

The court began its opinion by stating that there was no question that the port owned the facility. While such a finding was sufficient to hold a lender liable in a number of earlier decisions, the *Bergsoe* court went on to say that the port could cloak itself in the secured creditor's exemption if it could demonstrate that it held title simply to protect its security interest and did not participate in the management of the facility.

Adopting an analysis that had not been used since the 1985 *Mirabile* decision, the court examined the motive behind the lender's acquisition of title in the property. The court acknowledged that the port was in a different position from the usual lender, who holds indicia of ownership to ensure repayment of its debt. In this case, the court observed, the port's involvement was merely to facilitate the financing transaction. In addition, the court noted that the leases gave Bergsoe all of the traditional indices of ownership (e.g., responsibility for paying taxes, purchasing insurance, and assumption of risk of loss), and that the rent was equal to the principal and interest due under the bonds. The court concluded that the leases were, in reality, security agreements, and that EAC had failed to demonstrate that the port's indicia of ownership had any other purpose but to protect its security interest.

The court also strongly rebuffed the plaintiff's allegation that the port had participated in the management of the facility. EAC had argued that the port had so participated, because it had "negotiated and encouraged" the building of the plant; had the right to inspect, enter, and take possession of the premise upon foreclosure; and had allowed the management company to run the plant. The court, however, said that all secured creditors reserved certain rights in loan documents that were necessary to protect their investment. In dismissing these claims, the court wrote:

> Were [these actions] sufficient to remove a creditor from the security interest exemption, the exception would cease to

> have any meaning. Creditors do not give their money blindly, particularly the large sums needed to build industrial facilities. Lenders normally extend credit only after gathering a great deal of information about the proposed project, and only when they have some degree of confidence that the project will be successful. A secured creditor will always have some input at the planning stages of any large-scale project and, by the extension of financing, will perforce encourage those projects it feels will be successful. If this were "management," no secured creditor would ever be protected.

With equal significance, the court said that the mere ability to control a borrower's actions would not constitute participation in the management of a facility.

> We hold that a creditor must, as a threshold matter, exercise actual management authority before it can be held liable for action or inaction which results in the discharge of hazardous wastes. Merely having the power to get involved in the management, but failing to exercise it, is not enough.

Interestingly, the court said that it was not creating a rule for the Ninth Circuit, but was merely following the *Fleet Factors* decision. By ruling that *Fleet Factors* stood for the proposition that a lender had to engage in some threshold of involvement with the borrower's operation, and that the mere ability to control was insufficient to expose a lender to liability under CERCLA, the court narrowed the reach of the decision. This limited view of *Fleet Factors* is consistent with the analysis of that case that appeared in the August 1990 article discussing the *Fleet Factors* case.[7]

CONCLUSION

The *Bergsoe* decision was significant in several respects. First, the three-judge panel ruled that a creditor who forecloses on contaminated property would not lose its immunity from liability as long as the action was taken to protect its security interest. By linking title with intent, the decision directly contradicts *Fleet Factors* as well as the line of cases that have held that a bank will be liable if it forecloses on property, regardless of the length of time it holds title.[8]

Second, the court held that a creditor had to be actively involved in the management of a facility before it could be liable under CERCLA, and that the mere ability to control the actions of a borrower would not be sufficient to expose a lender to CERCLA liability. Some counsel of financial institutions had recommended that management clauses be stricken from loan documents because they could be interpreted to have conferred upon lenders the ability to control the actions of their borrowers. Under *Bergsoe,* such a knee-jerk reaction is unnecessary. It is the exercise of the powers contained in those management clauses, not the existence of the provisions themselves, that could cause a lender to lose its immunity under CERCLA.

Finally, *Bergsoe* will be helpful to lenders during workouts. Lenders face their greatest exposure under CERCLA during workouts because they exercise greater supervision over their borrowers' activities during such periods. Previous courts have imposed liability on financial institutions who were simply engaged in the actions that lenders traditionally have taken during workouts. In contrast, *Bergsoe* stands for the proposition that so long as the lender's actions are intended to preserve the value of its collateral, it should not be liable for the environmental costs of the site.

The *Bergsoe* decision is a pragmatic decision that recognizes the reality of the way lenders conduct business. It reassures lenders by recognizing that they must take certain actions to protect their security interests, and that these actions should not expose them to CERCLA liability. If other courts follow this opinion, *Fleet Factors* may represent the high-water mark for lender liability under CERCLA. ■

7. Larry Schnapf and Howard P. Epstein, *United States v. Fleet Factors,* 6 Rev. Banking & Finan. Serv. Reg., No. 2 (Aug. 15, 1990).

8. See *United States v. Maryland Bank and Trust Company,* 632 F.Supp. 573 (D. Md. 1986); *Guidice v. BFG Electroplating & Manufacturing Company,* No. 86-2093 (W.D. Pa., Sept. 1, 1989).

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