Lender liability rule not enough protection, say lawyers

As the dust begins to settle on EPA's new Superfund lender liability proposal, representatives for financial institutions are urging Congress to address several lingering problems they say will leave them unprotected. Specifically, the EPA plan won't shield lenders from cleanup liability for Superfund sites in which they have a financial stake.

EPA's proposed rule, unveiled in June, is an effort to assuage lenders' fear about that most potent of Superfund weapons: joint and several liability. It is also viewed by some as an effort by the agency to preempt congressional attempts to redefine the extent of lender liability at Superfund sites.

The smoldering lender liability issue was ignited in May 1990 when a federal appeals court broadened the likelihood that a lending institution that takes control of a Superfund site, either willfully or involuntarily, could be held liable for a cleanup. The decision in the Fleet Factors case sent chills through the lending community and led to calls for clarification of lender liability under Superfund from both bankers and potentially responsible parties (PRPs).

But lawyers for lenders remain dissatisfied with the proposed rule.

"There's good news and bad news," says Larry Schnapf, an environmental attorney with the New York City-based firm Lord Day & Lord, Barrett Smith, who represents lending institutions. "The good news is that the Fleet Factors decision has been expressly overruled. The agency has attempted to give lenders some certainty by offering examples of actions they can take to avoid being a participant in the management of a facility."

The bad news is that the proposed rule "does not give [lenders] any more protection than existing case law," which leaves them far too vulnerable to Superfund liability, he argues.

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Specifically, he says, lenders are still open to suits by states and "third parties" that are not affected by EPA's rule. And although the rule prescribes EPA's interpretation of Superfund regulations, federal judges are free to overrule the EPA if they feel it doesn't offer a correct interpretation.

Schnapf says lenders would prefer a congressional fix that would also limit third-party and states' ability to sue for liability and reduce the possibility of judicial interpretation undermining EPA's rule. Several new bills on Capitol Hill would do just that.

Law firms that regularly represent PRPs predictably have a different perspective.

The current proposed rule "is much more protective of lenders than earlier drafts," says Mark Atlas, attorney for the Washington law firm of Hale and Dorr, which counsels the National Association of Manufacturers on environmental issues. "They substantially narrowed the circumstances in which a lender could be held liable," he says. He attributes the changes to a lobby effort by financial institutions.

"In some cases, they essentially scrapped entire portions of earlier drafts," he says.

Atlas argues that because it's rare that a lender actually ends up with a Superfund site, EPA's rule and congressional proposals are reacting more to the prospect of lender vulnerability than the reality. The result is an "unfair" shift of liability risk onto the shoulders of PRPs, he maintains.

"The concern of industry is that if you start exempting some segments of society from Superfund liability, their share of liability is going to be picked up by industry. The result is a burden shift that may not be equitable," he says.

The crux of the debate over lender liability is a section of the Superfund law that defines requirements for a "security interest exemption" for lending institutions that excludes them from Superfund liability. The essential ingredients needed to qualify for the exemption are evidence that a lender's ownership is primarily to protect security interests and that the lender does not participate in the management of the facility.

The proposed rule lays out a framework of circumstances under which a lender would be considered to be participating in the management of a Superfund site and thus disqualified from the security interest exemption. In addition, the proposal requires lenders that foreclose on a Superfund site or otherwise acquire ownership to advertise the property within 12 months of acquisition.

Key members of both houses of Congress are pursuing legislative proposals despite the proposed rule. At a Senate banking committee hearing held the week following the EPA proposal, Sen. Jake Garn (R-Utah) said the rule would not ease the threat of liability facing the lending community. Garn is the sponsor of one proposal.

His views were echoed by representatives of the American Bankers Association, the Federal Depositors Insurance Corp. and others at a Senate hearing.

Both Garn's bill and a companion measure in the House would provide additional assurances to bankers by limiting state and third party suits against them for Superfund liability.