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LOAN WORKOUTS, SUPERFUND, AND LENDER LIABILITY: DE MINIMIS SETTLEMENTS — THE “MAGIC BULLET”? 

by
TIMOTHY J. SZUHAJ* 

INTRODUCTION

Over the past decade, hazardous waste problems have come to the forefront of the political and social agenda. The Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA or Superfund)1 has been a primary force in shaping these agenda. CERCLA, through a scheme of strict, joint and several liability,2 strives to “cleanup” hazardous waste sites while placing the costs of such remedial efforts on the polluter.3 The effects of CERCLA on all aspects of contemporary society is well documented.4 Although CERCLA’s goals are generally accepted as appropriate and beneficial, the legal paradigm created by the Act has clashed—or at least conflicted—with other areas of existing law.5 Traditional creditors’ practices with respect to their debtors is one such area which CERCLA has affected.

CERCLA’s magnanimous pursuits have infringed upon a preexisting economic infrastructure. Contemporary commercial practices have generated an extensive network of financial options, and both a creditor and a debtor are almost always at the center of this financial web.6 Lenders have often enjoyed wide

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2 Id. §107(a). For a discussion of CERCLA’s liability scheme, see infra notes 53-67 and accompanying text.


discretion with respect to the oversight of such debtors, ultimately protecting their loans. CERCLA, however, has brought these “traditional” creditors’ practices to the epicenter of the collision between environmental and commercial law.

One recent court decision has further energized the debate over the extent to which environmental liability discourages the exercise of traditional creditors’ practices. *United States v. Fleet Factors Corp.*, has triggered a flurry of activity by every conceivable interest group. The lending industry, for the most part, rallies around traditional creditors’ practices to the exclusion of environmental liability. Environmentalists, not surprisingly, tout the virtue of a clean environment through the extension of CERCLA liability to those parties—sometimes lenders—that play a role in the creation, handling and disposal of hazardous waste.

This article will focus on whether there is a practical solution for reconciling this clash between creditors’ rights and environmental liability. In an effort to provide a tangible basis for critical analysis, the following hypothetical situation will be employed throughout this article. This hypothetical is intended to demonstrate a generic two party loan situation. Although this model may be an oversimplification, its basic assumptions adequately provide the basis for analysis.

In 1982, C makes a loan to D. D secures the loan with property on which D operates a small electroplating facility. Although fairly successful in the past, D begins to experience financial difficulties in 1986. C, fearful that D will default on its debt, proposes and initiates a “workout agreement” with D. Under the agreement, C is allowed to (1) monitor D’s financial transactions and (2) limit D’s expenditures. This arrangement continues until 1988, at which time D declares bankruptcy. Later that year, C forecloses on its security interest and liquidates portions of the equipment at the facility. In 1989, the Environmental Protection Agency (EPA) enters D’s property and discovers widespread contamination. Later that year, EPA brings suit against C as a potentially responsible party (PRP), and thus alleges that C is liable for the clean-up costs of the site under CERCLA.

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7 See infra notes 16-23 and accompanying text.
8 901 F.2d 1550 (11th Cir. 1990), cert denied, 111 S. Ct. 752 (1991).
11 See infra notes 184-208 and accompanying text.
12 “Workout” agreements (also referred to as out-of-court settlements) are defined as follows:

There are two types of out-of-court workouts. One type involves a moratorium pending resolution of the debtor’s difficulties through refinancing, a major sale, or infusion of investment capital. The other type of out-of-court workout involves adjustment of indebtedness between the debtor and its creditor.

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Prior to the emergence of environmental statutes, common law almost exclusively defined appropriate practices with respect to debtors. What follows is a review of (1) creditors' practices generally considered necessary and appropriate in the area of commercial law and (2) activities which generally result in the imposition of derivative liability upon creditors under common law. This overview is intended to provide a rough model of the "traditional" lending community. As such, it should present the basis for comparative analysis regarding the effects of environmental liability on the lending industry. In short, what could creditors do in the past without incurring derivative liability?

Traditional Creditors' Rights with Respect to Debtors

At the core of commercial law is the creditor's contractual ability to foreclose on a delinquent loan and thereby collect the debtor's promised collateral. This right is fundamental to the loan process; it facilitates loan-making through the assurance that the collateral will, in the case of a default by the debtor, provide some measure of monetary return to the lender. Foreclosure, however, may not always be the ideal solution for a situation in which a debtor faces financial hardship. Loan "workout agreements" may be more beneficial to both the debtor and the lender. Such agreements can allow the debtor to continue business operations while bolstering the likelihood that the creditor will receive a more complete return on its investment. Foreclosure also imposes certain transactional costs on both parties, costs which could hinder the creditor's opportunity to fully recoup its outlay.

For example, in the hypothetical situation outlined above, assume that D's facility, if sold "as is," would not cover the amount loaned by C. C, therefore, received a greater return on its investment by working with its troubled debtor from 1986 to 1988, than it would have had it foreclosed in 1986 and sold the collateral. The debtor's collateral was worth more as an operational facility. Therefore, the "workout agreement" ameliorated the inherent transactional costs unavoidably linked to foreclosure, and ensured productivity which would have been lost had D simply foreclosed on its loan.

16 1 P. Coogan, W. Hogan & D. Vagt, Secured Transactions Under the Uniform Commercial Code § 1.04(3) (1985).
17 Id.
19 Id.
20 Id. See also L. King & M. Cook, supra note 12, at 541-42.
21 Burcat, supra note 18, at 528. See also L. King & M. Cook, supra note 12, at 542.
In light of these commercial practices, courts have allowed creditors to undertake specific actions and controls aimed at protecting the obligation owed by the debtor. However, if the creditor becomes overly involved with the debtor’s affairs, courts may impose liability upon the creditor for the debtor’s other obligations.

**Traditional Common Law Creditor’s Liability**

1. **Instrumentality or “Alter Ego” Theory**

   Courts have held creditors liable under the alter ego or instrumentality theory for all the debts owed by their debtor—that is, liability to the debtor’s other creditors. Although courts have not clearly defined the contours of this theory, liability appears more likely to attach when a creditor “demands and assumes such control over the entire spectrum of a debtor’s business affairs that existing management is supplanted and is reduced to carrying out the directions of the creditor.” Under this theory, however, courts seem less likely to impose liability on a creditor for such activities as collecting all necessary information, requesting a negative veto power over the debtor’s financial transactions and providing assistance or counseling to the debtor.

   An excellent example of the latitude courts grant to creditors exercising control over their debtor is provided by *Krivo Indus. Supply Co. v. Nat’l Distillers & Chem. Corp.* In *Krivo*, the plaintiffs, ten creditors of a certain debtor, sued the major creditor, National Distillers & Chemical Corp. (National). The action was instituted to recover money owed them by the debtor. The plaintiffs alleged that National was liable because it controlled the debtor to such an extent that the debtor was a “mere instrumentality” of National.

   Prior to the debtor’s default, National entered into an agreement with the troubled debtor to “(1) provide internal financial management assistance to help [the debtor] eliminate costly waste, (2) lend [the debtor] another $600,000 in cash, (3) defer payments on the $630,000 accounts receivable, [and] (4) help [the debtor] liquidate unprofitable holdings to provide more capital for [the debtor] . . . .” Furthermore, in an effort to strengthen the debtor’s financial management, National

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23 See id. at 523. See also Burcat, *supra* note 18, at 528; E. MANNINO, LENDER LIABILITY AND BANKING INDUSTRY § 6.01 (1990).
25 Id. at 534.
26 Id. at 533.
27 483 F.2d 1098 (5th Cir. 1973), reh’g denied, 490 F.2d 916 (5th Cir. 1974).
28 Id. at 1101.
29 Id.
30 Id. at 1108.
sent an internal auditor to "oversee [the debtor's] finances an to establish control procedures for managing cash and investments." Although the internal auditor worked with the debtor for fifteen months, the debtor eventually ceased operations.

The Court of Appeals for the Fifth Circuit, following appeal of a directed verdict for National, began its analysis by setting forth its principle of control liability:

An examination of 'instrumentality' cases involving the creditor-debtor relationship demonstrates that courts require a strong showing that the creditor assumed actual, participatory, total control of the debtor. Merely taking an active part in the management of the debtor corporation does not automatically constitute control, as used in the instrumentality doctrine, by the creditor corporation.

Applying this principle, the court held that there was insufficient evidence to establish a jury question with regard to the issue of control. It therefore affirmed the trial court's grant of National's motion for directed verdict.

In short, the instrumentality theory of liability appears to apply to those creditors who have made their control over the debtor so complete that the debtor is merely a pawn in its own financial dealings.

2. Liability Arising from Agency Theory

Agency theory, also based on the degree of control exerted by a creditor, seems to espouse a broader rule of creditor liability than that set forth by the alter ego theory. It has been hypothesized that this easing of the instrumentality rule may have occurred "in order to provide necessary protection for other creditors where a position of control has been wrongfully abused." Regardless of the rationale underlying this theory, as with the instrumentality theory, courts have declined to establish a "bright line" test for improper exercise of control.

A illustrative example of both this broader rule of liability and the uncertain standard used by courts under the agency theory may be drawn from a comparison of the results in Jenson Farms Co. v. Cargill, Inc. and Buck v. Nash-Finch Co.
In *Jenson*, the plaintiffs-creditors were owed $2,000,000 by the debtor. Subsequently, the creditors brought suit against Cargill, Inc. (Cargill), claiming that Cargill was a principal of the debtor and, therefore, jointly liable for the debtor's outstanding financial obligations. 41 Prior to the lawsuit, Cargill agreed—based on years of financial interaction between Cargill and the debtor—to increase funding to the debtor under certain conditions. 42 The debtor accepted these conditions and Cargill received: (1) access to the debtor's records; (2) a right to prior approval of the debtor's capital improvements in excess of $5,000; and (3) a right to prior approval of both the debtor's declaration of dividends and the sale and purchase of stock. 43 Furthermore, Cargill made several recommendations to the debtor concerning the operation of its business. 44 After a series of additional financial transactions, the debtor ceased operations. 45

After reviewing the record, the Minnesota Supreme Court, held that Cargill, "by its control and influence over [the debtor], became a principal with liability for the transactions entered into it by its agent [the debtor]." 46

In contrast, the South Dakota Supreme Court, in *Buck*, reached the opposite result despite similar facts. 47 The defendant Nash-Finch Co. (Nash), had loaned money to the debtor, and as a result Nash (1) secured access to and dominion over the debtor's financial records; (2) made recommendations with respect to the debtor's operations; and (3) made strong suggestions regarding the debtor's employment of managerial staff. 48 Like the Minnesota Supreme Court, the *Buck* court "experienced no difficulty in discovering a basis in the evidence warranting a finding of an assumption of control by Nash-Finch Company, and a yielding of and acting under such control by [the debtor] in certain phases of his business. 49 However, the court declined to impose liability upon Nash because the record failed to indicate that Nash controlled the debtor's buying operations. 50

Although the result in *Buck* is questionable, 51 the reasoning underlying *Jenson* and *Buck* demonstrate, at the very least, a greater willingness of courts to impose liability upon participatory creditors under the agency theory of control liability. Regardless of this broader application of liability, the extent of control exercised by a participatory creditor must be relatively extensive before liability will attach under the agency theory. 52

41 *Jenson*, 309 N.W.2d at 290.
42 *Id.* at 289.
43 *Id.* at 288.
44 *Id.* at 289.
45 *Id.*
46 *Id.* at 290.
47 *Buck*, 102 N.W.2d at 85-91.
48 *Id.* at 85-86.
49 *Id.* at 89-90.
50 *Id.* at 91.
52 See *supra* notes 43, 48, 50, and accompanying text.
In summary, common law creditor liability, under either the instrumentality theory or the agency theory, hinges upon the extent of control that a creditor exercises over the business affairs of its debtor. Although the courts have hesitated to establish an absolute test for excessive control, it appears that most creditor practices, short of complete control of the debtor, may be a permissible means of policing debt.

CERCLA'S LIABILITY SCHEME AND THE SECURED CREDITOR

The "Draconian" Statute

In an effort to remediate hazardous waste problems, CERCLA sets forth a scheme of liability which is intended to place the burden of cleanup on those parties responsible for the problem. Under section 107 of the Act, liability falls upon past and present owners of a facility, generators of the hazardous waste, and those who accept hazardous waste for transport to disposal facilities. Liability is strict, joint, several and retroactive.

Many traditional common law principles have either succumbed to or been altered by CERCLA's congressional "mandate." For example, courts have consistently held that liability under CERCLA, although not clearly indicated in the statute, is strict, joint and several. Therefore, in situations where common law causation is an issue, present owners of a facility have been subject to strict, although arguably "absolute," liability.

New York v. Shore Realty Corp. is the seminal case with respect to this concept. The court in Shore Realty held that causation was not a fundamental requirement for the purposes of liability under section 107(a)(1) of CERCLA. The court based its holding on "legislative history...[which] specifically rejected including a causation requirement in section [107(a)(1)]." Furthermore, the Court wished to avoid rendering superfluous CERCLA's affirmative defenses, which are based on causation.

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54 42 U.S.C. § 9607(a).
56 See supra note 5.
59 Id. at 1044.
60 Id.
61 Id.
While now generally accepted as a permissible operation of CERCLA, imposition of liability upon a land owner, absent a demonstration of any conduct related to hazardous waste, is a departure from the general common law concept of legal causation as a requisite for liability. As previously noted, courts use the term “strict” liability as the standard set forth by CERCLA, while in practice, imposition of liability is arguably “absolute”—nothing other than ownership must be shown to impose liability. This deference to CERCLA’s mandate clearly takes precedence over the common law causation principle, thus curbing the application of a conflicting principle in favor of the congressionally sanctioned alternative.

The reach of CERCLA liability is not without exception, however. CERCLA’s definition of “owner or operator” exempts “a person, who, without participating in the management of a . . . facility, holds indicia of ownership primarily to protect his security interest in the . . . facility.” The extent and application of this “secured creditors exemption” has fanned the flames of controversy which rage with respect to the imposition of environmental liability regardless of traditional commercial practices.

**Superfund Case Law and Lender Liability**

1. United States v. Mirabile

The first court to deal with CERCLA’s secured creditor exemption focused its analysis primarily upon the creditors’ control of the debtor. In United States v. Mirabile, the United States District Court for the Eastern District of Pennsylvania granted summary judgment for two defendant creditors, but denied a third defendant creditor’s motion for summary judgement, pending further development of the factual record. In ruling on the motions, the Court set forth a distinction between management of the debtor’s financial matters and management of the debtor’s “operational, production, or waste disposal activities.” The court noted that this distinction is critical and thus, if imposed at all, liability would fall only upon creditors who participate in the operational aspects of the debtor’s facility. The court then narrowed this distinction by holding that only “day-to-day” involvement...
in such "operational" activities would constitute a basis for the imposition of liability.\textsuperscript{73}

In \textit{Mirabile}, the United States filed suit against Anna and Thomas Mirabile, the present owners of the contaminated site.\textsuperscript{74} Subsequently, the Mirabiles joined American Bank and Trust (ABT), the Small Business Administration (SBA), and Mellon Bank (Mellon) as third-party defendants.\textsuperscript{75} The Mirabiles asserted that the actions of these creditors—each had provided financing to the previous operator of the facility—also exposed them to CERCLA liability.\textsuperscript{76}

ABT had loaned money to the previous owner of the facility.\textsuperscript{77} The loan was secured by a mortgage on the owner’s real estate and equipment.\textsuperscript{78} When the debtor defaulted, ABT foreclosed on the property and subsequently placed the high bid at the foreclosure sale.\textsuperscript{79} ABT assigned the bid to the Mirabiles four months later. Prior to assigning the bid and several months after operations at the site had ceased, ABT “secured the buildings [at the site] against vandalism . . . , made inquiries as to the approximate cost of disposal of various drums located on the property, and through its loan officer . . . visited the property on various occasions for the purpose of showing it to prospective buyers.”\textsuperscript{81}

The court granted ABT’s motion for summary judgment, indicating that ABT’s “involvement with the site present[ed] the most compelling case for the granting of such a motion.”\textsuperscript{82} The court held that ABT’s actions at the site were taken to protect its security interest in the property, and were by no means a continuation of its debtor’s operations at the site.\textsuperscript{83} Therefore, the court concluded that ABT did not take part in the “day-to-day” operational activities of the facility, and thus, CERCLA’s secured creditor exemption applied to ABT.\textsuperscript{84}

SBA’s motion for summary judgment was also granted on the basis of the secured creditor exemption.\textsuperscript{85} In 1979, SBA made a loan to the debtor which was secured through a second mortgage and additional items of collateral.\textsuperscript{86} However, SBA’s agreement with the debtor, provided for SBA to supply management
assistance to its borrowers. The court concluded that SBA had never provided such managerial assistance to the debtor and, more importantly, that "participation in purely financial aspects of operation, of the sort which occurred here, is [not] sufficient to bring the lender [SBA] within the scope of CERCLA liability."  

The court denied Mellon's motion for summary judgment in favor of developing a more complete record. Mellon's predecessor in interest, Girard Bank, lent money to the debtor and then supplied one of its loan officers to serve on an advisory board to the debtor. Following the debtor's bankruptcy, a second loan officer closely monitored the debtor's activities. Because the Mirabiles had presented some grounds, slender as they may be, for imposing liability and "bearing in mind that all doubts are to resolved in favor of that party opposing a motion for summary judgment." The court concluded that Mellon's motion should be denied in favor of developing a more complete record.

In short, all three creditors were protected from CERCLA liability if they could demonstrate that their involvement with the site was purely financial, seemingly regardless of the degree of that involvement. The Mirabile Court set forth a broad formulation of CERCLA's secured creditor exemption.

2. United States v. Fleet Factors Corp.

United States v. Fleet Factors Corp. announced a new and narrower construction of the secured creditor exemption. In 1976, Fleet Factors Corporation (Fleet), entered into an agreement by which Fleet advanced funds to the debtor against the assignment of the debtor's accounts receivable. The loan was secured by the debtor's facility and all of its equipment, fixtures and inventory. Although the debtor experienced financial difficulties and subsequently ceased operations in 1981, Fleet continued to collect the debtor's accounts receivable and substantially increased its involvement with the debtor as it wound down its affairs.

In 1982, after the debtor had been adjudicated a bankrupt, Fleet foreclosed on some of the debtor's inventory and equipment. Fleet then contracted with Baldwin Industrial Liquidators (Baldwin) to auction off the debtor's collateral. After the

87 Id.
88 Id. at 20997.
89 Id.
90 Id. at 20096.
91 Id.
92 Id.
93 Id.
94 901 F.2d 1550 (11th Cir. 1990).
95 Id. at 1552.
96 Id.
97 Id.
98 Id.
99 Id.
auction was completed, Nix Riggers (Nix) was allegedly engaged by Fleet to remove the remaining unsold collateral and to leave the premises “broom clean.” Nix completed this work and left the site by the end of the 1983.

In 1984, the EPA, discovered hazardous materials on the site, cleaned up the site, and subsequently brought suit against Fleet to recover the clean-up costs. Fleet filed a motion for summary judgment with the United States District Court for the Southern District of Georgia. The court denied Fleet’s motion and certified the summary judgment issue for interlocutory appeal to the Eleventh Circuit. Fleet appealed.

The United States Court of Appeals for the Eleventh Circuit thus became the first federal appellate court to interpret the construction of the secured creditor exemption. After addressing the parties’ constructions of the exemption, the Court “specifically reject[ed] the formulation of the . . . exemption suggested by the district court in Mirabile.” Instead, the court adopted a narrow construction of the statutory language and held that a secured creditor “may incur . . . liability, without being an operator, by participating in the financial management of a facility to a degree indicating a capacity to influence the corporation’s [debtor’s] treatment of hazardous waste.” The court concluded that it is not “necessary for the secured creditor actually to involve itself in the day-to-day operations of the facility in order to be liable—although such conduct [would] certainly lead to the loss of the protection of the statutory exemption.”

The court further supported its ruling by asserting two assumptions. First, the court stated in dicta that its ruling would encourage potential creditors to investigate the environmental soundness of a potential debtor’s waste systems and practices.

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100 Id.
101 Id.
102 Id.
103 Id.
104 Id.
105 Id.
106 Id.
107 Id. at 1558.
108 Id. at 1557. The court explains in a footnote, however, that there is a distinction between operator liability and liability imposed upon secured creditors which fall outside of the secured creditor exemption. Id. at 1156 n.6. The court stated that “Fleet is liable under the statute if it operated the facility within the meaning of the statute. Alternatively, Fleet can be held liable if it had an indicia of ownership in [the debtor] and managed the facility to the extent necessary to remove it from the secured creditors liability exemption.” Id. Without sufficiently differentiating between the culpable activities associated with operator liability and unprotected creditor liability, the court leaves unanswered the issue of the minimum creditor involvement necessary to fall outside the exemption. Some commentators believe that “sweeping pronouncements regarding the secured creditor exemption” were unnecessary because the court indicated that Fleet’s participation was clearly sufficient to impose operator liability. Bolstein & Reznick, Lender Liability After Fleet Factors, 10 A.B.A. STANDING COMM. ENVTL. L. No. 3 at 3 (1990).
109 Fleet Factors, 901 F.2d at 1557 (emphasis added).
110 Id. at 1557-58.
According to the court this would, allow creditors to weigh potential environmental liability when fashioning a loan agreement. It would also encourage debtors, sensitive to the effect of inadequate hazardous waste systems on the probability of obtaining a loan, to "improve their handling of hazardous waste." Second, the court asserted that the potential implication of CERCLA liability upon creditors would "encourage creditors to monitor the hazardous waste treatment systems and policies of their debtors and insist upon compliance with acceptable treatment standards as a prerequisite to continued and future financial support." In short, the court would "deputize" the lending industry as "quasi-EPA monitors."

Applying its formulation to Fleet's involvement with its debtor, the court held that, if proved, Fleet's involvement with the debtor's affairs during the debtor's winding down period prior to its 1981 cessation of operations, would be sufficient to "remove Fleet from the protection of the secured creditor exemption."

In summary, the Fleet Factors court set forth a very narrow formulation of the secured creditor exemption. Under the court's holding, not only can a creditor be liable for financial, rather than strictly operational management of a debtor, but also that involvement need not actually effect the debtor's hazardous waste practice—a capacity to effect such practices is sufficient.

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112 Id.
113 Id.
115 Fleet Factors, 901 F.2d at 1559. The government alleged that Fleet's activities included the following:

Fleet required [the debtor] to seek its approval before shipping its goods to customers, established the price for excess inventory, dictated when and to whom the finished goods should be shipped, determined when employees should be laid off, supervised the activity of the office administrator at the site, received and processed [the debtor's] employment and tax forms, controlled access to the facility, and contracted with Baldwin to dispose of the fixtures and equipment at [the site].

Id.
116 Id. at 1557.
117 Id. Subsequently, the United States Court of Appeals for the Ninth Circuit has handed down the first post-Fleet Factors decision concerning the secured creditor exemption. Bergsoe Metal Corp. v. East Asiatic Co., 910 F.2d 668 (9th Cir. 1990). In its decision, the Bergsoe court, although citing the Fleet Factors case, demurred on adopting the Eleventh Circuit's formulation of the exemption and instead focused its construction on the creditor's actual participation with the management of the debtor's operations. Id. at 672.

Bergsoe involved a series of complex financial arrangements. Id. at 669-70. In essence, the St. Helens Port Authority (Port) gave land to the Bergsoe Metal Corporation (Bergsoe) in exchange for a security interest which included a mortgage on the property. Id. Bergsoe built a recycling plant on the site which opened in 1982. Id. at 670. The plant suffered financial problems from its beginning. Through a workout agreement—arrangement by Bergsoe and another financial institution involved in the complex landscape under lying the operation—the Port agreed to allow a third party to manage the facility in lieu of foreclosing on its security interest. Id. Nevertheless, the plant failed and subsequently shut down in 1986. Id. After Bergsoe was forced into involuntary bankruptcy, the Oregon Department of Environmental Quality determined that contamination caused by hazardous substances occurred at the site. Id. An action
CERCLA was a hastily drafted statute, and as such its language is at times, ambiguous. However, many courts have endeavored to clarify some of these ambiguities. Their opinions have often resulted in a flurry of critical commentary, and the Eleventh Circuit's Fleet Factors opinion is no exception. The court took an ambiguous phrase and fashioned its own construction of the secured creditor exemption. The purpose of this article, however, is not to critique the Fleet Factors Court. Instead, barring drastic changes in the law or the courts, this article accepts the Fleet Factors decision as the present state of the law with respect to lender liability under CERCLA. Therefore, this article, given the present state of the law, will seek to elucidate the following: (1) what is the effect of Fleet Factors on the lending industry?; and (2) is there a viable solution to the unrest created by this impact?

The Ninth Circuit began its analysis by citing Fleet Factors for the proposition that "CERCLA . . . protects secured creditors who do not participate in the management of the facility." Id. at 671. The court held that the exemption applied to the Port if it could meet a two pronged test: (1) that Port holds indicia of ownership primarily to protect its security interest in the Bergsoe plant; and (2) that Port did not participate in the management of the facility. Id. at 671-72. After determining that the Port did hold indicia of ownership as a security interest, the court held that the Port had not involved itself in the actual management of the Bergsoe facility and therefore escaped liability through the secured creditor exemption. In reaching its holding, the court explicitly stated that it wished to "leave for another day the establishment of a Ninth Circuit rule on this difficult issue." Id. at 672. Instead, the court held that "there must be some actual management of the facility before a secured creditor creditor will fall outside the protection afforded by the exemption." Id. Therefore, because Port had not engaged in the actual management of the facility, the court did not feel compelled to reach the interpretational issue with respect to the secured creditor exemption. However, as the first post-Fleet Factors federal appellate decision, it indicates, although not explicitly, a possible move away from the Eleventh Circuit's formulation of the exemption.

In short, the Ninth Circuit indicated a willingness to ameliorate the effect on lenders of Fleet Factors. According to the court's holding, whether establishing a rule or not, secured creditors, at least in a situation similar to the one in Bergsoe, must participate in some actual management of the facility before the proecion afforded by the exemption is lost.


See supra note 5.

See infra note 122.

See supra note 109 and accompanying text.

LENDER LIABILITY AND ITS PERCEIVED REALITIES: THE SKY IS FALLING — NO IT'S NOT

The lending industry is upset. Some industry leaders warn "that environmental problems buried deep in the books of ailing banks and thrifts could weaken the nation's beleaguered financial institutions." These leaders also warn that "they could be forced to stop making loans to real estate developers and business owners if they can be held responsible for cleaning up the property they did not pollute." 

Concerns have also been expressed by the federal government. The Federal Deposit Insurance Corporation (FDIC) and the Resolution Trust Corporation (RTC) have inherited a number of failed banks and thrifts which hold contaminated properties and therefore could face potential Superfund liability. "FDIC officials . . . have said that contamination problems have been found at 270 properties their agency holds and that cleanup costs for [fifty] of those properties may be as much as three times their market value."

At least one commentator has expressed the extreme view that "the U.S. is poised for its first regulatory recession, prompted chiefly by environmental judgments that expose many financial institutions to bankruptcy because of liabilities associated with previous lending."

A privately conducted study, which utilized an EPA database, suggests that the lending industry may be overstating the potential fallout from the imposition of CERCLA liability upon certain creditors. The study states that "[l]enders comprise 0.23% of PRPs—40 of 17,095—in the [EPA's] database." The thirty individual lenders who have been named as PRPs represent "one-tenth of one percent of the nation’s more than 30,000 commercial banks, S&Ls and credit unions." "Altogether, lenders are PRPs at [twenty-seven] separate sites, 2.24 percent of the total 1207 sites on EPA’s National Priorities List." Of these PRPs, "only seven lenders have paid EPA anything for Superfund site cleanup" and "[a]ll but two have paid less than $8,100."

Although these figures indicate that lenders have been relatively unaffected by CERCLA liability, there is no indication that this trend will continue in the post-
Summer, 1991]

\textit{Fleet Factors} era\textsuperscript{133} Therefore, the relative weight which should be accorded to these figures is uncertain\textsuperscript{134}.

The rhetoric generated by the lender liability issue has been polar, and less than a modicum of clarity\textsuperscript{135}. This divergence of views has, as a practical matter, clouded the issue and has impeded systematic attempts at obtaining a viable solution\textsuperscript{136}.

\textbf{THE ROLE OF CREDITORS WITH RESPECT TO THEIR DEBTORS: \newline THE POST \textit{Fleet Factors} NEW LEGAL ORDER?}

\textit{Fleet Factors}' Assumptions and Their Possible Effect on the Lending Industry

Of the handful of courts which have dealt with the secured creditor exemption, arguably the \textit{Fleet Factors} court is the only court to give environmental liability clear priority over established commercial practices\textsuperscript{137}. Accordingly, this places the \textit{Fleet Factors} holding and its dicta at the center of critical commentary\textsuperscript{138}. The \textit{Fleet Factors} court, in taking a unique path, explicitly outlined the effects that it intended its opinion to have: (1) to encourage lenders to investigate potential environmental liability prior to executing loan agreements, and thereby compel potential debtors seeking favorable loan terms to maintain adequate hazardous waste practices\textsuperscript{139}; and (2) to encourage lenders, after making a loan, to monitor debtors' hazardous waste practices in an effort to minimize the lenders' potential liability\textsuperscript{140}.

The incentives created by the threat of potential liability, although essentially new to the interplay between environmental and commercial law, do find some support in Congress' expansive commitment to maintaining a safe and clean environment\textsuperscript{141}. In enacting CERCLA, Congress stated that its overriding purpose was to remediate hazardous waste contamination\textsuperscript{142}. The costs generated by this beneficial program were intended to be borne by the parties having some involvement in the creation of the pollution problem: "the polluter should pay."\textsuperscript{143} Although

\textsuperscript{133} The information analyzed in the report represents data through mid-August 1990. \textit{Id.} at 11. Therefore, the data reflects a relatively small time lapse between the \textit{Fleet Factors} decision (May 23, 1990) and the compilation of the data. The effect of \textit{Fleet Factors} may take longer than three months to be felt.

\textsuperscript{134} \textit{Id.}

\textsuperscript{135} \textit{See supra} notes 123-34.

\textsuperscript{136} \textit{Id.}


\textsuperscript{138} \textit{See supra} note 122.

\textsuperscript{139} \textit{Fleet Factors}, 901 F.2d at 1558.

\textsuperscript{140} \textit{Id.}

\textsuperscript{141} \textit{See} S. Rep. No. 848, 96th Cong., 2d Sess. 13 (1980) (CERCLA's purpose is to assure "that those who benefit financially from a commercial activity internalize the health and environmental costs of that activity into the costs of doing business").


this proposition is generally accepted, the extent of its reach to those indirectly related to hazardous waste management is, as previously indicated, the source of ongoing debate. 144

Inherent in this debate are the costs and benefits of compelling lenders to change their conduct with respect to their debtors. Many pro-lender advocates profess that imposing CERCLA liability upon creditors casts a forbidding shadow on not only the lending industry but also, and rather apocalyptically, over the entire economy. 145 Some assert that compelled monitoring by lenders will increase transaction costs, ultimately causing interest rates to rise. 146 Others predict that imposition of environmental liability upon creditors will lead to an increase in loan failures due to lender’s increasing willingness to allow loans with potential environmental liability to go uncollected. 147 In light of the recent economic turmoil surrounding the savings and loan bailout, any further indication of failed loans seems to trigger a chorus of pessimism and voices of doom. 148 Realistically, regardless of the alarmist tone, increased imposition of CERCLA liability upon creditors could have an adverse effect on the lending industry with some residual effect on the overall economy. 149

In response to these assertions, environmental advocates indicate that imposition of CERCLA liability upon “participatory” creditors benefits society as a whole by imposing the risk of liability upon those parties—in this case lenders—which are best able to spread the costs. 150 Historically loan making has not been curbed by the increasing complexity and potential pitfalls inherent in our modern economy. 151 There is no indication that overall lending will diminish; however, creditors’ practices will most likely change to accommodate the added layer of complexity. 152 Lenders already possess a highly integrated network of sophisticated monitoring services. 153 The addition of one more variable, environmental compliance, could be done efficiently and at relatively low cost. 154 Furthermore, the prediction of widespread liability and its increased cost to the economy seems, at present, to be unsubstantiated. 155 Assuming that there is a direct correlation between

144 See supra notes 123-36.
145 See supra notes 123-27.
146 See Comment, supra note 114, at 900.
148 See supra notes 123-27.
149 Id.
150 See Note, supra note 114, at 932.
151 See, e.g., Levmore, Monitors and Freeriders in Commercial and Corporate Setting, 92 YALE L.J. 49, 51 (1982).
152 See, e.g., H. GUTHMANN & H. DOUGALL, CORPORATE FINANCIAL POLICY 3-4 (1955); W. HUSBAND & J. DOCKЕRAY, MODERN CORPORATE FINANCE 3 (1946).
153 See Levmore, supra note 151, at 50-55.
155 See supra notes 128-34 and accompanying text.

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the actual number of creditor PRPs, which is relatively small, and the overall effect on the economy, there appears to be little foundation for implicating an impending economic crisis.

Any change in the status quo reasonably leads to the development of competing interests and arguments. Changing the role of creditors with respect to their debtors is no exception. However, an evaluation of the polar views advanced by the competing interests seems to indicate that encouraging creditors to change their behavior is beneficial to the whole society, while the dire predictions espoused by the lending industry are, at best, a response to the lack of more tangible guidance and, quite possibly, the lending industry’s latent attempt to operate in a “risk free” environment.

The Contrast Between Fleet Factors and Common Law

Derivative Liability of Creditors

As previously noted, at common law, creditors are traditionally permitted some degree of control over their debtors. The extent of this allowable participation in the common law context, while nebulous, is patently more extensive than the Fleet Factors formulation of CERCLA’s secured creditor exemption. Therein lies the rub.

Generally accepted common law principles applicable to commercial transactions are completely eviscerated when environmental liability under Fleet Factors becomes an issue. Common law principles, predicated on the extent of control exercised by a creditor, grant a creditor a great deal of latitude before liability attaches. Fleet Factors erodes this latitude by imposing liability upon creditors who “participate in the financial management of a facility to a degree indicating a capacity to influence the [debtor’s] treatment of hazardous waste.” Creditors under common law could actively protect their loans up to a point close to complete control of the debtor. Under Fleet Factors, however, the threshold for liability is lowered below active participation, regardless of its extent, to the mere potential of culpable behavior. This disparity in legal standards, in conjunction with the potential for adverse economic consequences, necessitates the need for a viable reconciliation of the myriad of competing interests spawned by the lender liability issue.

156 Id.
157 Id.
158 See infra notes 161-66 and accompanying text.
159 Id.
160 See Note, supra note 114, at 931; Atlanta Constitution, Aug. 2, 1990, at A18, col. 2.
161 See supra note 22 and accompanying text.
162 See supra notes 108-09 and accompanying text.
163 Id.
164 See supra notes 24-52 and accompanying text.
PROPOSED SOLUTIONS

Exempt Lenders Completely

One proposed solution to the clash between traditional creditors' practices and environmental liability is to completely exclude secured creditors from potential CERCLA strict liability. This solution would allow creditors to freely police loans under the traditional confines dictated by the common law and would without a doubt appease pro-lender constituencies. However, this solution is arguably inappropriate. Lenders that regulate their debtors can, with such a free hand, allow hazardous waste problems to continue or to happen. When a debtor faces financial hardship, it is not unthinkable that a creditor, working with the troubled debtor, could in an effort to reduce expenditures, reduce or eliminate funding for expensive disposal measures. To sanction such a potential situation is inconsistent with CERCLA's mandate: "the polluter should pay.

The effect of this solution can be seen in the ongoing hypothetical. Assume that C, during the period of D's financial troubles, provides financial advice to D which affects D's disposal of hazardous waste. C, subject to a complete exemption from liability, could indirectly instruct D to reduce or eliminate costs connected with hazardous waste treatment and disposal in an effort to assure a greater probability of return on its outlay. It is obvious under this scenario that both C and D would save money by cutting disposal costs. It is equally obvious that such a measure could result in the increased risk of environmental contamination. In short, absent the threat of liability, cutting costs to save a troubled loan may eliminate any compelling reason to spend capital on hazardous waste disposal.

Judicial Provisions Which Clearly Define Inappropriate Creditor Involvement: A Common Law "Bright Line"

This approach is problematic. Several Courts have attempted to provide creditors with a simple definition of inappropriate creditors' behavior. As previously noted, a recent variation of this proposed solution was set forth in the Fleet Factors decision. The Fleet Factors court, not unlike other courts, announced a standard which ultimately, and not surprisingly, hinges on semantics. The court

165 Fleet Factors, 901 F.2d at 1557 (emphasis added).
166 See supra notes 24-52 and accompanying text.
167 See, e.g., S. 651, 102d Cong., 1st Sess., 137 CONG. REC. S3457-01 (daily ed. March 14, 1991); Comment, supra note 122, at 95.
168 Id. See supra notes 24-52.
169 See Note, supra note 114, at 931.
170 See id.
171 See supra note 3.
172 See Mirabile, 15 Envtl. L. Rep (Envtl. L. Inst.) at 20096 (creditor must participate in the "day-to-day" operation activities of a facility before secured creditor exemption is forfeited).
173 Fleet Factors, 901 F.2d at 1557.
announced that under its standard "a secured creditor may incur... liability... by participating in the financial management of a facility to a degree indicating a capacity to influence the [debtor's] treatment of hazardous waste."\(^{174}\) What is troublesome about this standard, and arguably other similar standards, is that it fails to adequately define its operative terms. What does "degree indicating a capacity to influence" mean in a practical sense?\(^{175}\) Although, a flexible standard may address the realities of the commercial marketplace,\(^{176}\) it is questionable whether judicial formulation and application of such a standard is efficacious.\(^{177}\) Such formulations invite case-by-case adjudication, and thus could fail to provide creditors with helpful guidance.\(^{178}\)

Conversely, a discrete judicial standard would fail to address the diverse practices inherent in commercial transactions.\(^{179}\) A strictly defined standard, although providing some measure of predictability, would likely curb certain legitimate commercial practices.\(^{180}\)

These points may be clarified through the use of the ongoing hypothetical. Assume that the Fleet Factor language applied to C's situation. Without a clear definition of "capacity to influence,"\(^{181}\) C may choose not to offer any financial advice to its troubled debtor. This could result in an eventual default by D which is detrimental to C and possibly, if repeated a substantial number of times, to the economy itself. If C chooses to offer financial advice to D, C may be found liable under the Fleet Factors standard.

In the alternative, assume, that "capacity to influence"\(^{182}\) was further defined, in the extreme case, to explicitly include financial advice. Prudently, C would not offer D financial advice. This would effectively foreclose C and D from formulating any type of flexible "workout"\(^{183}\) agreement and thus eliminate a valuable commercial tool.

A Middle Ground: Case-by-case Analysis with the Option of De Minimis Settlement

To the discomfort of many lenders, a first step toward reaching an adequate

\(^{174}\) Id. (emphasis added).

\(^{175}\) Does this capacity include the amount of money the creditor has invested? Or does it focus primarily on the participation of the creditor in the financial affairs of the debtor?

\(^{176}\) See supra notes 16-23 and accompanying text.


\(^{178}\) See Note, supra note 114, at 930-31.

\(^{179}\) See supra notes 16-23 and accompanying text. The same argument may be made against a congressional standard.

\(^{180}\) Id.

\(^{181}\) Fleet factors, 901 F.2d at 1557.

\(^{182}\) Id.

\(^{183}\) See supra note 12.
solution to this conflict would be to analyze each situation on a case-by-case basis. Although cases may have some similarities, each case is inherently fact sensitive. The control exercised by each creditor varies as to the particular debtor, its financial standing, and an array of other market forces. Because of the unique nature of every loan situation, any mechanism constructed to cope with this diversity must be flexible. A rigid mechanical standard would fail to address the realities of the loan market.

Although not at first apparent, this need for flexibility does lend itself to a potential statutory solution. Liability is the threshold analysis under CERCLA; however, the extent of such liability may be ameliorated. Section 122 of CERCLA authorizes the President, through EPA, to enter into settlement agreements with PRPs under certain circumstances. These agreements are beneficial to a PRP for two reasons: (1) a settlement agreement allows the PRP to fix the amount of liability it faces; and (2) settlement shields the PRP from contribution suits brought by other PRPs. Section 122 also allows expedited settlement with de minimis parties. The section lists a set of relevant factors to be used in determining de minimis status. These factors create a flexible mechanism which can accommodate a diverse group of PRPs.

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185 See supra notes 16-23 and accompanying text.

186 Id. See also supra notes 24-52.

187 Id.

188 CERCLA §§107(b), 113(f), 122, 42 U.S.C. §§9607(b), 9613(f), 9622.

189 Id. §122, 42 U.S.C. § 9622(a). This section states the following conditions:

Whenver practicable and in the public interest, as determined by the President, the President shall act to facilitate agreements under this section that are in the public interest and consistent with the National Contingency Plan in order to expedite effective remedial actions and minimize litigation.

Id.

190 Id.


192 CERCLA § 122(g), 42 U.S.C. § 9622(g).

193 Id. This section states in pertinent part:

Whenever practicable and in the public interest...the President shall...reach final settlement with a potentially responsible party...if such settlement involves only a minor portion of the response costs at the facility concerned and...the conditions in...the following...are met:

(A) Both of the following are minimal in comparison to other hazardous substances at the facility:

(i) The amount of the hazardous substances contributed by that party to the facility.

(ii) The toxic or other hazardous effects of the substances contributed by that party to the facility...
A "workable" statutory solution based on this existing mechanism would appear to be completely reasonable. Amending section 122 to explicitly allow settlement with secured creditors seems feasible and possibly desirable. The use of factors based on the realities of commercial practices as the operative language of the amendment would create a flexible mechanism more suited to the diversity of the loan market. Additional flexibility would be supplied by the courts and EPA. The courts and EPA have dealt with analogous standards under CERCLA and, therefore, possess a certain degree of sophistication with respect to the application of CERCLA on a case-by-case basis.

195 See supra notes 16-23 and accompanying text.
196 EPA has entered the fray. In late Spring 1991, shortly after the Fleet Factors decision, EPA made public its proposed solution to the lender liability conundrum. See EPA Proposal to Limit Liability of Financial Institutions Under CERCLA, 22 Envtl. Rep. (BNA) 430 (June 14, 1991). The proposed rule would allow a lender to remain within the secured creditor exemption, if that lender—in the context of a loan workout—undertakes actions that are both structured to protect . . . the security interest . . . [and] are taken . . . when the security holder is assisting the borrower in an effort to prevent default of the loan or diminution of the value of the security." Id. at 436-37. Pursuant to this paradigm, EPA would consider the following activities permissible in the course of protecting a security interest: "restructuring or renegotiation of the terms of the loan obligation, requiring payment of additional interest, extension of the payment period, specific financial or operational advice, suggestions, counselling, guidance or any other action reasonably necessary to protect the security interest." Id. at 437 (emphasis added). A lender, however, will fall outside the exemption and face potential liability for "participating" in the management of a facility "if [the lender's] actions contribute to the contamination at a facility." Id. (emphasis added).

Taken as a whole, this proposed rule strives to strike a balance between traditional commercial practices and environmental liability. Id. at 433 & 436. The proposed rule does cut both ways, however. It does endeavor to curb the harsh effects of the Fleet Factors decision by granting lenders a wide range of permissible activities undertaken to protect a security interest. Unfortunately, the rule fails to adequately define impermissible activities: what actions rise to the level of "contribut[ing] to the contamination at a facility"? If the nexus between the creditor's action and the corresponding result is given broad application, the resulting latitude granted to creditors would be quite narrow. It is not inconceivable that a financial restructuring, no matter how small, could have a residual effect on the debtor's disposal practices; therefore, under a "loose nexus" approach, minimal residual effects could result in lender liability. This does not appear to be EPA's intention. Under the proposed rule, EPA states, "[w]hile a security holder does not 'participate[e] in the management' of a facility . . . merely because it causes or contributes to hazardous substance contamination, in general a security holder must be cautious that its own actions do not result in independent liability under CERCLA. Id. at 437 (emphasis added). On its face, this caveat does not appear to implicate a loose nexus between the creditor's actions and the resulting effects; therefore, some latitude on the part of a creditor appears to be available—but how much? Again, this raises the specter of indirect control of the debtor's disposal practices. In short, controlling the purse strings could ultimately affect environmental compliance. See supra notes 169-71 and accompanying text.

Further, the rule does not guarantee a finality which would be established by a statutory process. See supra notes 190-93 and accompanying text. Under the proposed rule, EPA is the final arbiter; EPA decides whether to take action against certain PRPs. This rule does not, however, foreclose third parties from exercising their existing statutory right to bring contribution actions against others, potentially lenders, that they believe are also responsible parties. CERCLA § 113 (f), 42 U.S.C. § 9613(f). In short, the rule only voices EPA's interpretation of lender liability.

Although EPA's proposed rule does contain certain inadequacies, it does reflect a willingness on the part of EPA to approach debtor/creditor situations in a flexible manner cognizant of commercial lending practices. EPA's recognition of these competing interests, placed in the context of a statutory amendment, could be highly beneficial to the resolution of competing commercial practices and environmental concerns.

Such an amendment could allow creditors to take a more traditional approach to their involvement with a debtor.198 Under this scheme, the extent of a creditor's control over its debtor would be measured by standards cognizant of the financially beneficial aspects of control, while at the same time serving to safeguard environmental concerns.199 It is a matter of degree. Although a participatory lender faces the possible imposition of liability, settlement as a de minimis party, under the proposed amendment, would be appropriate if the creditor's activities with respect to the debtor contributed little to the overall contamination of the site.200

The benefits of such an amendment are numerous. First, it is based upon a preexisting statutory scheme.201 This allows for greater efficiency because both the courts and enforcement agencies have already developed a sophistication with respect to the settlement process.202 Second, the amendment would provide greater protection for the environment than would a complete exemption which would have to rely primarily on the lending industry's self-constraint.203 Third, the scheme created by the amendment would provide the lending industry with a tangible, although relatively flexible, standard.204 Fourth, lenders would still be compelled to monitor their debtors, and the threat of liability would still exist; however, the extent of that liability would be contingent on the impact of the creditor's activities.205 Finally and importantly, such an amendment could be the vehicle for the reconciliation of traditional creditors' practices with the tenets of environmental liability.206

Although the settlement process is basically structured for a case-by-case approach, the use of the ongoing hypothetical is helpful in demonstrating the advantages of a statutory settlement provision. Assume that C, during the period of D's financial troubles, again provides financial advice which affects D's disposal of hazardous waste. Under the proposed amendment to CERCLA, which would explicitly provide for settlement with creditors based on equitable factors, C's actions in protection of its loans could be balanced against the overall environmental impact of those actions. If the resulting impact was small, then the EPA would be empowered to settle with this de minimis party. However, if the impact was great, then the creditor would be exposed to full CERCLA liability.


198 See supra notes 24-52.
199 See supra note 193.
200 Id.
201 CERCLA § 122(g), 42 U.S.C. §9622(g).
202 See supra notes 196-197.
203 See supra notes 167-71.
204 See supra, notes 196-197.
205 See supra notes 154 and 196-97.
206 See supra notes 123-66.

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Therefore, assume that C’s activities with respect to D have little environmental effect. C would now have the option to “cash out” of the litigation for a fixed and relatively small amount. Further, C, through *de minimis* settlement, would foreclose the possibility of contribution suits and thereby add additional predictability to the settlement process. However, if C’s actions were to have a more significant environmental impact, then the *de minimis* settlement option would not be available. C would be left to use other approaches.

**CONCLUSION**

On its march toward a cleaner environment, CERCLA has periodically laid waste to conflicting common law principles. Traditional commercial practices with respect to debtors are no exception. The *Fleet Factors* decision, if nothing else, energized the debate over the impact of imposing CERCLA liability upon participatory creditors. The impact of *Fleet Factors* on the legal, lending and economic communities is presently in its infancy. Speculation abounds on all fronts, and at times verges on hyperbole.

From this morass, however, a viable solution—capable of effectively balancing the diverse interests generated by this issue—is conceivable. An amendment to CERCLA explicitly allowing secured creditors to settle as *de minimis* parties would be an efficient, flexible and “environmentally friendly” solution to the lender liability issue.

Would this approach be acceptable to both the lending industry and environmental groups? This question is left open to the ongoing debate. However, in light of the present state of lender liability under Superfund, a step towards compromise cannot be dismissed lightly.

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207 C could, however, still opt to pursue the secured creditors exemption.

208 Id.