

LENDER LIABILITIES

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In the aftermath of a recent court decision, the volatile issue of lender liability for hazardous waste site cleanups has come close to a boil. Even before that case was decided, bills were introduced in both the U.S. House and Senate to limit the liability which the developing case law would impose on lending institutions. Pennsylvania and Colorado have passed legislation aimed at resolving this issue at the state level, and in a startling addition to the controversy, the Resolution Trust Corporation, overseeing the Savings and Loan bailout, apparently has already inherited about 36,000 contaminated sites from failed S and L's. Liability for that massive cleanup could accrue to the taxpayer.

The traditional limitation on liability of lenders under the Federal Superfund statute, was narrowed by the recent Federal Appeals Court decision *United States v. Fleet Factors Corp.* Under Superfund, lenders which hold only a security interest in property (i.e. a mortgage) are not subject to liability for cleanup costs if the property subject to the mortgage is found to be contaminated. Calling previous interpretations of this creditor exemption "too permissive," the Court held that "a secured creditor will be liable if its involvement with the management of the facility is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chooses."

The case is being appealed to the U.S. Supreme Court. Liability based on the mere opportunity to control hazardous waste, exercised or not, is a new development in Superfund case law. This expansion of the degree of liability faced by financial institutions may soon disrupt the flow of capital to America's businesses.

The Environmental Defense Fund and other advocacy groups have entered into the fray in opposition to the liability-limiting bills currently before Congress, while EPA Administrator William Reilly has conceded that some lenders who are being held liable, are really innocent bystanders. Although Congressional hearings have been held concerning the lender liability bills in both houses of Congress, with the 1990 Session shortened by election year demands, chances for passage of the lender liability bills this year appear fairly slim. Nevertheless, with the Federal Superfund statute up for reauthorization in 1991, current efforts, at the very least, can be seen as a probable prelude to eventual consideration of lender liability legislation by the full Congress at the same time.

The House of Representatives

Legislation introduced by Representative John LaFalce would "insulate corporate lending institutions from inappropriate Superfund liability when they foreclose on property that turns out to be contaminated . . ." according to the Congressional Record. Support for the bill was expressed at Congressional hearings, where Thomas Greco, Associate General Counsel for the American Bankers Association, warned that unless relief in the form of the proposed legislation occurs: "Whole groups of businesses are not going to be able to get loans from banks."

The House bill does not address the issue of liability for creditor participation in management but serves only to protect the immune status of lenders which foreclose on contaminated property and adds protection for corporate fiduciaries or trustees. Nor does the House bill address the S and L problem. Rep. LaFalce admits that his bill is outdated by the intervening decision in *Fleet Factors*, which demands that the question of lender participation be addressed. For this reason, LaFalce may be ready to adopt the Senate version of the bill. At the July 19 hearing on the Senate bill, LaFalce stated that he would support any bill that would undo the effect of *Fleet Factors*.

The Senate's Stance

Senator Jake Garn has introduced a related but distinctly different bill in order to protect commercial lenders in general, and the Resolution Trust Corporation (RTC) in particular. The proposed legislation grants comprehensive protection to diligent lenders and financial fiduciaries, safeguards the RTC, and requires that standards be developed for environmental due diligence. Key sections of the bill state:

No insured depository institution or mortgage lender shall be liable under any law imposing strict liability for the release, threatened release, storage or disposal of a hazardous substance or similar material from property . . . (1) acquired through foreclosure, (2) held in a fiduciary capacity, (3) held, controlled or managed pursuant to the terms of an extension of credit. Another section absolves the RTC from liability in the course of cleaning up the S and L's, and another mandates environmental due diligence.

The Senate bill was purposely crafted to cure the liability created by Fleet Factors. While the bill would not protect a person who directly causes a release of a hazardous substance, or who unreasonably fails to prevent a release of which he has actual knowledge, the bill would allow participation by a lender or fiduciary in the affairs of a borrower, where it was related to protection of the lender's interests, without incurring liability. This includes foreclosure.

However, since the bill would require there to be actual knowledge or a release or actual contamination in order for liability to be imposed, the bill may not satisfy public demand for environmental due diligence. In the words of Bill Roberts of the Environmental Defense Fund: "Under this bill, if you are a lender, what you don't know can't hurt you . . . lenders need more incentives to carefully review their loans, not less."

The immunity granted to the RTC is an attempt to defuse a potential time bomb. Rep. Thomas Lukan announced that 36,000 contaminated properties had already become the responsibility of the RTC. Steven Seelig, director of the FDIC's division of liquidation, asked the Senate Committee to make the immunity that would be granted to lenders under the bill transferable to subsequent asset purchasers in order to increase the marketability of seized properties and facilitate the S and L bailout process. However, the present version of the Senate bill does not go that far. Seelig testified that the cost of cleaning up 270 of these so-called assets, with a book value of \$365 million, could be three times their market value and concluded: "Inability to collect the principal of assets is one thing, but findings of . . . liability on top of that could jeopardize the financial soundness of a financial institution and the deposit insurance system."

One would think that the magnitude of this potential financial burden must elicit some response, thus favoring the Garn bill which addresses the problem, inasmuch as LaFalce's version is silent on the issue. On the other hand, if the environmental costs are consolidated into the general S and L bailout, the cleanup will go off budget like the bailout as a whole has up to now. This may have appeal for a deficit conscious Congress, especially in an election year.

Future Developments

Rep. LaFalce was unambiguous in declaring his motivation for reversing the effect of decisions such as Fleet Factors: "Congress, in enacting Superfund in 1980, never intended to hold lenders liable when they foreclose on contaminated property and . . . recent court decisions holding such lenders liable stand in direct violation of Congressional intent."; He originally hoped to attach his bill to the Resource Conservation and Recovery Act reauthorization this year, and avoid the struggle over the Superfund reauthorization in 1991-1992. Although Congressional Committee hearings were finished before the traditional August break, the full Congress has yet to consider them as of mid-August. The House bill, which is less sweeping than the Senate bill, is gaining co-sponsors rapidly, going from 118 on June 8, to 300 as of July 24, 1990. The Senate bill has garnered only 19 co-sponsors as of July 30. The autumn months will probably reveal what bill if any will become law.