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I. INTRODUCTION

The bill which became law was hurriedly put together by a bipartisan leadership group of senators (with some assistance from their House counterparts), introduced, and passed by the Senate in lieu of all other pending measures on the subject. It was then placed before the House, in the form of a Senate amendment of the earlier House bill. It was considered on December 3, 1980, in the closing days of the lame duck session of an outgoing Congress. It was considered and passed, after very limited debate, under a suspension of the rules, in a situation which allowed for no amendments. Faced with a complicated bill on a take-it-or-leave it basis, the House took it, groaning all the way.1

Although this quote could be referring to any number of laws enacted by Congress, one reasonable conclusion can be inferred—a difficult road lies ahead for the future interpretation and application of this law. Such is the case with the law referred to above: The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA).2 In an attempt to redress the hazardous waste problems in this country, CERCLA established a “Superfund” which provides the Environmental Protection Agency (EPA)3 with financial assistance for hazardous waste cleanups. This Superfund is only used, however, if someone cannot be found liable for the cleanup costs at the contaminated site.

Section 9607(a) of CERCLA names four classes of persons4

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4 CERCLA defines a person as "an individual, firm, corporation, association, part-
potentially responsible for cleanup costs at contaminated sites. These potentially responsible parties (PRP's) include: (1) the current "owner and operator" of a facility;⁵ (2) the "owner or operator" of a facility when the hazardous wastes were disposed;⁶ (3) the person or entity that arranged for treatment or disposal of substances at the facility;⁷ and (4) the person or entity that transported the substances to the facility.¹ CERCLA subjects these PRP's to strict liability which is joint and several.¹⁰ Thus, once a person is found liable under CERCLA, the ramifications can be tremendous.¹¹ Although CERCLA provides affirmative defenses to

nership, consortium, joint venture, commercial entity, United States Government, State, municipality, commission, political subdivision of a State, or any interstate body." 42 U.S.C. § 9601(21).

⁵ Section 9607(a)(1) holds liable "the owner and operator of a vessel or a facility. . . ." Id. § 9607(a)(1).

⁶ Section 9607(a)(2) holds liable "any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of. . . ." Id. § 9607(a)(2).

⁷ Section 9607(a)(3) holds liable:

any person who by contract, agreement, or otherwise arranged for disposal or treatment, or arranged with a transporter for transport for disposal or treatment, of hazardous substances owned or possessed by such person, by any other party or entity, at any facility or incineration vessel owned or possessed by such person, by any other party or entity, at any facility or incineration vessel owned or operated by another party or entity and containing such hazardous substances. . . .

Id. § 9607(a)(3).

⁸ Section 9607(a)(4) holds liable "any person who accepts or accepted any hazardous substances for transport to disposal or treatment facilities, incineration vessels or sites selected by such person, from which there is a release, or a threatened release which causes the incurrence of response costs, of a hazardous substance. . . ." Id. § 9607(a)(4).


¹¹ According to the Environmental Protection Agency (EPA), the average cost of cleaning up a site on the EPA's National Priorities List is $25 million, with the cost at some sites almost $100 million. Federal Contract Policy; Revolving Door Issue Tops Legislative Agenda, [Special Report] Daily Rep. for Executives (BNA) No. 13, at S-42 (Jan. 18, 1991).
liability, these defenses only offer narrow margins for success.\textsuperscript{12} The key, therefore, is to avoid CERCLA liability altogether.

Nevertheless, secured creditors,\textsuperscript{13} such as a commercial bank holding a mortgage on property contaminated with hazardous wastes, have found themselves unable to avoid CERCLA liability. Lender liability under CERCLA has created a conflict between economic interests and environmental interests, with the controversy centering on the exemption of secured creditors from the

This has increased from the EPA's estimated average cost of $12 million per site in the early 1980's. \textit{Lender Liability Under Superfund: The Increasing Risks of Exposure}, 12 Issues in Bank Regulation (Bank Administrative Institute) No. 1, at 3 (Summer 1988).

\textsuperscript{12} CERCLA allows PRP's to escape liability if a person can establish by a preponderance of the evidence that the hazardous substance release (or threat of release and damages resulting therefrom) was caused solely by one of the following: (1) an act of God; (2) an act of war; or (3) an act or omission of a third party with whom the defendant had no contractual relationship existing, directly or indirectly. 42 U.S.C. § 9607(b). This last defense, "the third party defense," requires the defendant to establish that "(a) he exercised due care with respect to the hazardous substance concerned . . . and (b) he took precautions against foreseeable acts or omissions of any such third party and the consequences that could foreseeably result from such acts or omissions . . . ." \textit{Id.} § 9607(b)(3).

In 1986, Congress adopted the Superfund Amendment and Reauthorization Act (SARA), Pub. L. No. 99-499, 100 Stat. 1613-1782. SARA addressed some of the problems with the third-party defense and enacted the "innocent landowner" defense to CERCLA liability. The innocent landowner defense excludes from the definition of contractual relationship the acquisition of title by innocent parties. Nevertheless, the defense is only available to purchasers who "did not know and had no reason to know that any hazardous substance which is the subject of the release or threatened release was disposed of on, in, or at the facility." 42 U.S.C. § 9601(35)(A)(i). In order to establish that the defendant had no reason to know of the hazardous waste, "the defendant must have undertaken, at the time of acquisition, all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability." \textit{Id.} § 9601(35)(B).

This "innocent landowner" defense also excludes state and local governments acquiring "ownership or control involuntarily through bankruptcy, tax delinquency, abandonment" or similar means from liability as an "owner or operator." \textit{Id.} § 9601(20)(D). Instead, "any person who owned, operated, or otherwise controlled activities at such facility immediately beforehand" is held liable. \textit{Id.} § 9601(20)(A)(iii). \textit{See infra} note 181 (discussing EPA proposed rule on this issue).

SARA also created a federal lien in favor of the government for recovering the costs of hazardous waste cleanups. The lien attaches only to the property subject to cleanup and arises when the government first incurs cleanup costs or notifies the responsible party, whichever occurs first. The rights of the government are subordinated, however, to the rights of others whose interests were perfected before either notice of the lien is filed or actual notice is received. \textit{Id.} § 9607(f).

\textsuperscript{13} A secured creditor is one with a security interest which is a "form of interest in property which provides that the property may be sold on default in order to satisfy the obligation for which the security interest is given. A mortgage is used to grant a security interest in real property." \textit{Black's Law Dictionary} 1217 (6th ed. 1979). \textit{See also} U.C.C. § 9-201 (1989) (defining a security interest in personal property or fixtures).
definition of "owner or operator."14 Section 9601(20)(A) of CERCLA defines an "owner or operator" as:

in the case of an onshore facility . . . any person owning or operating such facility . . . . Such term does not include a person, who, without participating in the management of a . . . facility, holds indicia of ownership primarily to protect his security interest in the . . . facility.15

Therefore, a secured creditor is exempted from owner or operator status under CERCLA if its activities comply with the requisite criteria: (1) it does not participate in the management of the site, and (2) it holds indicia of ownership primarily to protect its security interest.16 When a secured creditor fails to meet even one of these criteria, however, it may be found to be an "owner or operator," and, thus, face CERCLA liability. The difficulty arises in determining when a secured creditor's activities fall outside the scope of the security interest exemption.

Although control is not explicitly stated as an element of the security interest exemption, it is implied from both of the exemption's criteria. Both issues — whether a secured creditor participated in the management of its debtor's business and whether a secured creditor held indicia of ownership primarily to protect its security interest — are determined by how much control the secured creditor exerted over its debtor.17 A secured creditor will fall outside the scope of the security interest exemption if it exercises too much control over the debtor and its business activities.18 Therefore the crucial issue becomes how much control is too much control? In other words, what amount or

14 Section 9607(a)(1) states "owner and operator" while § 9607(a)(2) states "owner or operator." Courts have interpreted the statutory intent as meaning "owner or operator." Thus, a party need only own or operate a facility to face CERCLA liability. This Note uses the phrase "owner or operator" when referring to both §§ 9607(a)(1) and 9607(a)(2). See generally United States v. Fleet Factors Corp., 901 F.2d 1550, 1554 n.3 (11th Cir.), reh'g denied, 911 F.2d 742 (11th Cir. 1990), cert. denied, 111 S. Ct. 752 (1991) (discussing reasons for construing § 9607(a)(1) in the disjunctive); United States v. Maryland Bank and Trust Co., 632 F. Supp. 573, 578 (D. Md. 1986) ("[T]o slavishly follow the laws of grammar while interpreting acts of Congress would violate sound canons of statutory interpretation.").


16 These two criteria are not separate and distinct. Accordingly, they must be examined together. See infra text accompanying notes 178, 214-15.

17 See infra part III A.

18 See id.
degree of control must a lender exert over a debtor to lose the security interest exemption?

The statutory language of CERCLA does not specify the degree of control required for a secured creditor to fall outside the scope of the security interest exemption. Likewise, CERCLA's legislative history is silent as to the requisite degree of control. Therefore, with only CERCLA's broad remedial policy as insight into the legislature's intent, it is necessary for courts to turn to common-law principles of lender liability in order to determine the allowable degree of control under CERCLA. It is a well-established rule of statutory construction that "[i]f a statute is ambiguous or its meaning uncertain, it should be construed in connection with the common law in force when the statute was enacted." Additionally, there is a "presumption that the law-makers did not intend to abrogate or alter it [the common law] in any manner . . . ." Therefore, since Congress left unclear the defini-

19 Representative Harsha of Ohio, who introduced the security interest exemption stated:

This change is necessary because the original definition inadvertently subjected those who hold title to a . . . facility, but do not participate in the management or operation and are not otherwise affiliated with the person leasing or operating the . . . facility, to the liability provisions of the bill.


20 EARL T. CRAWFORD, THE CONSTRUCTION OF STATUTES § 228, at 422 (1940). See United States v. Sanges, 144 U.S. 310, 311 (1892) ("This statute, like all acts of Congress, and even the Constitution itself, is to be read in the light of the common law, from which our system of jurisprudence is derived."); United States v. Tilleraas, 709 F.2d 1088, 1092 (6th Cir. 1983) ("[T]he scope of the common law will be altered no further than is necessary to give effect to the language of the statute."); United States v. Cox, 593 F.2d 46, 49 (6th Cir. 1979) ("[S]tatutes are to be interpreted with reference to the common law and where there is no indication to the contrary, given their common law meaning."). See generally CRAWFORD, supra, § 228; 2B NORMAN J. SINGER, STATUTES AND STATUTORY CONSTRUCTION §§ 50.01-05 (5th ed. 1992).

21 CRAWFORD, supra note 20, § 228, at 423. See Midlantic Nat'l Bank v. New Jersey Dep't of Envl. Protection, 474 U.S. 494, 501, reh'g denied, 474 U.S. 1090 (1986) ("[I]f Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific."); Isbrandtsen Co. v. Johnson, 349 U.S. 779, 783 (1953) ("Statutes which invade the common law . . . . are to be read with a presumption favoring the retention of long-established and familiar principles, except when a statutory purpose to the contrary is evident."); Citizens Action League v. Kizer, 887 F.2d 1003, 1006 (9th Cir. 1989), cert. denied, 494 U.S. 1056 (1990) ("[U]nless Congress has made manifest an intent to the contrary, a presumption obtains that when Congress uses a common law term, it intends to use it in its common law sense."); United States v. Bowman, 358 F.2d 421, 423 (3d Cir. 1966) ("[C]hanges in the common law effected by stat-
tion of control under the security interest exemption, common-law principles of lender liability should be used to determine the degree of control that a secured creditor must exercise over its debtor so as to face CERCLA liability.\(^2\)

Part II of this Note analyzes and draws distinctions between two common-law principles useful in examining the security interest exemption: agency theory and instrumentality theory. Part III examines the inconsistency between the executive, judiciary and congressional branches of government in interpreting CERCLA's security interest exemption, and evaluates these inconsistent results under common-law principles of lender liability. The EPA's final rule on lender liability is also considered in Part III. Part IV concludes that while the judiciary should interpret CERCLA's security interest exemption using common-law principles of lender liability, the executive has failed to use these principles in its interpretation of CERCLA. Therefore, an inconsistency will result between the two branches of government, and congressional action is ultimately needed to resolve this issue.

II. COMMON-LAW THEORIES OF LENDER LIABILITY

Lenders have traditionally faced liability under the common law. Agency and instrumentality are two of these common-law principles which provide helpful insight into the interpretation of CERCLA's security interest exemption.\(^2\) Both the agency and  

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\(^2\) Some examples of cases which have construed statutes or constitutions with reference to the common law include: United States v. Wong Kim Ark, 169 U.S. 649 (1898) (definition of "citizen" under the United States Constitution construed with reference to the common law); United States v. Spencer, 839 F.2d 1941 (9th Cir.), cert. denied, 487 U.S. 1238 (1988) (court construed common-law crime of fetal infanticide as within the meaning of "murder" under 18 U.S.C. § 1111(a)); Jones v. H.D. & J.K. Crosswell, Inc., 60 F.2d 827 (4th Cir. 1932) (contracts giving right to bottle and sell Coca-Cola would constitute intangible property under the common law, and also constitute intangible property under the Income Tax Statute since there is no indication to the contrary); United States v. Chem-Dyne Corp., 572 F. Supp. 802 (S.D. Ohio 1983) (CERCLA's liability scheme construed with reference to the common law); Powars v. United States, 285 F. Supp. 72 (C.D. Cal. 1968) (referring to the common law, citrus trees are not tangible personal property within the meaning of § 179 of the Internal Revenue Code).

\(^2\) Other common-law theories of lender liability include equitable subordination, the duty of good faith, breach of fiduciary duty, fraud, and interference with contractual relationships.

Equitable subordination allows a bankruptcy court to subordinate the claims of a secured creditor who exercised inequitable conduct. See, e.g., Benjamin v. Diamond, 563 F.2d 692 (5th Cir. 1977). Unlike agency and instrumentality, this theory is inapplicable to the present analysis as equitable subordination only considers situations where the secured
instrumentality theories provide standards — focusing on control — for when a secured creditor will face liability for its debtor's obligations to third parties.\(^{24}\) This Note does not offer these theories as separate bases for CERCLA owner or operator liability. Rather, these common-law principles of lender liability are offered as insight to aid the judiciary, executive, and legislature in their quest to determine the allowable degree of control under CERCLA's security interest exemption.

**A. Agency — The Creditor Liable**

"Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act."\(^{25}\) Three elements must be present in order for an agency relationship to arise: (1) a "manifestation by the principal that the agent shall act for him;"\(^{26}\) (2) an "agent's acceptance of the undertaking;"\(^{27}\) and (3) "the understanding of the parties that the principal is to be in control of the undertaking."\(^{28}\) Nevertheless, these elements need not include intent nor knowledge of the legal consequences of an agency relationship for such a relationship to arise.\(^{29}\)

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\(^{24}\) While each state may interpret these two theories slightly differently, an examination of every jurisdiction is outside the scope of this Note.

\(^{25}\) RESTATEMENT (SECOND) OF AGENCY § 1 (1957).

\(^{26}\) Id. cmt. b.

\(^{27}\) Id. This Note does not focus on these first two elements because they do not offer insight into a lender's allowable degree of control over its borrower.

\(^{28}\) Id.

\(^{29}\) Id.
Section 14 O of the Restatement (Second) of Agency ("the Restatement") specifically provides when a creditor/debtor relationship becomes an agency relationship: "A creditor who assumes control of his debtor's business for the mutual benefit of himself and his debtor, may become a principal, with liability for the acts and transactions of the debtor in connection with the business." In other words, a creditor will be transformed into a principal and face potential liability for its agent's actions if the creditor "assumes control." Comment (a) elaborates on the required amount of control: A secured creditor will not become liable as a principal by "merely exercis[ing] a veto power over the business acts of his debtor by preventing purchases or sales above specified amounts . . . ." A secured creditor does become a principal, however, by "tak[ing] over the management of the debtor's business . . . and direct[ing] what contracts may or may not be made . . . ." Therefore, when a creditor "assumes de facto control over the conduct of his debtor" the creditor becomes a principal and the debtor its agent. Unfortunately, neither the Comment nor the Reporter's Notes to the Restatement nor the American Law Institute proceedings include any further explanation of the degree of control necessary for a secured creditor to become a principal. Nevertheless, Professor William Seavey, the Reporter for the Restatement, referred to the amount of control needed under section 14 O in his writings after the Restatement's drafting:

The situation which raises the question as to the existence of the relation in its broadest form, as well as illustrating the consequences of finding it, is that created when creditors, fearing the financial collapse of a debtor, assume more or less control over his assets and business. Since Cox v. Hickman [8 H.L. Cas. 268 (1860)], the fact that the creditors are to share

30 Although the text of section 14 O refers to a creditor and debtor, the title of this section is "Security Holder Becoming a Principal" and the comment to this section refers specifically to a security holder. Thus, there is a question as to whether section 14 O pertains only to a specific type of creditor — the secured creditor. See generally J. Dennis Hynes, Lender Liability: The Dilemma of the Controlling Creditor, 58 TENN. L. REV. 635, 642-43 (1991) (discussing the inconsistency between the text, title, and comment to section 14 O).

31 Restatement (Second) of Agency § 14 O (1957) (emphasis added).

32 Id. cmt. a.

33 Id.

34 Id.

35 Hynes, supra note 30, at 637 & n.10.
the profits of the business to the extent of their interests does not cause them to be partners, and if they are satisfied with giving advice they do not become liable to new creditors even though in fact they become the direct beneficiaries of their attempt to secure solvency for the debtor. On the other hand, if they go beyond this and exact obedience from the debtor so that in effect they are operating the debtor's business, they may lose their immunity and become liable for the debts of the concern of which they now have become the masters.\textsuperscript{36}

In analyzing section 140 for the purposes of this Note — to compare the relationship to that required under CERCLA's security interest exemption — it is necessary to address the situation where a secured creditor becomes liable as a principal for the torts committed by its debtor against third parties.\textsuperscript{37} To deter-


\textsuperscript{37} When a debtor disposes hazardous wastes in violation of CERCLA, this action is more analogous to that of a tort than a contract. There is no contract between the debtor and the EPA (or other party bringing the action); rather, the debtor has committed a wrong. Under CERCLA the debtor had a duty to dispose of hazardous waste according to the proper procedure, and by improperly disposing of the hazardous waste the debtor breached that duty (there is no proximate cause requirement since CERCLA imposes strict liability). Courts finding an agency relationship between a creditor and debtor, however, have done so in the context of the creditor being held liable as a principal for the debtor's contracts with third parties. There is a distinction between a principal being held liable in contract as opposed to tort. See text accompanying infra notes 38-43.

A principal is always potentially liable for authorized contracts of its agent regardless of whether the principal is disclosed, partially disclosed, or undisclosed, or whether the agent is a general agent or special agent. The same is not true if the contracts are unauthorized. If unauthorized, the principal's liability partly depends on whether the agent was a general agent or a special agent — a distinction depending on "[c]ontinuity of service rather than the extent of discretion or responsibility . . . ." \textit{Restatement (Second) of Agency} § 3 cmt. a (1957).

A general agent is "an agent authorized to conduct a series of transactions involving a continuity of service." \textit{Id.} § 3(1). A principal will be held liable "for acts done on his account by a general agent which are incidental to or customarily a part of a transaction which the agent has been authorized to perform." \textit{Harold G. Reuschlein & William A. Gregory, Handbook on the Law of Agency and Partnership} § 97, at 163 (1979). \textit{See Dixie Life & Accident Ins. Co. v. Hamm, 344 S.W.2d 601} (Ark. 1961). There is, however, some difference in a principal's liability for a general agent's unauthorized contracts depending on whether the principal is disclosed, partially disclosed, or undisclosed. If the principal is disclosed or partially disclosed, the principal will be subject to liability for a general agent's unauthorized contracts if the unauthorized acts "usually accompany or are incidental to transactions which the agent is authorized to conduct if, although they are forbidden by the principal, the [third] party reasonably believes that the agent is authorized to do them and has no notice that [the agent] is not so authorized." \textit{Restatement}
mine whether a principal will be held liable for its agent’s tortious conduct, the first question is whether the principal intended the tortious conduct. If the tort was intended by the principal, then the principal is unquestionably liable.\textsuperscript{58} This rule does not depend on the law of agency, but rather on the general rule “that one causing and intending an act or result is as responsible as if he had personally performed the act or produced the result.”\textsuperscript{59} Likewise, if a secured creditor intends for its debtor to violate CERCLA by improperly disposing hazardous wastes, the secured creditor will face direct liability under CERCLA. In this scenario, the security interest exemption is not even an issue, since the secured creditor’s liability is independently based. If the principal did not intend the tortious conduct of its agent, however, the principal’s vicarious liability will depend on the amount of control the principal exercised over its agent’s conduct, i.e., whether the principal was a master and the agent its servant.

“A master is a principal who employs an agent to perform service in his affairs and who controls or has the right to control the physical conduct of the other in the performance of the service.”\textsuperscript{40} While control is the focus of this relationship, “it is not so much the actual exercise of control as possession of the right to control which is determinative.”\textsuperscript{41} Once the requisite degree of

\textsuperscript{58} Restatement (Second) of Agency § 161 (1957). If the principal is undisclosed, however, a general agent will subject the principal to liability for unauthorized contracts if the unauthorized acts are “usual or necessary in such [authorized] transactions, although forbidden by the principal to do them.” Id. § 194.

On the other hand, a special agent is “an agent authorized to conduct a single transaction or a series of transactions not involving continuity of service.” Id. § 3(2). With few exceptions, a principal is not bound by the unauthorized acts of a special agent. See generally Reuschlein & Gregory, supra, § 97, at 163-64 (discussing specifically when a special agent can hold its principal liable for the agent’s unauthorized acts).

Since debtors found to be agents under section 140 are general agents, Restatement (Second) of Agency § 140 cmt. a (1957), the secured creditors will face liability even for the debtors’ unauthorized contracts (if all of the above elements are met).

\textsuperscript{59} Restatement (Second) of Agency § 212 (1957). See 2 Floyd R. Mecham, A Treatise on the Law of Agency § 1856, at 1437 (1914) (“If the act be one which was specifically and immediately directed by the principal, it may be charged to him as being really his own act, the servant or agent intervening merely as a mechanical instrument.”).

\textsuperscript{39} Restatement (Second) of Agency § 212 cmt. a (1957).

\textsuperscript{40} Id. § 2(1). Likewise, a servant is “an agent employed by a master to perform service in his affairs whose physical conduct in the performance of the service is controlled or is subject to the right to control by the master.” Id. § 2(2).

\textsuperscript{41} Reuschlein & Gregory, supra note 37, § 50, at 99. Agency law concerns itself with the distinction between principal and agent, master and servant, and employer and independent contractor. An agent has the right to bind the principal in contract, while a servant does not. A servant, on the other hand, can hold the master liable for the
control is present, masters are subject to liability for their servants' tortious conduct "committed while acting in the scope of their employment."42 This is the doctrine of vicarious liability or respondeat superior. Therefore, for a principal/creditor to be held liable for the unintended (by the creditor) torts of its agent/debtor, two elements must be met: (1) the creditor must exercise, or have the right to exercise, control over the physical conduct of the debtor, and (2) the debtor must have been acting within the scope of its employment when the tort was committed.43 If these two elements are met, the debtor's tortious conduct will be imputed to the creditor.

1. Whether the Creditor Exercised, Or Had the Right to Exercise, Control Over the Physical Conduct of the Debtor

Considering the first element — whether the creditor exercised, or had the right to exercise, control over the physical conduct of the debtor — section 140 actually considers this element in determining whether an agency relationship arose between a creditor and debtor. Section 140 requires the creditor to exercise de facto control over the debtor's business, in other words physical control over the debtor's business. Professor Seavey, writing about section 140, referred to the creditor as a master: "[If the creditor] exact[s] obedience from the debtor so that in effect [the creditor is] operating the debtor's business, [the creditor] may lose [its] immunity and become liable for the debts of the concern of which [the creditor] now ha[s] become the master[]."44 Therefore, since such a high degree of control — de facto control — is required for a creditor to become liable as a principal, this principal/agency analysis of section 140 can be used to deter-

servant's tortious conduct, while an agent cannot. An independent contractor has neither the power to bind the "principal" contractually, nor the power to hold the "principal" liable for tortious conduct. Rather, an independent contractor "is one who performs services for his constituent but does so neither as servant or as agent." Id. at 100.

The use of these terms to denote three different relationships is often criticized since very often a master/servant relationship will also be a principal/agent relationship. See generally, id. at 101-112 (discussing master/servant relationship as opposed to principal/agent relationship and independent contractor in more detail).

42 RESTATEMENT (SECOND) OF AGENCY § 219(1) (1957).

43 "Employment" in the context of the creditor/debtor relationship is broader than the common usage of the term, and, therefore, can cause confusion. It does not mean that the agent/debtor is on the principle/creditor's payroll. For a further discussion of scope of employment, see infra notes 94-100 and accompanying text.

44 Seavey, supra note 36, at 504.
mine whether a creditor is liable as a master for the unauthorized
torts of the debtor. In other words, if a creditor is found to fulfill
the requisite degree of control under section 14 O, it will also be
found to be a master and, thus, potentially liable for the tortious
conduct of the debtor.\footnote{See Lawrence, supra note 36, at 1413 ("This requirement [de facto control under section 14 O] is consistent with general tort and agency law concepts concerning a principal's tort liability to third persons.").}

Since the commentary on section 14 O is sparse, case law
must be examined to determine the threshold of control required
under section 14 O which constitutes de facto control, thereby
giving rise to master liability for an agent's tortious conduct. It is
important to note that cases considering a creditor's conduct in
the context of section 14 O have done so to determine whether
the creditor is liable for the debtor's contracts. This analysis is
different than that required to determine a creditor's liability for
its debtor's torts.\footnote{See supra notes 37-43 and accompanying text.} Therefore, these cases are not used for a final
resolution on the issue of creditor liability, but rather as examples
of what factors constitute de facto control and, thus, fulfill the
first requirement of the master/servant analysis.

In \textit{A. Gay Jenson Farms Co. v. Cargill, Inc.},\footnote{309 N.W.2d 285 (Minn. 1981).} the case cited
most often for finding an agency relationship between a creditor
and debtor,\footnote{Lawrence, supra note 36, at 1416.} the Supreme Court of Minnesota held that the fi-
nancial and managerial control assumed by Cargill (the secured
creditor) over the operation of Warren Grain & Seed Company
(the debtor) established an agency relationship whereby the se-
cured creditor was liable for the debtor's obligations to 86
farmers.\footnote{309 N.W.2d at 287-88. The plaintiffs were eighty-six individual, partnership or
corporate farmers. These farmers brought this action because the debtor "defaulted on
the contracts made with plaintiffs for the sale of grain." \textit{Id.} at 287.} In 1964 the debtor, an operator of a grain elevator,\footnote{The debtor purchased cash or market grain from local farmers. The cash grain
was resold through the Minneapolis Grain Exchange or to the terminal grain companies
directly. Additionally, the debtor stored grain for farmers; sold chemicals, fertilizer and
steel storage bins; and, operated a seed business where seed grain was bought from farm-
ers, processed, and resold for seed to farmers and local elevators. \textit{Id.} at 288.} and the secured creditor entered into an agreement whereby the
secured creditor loaned money for working capital to the debtor
on an "open account" up to a stated limit of $175,000. This agree-
ment was secured by a mortgage on the debtor's real estate and a
chattel mortgage on its inventories of grain and merchandise. The
debtor received funds and paid its expenses by issuing drafts drawn on the secured creditor through Minneapolis banks. These drafts were imprinted with both the secured creditor's and the debtor's names. Proceeds from the debtor's sales were deposited with the secured creditor and credited to its account. Additionally, the debtor appointed the secured creditor as its grain agent for transaction with the Commodity Credit Corporation, and the secured creditor was given a right of first refusal to purchase market grain sold by the debtor to the terminal market.\(^{51}\)

In 1967 the debtor and secured creditor negotiated a new contract. This new contract increased the "open account" to a $300,000 limit, required the debtor to furnish the secured creditor with annual financial statements, provided the secured creditor with the right of access to the debtor's books for inspection, and required either the secured creditor to keep the books for the debtor or an independent firm to conduct an audit.\(^{52}\) Additionally, this new contract required the secured creditor's prior approval before the debtor did any of the following: (1) made capital improvements or repairs in excess of $5,000, (2) encumbered its assets or became liable as a guarantor on another's indebtedness, and (3) declared a dividend or sold and purchased stock.\(^{53}\)

One of the secured creditor's memos reflected its attitude toward the debtor: "This organization [the debtor] needs very strong paternal guidance."\(^{54}\) Between 1967 and 1973 the secured creditor reviewed the debtor's operations and expenses, and recommended that certain actions be taken.\(^{55}\) The debtor purchased

\(^{51}\) Id.

\(^{52}\) Id.

\(^{53}\) Id. Shortly after this second contract was negotiated, the secured creditor visited the debtor and examined the annual statements, the accounts receivable, expenses, inventory, seed, machinery, and other financial matters. The secured creditor informed the debtor that it would be reminded periodically to make improvements recommended by the secured creditor. Id.

\(^{54}\) Id. at 289.

\(^{55}\) Although the secured creditor suggested numerous changes to the debtor, apparently none of the ideas were implemented. These changes included:

1. a reduction of seed grain and cash grain inventories;
2. improved collection of accounts receivable;
3. reduction or elimination of its wholesale seed business and its specialty grain operation;
4. marketing fertilizer and steel bins on consignment;
5. a reduction in withdrawals made by officers;
6. a suggestion that [the debtor's] bookkeeper not issue her own salary checks; and
7. cooperation with [the secured creditor] in implementing the recommendations.

Id. at 289 n.4.
various business forms and received sample forms printed by the secured creditor in order to develop its own business forms.\textsuperscript{56} The security agreement was again renegotiated and the "open account" line was increased to $750,000, and then later it was raised to $1,250,000.\textsuperscript{57} As the debtor's unpaid obligations continued to grow in excess of its credit line, the secured creditor's control over the debtor's financial operations continued to increase.\textsuperscript{58} In 1975 the secured creditor began to keep a daily debit position on the debtor, and in 1976 a bank account was opened in the debtor's name and funded by drafts drawn on the secured creditor by the bank.\textsuperscript{59}

Nevertheless, in 1977 an audit of the debtor revealed that the debtor was $4 million in debt. The secured creditor, realizing that the debtor's financial statements had been deliberately falsified, refused to extend any additional financing to the debtor. The debtor ceased operations, and in the debtor's final days the secured creditor supervised the winding down operations of the elevator, including disbursement of funds and income generated by the elevator.\textsuperscript{60}

The Supreme Court of Minnesota held that the secured creditor had become the debtor's principal and, as such, was liable on the contracts the debtor had entered into with the plaintiffs. The court found that the relationship between the secured creditor and the debtor fulfilled the three requirements of an agency: (1) the secured creditor manifested its consent that the debtor would act as its agent by directing the debtor to implement its recommendations,\textsuperscript{61} (2) the debtor acted on behalf of the secured creditor by procuring grain for the secured creditor,\textsuperscript{62} and (3) the secured creditor interfered with the internal affairs of the debtor, and, thus, exercised de facto control of the elevator.\textsuperscript{63}

\textsuperscript{56} Id. at 289.
\textsuperscript{57} Id.
\textsuperscript{58} Id. The secured creditor told the debtor that a regional manager would be working with the debtor "on a day-to-day basis as well as in monthly planning meetings." Id. The secured creditor took the attitude that since its money was being used, the debtor "should realize that [the secured creditor] had the right to make some critical decisions regarding the use of the funds." Id.
\textsuperscript{59} Id.
\textsuperscript{60} Id.
\textsuperscript{61} Id. at 291.
\textsuperscript{62} Id. ("[The debtor] acted on [the secured creditor's] behalf in procuring grain for [the secured creditor] as the part of its normal operations which were totally financed by [the secured creditor].").
\textsuperscript{63} Id.
The court found a number of factors indicative of de facto control:

(1) [The secured creditor’s] constant recommendations to [the debtor] by telephone; (2) [The secured creditor’s] right of first of refusal on grain; (3) [The debtor’s] inability to enter into mortgages, to purchase stock or to pay dividends without [the secured creditor’s] approval; (4) [The secured creditor’s] right of entry onto [the debtor’s] premises to carry on periodic checks and audits; (5) [The secured creditor’s] correspondence and criticism regarding [the debtor’s] finances, officers salaries and inventory; (6) [The secured creditor’s] determination that [the debtor] needed “strong paternal guidance;” (7) Provision of drafts and forms to [the debtor] upon which [the secured creditor’s] name was imprinted; (8) Financing of all [the debtor’s] purchases of grain and operating expenses; and (9) [The secured creditor’s] power to discontinue the financing of [the debtor’s] operations.\(^64\)

Although the court “recognize[d] that some of these elements . . . are found in an ordinary debtor-creditor relationship,”\(^65\) it stressed that the elements must be considered in the context of the secured creditor’s “aggressive financing” of the debtor — not as isolated elements.\(^66\) The secured creditor was “an active participant in [the debtor’s] operations rather than simply a financier”\(^67\) — “in essence, the owner of the operation . . . .”\(^68\) Therefore, the court held the secured creditor liable as a principal for its debtor-agent’s unpaid obligations to the plaintiff-farmers, because the secured creditor’s activities constituted de facto control over the debtor.

Other decisions considering whether a secured creditor has exercised the requisite degree of control under section 140 concur with Cargill as to what factors constitute de facto control.\(^69\)

\(^64\) Id.
\(^65\) Id.
\(^66\) Id.
\(^67\) Id. at 292.
\(^68\) Id.

\(^69\) See, e.g., Save Way Oil Co. v. Mehlman, 496 N.Y.S.2d 537 (N.Y. App. Div. 1985). In this case, Save Way Oil Company (plaintiff) delivered fuel oil to a premises operated by Mehlman (the debtor). Jamaica Savings Bank (the secured creditor) held a mortgage on the premises, and plaintiff brought an action against the secured creditor as a principal for the cost of the unpaid fuel oil delivered to the debtor.

The facts indicating that the secured creditor exercised a sufficient degree of control over the debtor to be held liable as a principal included the following: (1) the se-
One decision is repeatedly cited, however, as disagreeing with _Cargill_ and narrowing the degree of control required under section 14 O.\(^70\) _Buck v. Nash-Finch Co._\(^71\) held that the secured creditor did not exert enough control over the debtor to be held liable under an agency theory. Lawrence "Doc" Boedeker (the debtor) operated a market in Mitchell, South Dakota. The Nash Finch Company (the secured creditor)\(^72\) suggested to the debtor, its

cured creditor opened a joint bank account with the debtor and the checks drawn on this account bore on their face both the names of the secured creditor and debtor, and (2) some of plaintiff's previous bills for fuel oil were paid with these checks. \textit{Id.} at 538.

The trial court granted plaintiff's motion for summary judgment against the secured creditor, and, likewise, denied the secured creditor's motion for summary judgment. On appeal, the court, relying on section 14 O, ruled that there were material issues of fact as to whether the secured creditor exercised the requisite degree of control to be held liable as a principal. Therefore, the granting of plaintiff's motion for summary judgment was reversed and the denial of the secured creditor's motion for summary judgment was upheld. \textit{Id.}

This decision supports a broad interpretation of section 14 O since the denial of the secured creditor's motion for summary judgment was upheld when the facts only indicated that the secured creditor's control, at best, extended to the financial aspects of the debtor's ordering of fuel oil from plaintiff, and not the actual management of the debtor's fuel oil orders.

\textit{See also} Plymouth Rock Fuel Corp. v. Leucadia, Inc., 474 N.Y.S.2d 79 (N.Y. App. Div. 1984), \textit{appeal after remand}, 498 N.Y.S.2d 453 (N.Y. App. Div. 1986). In this case, Plymouth Rock Fuel Corporation (plaintiff) brought this action against Leucadia (the secured creditor) to recover the cost of heating oil delivered and service repair calls made to three buildings owned and operated by Isaac Silverman (the debtor). The court found that the secured creditor exercised the requisite degree of control in the following ways: (1) the secured creditor, a second mortgagee of the buildings, paid the debtor's bills to plaintiff for nearly three years, (2) the debtor assigned to the secured creditor all the rents and profits derived from the operation of the buildings, with the tenants paying their rent directly to the secured creditor, (3) although the debtor performed the day-to-day operations in the buildings, the secured creditor constantly communicated with the debtor and approved all of the debtor's expenditures, and (4) the secured creditor drew all checks and made all disbursements for expenses in operating the buildings, including payroll expenses. \textit{Id.} at 80-81.

Thus, the court found that the secured creditor exercised the required degree of control under section 14 O - albeit financial control - and, thus, became liable as a principal for the fuel delivered to the debtor's buildings.


70 Most of the other decisions employing a different standard than _Cargill_ were decided prior to the publication of section 14 O. \textit{See}, \textit{e.g.}, Wasilowski v. Park Bridge Corp., 156 F.2d 612 (2d Cir. 1946); Ford v. C.E. Wilson & Co., 129 F.2d 614 (2d Cir. 1942); Harris Trust & Sav. Bank v. Keig, 98 F.2d 952 (7th Cir. 1938), \textit{cert. denied}, 305 U.S. 658 (1939); Commercial Credit v. L.A. Benson Co., 184 A. 236 (Md. 1936); Kelly v. Tracy & Avery Co., 73 N.E. 455 (Ohio 1905). \textit{See also} Midland Bean Co. v. Farmers State Bank of Brush, 552 P.2d 317 (Colo. Ct. App. 1976) (secured creditor held not liable as principal without reference to section 14 O).

71 102 N.W.2d 84 (S.D. 1960).

72 The secured creditor, a wholesaler of merchandise, financed the debtor through its wholly owned subsidiary, the Merchants Finance Company. \textit{Id.} at 85.
customer, that he undertake a larger operation. This suggestion was acted upon by the debtor when his market burned down in August 1965, and thereafter the debtor contracted to build a Piggly Wiggly market. The secured creditor financed the debtor's endeavor with a $50,000 loan, of which, at the insistence of the secured creditor, almost $20,000 was used in stocking the store.

As in Cargill, the secured creditor became heavily involved with the internal financial operations of the debtor. After the initial loans, the secured creditor and the debtor entered into an arrangement whereby the secured creditor did the accounting for the market. One of the secured creditor's accountants visited the store twice a week, made up the payroll, entered checks on the register, and compiled an operating report every week and a financial statement at five week intervals. Then, early in 1957, the accountant began to countersign all checks issued by the debtor. These facts indicated that the secured creditor had a large degree of control over the debtor's financial decisions.

As with the exchange of grain between the debtor and secured creditor in Cargill, merchandise was exchanged between the debtor and secured creditor in Nash-Finch. The debtor purchased merchandise from the secured creditor according to a check with order requirement. The secured creditor in Nash-Finch also mirrored the actions of the secured creditor in Cargill by keeping in constant contact with the operations and financial condition of the

73 The debtor contracted with the Piggly Wiggly Company and the Metzger Company for a Piggly Wiggly franchise. Id.
74 Id. Initially, the secured creditor extended a loan of $30,000 to the debtor, but when it became apparent that more money was needed for the endeavor, an additional $20,000 loan was extended to the debtor. Id. This loan was secured by chattel mortgages on the fixtures, equipment and stock of merchandise, real estate mortgages on two residence properties, and an assignment of insurance contracts on the life of the debtor. Id.
75 The secured creditor was able to provide this service through its Retail Service Divisions which provided advertising, merchandising, and accounting services. The debtor paid a monthly fee for the accounting services. Id.
76 Id.
77 Id. In essence, merchandise was provided to the debtor by the secured creditor with the understanding that it would be paid for up-front by the debtor. After the initial loans, the debtor received almost no additional credit. Id.

Nevertheless, the debtor did not purchase all of his merchandise from the secured creditor. The debtor was in the practice of purchasing large shipments of coffee and cigarettes which were then resold at wholesale to other merchants. To avoid paying a percentage for these wholesale transactions under his Piggly Wiggly franchise contract, the debtor did not run them through his register, but rather retained the cash separately. Id. at 85-86.
store, which only increased as the debtor's financial stability decreased. In late 1956 it became apparent that the market was not doing so well. The secured creditor wanted the debtor to hire an experienced and skilled store manager, and after some initial resistance by the debtor, the secured creditor introduced the debtor to Estel Parshall.\footnote{From the outset, the debtor was against hiring a store manager as the secured creditor suggested. According to the debtor, when he was introduced to Estel Parshall, the secured creditor made the debtor feel that he "had to get along with Estel or else." \textit{Id.} at 86. The debtor took this to mean that he had to hire Parshall or else the secured creditor would foreclose on the loans. \textit{Id.}} In April 1957 the debtor hired Parshall as his store manager.\footnote{\textit{Id.}} Initially, the secured creditor subsidized Parshall's payroll, and Parshall's duties as store manager were defined by the secured creditor.\footnote{\textit{Id.}} These duties resulted in a reorganization of the methods by which the debtor ran his store.\footnote{After Parshall was hired, the secured creditor sent a memo to the debtor describing Parshall's duties. During the trial, however, the debtor disputed his agreement regarding these duties. The debtor stated that it had been his understanding that "Parshall was to come in to help him with advertising and promotions, and to take charge of the produce department; they would talk over store problems; they would each draw $75 per week; and buying from sources other than [the secured creditor] would be discontinued as soon as possible." \textit{Id.} at 87-88. Nevertheless, what actually happened after Parshall was hired was more in line with the duties outlined by the secured creditor. See \textit{id.}.} Nevertheless, even with Parshall as the new store manager, the debtor remained predominately in charge of buying merchandise for the store.\footnote{Parshall handled all the money coming into the store, as well as all the money going out of the store. Parshall checked the cash registers, made the deposits, changed the locks on the store, and handled all payouts and the payroll. Parshall also handled all the books and records needed for the secured creditor's accountant, with the goal being that Parshall would eventually assume the duties of the accountant. The debtor and Parshall were to jointly be in charge of the personnel and overall store problems including expense and promotion. Nevertheless, Parshall, after seeking advice from the secured creditor, fired the debtor's stepson. \textit{Id.} at 88. Additionally, the debtor's practice of keeping the cash separate from his wholesale transactions was discontinued, and eventually the practice of buying merchandise from sources other than the secured creditors was to be discontinued.}

After Parshall's appointment, the secured creditor still continued its service visits, advice, and help as before. Nevertheless, except when the cash in the bank was insufficient to meet a check upon presentation, the secured creditor's accountant did not refuse to prepare and countersign any check requested by the debtor.\footnote{Parshall, as head of the produce department, purchased merchandise for that department. \textit{Id.} at 91.} This procedure of operation continued until September 20,
1957, when the debtor sold his store to the Piggly Wiggly Hills Company, a corporation in which the secured creditor held a controlling interest. Thereafter, unpaid creditors of the debtor brought an action against the secured creditor.

The issue on appeal was whether the trial court correctly ruled that the secured creditor was the undisclosed principal of the debtor, and, as such, liable for the unpaid obligations of the debtor on merchandise sold and delivered to his store.\(^4\) Although the appellate court "experienced no difficulty in discovering a basis in the evidence warranting a finding of an assumption of control by [the secured creditor] . . . , and a yielding of acting under such control by [the debtor] . . . ,"\(^5\) the court stated that the real issue was whether the degree of control extended to that part of the debtor's business involved in buying merchandise.\(^6\) In other words, did the secured creditor merely exercise a veto power over the debtor's purchases of merchandise, or did it actually take over the management of the debtor's merchandise purchases? Although the secured creditor ultimately planned to become the sole supplier of the debtor's merchandise, this plan was never implemented.\(^7\) The court viewed the secured creditor as only having control over the merchandise purchases to the extent that the accountant refused to countersign checks when there was not enough money in the bank.\(^8\) Therefore, the court held that the creditor had a veto power over the debtor's purchases of merchandise, and, as such, this veto power was not enough to find the secured creditor liable as a principal for the debtor's unpaid purchases of merchandise.\(^9\)

The *Nash-Finch* decision is not the proper analysis by which to determine a creditor's allowable degree of control under section 14 O. Relying on three cases decided prior to the publication of section 14 O,\(^10\) *Nash-Finch* improperly analyzed the Restatement. The court failed to examine the creditor-debtor relationship in its

\(^{84}\) *Id.* at 84.

\(^{85}\) *Id.* at 89-90.

\(^{86}\) *Id.*

\(^{87}\) *Id.* at 91. Since the secured creditor was not at the point where it wanted to grant credit to the debtor for the purchases, the plan was never implemented. The court focused on this fact, reasoning that this was "the only hint of criticism of [the debtor] as a buyer . . . ." *Id.*

\(^{88}\) *Id.*

\(^{89}\) *Id.* at 91.

\(^{90}\) *Id.* at 92.
entirety, and instead only narrowly focused on the amount of control the creditor exercised over the debtor's buying operations.\footnote{Labeling the Buck court's analysis a "narrow perspective," one commentator stated, "Unlike other control cases, the court focused on one element of the parties' relationship, albeit an important one, the buying operations. However, it failed to examine the entire relationship between the parties." K. Thor Lundgren, \textit{Liability of a Creditor in a Control Relationship with its Debtor}, 67 \textit{MARQ. L. REV.} 523, 537-38 (1984).} The secured creditor did exercise, however, de facto control over the debtor's entire business — it instigated the debtor's investment into the store, financed the debtor's investment of the store, provided internal financial management of the debtor's store, made constant recommendations to the debtor, approved all expenditures by the debtor, had a right of entry onto the debtor's premises to carry on periodic checks and audits (and through Parshall was constantly present), controlled the purchasing of produce merchandise (also through Parshall), and eventually benefited when the debtor sold his store to a corporation in which the secured creditor held a controlling interest. The secured creditor in \textit{Cargill} and the secured creditor in \textit{Nash-Finch} did not exercise control through the exact same activities (although some were the same), but taken together the activities of the secured creditor in \textit{Nash-Finch} exhibit an agency relationship between the secured creditor and the debtor according to the standards applied in \textit{Cargill}. While it is arguable that the \textit{Cargill} standards are incorrect, \textit{Cargill} is consistent with cases decided subsequent to the publication of section 140. Furthermore, the \textit{Nash-Finch} decision is dependent upon cases decided prior to section 140. Additionally, \textit{Cargill} holds up under the agency analysis while \textit{Nash-Finch} does not. Since the \textit{Nash-Finch} court admitted that there was an assumption of control by the secured creditor, it should not have focused on whether the secured creditor exercised complete control over all aspects of the debtor's business. Instead, the court should have determined that an agency relationship had indeed been established between the secured creditor who exercised de facto control and the debtor who yielded to this control. This analysis is supported by \textit{Cargill}. Once the agency relationship was established, then the \textit{Nash-Finch} court would have to inquire into whether the principal/secured creditor was liable for its agent/debtor's contracts under the typical analysis of principal liability in contract.\footnote{See supra note 37.} In other words, the \textit{Nash-Finch} inquiry should not have been whether there was an agency relationship, but whether the prin-
cipal was liable for the agent’s buying contracts. By focusing on whether the secured creditor exercised complete control over every facet of the debtor’s business, the Nash-Finch court actually analyzed the secured creditor’s liability under the instrumentality theory. Therefore, the standards employed in Cargill are the proper methods for determining whether a secured creditor exercised de facto control.

2. Whether the debtor was acting within the scope of employment

The second element of agency liability, whether or not an agent/debtor was acting within the scope of its employment so as to hold its principal/creditor liable for its tortious acts, is, as with the issue of control, a fact-specific inquiry. “Within the scope of employment” refers to “those acts which are so closely connected with what the servant is employed to do, and so fairly and reasonably incidental to it, that they may be regarded as methods, even though quite improper ones, of carrying out the objectives of the employment.” An agent’s conduct is considered within the scope of employment only if: “(a) it is of the kind [the agent] is employed to perform; (b) it occurs substantially within the authorized time and space limits; [and] (c) it is actuated, at least in part, by a purpose to serve the master . . . .” Therefore, if the agent’s conduct is authorized by the principal, it is considered within the scope of employment. If the conduct is unauthorized, however, it will only be within the scope of employment if it is “of the same general nature as that authorized, or incidental to the conduct authorized.” Factors to be considered when determining whether unauthorized conduct is within the scope of employment include:

93 See infra part II B.
94 This Note uses the terms “servant” and “agent” as well as “master” and “principal” interchangeably since a creditor will only be a principal if it exercises the requisite degree of control required to become a master.
96 RESTATEMENT (SECOND) OF AGENCY § 228 (1957). The fourth requirement, that the servant’s use of force is not unexpected by the master, is irrelevant for the purposes of this Note.
97 Id. § 215.
98 Id. § 229.
(a) whether or not the act is one commonly done by such servants; (b) the time, place and purpose of the act; (c) the previous relations between the master and the servant; (d) the extent to which the business of the master is apportioned between different servants; (e) whether or not the act is outside the enterprise of the master or, if within the enterprise, has not been entrusted to any servant; (f) whether or not the master has reason to expect that such an act will be done; (g) the similarity in quality of the act done to the act authorized; (h) whether or not the instrumentality by which the harm is done has been furnished by the master to the servant; (i) the extent of departure from the normal method of accomplishing an authorized result; and (j) whether or not the act is seriously criminal.99

Such an inquiry is obviously very fact specific and can only be determined on a case-by-case basis.100

Therefore, for purposes of interpreting the degree of control permitted a creditor under CERCLA's security interest exemption, the common-law theory of agency provides well-established standards for when a secured creditor will be held liable for its debtor's tortious conduct. A secured creditor will face such liability when it exercises de facto control over its debtor's conduct. If de facto control is present, the creditor becomes a master and the debtor its servant, with liability attaching to the debtor's tortious conduct performed within the scope of employment.

B. The Instrumentality Theory or Alter Ego Doctrine

The instrumentality or alter ego rule101 is a common-law doctrine which allows a corporation to be held liable for the debts of another corporation when it misuses that corporation as a mere instrumentality or when the subservient corporation becomes the alter ego of the dominant corporation.102 Courts generally apply

99 Id. § 229(2).
100 See generally W. PACE KEETON ET AL., supra note 95, §§ 69-70.
101 While the "instrumentality" or "alter ego" rule is probably the term most frequently used to describe this doctrine, courts also use other terms such as the "identity" theory, "agent, adjunct, branch, dummy, department, or tool." Krivo Indus. Supply Co. v. Nat'l Distillers and Chem. Corp., 483 F.2d 1098, 1103 (5th Cir. 1973). See infra part II C (comparing and contrasting the instrumentality and agency theories).
102 This Note only discusses the "instrumentality" doctrine as applied to lenders. For a discussion of this doctrine as applied to parent corporations, see, e.g., Robert C. Clark, The Duties of the Corporation Debtor to its Creditors, 90 HARV. L. REV. 505 (1977); Asa S.
a two-prong test in determining whether to invoke this doctrine. First, the dominant corporation must have controlled the subservient corporation. Second, the dominant corporation must have proximately caused the plaintiff harm by misusing that control.\textsuperscript{103}

When applied to debtor/creditor relationships, the test is refined so that the first prong requires \textit{actual, total control}.\textsuperscript{104} Thus, under this common-law doctrine, liability for the obligations of the debtor is imposed where a creditor's control over a debtor's business and financial affairs is so dominant that either the creditor has become the alter ego of the debtor or the debtor has become the creditor's 'instrument.'\textsuperscript{105}

\textit{Krivo Industrial Supply Co. v. National Distillers and Chemical Corp.}\textsuperscript{106} is the leading authority on when a creditor becomes a debtor's alter ego.\textsuperscript{107} In \textit{Krivo} ten creditors (plaintiffs) of Brad's Machine Products (the debtor) sued National Distillers and

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\textsuperscript{103} Roslyn Tom, \textit{Interpreting the Meaning of Lender Management Participation Under Section 101(20)(A) of CERCLA}, 98 YALE L.J. 925, 942 (1989). Some courts also require a third element, namely "use of control by the [dominant corporation] to commit fraud or a dishonest and unjust act in contravention of legal rights, or to perpetrate a violation of statutory or other positive duty ... ." Jeremy W. Dickens, Note, \textit{Equitable Subordination and Analogous Theories of Lender Liability: Toward a New Model of "Control"}, 65 TEX. L. REV. 801, 838 (1987). This third element is included, however, in the second requirement of the previously stated two-prong test in that the plaintiff's harm must be proximately caused through misuse by the dominant corporation.

This Note does not discuss the second prong of this test any further since CERCLA imposes strict liability.

\textsuperscript{104} Tom, \textit{supra} note 103, at 942.

\textsuperscript{105} Lundgren, \textit{supra} note 91, at 523-24.

\textsuperscript{106} 483 F.2d 1098 (5th Cir. 1973), \textit{reh'g denied}, 490 F.2d 916 (5th Cir. 1974).

\textsuperscript{107} For other cases holding that secured creditors did not exert enough control to be held liable under the instrumentality theory, see, e.g., Valdes v. Leisure Resource Group, Inc., 810 F.2d 1345, 1352-56 (5th Cir. 1987); Harris Trust & Savings Bank v. Keig, 98 F.2d 952, 959-68 (7th Cir. 1938), \textit{cert. denied}, 305 U.S. 658 (1939); Chicago Mill & Lumber Co. v. Boatman's Bank, 234 F. 41, 45-46 (8th Cir. 1916); \textit{cf. Credit Managers Ass'n of S. Cal. v. Superior Court}, 124 Cal. Rptr. 242 (Cal. Ct. App. 1975).

For cases employing the same standard, but holding the secured creditor liable under the instrumentality theory, see, e.g., Centmont Corp. v. Marsch, 68 F.2d 460 (1st Cir. 1933), \textit{cert. denied}, 291 U.S. 680 (1934); American Nat'l Bank v. National Wall-Paper Co., 77 F. 85 (8th Cir. 1896); Henderson v. Rounds & Porter Lumber Co., 99 F. Supp. 376 (W.D. Ark. 1951); In re Otsego Waxed Paper Co., 14 F. Supp. 15 (W.D. Mich. 1935); Portsmouth Cotton Oil Refining Corp. v. Fourth Nat'l Bank, 280 F. 879 (M.D. Ala.).
Chemical Corporation (the secured creditor) for the debtor's unpaid obligations, claiming that the debtor was a mere instrumentality of the secured creditor. In 1966 the debtor, a machine production business owned by John and Mary Bradford, became involved in the munitions industry and contracted with the government to produce M-125 fuses, the principal component of which was brass. The secured creditor supplied the majority of brass to the debtor for the production of these fuses, which accounted for ninety percent of the debtor's gross sales. The debtor devised a unique system for manufacturing these fuses, and, at first, prospered. Nevertheless, the debtor's numerous investments eventually drained the business's financial resources.

In early 1969, the secured creditor was shipping the debtor approximately $400,000 to $500,000 worth of brass every month, and by March of that same year, the debtor owed the secured creditor approximately $1,000,000. At the debtor's request, the secured creditor agreed to transform this debt into a promissory note secured by a mortgage on some of the debtor's property. After this agreement, the secured creditor continued to supply brass to the debtor, with payments to be made by the debtor within a month after receiving the shipment. Nevertheless, the debtor's unpaid debt to the secured creditor continued to increase, with the debtor building up an additional $630,000 in accounts payable.

In August 1969, with the debtor facing financial ruin, the debtor and secured creditor entered into an agreement whereby the secured creditor would: (1) provide internal financial management assistance to help the debtor eliminate costly waste, (2) lend the debtor another $600,000 in cash, (3) defer payment on the $630,000 accounts receivable, (4) assist the debtor in

108 483 F.2d at 1107.
109 Id. at 1107.
110 Id. at 1107-08.
111 It was actually many oral and written agreements entered into by the debtor and secured creditor. Id. at 1108-09.
112 The secured creditor sent one of its "Internal Auditors" to oversee the debtor's finances and "to establish control procedures for managing cash and investments." Id. at 1108. This "Internal Auditor" remained with the debtor for fifteen months, during which time the secured creditor loaned the debtor an additional $169,000 and deferred almost another $668,000 in accounts payable by the debtor to the secured creditor. Id. at 1109.
113 In exchange for the $600,000 cash loan and the $630,000 in unpaid accounts receivable, the secured creditor became a mortgagee of the debtor's plant, and gained a security interest in the plant's furniture and fixtures. Additionally, the debtor assigned to the secured creditor some shares of stock in other corporations, several oil and gas leas-
liquidating unprofitable holdings to provide more capital, and (5) intervene with the government to prevent cancellation of the current contract.\footnote{114}

After examining these facts under the instrumentality theory of lender liability, the Fifth Circuit upheld the district court's directed verdict in favor of the secured creditor. Discussing when a lender's actions fulfill the control requirement of the first prong of the instrumentality test, the Fifth Circuit stated:

The general rule is that the mere loan of money by one corporation to another does not automatically make the lender liable for the acts and omissions of the borrower . . . . If a lender becomes so involved with its debtor that it is in fact actively managing the debtor's affairs, then the quantum of control necessary to support liability under the 'instrumentality' theory may be achieved.

An examination of 'instrumentality' cases involving creditor-debtor relationships 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.\footnote{115}

Examining whether the secured creditor exercised "actual, participatory, total control" over the debtor, the Fifth Circuit held that the requisite degree of control under the instrumentality doctrine was not present for the following reasons: (1) although stock ownership "is a factor to be considered in assessing the relationship . . . .,"\footnote{116} plaintiffs never established that the stock in the debtor's business was actually transferred to the secured creditor;\footnote{117} (2) the secured creditor "considered control of [the debtor] to be, at most, only partly shared between [the secured creditor and the debtor];"\footnote{118} and (3) the secured creditor "narrowly
restricted [its activities] to safeguarding its interests as a major creditor of the [debtor's]" and the secured creditor only "participated in the corporate decisionmaking [of the debtor's] . . . to a limited degree . . . ." Although the secured creditor provided internal financial management, lent money to the debtor while at the same time deferring payment of outstanding loans, and actually managed portions of the debtor's business in a limited capacity, this was not enough control to meet the instrumentality standard of "actual, participatory, total control."

C. The Agency Theory v. Instrumentality Theory

Neither the agency theory nor the instrumentality theory contains bright-line rules; rather, both require fact-specific inquiries. Nevertheless, each theory is based upon a different level of control and results in a different standard of liability. Agency requires a lesser degree of control and results in a more restricted standard of liability than does the instrumentality theory. Under the common-law theory of agency, a secured creditor will be held liable for its debtor's tortious conduct if the secured creditor exercises de facto control over the debtor's conduct, and the debtor is acting within the scope of its employment. De facto control is not present if the secured creditor merely exercises a veto power, shares in the profits to the extent of its interest, and gives advice periodically. Rather, the factors indicative of de facto control include: (1) taking over the management of the debtor's

stating that the debtor "voluntarily shared control" with the secured creditor; the fact that the secured creditor wanted to fire John Bradford, but did not feel it had the power to do so; and, the fact that the secured creditor could have only fired the debtor's personnel by cutting off the loans and credit and, thus, putting the debtor out of business. Id. 119 Id. The court focused on the fact that the secured creditor's "Internal Auditor" was sent at the debtor's request, not "thrust upon [the debtor] unwanted or unneeded." Id. The "Internal Auditor" approved most, if not all, of the debtor's purchase orders and signed all checks for the debtor's account. Nevertheless, the court concluded that these were merely veto powers, and the "Internal Auditor's" management powers did not extend beyond "those decisions having an immediate effect on [the debtor's] financial position . . . ." Id. at 1111.

For a further explanation of the three reasons the secured creditor was not held liable, and other reasons behind the Fifth Circuit's ruling, including the finding that the secured creditor did not abuse the debtor in a way only possible with the requisite amount of control, see id. at 1109-14.

120 RESTATEMENT (SECOND) OF AGENCY § 14 O cmt. a (1957).
122 Seavey, supra note 36, at 504.
123 These factors are not inclusive, and should be examined together. The absence of
business, (2) directing what contracts are made by the debtor, (3) exacting obedience from the debtor, (4) constantly giving advice, (5) having the right of entry onto the debtor's premises, (6) paternally guiding the debtor's activities, (7) conducting business with documents or forms bearing the creditor's name or both the creditor's and debtor's names, (8) controlling the finances of the debtor's business, and (9) using power to discontinue financial support as a leverage for control.

De facto control differs from the "actual, participatory, total control" required by the instrumentality theory in that the agency relationship can only arise if there is consent between the two parties — a factor not required by the instrumentality theory. Additionally, regardless of the control exerted by a secured creditor under the agency theory, the secured creditor and debtor remain separate entities — the principal and the agent. Under the instrumentality theory, the secured creditor exerts so much control over the debtor that the two entities cannot be distinguished from each other — the secured creditor becomes the alter ego of the debtor.

The latter distinction between the two theories — whether the secured creditor and debtor are separate entities — is assured by the second element of tort liability under the agency theory: the debtor must be acting within the scope of its employment. No one factor does not negate de facto control. Likewise, the presence of only one factor does not indicate de facto control.

124 See RESTATEMENT (SECOND) OF AGENCY § 14 O cmt. a (1957).
125 See A. Gay Jenson Farms Co. v. Cargill, 309 N.W.2d 285, 291 (Minn. 1981); Plymouth Rock Fuel, 474 N.Y.S.2d at 80-81; RESTATEMENT (SECOND) OF AGENCY § 14 O cmt. a (1957).
126 See Seavey, supra note 36, at 504.
127 See Cargill, 309 N.W.2d at 291; Plymouth Rock Fuel, 474 N.Y.S.2d at 81.
128 See Cargill, 309 N.W.2d at 291.
129 See id.
131 See Cargill, 309 N.W.2d at 291; Save Way Oil, 496 N.Y.S.2d at 538; Plymouth Rock Fuel, 474 N.Y.S.2d at 80-81.
132 See Cargill, 309 N.W.2d at 291.
133 Distinguishing between the agency and instrumentality theories in the context of parent corporations and their subsidiaries, Judge Learned Hand wrote, "At times this [instrumentality theory] is put as though the subsidiary then became an agent of the parent. That may no doubt be true, but only in quite other situations; that is, when both intend that relation to arise, for agency is consensual." Kingston Dry Dock Co. v. Lake Champlain Transp. Co., 31 F.2d 265, 267 (2d Cir. 1929).
such element exists under the instrumentality theory, since under this theory all of the debtor's conduct is within the scope of its employment for strict liability purposes.\textsuperscript{134} In other words, a separate liability scheme exists under each theory. Regardless of the de facto control exerted by a principal/creditor, it will only be subject to liability for its agent/debtor's tortious conduct when the conduct was within the scope of employment. This is true because the principal and agent still remain separate entities, with liability only extending to that conduct affected by or incidental to the de facto control. On the other hand, if the requisite degree of control is present under the instrumentality theory, there is no further inquiry; the secured creditor is liable for its debtor's tortious conduct. This is true because the instrumentality theory assumes that, as the alter ego of the debtor, the secured creditor exercises control over all aspects of the debtor's business. Thus, compared to the agency theory, the instrumentality theory requires a higher degree of control, and the secured creditor faces a broader standard of liability.

III. THE THREE BRANCHES OF GOVERNMENT - INCONSISTENCY

Although well-established doctrines of lender liability exist in the common law, neither the courts nor the EPA have effectively utilized these doctrines to interpret CERCLA's security interest exemption. Instead, the EPA and the courts have attempted to apply this exemption to the secured creditor/debtor relationship with little guidance from Congress as to the allowable degree of lender control permitted under the exemption. The result has been inconsistency within each branch of government, as well as among the three branches of government. With the EPA's issuing of the final rule on CERCLA's security interest exemption, and the judiciary's mandate to interpret the security interest exemption with reference to common-law principles, Congress must act to resolve the inevitable confusion regarding lender liability under CERCLA. In enacting its interpretation of the security interest exemption, Congress should refer to well-established common-law

\textsuperscript{134} Although the instrumentality theory has a second requirement of proximate cause, see supra note 103 and accompanying text, this negligence element is not required where strict liability is imposed, as in CERCLA. Nevertheless, even when strict liability is imposed, the agency theory requires that the agent was acting within the scope of its employment.
principles of lender liability (agency and instrumentality) as aids in clarifying CERCLA.

A. The Courts

Only two circuit courts have considered the issue of whether a secured creditor's activities fall within the scope of the security interest exemption. Before the issue reached these courts, however, district and bankruptcy courts had considered the issue.\footnote{135 See, e.g., Guidice v. BFG Electroplating & Mfg. Co., 782 F. Supp. 556 (W.D. Pa. 1989); United States v. Maryland Bank and Trust Co., 632 F. Supp. 573 (D. Md. 1986); In re T.P. Long Chemical, Inc., 45 B.R. 278 (Bankr. N.D. Ohio 1985); United States v. Mirabile, 15 Envtl. L. Rep. (Envtl. L. Inst.) 20,992 (E.D. Pa. 1985).} These decisions reflected various interpretations of the security interest exemption including: (1) in order to be considered to be participating in the management of a facility, a secured creditor "must, at a minimum, participate in the day-to-day operational aspects of the site;"\footnote{136 Mirabile, 15 Envtl. L. Rep. at 20,996 (emphasis added). Mirabile involved an EPA cleanup of hazardous wastes allegedly created by Turco Coatings, Inc. (Turco) which operated a paint manufacturing business at the contaminated site (the Turco site). In 1978 American Bank and Trust Company (the secured creditor) negotiated a loan with Arthur C. Mangels Industries (Mangels) which was secured in part by a mortgage on the Turco site. Three years later, Turco acquired 95 percent of Mangels' outstanding shares and began manufacturing paint at the Turco site. The secured creditor's mortgage remained in effect throughout, and, in 1980, Turco filed for Chapter 11 bankruptcy. On August 21, 1981, the secured creditor foreclosed on the Turco site, and on December 15, 1981, the secured creditor assigned its bid to the Mirabiles. Between August and December, the secured creditor "secured the building against vandalism by boarding up windows and changing locks, made inquiries as to the property, and ... visited the property on various occasions for the purpose of showing it to prospective purchasers." Id.}

Considering whether the secured creditor participated in the management of the facility during these four months sufficiently to void the security interest exemption, see infra note 137 (discussing whether the Mirabile secured creditor held indicia of ownership primarily to protect security interest), the court held:

The actions undertaken by [the secured creditor] ... simply cannot be deemed to constitute participation in the management of the site .... [I]n enacting CERCLA Congress manifested its intent to impose liability upon those who were responsible for and profited from improper disposal practices. Thus, it would appear that before a secured creditor ... may be held liable, it must, at a minimum, participate in the day-to-day operational aspects of the site.

Id. (emphasis added).

According to the Mirabile court, the security interest exemption's reference to management of the facility rather than management of the affairs of the actual owner or operator of the facility suggested "that the participation which is critical is participation in operational, production, or waste disposal activities. Mere financial ability to control waste disposal practices ... is not ... sufficient for the imposition of liability." Id. at 20,995.
closure indicates that the secured creditor holds indicia of ownership primarily to protect its security interest; and (3) holding property for four years after foreclosure and during the EPA cleanup of hazardous wastes indicates that the secured creditor holds indicia of ownership for investment purposes.

Guidice also supported the requirement of day-to-day participation in the management of a facility. In 1986, residents of the Borough of Punxsutawney, Pennsylvania, commenced an action against BFG Electroplating and Manufacturing Company (BFG) for unlawfully contaminating the environment under CERCLA. BFG filed a third party complaint against current and past owners of adjacent land (the Berlin Property) which included the National Bank of the Commonwealth (the secured creditor). During the 1970's, Berlin Metal Polishers (Berlin) had operated a metal polishing company at the Berlin Property. In 1971, the secured creditor had approved a line of credit for Berlin which was secured by assignment of Berlin's accounts receivable. Between 1971 and 1975, the secured creditor approved several extensions and renewals of this line of credit. Nevertheless, Berlin defaulted on the loan and, in April 1982, the secured creditor foreclosed on the property. Guidice, 792 F. Supp. at 558-60.

Considering whether the secured creditor was liable as a potential owner or operator before the foreclosure, the Guidice court stated:

Interpretation of 'participating in the management' and 'primarily to protect its security interest' has permitted secured creditors 'to provide financial assistance . . . [in] . . . general, and even isolated instances of specific management advice to its debtors without risking CERCLA liability if the secured creditor does not participate in the day-to-day management of the business or facility . . . .


Since there was no evidence that the secured creditor "controlled operational, production, or waste disposal activities at the Berlin Property," the court held that the secured creditor was not liable as an owner or operator prior to foreclosure due to the security interest exemption. Id. at 562. See infra note 138 (discussing liability of the Guidice secured creditor after foreclosure).

137 Mirabile, 15 Envtl. L. Rep. at 20,996. The secured creditor foreclosed on the debtor's property and held the property for four months. During those four months, the secured creditor "secured the building against vandalism by boarding up windows and changing locks, made inquiries as to the property, and . . . visited the property on various occasions for the purpose of showing it to prospective purchasers." Id. Nevertheless, the court concluded that these activities fell within the scope of the security interest exemption because the secured creditor's "actions with respect to the foreclosure were plainly undertaken in an effort to protect its security interest in the property." Thus, the secured creditor fulfilled part of the exemption: it held "indicia of ownership" primarily to protect its security interest. See supra note 136 (discussing why the Mirabile secured creditor did not participate in the management of the facility so as to void the exemption).

138 Maryland Bank & Trust, 632 F. Supp. at 579. As in Mirabile, the Maryland Bank & Trust court considered whether a secured creditor's activities after foreclosure fell outside the scope of the security interest exemption. From 1944 through 1980, Herschel and Nellie McLeod owned property (the CMD site) on which they conducted two businesses — Greater St. Mary's Disposal and Waldorf Sanitation of St. Mary's. During the 1970's the McLeod's received loans from Maryland Bank and Trust (the secured creditor) which
United States v. Fleet Factors Corp. was the first federal appellate court case to consider the scope of a secured party’s liability under CERCLA. The EPA brought this action to recover a $400,000 cleanup of toxic chemicals and asbestos at Swainsboro

were secured by a mortgage on the CMD site. In 1972 and 1973, the McLeod's allowed hazardous waste disposal on the CMD site, and in 1980 Mark McLeod, the McLeod's son, purchased the CMD site from his parents with a loan from the secured creditor. When Mark failed to make payments on the loan, the secured creditor purchased the site at a foreclosure sale on May 15, 1982. In 1983, the EPA initiated cleanup of the site, incurring approximately $552,000 in cleanup costs. Unlike the secured creditor in Mirabile, however, the secured creditor still held title to the property after the foreclosure sale and during the EPA cleanup. Id. at 575-76.

In analyzing the issue of the secured creditor's liability as an owner or operator, the court stressed that the security interest must exist at the time of the cleanup in order to gain protection under the security interest exemption. Focusing on the fact that the secured creditor "purchased the property at the foreclosure sale not to protect its security interest, but to protect its investment," the court held that only prior to foreclosure did the secured creditor hold indicia of ownership primarily to protect its security interest. Id. at 579. Allowing a creditor-turned-owner to claim the security interest exemption would cause:

the federal government alone . . . [to] . . . shoulder the cost of cleaning up the site, while the former mortgagee-turned-owner, would benefit from the cleanup by the increased value of the now unpolluted land . . . .

In essence, th[is] . . . would convert CERCLA into an insurance scheme for financial institutions, protecting them against possible losses due to the security of loans with polluted properties . . . . CERCLA will not absolve them from responsibility for their mistakes of judgment.

Id. at 580.

According to the court, Congress intended the security interest exemption's indicia of ownership criteria to address situations in those states where the common law operates so that mortgagees hold title to the property during the life of the mortgage. Id. at 579. Nevertheless, "[t]he exclusion does not apply to former mortgagees currently holding title after purchasing the property at a foreclosure sale, at least when, as here, the former mortgagee has held title for nearly four years, and a full year before the EPA cleanup." Id. Although Maryland Bank & Trust did not address the issue of "participation in management," it did enunciate a broader interpretation than Mirabile of the security interest exemption's reference to "indicia of ownership" as it pertains to lenders who take title upon foreclosure.

Likewise, in Guidice the court adopted Maryland Bank & Trust's approach to whether the security interest exemption applies to a secured creditor after foreclosure. See supra note 136 (discussing the Guidice secured creditor's liability prior to foreclosure). According to the Guidice court, Mirabile and Maryland Bank & Trust approached the issue from different directions: Mirabile asked "whether a lender is precluded from invoking the security interest exemption," while Maryland Bank & Trust asked "whether the exemption applies in the first place." 732 F. Supp. at 562. The Guidice court held, "When a lender is the successful purchaser at a foreclosure sale, the lender should be liable to the same extent as any other bidder at the sale would have been." Id. at 563.

139 901 F.2d 1550 (11th Cir.), reh'g denied, 911 F.2d 742 (11th Cir. 1990), cert. denied, 111 S. Ct. 752 (1991).
Print Works (SPW), a cloth printing facility. In 1976, Fleet Factors Corporation (Fleet) and SPW entered into a factoring agreement. Pursuant to this agreement, Fleet agreed to advance funds against SPW's accounts receivable, and Fleet obtained a security interest in SPW's textile facility and all of its equipment, inventory, and fixtures. Although SPW filed for Chapter 11 bankruptcy in 1979, the factoring agreement continued with court approval. Two years later Fleet ceased advancing funds to SPW, but continued to collect on the accounts receivable assigned to it under the court-approved factoring agreement. By the end of 1981, SPW had been adjudicated bankrupt, and a trustee assumed title and control of the facility. In May 1982, Fleet foreclosed on its security interest in some of SPW's inventory and equipment (but not property). Fleet contracted with Baldwin Industrial Liquidators (Baldwin) to conduct an auction where the items were sold "as is" and "in place." The purchasers of the items were responsible for their removal. Baldwin allegedly removed fifty-five gallon drums of toxic chemicals away from the sales area before the auction. Additionally, the purchasers at the auction allegedly disturbed asbestos that was on the pipes connected to the equipment and machinery.

Approximately three months later, Fleet contracted with Nix Riggers to remove the unsold equipment from the facility, and by the end of 1983, Nix vacated the premises. Before vacating the premises, however, Nix allegedly disturbed asbestos in the same manner as the purchasers at the auction.

140 Id. at 1553.
141 A factoring agreement is typically "a sale of accounts receivable to another party at a discount. The purchasing party assumes the risk of loss from the receivables. This type of agreement envisions that the purchasing party will be substantially involved in the financial affairs of the seller of the receivables." Bruce P. Howard & Melissa K. Gerard, Lender Liability Under CERCLA: Sorting Out the Mixed Signals, 64 S. CAL. L. REV. 1187, 1195 n.35 (1991).
142 901 F.2d at 1552.
143 Id.
144 Id. Fleet ceased advancing funds because SPW's debt exceeded Fleet's estimate of the value of SPW's accounts receivable. Id.
145 Id.
146 Id. at 1552-53. The auction took place on June 22, 1982.
147 Id. at 1560 n.14.
148 Id. at 1553. Nix Riggers was instructed to leave the premises "broom clean." At deposition, Nix testified that he "understood that he had been given a 'free hand' by Fleet or Baldwin to do whatever was necessary at the facility to remove the machinery and equipment." Id.
149 Id. at 1560 n.14.
An EPA inspection of the facility after a fire in early 1983 revealed 700 fifty-five gallon drums of toxic chemicals and forty-four truckloads of asbestos materials.\textsuperscript{150} On July 9, 1987, two days after Emanuel County, Georgia, gained title to the facility through a foreclosure sale, the EPA brought this action against Fleet to recover the $400,000 cost of the hazardous waste cleanup.\textsuperscript{151}

On appeal the Eleventh Circuit affirmed the district court's denial of Fleet's motion for summary judgment. The Eleventh Circuit considered Fleet's liability under both present owner or operator status (§ 9607(a)(1)), and owner or operator status at the time of disposal (§ 9607(a)(2)). While the Court of Appeals dismissed Fleet's possible liability under § 9607(a)(1),\textsuperscript{152} it held that § 9607(a)(2) provided a basis for liability. Under § 9607(a)(2), Fleet could be held liable either if it operated the facility within the meaning of § 9607(a)(2), or if it held indicia of ownership and participated in the management of the facility to a degree which would eliminate the security interest exemption. Although Fleet could be held liable under either theory, the Court of Appeals only considered Fleet's potential liability under the latter analysis - that is, the secured creditor analysis.\textsuperscript{153}

Accepting as undisputed the fact that Fleet held an "indicia of ownership" in the SPW facility primarily to protect its security interest,\textsuperscript{154} the Court of Appeals focused on "whether Fleet participated in management sufficiently to incur liability under the statute."\textsuperscript{155} The dispositive question for the court was not whether

\textsuperscript{150} Id. at 1553.

\textsuperscript{151} Id.

\textsuperscript{152} Id. at 1554-55. At the time the litigation commenced, Emanuel County, Georgia, was the owner of the SPW facility. CERCLA provides, however, that if a state or local government involuntarily acquires title to a facility, one must look to the "person who owned, operated, or otherwise controlled activities at such facility immediately beforehand" in order to determine the person who has current owner or operator status under § 9607(a)(1). 42 U.S.C. § 9601(20)(A)(iii). Since the bankrupt estate and trustee of SPW were the owners of the facility "immediately beforehand," Fleet could not be held liable under § 9607(a)(1). Fleet's involvement with the facility terminated more than three years before the county assumed ownership. 901 F.2d at 1555.

\textsuperscript{153} Id. at 1556 n.6. "In order to avoid repetition, and because this case fits more snugly under a secured creditor analysis, we will forgo an analysis of Fleet's liability as an operator." Id.

\textsuperscript{154} Id. at 1556.

\textsuperscript{155} Id. The EPA argued that the security interest exemption should be narrowly interpreted so that "any secured creditor that participates in any manner in the management of a facility," would be excluded from the protection of the security interest exemption. Id. at 1556. The court rejected the government's interpretation because "it would largely eviscerate the exemption Congress intended to afford to secured creditors." Id. The court
the secured creditor acted with the purpose of protecting its security interest, but rather, what was the character and scope of the secured creditor’s involvement with the facility. Enunciating its standard for holding secured creditors liable as owners under § 9607(a)(2), the court stated:

[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 treatment of hazardous wastes. 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 . . . . Nor is it necessary for the secured creditor to participate in management decisions relating to hazardous waste. Rather, 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 chose.\(^{156}\)

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**stated:**

Secured lenders frequently have some involvement in the financial affairs of their debtors in order to insure that their interests are being adequately protected. To adopt the government’s interpretation of the secured creditor exemption could expose all such lenders to CERCLA liability for engaging in their normal course of business.

*Id.*

On the other hand, Fleet urged the court to “adopt the distinction delineated by some district courts [including the court below and *Mirabile*] between permissible participation in the financial management of the facility and impermissible participation in the day-to-day or operational management of a facility.” *Id.* (emphasis added). As with the EPA’s interpretation, however, the Eleventh Circuit rejected Fleet’s interpretation:

In order to achieve the “overwhelmingly remedial” goal of the CERCLA statutory scheme, ambiguous statutory terms should be construed to favor liability for the costs incurred by the government in responding to the hazards at such facilities . . . . [A] broad interpretation of the exemption would essentially require a secured creditor to be involved in the operations of a facility in order to incur liability. This construction ignores the plain language of the exemption and essentially renders it meaningless. Individuals and entities involved in the operations of a facility are already liable as operators under the express language of section 9607(a)(2). Had Congress intended to absolve secured creditors from ownership liability, it would have done so. Instead, the statutory language chosen by Congress explicitly holds secured creditors liable if they participate in the management of a facility.

*Id.* at 1557.

156 *Id.* at 1557-58 (emphasis added). Commentators argue that this language is dicta since the court did not have to enunciate such a broad standard in order to deny Fleet’s motion for summary judgment.
Applying this standard to Fleet's alleged involvement with SPW, the court found that Fleet was removed from the protection of the secured creditor exemption.\textsuperscript{157}

The Court of Appeals divided Fleet's involvement with the borrower into three stages of activity: (1) 1976 until SPW ceased printing operations in early 1981, (2) early 1981 until the auction, and (3) after the auction.\textsuperscript{158} The court found Fleet's second and third stage activities impermissible under CERCLA.\textsuperscript{159} During the second stage, Fleet participated in the financial management of SPW to a degree indicating a capacity to influence hazardous waste decisions through the following alleged activities: (1) requiring SPW to seek Fleet's approval before shipping goods, (2) establishing the price for excess inventory, (3) dictating who should receive finished goods and when they should receive them, (4) deciding when to fire employees, (5) supervising the activity of SPW's office administrator, (6) controlling access to the facility, (7) receiving and processing SPW's employment and tax forms, and (8) contracting with Baldwin to conduct the auction.\textsuperscript{160} Additionally, during the third stage Fleet's activities were impermissible under CERCLA's security interest exemption.\textsuperscript{161}

\textit{Hill v. East Asiatic Co.}\textsuperscript{162} is the only decision since \textit{Fleet Factors}\textsuperscript{163} to address the question of whether a lender is relieved from cleanup cost liability under CERCLA's security interest exemption. This case involved a complex set of financial arrangements among Bergsoe Metal Corporation (Bergsoe), the Port of St. Helens (the Port), the United States National Bank of Oregon (the Bank), and the EAC corporations (EAC).\textsuperscript{164} The Port, a

\begin{itemize}
\item \textsuperscript{157} Id. at 1559-60.
\item \textsuperscript{158} Id.
\item \textsuperscript{159} The court held that Fleet's activities during the first stage (advancing funds, paying and arranging security deposits for SPW's utility services, and ceasing funds when SPW's debt exceeded the value of the accounts receivable) were within the scope of the security interest exemption. \textit{Id.} at 1559.
\item \textsuperscript{160} Id.
\item \textsuperscript{161} Id. at 1560. Fleet's activities during this stage also indicated CERCLA operator status.
\item \textsuperscript{162} 910 F.2d 668 (9th Cir. 1990).
\item \textsuperscript{163} While no subsequent court decisions have been rendered addressing the concept of lender control under CERCLA's security interest exemption, cases have been filed and are pending in courts regarding this issue. See, e.g., Howard and Gerard, supra note 141, at 1199-1200 n.57.
\item \textsuperscript{164} 910 F.2d at 669. Bergsoe's stock was owned by the EAC corporations which were the East Asiatic Company, Incorporated, the East Asiatic Company, Limited, and Heidelberg Eastern, Incorporated.
\end{itemize}
municipal corporation authorized to issue revenue bonds to promote industrial development in the St. Helens, Oregon area, financed Bergsoe’s construction of a lead recycling plant through revenue bonds and leased Bergsoe the property on which the plant was built. The Port mortgaged the property and lead recycling plant to the Bank as trustee for the bondholders. The Bank not only acted as trustee, but also purchased the bonds from the Port, who, in partial consideration, subordinated all its rights and revenues under the leases to the Bank. Therefore Bergsoe paid rent directly to the Bank. Through these financial transactions, the Port gained the status of a secured creditor. When the plant experienced financial difficulties, the Bank and the Port agreed not to foreclose on Bergsoe, and instead, appointed Front Street Management Corporation (Front Street) to manage the plant. Nevertheless, the plant did not resolve its financial situation, and, on October 21, 1986, the Bank forced Bergsoe into Chapter 11 bankruptcy. By this time, it was discovered that the plant had been contaminated with hazardous substances and this action resulted. On appeal, the Ninth Circuit considered whether the Port’s activities fell outside the scope of the security interest exemption. EAC claimed that the Port’s activities constituted participation in management because the Port negotiated and encouraged the construction of the plant, decided to appoint Front Street to manage the plant, and held rights of inspection and reentry upon foreclosure. While the Ninth Circuit recognized the Fleet Factors standard, it stated, “It is clear from the statute that, whatever

165 Id. at 669-70.
166 Id. at 670.
167 Id. Additionally, the Port placed documents pertaining to the transactions in escrow with the Bank, with instructions to deliver the documents to Bergsoe if it exercised its option to purchase the facility. Id.
168 The court recognized that “the Port held title to the property not to ensure that it would receive payment [as in the case of most secured creditors], but to guarantee that Bergsoe would cover the Port’s own indebtedness under the bonds.” Id. at 671. The court concluded, however, that this difference does not change the analysis involved when determining whether the Port falls under CERCLA’s security interest exemption. Id.
169 Id. at 670.
170 Id.
171 The Bank and the trustee in bankruptcy requested that EAC be held liable for the costs of the hazardous waste cleanup. EAC filed a counterclaim, which included a third-party complaint against the Port. The Port moved for summary judgment which was granted by the bankruptcy court and affirmed by the district court. EAC appealed this ruling to the Court of Appeals. Id.
172 Id. at 672-73.
the precise parameters of ‘participation,’ there must be some actual management of the facility before a secured creditor will fall outside the exemption.”

Analyzing the Port’s involvement, the Ninth Circuit found that the Port had not participated in the management of the plant: “That a secured creditor reserves certain rights to protect its investment does not put it in a position of management. What is critical is not what rights the Port had, but what it did.” According to the court, the Port did not participate in the plant’s management and, thus, was not an “owner or operator” under CERCLA due to the security interest exemption.

The Ninth Circuit enunciated a different standard of participation required to void the security interest exemption. The Ninth Circuit required participation in the form of actual management, while the Eleventh Circuit required participation in financial management indicating a capacity to influence hazardous waste decisions. Therefore, due to the split in the circuits, which interpretation is correct — in other words, which interpretation is in congruence with the common law? The answer is that both the Ninth Circuit and the Eleventh Circuit reached the correct result, but neither used the correct analysis. Both circuits failed to refer to common-law principles of lender liability (agency and instrumentality) which offer insight into the allowable degree of a lender’s control.

_Fleet Factors_ involved a secured creditor whose conduct, from the time it ceased advancing funds in 1981 until Nix vacated the premises, constituted de facto control under the typical agency analysis. As did the secured creditor in _Cargill_, the secured creditor in _Fleet Factors_ was involved in the winding down operations of its debtor to such an extent that it controlled the manner and cost of the debtor’s sales of goods, as well as the internal operation and financial management of the debtor. Additionally, the secured creditor had the right of entry onto the debtor’s premises (and exercised this right), as did the secured creditor in _Cargill_. Therefore, the required degree of control under the agency theory was present through the _Fleet Factors_ secured creditor’s alleged

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173 Id. at 672.
174 Id.
175 The Ninth Circuit rejected these arguments due to a lack of facts, and because nearly all secured creditors have these rights and are in these positions. Thus, the Ninth Circuit stressed the need for actual participation. Id. at 672-73.
activities. The hazardous waste contamination occurred within the bounds of this control, or within the scope of the debtor’s employment, since the hazardous waste contamination resulted from activities authorized by the secured creditor. Additionally, the secured creditor’s involvement during the auction and subsequently constituted actual, total, participatory control as required by the instrumentality theory. Thus, the Eleventh Circuit reached the correct result, because the secured creditor’s activities caused it to lose the protection of the security interest exemption due to its amount of control.

The court’s reasoning in Fleet Factors, however, is flawed. The court stressed that financial management to a degree indicating a mere capacity to influence hazardous waste decisions could remove a secured creditor from the security interest exemption. Compared to both common-law principles of agency and instrumentality, this standard is much too broad. Both theories require a much higher degree of control by the secured creditor. The instrumentality theory requires actual, participatory, total control which is not present in a mere capacity to influence. The agency theory allows the degree of control to be present through a right to control, but this right must be more than a mere capacity to influence. It must be an actual right to de facto control—a higher standard than the mere capacity to influence hazardous waste decisions. Additionally, this right to de facto control must extend either explicitly or implicitly to the tortious conduct of the debtor. Thus, due to the agency theory’s requirement that the debtor’s tortious conduct was within the scope of employment, the secured creditor’s de facto control must encompass the debtor’s hazardous waste decisions—not merely influence these decisions, but actually authorize (explicitly or implicitly) these decisions.

In Hill v. East Asiatic Co. the Ninth Circuit also reached the correct result. The secured creditor’s activities did not constitute control under either the agency or instrumentality theory. Although the secured creditor appointed a third party to manage the debtor, negotiated and encouraged the construction of the debtor’s plant, and had the right of entry after foreclosure, the agency theory requires that the secured creditor’s activities be ex-

176 The secured creditor in Fleet Factors allegedly prohibited the debtor from selling several barrels of chemicals to potential buyers, and as a result, the barrels remained at the facility. 901 F.2d at 1559 n.13. Additionally, through the activities of third parties (Nix, Baldwin, and the purchasers at the auction), the secured creditor authorized the alleged activities which caused the hazardous waste contamination. Id. at 1560 n.14.
amined as a whole. As a whole, the secured creditor’s activities were simply too minimal to constitute de facto control. In essence, the secured creditor assigned any involvement it would have with the debtor to a third party (the Bank), and remained involved only on paper. Additionally, the secured creditor’s activities did not even approach the standard of control required by the instrumentality theory. Therefore, like the Ninth Circuit’s result, neither agency nor instrumentality would have found the secured creditor liable for the debtor’s tortious conduct. Again, however, the reasoning of the Ninth Circuit is incorrect. The Ninth Circuit disregarded a creditor’s rights as having any influence over whether it falls outside the security interest exemption. While the instrumentality theory requires actual participation by the creditor, the agency theory allows a creditor’s right to de facto control to meet the requisite degree of control under this common-law theory so long as the right to control encompasses the debtor’s scope of employment.

Both decisions are flawed in that neither used common-law principles to reach its decision. The agency and instrumentality theories should both be used to interpret CERCLA’s security interest exemption. These decisions are also flawed because both the Ninth and Eleventh Circuits examined each element of the security interest exemption separately. This is inappropriate because a secured creditor will no longer hold indicia of ownership primarily to protect its security interest when an agency or instrumentality relationship is established. Nevertheless, the existence of both an agency and instrumentality relationship is determined by the amount of control exerted over the debtor — i.e., the degree of participation in management. Therefore, both circuits ignored the reality that the factors indicative of participation in management are also indicative of whether a secured creditor held indicia of ownership primarily to protect its security interest.

B. The Environmental Protection Agency

In 1990, the EPA construed the allowable activities under the security interest exemption in a very narrow manner. In its brief before the Eleventh Circuit in Fleet Factors, the EPA stated:

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177 See supra notes 20-22 and accompanying text.
178 See text accompanying infra notes 211-15.
[The secured creditor] exemption is available only to those who do not participate in management of the facility, not those who participate in management for limited purposes, such as in order to protect their security interest. Read for its plain meaning, CERCLA's phrase 'without participating' cannot be twisted to mean 'while participating only for limited purposes.'

A test requiring participating in day-to-day management comes near to holding secured creditors liable only when their involvement would suffice to hold them independently liable as operators. This is unjustified, given their underlying status as owners. By waiting to foreclose until after a government funded cleanup was completed, they could unjustly benefit from the improvement in the property value. Isolated instances of making or sharing management decisions, especially when those decisions directly affect the release or disposal of hazardous substances, should suffice to attach liability.

Then a year later the EPA radically changed its view of the security interest exemption.

On June 24, 1991, the EPA proposed a rule ("proposed rule") to clarify the meaning of CERCLA's security interest exemption, and requested comments on this rule. Almost one year later, and after receiving over 350 comments on the proposed rule, the EPA issued its final rule ("final rule") on April 24, 1992. With the final rule, the EPA adopted a hands-off policy

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179 Brief for Appellee at 40-41, United States v. Fleet Factors, 901 F.2d 1550 (11th Cir.) (No. 89-8094), reh'g denied, 911 F.2d 742 (11th Cir. 1990), cert. denied, 111 S. Ct. 752 (1991), quoted in, Howard and Gerard, supra note 141, at 1202. See p.63 n.6. For the Eleventh Circuit's response to this argument, see supra note 155.


181 This rule also interprets CERCLA's § 101(35)(A)(ii) pertaining to "the ownership status under CERCLA of government entities that acquire contaminated facilities through escheat, eminent domain, involuntary transfer or acquisition, and other means ...." 56 Fed. Reg. 28798, 28798 (1991) (to be codified at 40 C.F.R. pt. 300) (proposed June 24, 1991). Under this section, a governmental lending entity, receiver, or conservator may be entitled to assert the "innocent landowner defense" if it involuntarily acquired a contaminated facility. See supra note 12. The EPA includes within the scope of this section "the acquisition of facilities by governmental entities through an involuntary transfer under statutes requiring the acquisition of property in which the governmental entity holds a security interest or has acted as a loan guarantor, conservator, or receiver, provided that the other elements of the defense are met." Id. Additionally, the EPA includes within the scope of this section other mechanisms of obtaining property, such as civil and criminal seizures and asset forfeitures. See id. at 28806-08.

Further analysis of this section of the EPA's proposed rule is beyond the scope of this Note.

by leaving lenders’ problems under CERCLA up to market determinations.\textsuperscript{185} As did the proposed rule, the final rule interprets § 9601(20)(A) as permitting “a person covered by the exemption to undertake a broad range of activity in the course of protecting a security interest in a facility that is subject to CERCLA, without being considered to be participating in the management of the facility.”\textsuperscript{184}

With the rule, the EPA attempts to define the three elements of the security interest exemption: “indicia of ownership,” “primarily to protect [the] security interest,” and “participating in the management.” “Indicia of ownership” is defined as “evidence of interests in real or personal property.”\textsuperscript{185} The final rule explicitly

\textsuperscript{184}\textsuperscript{} 1992) (unpublished rule on file with the Environmental Protection Agency). At the time that this Note was sent to the printer, the final rule had not yet been published in the Federal Register. The final rule will become effective once it is published. Id. (unpublished rule at 2).

One of the major differences between the proposed rule and the final rule is the final rule’s discussion of the coverage of trustees and fiduciaries. While the EPA does not extend the security interest exemption to trustees, it stresses that this is not necessary:

The assumption of several commenters — that a trustee is \textit{personally} liable under CERCLA solely because a trust asset is contaminated even if the trustee had no knowledge of the asset’s contamination and was in no way involved in the activities that resulted in the contamination — is incorrect. No case has so held, and no commenter cited any principle of law that would command this result. Id. (unpublished rule at 24).

Unlike the proposed rule, the final rule also addresses the application of this rule on CERCLA’s security interest exemption to other federal and state laws. The EPA states that it has begun to work on a proposed rule which would interpret the security interest Exemption of the Resource Conservation and Recovery Act (RCRA), 42 U.S.C. § 6991(h)(9) in a manner similar to the final rule’s interpretation of CERCLA’s security interest exemption. Nevertheless, the EPA explains that “this final rule does not preempt a holder’s potential liability under any other state or federal law to which the holder is also subject, nor can it be construed to subordinate CERCLA to other state or federal laws.” 57 Fed. Reg. (unpublished rule at 27).

Other differences and similarities are explained in part III of the final rule, and include other topics such as the general test of participation in management, see infra notes 200-03 and accompanying text, and the consistent application of the exemption to different types of property, 57 Fed. Reg. (unpublished rule at 44-45).

\textsuperscript{183} Leaving a lender’s cost for investing in an environmentally unsound debtor up to the market does not eliminate the lender liability problem; rather, it shifts enforcement of lender liability from the EPA to the market.

\textsuperscript{184} 57 Fed. Reg. (unpublished rule at 11).

\textsuperscript{185} Id. (unpublished rule at 133). According to the EPA, examples of “indicia of ownership” include “a mortgage, deed of trust, or legal or equitable title obtained pursuant to foreclosure or its equivalents, a surety bond, guarantee of an obligation, title held pursuant to a lease financing transaction in which the lessor does not select initially the leased property, or an assignment, lien, pledge, or other right to or form of encum-
recognizes that "[t]here is no limitation or qualification on the type, quality, or quantity of ownership indicia... provided that the indicia are held primarily as protection for a security interest...." The EPA's definition of "primarily to protect [the] security interest" distinguishes between a *bona fide* security interest and interests in the nature of an investment in the facility. This definition requires "that the ownership interest be maintained *primarily* for the purpose of, or *primarily* in connection with, securing payment or performance of a loan or other obligation (a security interest), and not an interest in property held for some other reason." Therefore, under the security interest exemption, "indicia of ownership" held "primarily to protect [a] security interest" does not include "interests in the nature of an investment in the facility, or an ownership interest held primarily for any reason other than as protection for a security interest." Nevertheless, revenue interests in the loan transactions that create security interests are not considered investment interests.

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186 *Id.*
187 *Id.* This definition includes types of ownership interests other than actual title or a security interest because comments on the proposed rule questioned the scope of the definition of "security interest." *Id.* (unpublished rule at 32). As a result, the EPA chose to include within the definition of holders of security interests (in addition to the holders of traditional security interests in real property, i.e., mortgages, liens, and deeds of trust) persons involved in lease financing transactions, and "other persons involved in ensuring the free flow of credit and in providing for needed financing . . . ." such as loan guarantors and sureties. *Id.* (unpublished rule at 37).
188 The EPA defines a security interest as arising from "a transaction that . . . provides the holder with recourse against real or personal property of the person pledging the security; the purpose of the interest is to secure the repayment of money, the performance of a duty, or of some other obligation." *Id.* (unpublished rule at 134). Examples of a security interest include "mortgages, deeds of trust, liens, and title held pursuant to lease financing transactions." *Id.* (unpublished rule at 135). Additionally, "[s]ecurity interests may also arise from transactions such as sale-and-leasebacks, conditional sales, installment sales, trust receipt transactions, certain assignments, factoring agreements or accounts receivable financing agreements, [and] consignments . . . ." *Id.*
189 *Id.* (unpublished rule at 134) (emphasis added).
190 *Id.* (unpublished rule at 135). This is the only element of the security interest exemption which considers the motivation of the secured creditor. While protection of a security interest need not be the sole motivation, and a secured creditor may be motivated by secondary reasons, the secured creditor's possession of indicia of ownership must be *primarily* motivated by the desire to protect a security interest. *Id.* (unpublished rule at 47).
191 *Id.* (unpublished rule at 136).
according to the EPA, a creditor holding indicia of ownership primarily for investment purposes cannot gain protection from the security interest exemption; rather, only creditors holding indicia of ownership primarily to protect their security interest — in other words, to secure repayment for their loan — fall within the security interest exemption’s scope.

The most controversial of the EPA’s definitions is the meaning the EPA places on “participating in the management of a facility.” Before discussing this definition, the EPA concedes that the issue of whether a secured creditor participated in the management is a fact-sensitive inquiry. Nevertheless, the EPA goes on to define this fact-sensitive term as “actual participation in the management or operation of the facility by the holder [of the indicia of ownership primarily to protect the security interest], [which] does not include the mere capacity or unexercised right or ability to influence facility operations.” The EPA gives examples of activities commonly taken by a secured creditor considered “consistent with holding ownership indicia primarily to protect a security interest.” These activities, which do not constitute participation in the management of the debtor’s facility, include: (1) undertaking actions at the inception of a security interest, (2) policing the security interest or loan, (3) consultation and negotiation concerning the structure and terms of the loan or other obligation, the payment of interest, the payment period, and specific or general financial or other advice, suggestions, counseling, guidance, or other actions incident or prior to time that indicia of ownership are held to protect a security interest. Additionally, a secured creditor may require an environmental inspection of a facility as a condition to the debtor’s ability to secure the loan. If such an inspection occurs, it cannot be used to show that the secured creditor participated in the management of the facility. If such an inspection reveals contaminated property, however, the secured creditor has many options, including requiring the debtor to conduct a cleanup, and extending the security interest even though the property is contaminated. The EPA stresses that a secured creditor that “knowingly takes a security

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192 Id. (unpublished rule at 137).
193 Id.
194 The EPA’s list of permitted activities is devised from case law and comments on the proposed rule. Id. (unpublished rule at 138).
195 Id.
196 Id. (unpublished rule at 141-43). Actions undertaken prior to or at the inception of a transaction are not considered participation in management because absent indicia of ownership (which is not present at the time of these activities), the security interest exemption does not apply. Therefore, the following activities do not constitute participation in management:

consultation and negotiation concerning the structure and terms of the loan or other obligation, the payment of interest, the payment period, and specific or general financial or other advice, suggestions, counseling, guidance, or other actions incident or prior to time that indicia of ownership are held to protect a security interest.

Id. (unpublished rule at 141).

Additionally, a secured creditor may require an environmental inspection of a facility as a condition to the debtor’s ability to secure the loan. If such an inspection occurs, it cannot be used to show that the secured creditor participated in the management of the facility. Id. (unpublished rule at 142). If such an inspection reveals contaminated property, however, the secured creditor has many options, including requiring the debtor to conduct a cleanup, and extending the security interest even though the property is contaminated. The EPA stresses that a secured creditor that “knowingly takes a security
ducting loan workouts,\textsuperscript{198} and (4) foreclosing and selling or liq-

uidating.\textsuperscript{199} Nevertheless, even if the secured creditor's activities

interest in a contaminated facility is not subject to CERCLA liability solely on this basis." \textit{Id.} (unpublished rule at 143).

\textsuperscript{197} \textit{Id.} (unpublished rule at 143-44) Examples of a secured creditor's allowable polic-
ing of a security interest or loan include, but are not limited to:

\begin{itemize}
\item [1] a requirement that the borrower clean up the facility prior to or during the life of the loan or security interest;
\item [2] a requirement of assurance of the borrower's compliance with applicable federal, state, and local environmental or other rules and regulations during the life of the loan or security interest;
\item [3] securing authority or permission for the security holder to periodically or regularly monitor or inspect the facility in which the holder possesses indicia of ownership (including site inspections), or the borrower's business or financial condition, or both;
\item [4] or to comply with legal requirements to which the holder is subject;
\item [5] or [5] other requirements or conditions by which the holder is able to police adequately the loan or security interest, provided that the exercise by the holder of such other loan policing activities are not considered evidence of management participation as provided in the rule's 'general test' of management participation.
\end{itemize}

\textit{Id.} (unpublished rule at 143).

Additionally, the "inclusion of environmental warranties and covenants are not considered to be evidence of a holder acting as an insurer or guarantor, and liability cannot be premised on the existence of such terms . . . ". \textit{Id.} (unpublished rule at 144).

\textsuperscript{198} \textit{Id.} (unpublished rule at 144-45). "Loan workout" activities are not considered participation in the management as long as the secured creditor complies with the general test of management participation. \textit{Id.} (unpublished rule at 145). The EPA specifies some loan workout activities that comply with this test. These activities which are not considered participation in management include, but are not limited to:

\begin{itemize}
\item [1] restructuring or renegotiating the terms of the security interest;
\item [2] requiring payment of additional rent or interest;
\item [3] exercising forbearance;
\item [4] requiring or exercising rights pursuant to an assignment of accounts or other amounts owing to an obligor;
\item [5] requiring or exercising rights pursuant to an escrow agreement pertaining to amounts owing to an obligor;
\item [6] providing specific or general financial or other advice, suggestions, counseling, or guidance;
\item [7] and exercising any right or remedy the holder is entitled to by law or under any warranties, covenants, conditions, representations or promises from the borrower.
\end{itemize}

\textit{Id.}

\textsuperscript{199} \textit{Id.} (unpublished rule at 145-53). According to the rule, the following activities are within the security interest exemption's requirement that the indicia of ownership must be held primarily to protect the security interest:

- foreclosure, purchase at foreclosure sale, acquisition or assignment of title in lieu of foreclosure, repossession in the case of a lease financing transaction, acquisition of a right to possession or title, or other agreement in settlement of the loan obligation, or any other formal or informal manner by which the holder acquires possession of the borrower's collateral for subsequent disposition in partial or full satisfaction of the underlying obligation . . .

\textit{Id.} (unpublished rule at 146).

Nevertheless, such activities will be protected only if the acquisition pursuant to foreclosure is temporary and the secured creditor is seeking to sell of otherwise divest the prop-
are not included in one of the foregoing specified categories of activities, the security interest exemption may still be available to the secured creditor if its activities pass the two-pronged general test of participation in the management of a facility.\textsuperscript{200}
The intent of this final rule's general test "is to protect 'lenders from being exposed to CERCLA liability for engaging in their normal course of business,' while imposing liability where a holder moves from oversight and advice to instances of actual facility management."201 The first prong of the test provides that a secured creditor "participates in management where [it] has exercised decisionmaking control over the borrower's environmental compliance (i.e., the borrower's hazardous substance disposal or handling practices) . . . . It is not necessary for a holder to cause a release in order to be exercising control over a facility's hazardous waste disposal or handling practices."202 The second prong of the test provides that a secured creditor "participates in management when it assumes or manifests responsibility for the overall management of the enterprise encompassing the day-to-day decisionmaking over either (a) the enterprise's environmental compliance or (b) all, or substantially all, of the operational aspects of the enterprise other than environmental compliance."203 Therefore, if a secured creditor participates in the management under either prong of the final rule's general test, the security interest exemption no longer applies.

(1) The security holder is exercising decisionmaking control over the borrower's environmental compliance, such that the security holder has undertaken responsibility for the borrower's waste disposal or hazardous substance handling practices which results in a release or threatened release, or (2) the security holder is exercising control at a management level encompassing the borrower's environmental compliance responsibilities, comparable to that of a manager of the borrower's enterprise, such that the security holder has assumed or manifested responsibility for the management of the enterprise by establishing, implementing, or maintaining the policies and procedures encompassing the day to day environmental compliance decisionmaking of the enterprise.


The final rule changes this general test somewhat, largely due to "comments that the proposed rule's general test permitted activities that courts construing the exemption had prohibited . . . ." 57 Fed. Reg. (unpublished rule at 65).

201 57 Fed. Reg. (unpublished rule at 67). Additionally, the EPA believes that the general test should "reflect the distinction between the control exercised by a person who is exercising decisionmaking authority over the operational aspects of the facility, and the influence that may be exerted (no matter how great) over the borrower by a person who is not part of the facility's decisionmaking hierarchy." Id. (unpublished rule at 68).

202 Id. (unpublished rule at 69).

203 Id. (unpublished rule at 72). "A holder's involvement in financial or administrative matters does not rise to a level of management participation that will void the exemption because involvement in such areas does not assume the functions of facility operations . . . ." Id. (unpublished rule at 72-73).
The EPA rule is part of the National Contingency Plan (NCP). Under § 9605(a) of CERCLA, the EPA\textsuperscript{204} is empowered to publish the NCP "to reflect and effectuate the responsibilities and powers created by [CERCLA]."\textsuperscript{205} Although the EPA rule enunciates a narrower interpretation of control than the common-law principles of lender liability,\textsuperscript{206} it most likely will withstand judicial scrutiny.\textsuperscript{207} While courts must resort to the common law when interpreting statutes, the EPA's published standards for the NCP need only be within the agency's authority and reasonable.\textsuperscript{208}

\textsuperscript{204} This section actually refers to the President, but in practice it is the EPA that publishes the NCP. Under § 9615, the President "is authorized to delegate and assign any duties or powers imposed upon or assigned to him and to promulgate any regulations necessary to carry out the provisions of this subchapter." 42 U.S.C. § 9615. See \textit{supra} note 3.

\textsuperscript{205} \textit{Id.} § 9605(a). This section reads, in part:

[The NCP] shall establish procedures and standards for responding to releases of hazardous substances, pollutants, and contaminants, which shall include at a minimum: . . .

(3) methods and criteria for determining the appropriate extent of removal, remedy, and other measures authorized by this chapter; . . .

(9) specified roles for private organizations and entities in preparation for response and in responding to releases of hazardous substances, including identification of appropriate qualifications and capacity therefor . . . .

The President [EPA] may, from time to time, revise and republish the national contingency plan.

\textit{Id.}

\textsuperscript{206} The EPA's definition of "participation in management" does not appear to comply with common-law principles of lender liability. To be held liable under the rule while a debtor is still in possession, a creditor must decide aspects of the debtor's environmental compliance either explicitly or through its overall management control. For example, a creditor may regularly monitor or inspect a debtor's facility, business and financial condition; advise the debtor both on its finances and operations; and hold property after foreclosure for at least six months. While these activities may be within the scope of control permitted under the instrumentality theory, such activities have been found outside the allowable scope of control under the agency theory. See \textit{supra} part II C. Additionally, other activities found outside the scope of the requisite degree of control under agency may be found where the EPA states that the creditor may take any other reasonably necessary steps to police the loan, and provide loan workouts. These bright-line rules defining "participation in management" are not in accordance with the common law.

\textsuperscript{207} In order to obtain judicial review of this rule, an interested person must apply to the District of Columbia Circuit within ninety days after the rule is promulgated. \textit{Id.} § 9613(a). Another way in which the final rule could possibly be reversed is through a legislative veto. 57 Fed. Reg. (1992) (to be codified at 40 C.F.R. subpt. L) (issued April 24, 1992) (unpublished rule on file with the EPA, at 3.)

\textsuperscript{208} Although commentators have argued that the EPA rule is outside the scope of its authority under CERCLA since it promulgates standards distinguishing who will face liability and who will not, the recent trend of courts leans towards giving deference to agency decisions. While the degree of judicial review will depend on the type of rule and other factors which are outside the scope of this Note, it appears unlikely from the recent
Therefore, assuming that the rule withstands judicial review, the EPA must comply with the final rule's standards when deciding whether to seek reimbursement for response costs from lenders. This does not, however, end the issue of lender liability under CERCLA. There still remains the question of whether this rule applies to third parties seeking contribution under CERCLA, or private parties suing lenders under CERCLA. In other words, when third parties or private parties bring suit against lenders for CERCLA liability, do courts have to use the EPA rule to interpret the security interest exemption?

Although many commentators suggest that it is questionable whether the EPA rule applies to third parties and private parties,\(^2\) \(\S\) 9607(a)(B) appears to require that all such actions be consistent with the NCP.\(^2\) Therefore, assuming that third parties and private parties can only bring actions under CERCLA consistent with the NCP, how do the common-law principles of lender liability come into play for courts interpreting whether a lender's activities fall within the scope of CERCLA's security interest exemption? Does not the EPA rule negate the necessity of resorting to common-law principles for interpreting the security interest exemption?

\(^2\) See generally KENNETH C. DAvis, ADMINISTRATIVE LAW OF THE SEVENTIES §§ 29.01-1 to 29.01-5 (1976).


The answer is no for two reasons. First, the EPA final rule does not define every specific activity allowed by a lender under CERCLA. When a specific fact situation left unclear by the final rule comes before a court, the court must use the general test of participation in management to determine if the secured creditor's particular activities fall outside the scope of the security interest exemption. This general test is, however, just that — a general test open to interpretation. In interpreting this general test, therefore, courts must still resort to common-law principles to resolve the issue. Examining this general test, it appears to conform with a court's need to interpret CERCLA's security interest exemption with reference to common-law principles. The first prong of the test, a requirement that the secured creditor exercise decisionmaking control over the borrower's environmental compliance, resembles an agency-based theory. As with the agency theory, the secured creditor's control must extend to that aspect of the borrower's business in which the tort was committed — i.e., the environmental aspects of the borrower's business. Therefore, when interpreting the first prong of the final rule, courts should look to agency theory to determine what type of control is required since the test merely states "control." As with agency theory, this prong's strictest requirement is not with its definition of control, but rather with the narrow scope of liability that the secured creditor is exposed to — only that part of the debtor's business involved in environmental compliance.

On the other hand, the second prong of the general test of participation in management resembles the instrumentality theory. This prong requires participation in management so that the secured creditor is involved in day-to-day decisionmaking over either the borrower's environmental compliance, or all of the borrower's operational aspects of the enterprise. Such a rule more closely resembles the instrumentality theory's requirement of actual, total, participatory control over all aspects of the debtor's business, and, as such, courts should refer to this common-law theory when interpreting the second prong of the EPA's general test for participation in management.

Although the general test does negate some aspects of the common-law theories of agency and instrumentality, such as control over financial aspects of the debtor's business having no impact on whether the secured creditor participated in the management of the facility, these theories are important for courts to use
when interpreting the final rule’s general test with its inevitable gaps which will become evident on a case-by-case basis.

The second reason that the EPA final rule does not negate a court’s need to use the common-law principles of agency and instrumentality when interpreting CERCLA’s security interest exemption is found in a court’s inevitable task of interpreting the EPA’s definition of “primarily to protect a security interest.” Before even reaching the general test and the controversial issue of whether a secured creditor participated in the management of the facility, under the final rule a court must first determine whether the secured creditor held indicia of ownership primarily to protect its security interest. This inquiry focuses on the distinction between an investment and a bona fide security interest to secure repayment for a loan. In other words, a court must determine whether the secured creditor held indicia of ownership as an investment. If so, the secured creditor’s activities fall outside the scope of the security interest exemption, and the question of whether the secured creditor participated in the management of the facility is never even addressed.

Since the proposed rule does not provide analysis as to when a secured creditor’s activities constitute an investment, a court interpreting the rule must resort to common-law principles of lender liability. When a creditor/debtor relationship rises to the level of an agency or instrumentality, the purpose is no longer to secure the repayment of a loan; rather, a relationship different from the typical creditor/debtor relationship has arisen. The principal and the alter ego of the debtor both have an investment in the debtor’s business. They are no longer merely typical secured creditors — the debtor/agent acts for the principal’s benefit, and the debtor in the instrumentality scenario is actually the instrument of the creditor. Thus, under the EPA proposed rule, the creditor/principal and alter ego of the debtor are excluded from the scope of the security interest exemption before the EPA’s third definition — “participation in management” — is even considered.

The problem with the EPA proposed rule, however, is that the creditor/debtor relationship rises to the level of an agency or

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212 See supra notes 188-91 and accompanying text.
instrumentality based upon the level of control the creditor exercises over the debtor — in other words, the level of participation in management. As the level of participation in management increases, so does the likelihood that the creditor has become a principal or alter ego of the debtor. Therefore, some of the EPA's allowable creditor activities would cause a secured creditor to be a principal or alter ego of the debtor; thus, the secured creditor would be investing in the debtor's business. The inconsistency arises in the EPA's definition of participation in management, where the final rule (unlike the proposed rule) specifically states that the defined activities will not eliminate the secured creditor's status as holding indicia of ownership primarily to protect its security interest. While the rule states that discussion of secured creditors holding indicia of ownership primarily for investment purposes is outside the scope of the final rule, it nevertheless attempts to include secured creditors holding indicia of ownership primarily for investment purposes within the definition of participation in management. Thus, although the EPA explicitly states in its definition of participation in management that certain investment activities do not negate the security interest exemption, its general definition of primarily to protect a security interest would negate such activities. Thus, there is an inconsistency within the final rule itself. Additionally, when courts interpret the final rule, they may, as they are required to do, resort to common-law principles to clarify the EPA's meaning of investment under primarily to protect a security interest. If courts do as they should, the most controversial aspects of the final rule included in the definition of "participation in management" will be negated because some of the allowable activities under this element are not permitted under the other elements of the rule, namely the definition of primarily to protect a security interest.

214 Id.
215 A case-by-case analysis is the only way to truly determine which activities are permitted under these common-law theories. Nevertheless, the activities most likely to raise the creditor/debtor relationship to that of an agency or instrumentality are regularly monitoring and inspecting the debtor's business, facility, and operations, assuming financial control over the debtor through loan workout policies, and foreclosing for investment purposes. Although these activities are very broad, it is impossible to get more detailed since the common law judges such activities on a case-by-case basis. This case-by-case analysis must be used because it is not each activity alone that creates the requisite degree of control (also whether or not the debtor was acting within the scope of its employment is a fact specific determination under the agency theory).
Because the EPA ignored the well-established principles of agency and instrumentality in promulgating its final rule, and because courts should interpret CERCLA and the EPA final rule in a manner owing deference to the common law,\textsuperscript{216} inconsistency will remain between these two branches of government in the interpretation of CERCLA’s security interest exemption.

C. Congress

While many bills have been proposed in Congress to clarify the meaning of CERCLA’s security interest exemption, the only recent action Congress has formally taken on the issue was the reauthorization of CERCLA by the Omnibus Reconciliation Act of 1990. The closest any bill has come to passing both the Senate and the House was Title X of the banking and deposit insurance reform bill (S 543), proposed by Senator Garn (R-Utah).\textsuperscript{217} Although the lender liability clause passed the Senate, it did not pass the House, and, thus, was eventually dropped from the final bill.\textsuperscript{218}

Although no new bills have been proposed to clarify the security interest exemption, it is projected that during 1992 there will be a series of congressional hearings on CERCLA issues.\textsuperscript{219} Whether or not such a bill, which has failed in previous attempts, will pass during an election year of troubled economic times, however, is questionable.\textsuperscript{220} If Congress ever does pass legislation to

\begin{footnotes}
\textsuperscript{216} See supra notes 20-22 and accompanying text.
\textsuperscript{218} A Number of Banking Bills Died for Year When Congress Adjourned, 57 Banking Report (BNA) No. 23, at 930 (Dec. 1991).
\textsuperscript{219} Superfund, 22 Env’t Rep. (BNA)(Env’t Rep. Cas.) No. 39, at 2197 (Jan. 24, 1992). The House Public Works and Transportation Subcommittee on Investigations and Oversight will continue hearings begun in 1991 on specific superfund sites in an attempt “to ascertain why cleanups move quickly at some sites and slowly at others.” Id. Additionally, the House Energy and Commerce Subcommittee on Oversight and Investigations plans to “address EPA contracting and contractor charges under the superfund program,” and examine whether CERCLA successfully reduces threats to human health. Id. Likewise, the Senate Environment and Public Works Subcommittee on Superfund, Oceans, and Water Protection plans to hold hearings on CERCLA. Id.
\textsuperscript{220} “[S]everal congressional aides said the issue is too controversial for an election year since environmental groups are opposed.” Financial Institutions Legislation: Major Banking Bill Unlikely in 1991, [Special Report] Daily Rep. for Executives (BNA) DER No. 12, at S-4 (Jan. 17, 1992) (“I think it’s going to be a very political, partisan year, and I
clarify the meaning of CERCLA’s security interest exemption, however, the common-law principles of agency and instrumentality should be used as well-established doctrines to help clarify CERCLA’s statutory language.

IV. Conclusion

CERCLA’s security interest exemption has been subjected to many different interpretations with many different results. Unfortunately, courts have ignored the role that the common law should play in their interpretations of this statute, and consequently have failed to use the common-law principles of agency and instrumentality as aids in interpreting the security interest exemption. This Note urges the courts to do just that. Additionally, if courts effectively use common-law principles of lender liability, they will inevitably reach a different result than the EPA did with its final rule. The application of the security interest exemption to lenders will differ depending on who brings an action against lenders—the EPA or a private party. The quest for consistency, however, does not relieve courts from their obligation to interpret CERCLA with reference to the common law; rather, Congress must step in to resolve this inconsistency and clarify the meaning of this exemption. In passing legislation, however, Congress would achieve greater success if the well-established principles of common-law lender liability (the agency and instrumentality theories) were used to interpret CERCLA’s security interest exemption.

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