Lender Liability for Hazardous Waste: An Economic and Legal Analysis

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LENDER LIABILITY FOR HAZARDOUS WASTE: AN ECONOMIC AND LEGAL ANALYSIS

I. INTRODUCTION

The explosion of litigation and public concern over hazardous waste and other forms of pollution brings into sharp focus the conflict between environmental policy goals and economic goals. On the environmental side, statutes such as the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA" or "Superfund"), the Resource Conservation and Recovery Act ("RCRA"), and the Federal Water Pollution Control Act ("FWPCA") represent an attempt to force cleanup of existing pollution and deter future polluting activities. On the economic side, the concern is to preserve economic health by promoting business activity in the private sector. One of the most recent and significant areas in which these two policy goals have clashed involves the imposition of CERCLA liability upon a lending institution that becomes involved in the borrower's polluting activity.


5. See W. TUCKER, supra note 1.


7. See generally Murphy, The Impact of "Superfund" and Other Environmental Statutes on Commercial Lending and Investment Activities, 41 BUS. LAW. 1133 (1986) (suggesting methods to avoid environmental liability); Soriano & Locket, Hazardous Waste Liability: The Emerging Problem for Lenders, 12 CHEMICAL WASTE LITIGATION REP. 47 (1986) (arguing that lenders may foreclose and avoid liability where there is a prompt reassignment); Berts & Sexton, Lending Into Hazardous Substance
The purpose of this Comment is four-fold. First, the CERCLA liability scheme will be discussed to provide the necessary statutory background to evaluate the efficiency of imposing liability on lenders. Second, the decisions of United States v. Mirabile,8 United States v. Maryland Bank & Trust Co.,9 and other cases concerning lender liability will be discussed and analyzed. Third, an effort will be made to isolate the standard for imposing lender liability. Finally, the imposition of lender liability will be critiqued from an economic perspective.

This economic analysis suggests that courts should impose liability on lenders only where the lender is sharing in the profits of the manufacturer and there is a clear "joint venture" between the lending institution and the polluting enterprise. The current CERCLA scheme imposes liability on the polluting company with the result that these firms will "internalize" the "external" costs of pollution. In other words, once the legal rule forces internalization, the individual firm's cost structure will reflect the true cost to society and the efficient level of production will be reached through the normal competitive process. However, imposing liability on a party who does not make production decisions, such as the lender, imposes costs without creating any offsetting benefit. Indeed, this imposition forces an inefficient result. The joint venture standard avoids this inefficiency by restricting the imposition of liability to those cases where the lender is in a position to exercise the production decisions.

II. THE CERCLA LIABILITY SCHEME

The CERCLA legislation, as amended, was enacted in response to the threat posed by an increasing number of hazardous waste dumps.10 In order to deter future pollution and foster cleanup of existing sites, CERCLA imposes broad liability for releases of any hazardous substance.11 When an "imminent and substantial

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endangerment\textsuperscript{12} to public health exists, the government has two options. It may conduct the cleanup itself and seek reimbursement from "responsible parties,"\textsuperscript{13} or seek to have the responsible parties undertake the remedial action.\textsuperscript{14} Potentially responsible parties may be liable for all costs of removal or remedial action, any other necessary costs of response, and damages for injury to, destruction of, or loss of natural resources, including the costs of assessing the injury, destruction or loss resulting from the release.\textsuperscript{15}

CERCLA imposes liability on three classes of actors: past\textsuperscript{16} and present\textsuperscript{17} owners and/or operators of the facility, transporters of hazardous substances,\textsuperscript{18} and generators of hazardous substances.\textsuperscript{19} Courts generally interpret CERCLA to impose strict liability.\textsuperscript{20} In addition, courts typically impose joint and several liability.\textsuperscript{21} However, liability will be divided if there is a reasonable basis for apportionment of damages.\textsuperscript{22}

Under CERCLA, parties responsible to the government for the costs of cleanup cannot, by indemnification, "hold harmless," or similar contractual clauses, avoid liability to the government.\textsuperscript{23} Nevertheless, this provision does not invalidate any agreements to insure, hold harmless, or indemnify a contractual party for any liability.\textsuperscript{24} Furthermore, CERCLA does not prevent "a cause of action that an owner or operator or any other person subject to liability under this section, or a guarantor, has or would have, by reason of subrogation or otherwise against any person."\textsuperscript{25} The end result of this confusing analysis is

\textsuperscript{12} CERCLA § 104(a)(1), 106(a), 42 U.S.C. § 9604(a)(1), 9606(a) (1982).
\textsuperscript{13} CERCLA § 107, 42 U.S.C. § 9607 (1982) allows the government to bring suit against "potentially responsible parties." The term is not formally used or defined in CERCLA, but is used frequently to denote parties who could be held liable. See 1 C.F.R. § 305.84-4 (1988) (introductory paragraph).
\textsuperscript{14} CERCLA § 106(a), 42 U.S.C. § 9606(a) (1982).
\textsuperscript{15} CERCLA § 107(a), 42 U.S.C. § 9607(a) (1982).
\textsuperscript{17} CERCLA § 107(a)(1), 42 U.S.C. § 9607(a)(1) (1982).
\textsuperscript{24} Id.
\textsuperscript{25} CERCLA § 107(e)(2), 42 U.S.C. § 9607(e)(2) (1982). See Wehner v. Syntex Agribusiness,
that a party can not avoid liability to the government, but parties are free to allocate responsibility among themselves.

This Comment will focus on the definition of "owners and operators." If a lender is to be liable under CERCLA, the court must find that the lender is an "owner and operator." The statute defines this potentially responsible party to include any person owning or operating a vessel or an offshore facility, or any person who owned or operated or otherwise controlled an abandoned facility immediately prior to its abandonment. Although the statute requires a party to be an "owner and operator" to be liable, courts interpret the language as imposing liability on owners or operators.

Since the purpose of CERCLA is to provide a prompt and effective response to releases and potential releases of hazardous substances, the definition of "owners and operators" is interpreted very broadly. As a result, any party who holds an interest in a hazardous waste facility is at risk of CERCLA liability. Furthermore, the definition applies to "owners" and "operators" whose actions have not contributed to the environmental problems. Thus, courts have imposed liability on present owners, a firm that held title for only one hour in order to transfer the property, an owner/lessor of a site, corporate officers, and bankruptcy trustees, even though their actions played no role in the creation of the hazardous condition.

Given the expansion of liability, it is not surprising that courts have found the Superfund legislation to be applicable to lenders who become actively involved in the polluter/borrower's activities, or lenders who acquire title through foreclosure. A lender generally is


not liable as an “owner” or “operator” under CERCLA. The statute expressly exempts “a person, who, without participating in the management of a vessel or facility, holds indicia of the ownership primarily to protect his security interest in the vessel or facility.”39 The policy rationale behind this “security interest exemption” is to encourage credit by not saddling lenders with environmental liabilities.40 Furthermore, courts limit the exemption to lenders who did not participate in the management of the facility.41 Consequently, a lender may be exposed to massive CERCLA liability for minimal involvement in management activities. From the bank’s perspective, the critical inquiry is to determine when its participation becomes sufficient to make an “owner” or “operator” under Superfund.42 This inquiry is only partly answered by the case law interpreting CERCLA.

III. The Case Law

A. In re T.P. Long Chemical, Inc.

The first case to discuss the potential environmental liability of a lender was In re T.P. Long Chemical, Inc.43 Long involved a dispute over funds held by a bankruptcy trustee. Following the filing of bankruptcy and the appointment of a trustee, an act of vandalism resulted in the release of a hazardous substance. When the trustee refused to take the necessary remedial action, the Environmental Protection Agency (“EPA”) did so itself and filed an application for reimbursement by the estate for the costs incurred in the cleanup. The EPA also sought reimbursement under the Bankruptcy Code from bankruptcy estate funds in which the BancOhio National Bank (“BancOhio”) held a perfected security interest.44

The bankruptcy court in Long held the estate liable for cleanup

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39. CERCLA § 101(20)(A), 42 U.S.C. § 9601(20)(A) (1982). It should be noted that the security interest exemption is still part of the definition. One of the unofficial reporting services inadvertently omitted the language from its 1986 supplement. It should also be noted that the 1986 reauthorization provides for an exemption for one who takes the property without knowledge of the toxic waste and who has made the requisite “reasonable inquiry”. However, since a prerequisite for the exemption is the absence of a duty to investigate, lenders will not be relieved of liability under this provision. Furthermore, the conference report specifically indicates that those engaged in a commercial transaction will be held to a higher standard. Thus, the protection provided to a lender under this section is speculative, at best. H.R. CONF. REP. NO. 962, 99th Cong., 2d. Sess. 4-5, 187 (1986).

40. Berz Sexton, supra note 7, at 37.
41. See infra notes 43-93 and accompanying text.
42. Berz & Sexton, supra note 7, at 38.
43. 45 Bankr. 278 (Bankr. N.D. Ohio 1985).
44. Id. at 280, 287 (under 11 U.S.C. § 506(c) (1982)). The EPA also sought recovery from the estate under 11 U.S.C. § 503(b)(1)(A) (Supp. IV 1986), arguing that the cleanup costs were an administrative cost expended to preserve the estate and hence should receive top priority. Long, 45 Bankr. at 280, 282.
costs as an administrative expense, even though the trustee had attempted to abandon the property.\(^{45}\) The court then found that BancOhio was not responsible under CERCLA for the costs incurred by the EPA. The court utilized the security interest exemption\(^{46}\) to find that “even if BancOhio had repossessed its collateral pursuant to its security agreement, it would not be an ‘owner or operator’ under CERCLA.”\(^{47}\) The court relied on the fact that BancOhio had not participated in the management of the property.\(^{48}\)

B. United States v. Mirabile

The Pennsylvania Federal District Court encountered the issue more squarely in United States v. Mirabile.\(^{49}\) In Mirabile, the United States sued the owners of a paint factory site to recover costs incurred in the cleanup of hazardous wastes on the site. The owners, the Mirabiles, in turn joined American Bank and Trust Company (“ABT”) and Mellon Bank (East) National Association (“Mellon”) as third party defendants. Both ABT and Mellon were involved in financing the operations of the paint company, which had owned the site at the time the hazardous condition was created. The Mirabiles contended that certain activities taken by the banks with respect to the paint site were sufficient to make the banks “owners” under CERCLA. ABT and Mellon counter-claimed against the Small Business Administration (“SBA”) under a similar theory. The banks and the SBA moved for summary judgment, arguing that their activities should not subject them to CERCLA liability.

The court granted the motion of ABT and the SBA, but refused to grant summary judgment to Mellon. The opinion focused on whether the creditors had become so “overly entangled” in the affairs of the paint manufacturer as to become an owner. The court sought guidance from related case law holding that an individual who owns stock in a corporation and actively participates in its management can be held liable for cleanup costs incurred as a result of improper disposal by the corporation.\(^{50}\) The court found these cases to be of limited

\(^{45}\) Long, 45 Bankr. at 282-87.
\(^{47}\) Long, 45 Bankr. at 288-89.
\(^{48}\) The court also denied the EPA’s request for an equitable lien. The court stressed that BancOhio had already suffered a loss on its loan due to the bankruptcy status of the borrower. While it assumed the risk of that loss when it extended the loan, the court found that “[i]t would be inequitable, however, to make BancOhio bear the risk of all damage caused by property in which it holds a security interest.” Id. at 289.
\(^{50}\) Specifically, the court looked to New York v. Shore Realty Corp., 759 F.2d 1032, 1052-53 (2d Cir. 1985) (imposing liability on corporate officer and stockholder) United States v. Carolawn, 14 Envtl.
value, however, because the individual defendants' involvement was so extreme that it was of no help in "defining the point at which participation is too attenuated to permit the imposition of liability." The court also noted that while there was clear congressional intent to impose the costs of cleanup on those responsible for the hazardous condition and those who bore the fruits of the disposal, secured creditors should not be considered a member of that class. In addition, the opinion referred to the security interest exemption to find legislative support for the policy argument.

Ultimately, the court found, with respect to ABT and the SBA, that, "[m]ere financial ability to control waste disposal practices of the sort possessed by the secured creditors in this case is not . . . sufficient for the imposition of liability." Specifically, the participation must be in the management of the hazardous waste "facility," i.e., participation in the "operational, production, or waste disposal activities." ABT took the property at a sheriff's sale following the paint manufacturer's Chapter 11 bankruptcy and immediately assigned the bid to the Mirabiles. In the interim, ABT took such actions as securing the building against vandalism, making inquiries concerning the costs of hazardous waste removal, and visiting the property in order to show it to prospective purchasers. The court found that ABT's actions "were plainly undertaken in an effort to protect its security interests in the property." Since ABT lacked the requisite level of participation, it was exempted from liability by the CERCLA security interest exemption.

The motion for summary judgment had even more merit with respect to the SBA. Although the SBA's loan agreement with the paint manufacturer contemplated involvement in the management of the facility, this involvement never occurred. In addition, mere financial restrictions, such as those on the use of loan proceeds, were

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52. Id. (citing United States v. Shell Oil Co., 605 F. Supp. 1064 (D. Colo. 1985)).
53. Id. Although the court did not explain why the argument cannot be applied with equal force to a secured creditor, presumably it is because the secured creditor does not put itself in the same position of risk as does one directly involved in the management of the facility. See infra notes 114 - 126 and accompanying text.
55. Id.
56. Id.
57. Id. at 20996.
58. Id. at 20997. It is unclear whether actual involvement is required before liability will be
held insufficient to make the SBA an owner despite the Mirabiles’ argument that these restrictions may have prevented the redirection of funds into cleanup activities. Since the SBA’s involvement was only in the financial aspects of the company, and not in the management of the facility, it was entitled to summary judgment absolving it from liability.

In contrast to ABT and the SBA, Mellon’s lending activities were closely enough entangled with the polluter to present a jury question regarding Mellon’s status as an “owner” or “operator.” Of particular concern to the court was the constant presence of one Mellon loan officer at the paint company. The officer testified that he became more involved with the paint company because “his superiors at Mellon wanted him to have ‘more of a day-to-day hands-on involvement.’” More specifically, the officer was to monitor the cash collateral accounts, establish a reporting system between the company and Mellon, and determine the order in which paint orders would be filled. The officer also insisted on additional sales efforts and certain manufacturing changes. While noting that “[t]he reed upon which the Mirabiles seek to impose liability on Mellon is slender indeed,” the court found that the testimony presented a genuine issue of fact and, thus, denied Mellon’s request for summary judgment.

C. United States v. Maryland Bank & Trust

The United States District Court for the District of Maryland attempted to clarify the standard in United States v. Maryland Bank & Trust. In Maryland Bank, the original owners, the McLeods, operated a trash and garbage business on the site that was eventually labeled the California Maryland Drum site or “CMD site.” The son of the original owners purchased the property with a loan from Maryland Bank & Trust (MBT), but soon defaulted on the loan payments. MBT foreclosed and took title at a foreclosure sale. Following the discovery of the hazardous waste at the site, the EPA requested that MBT, as an owner, initiate cleanup activities. The bank refused, so the agency cleaned up the site itself and filed the action seeking response costs from MBT.

MBT argued that the security interest exemption applied. The

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60. Id.
61. Id.
court responded by stating that when MBT purchased the property at the foreclosure sale, its security interest ripened into an investment. Thus, MBT “purchased the property at the foreclosure sale not to protect its security interest, but to protect its investment.” The court distinguished Mirabile based upon the length of time that the secured party held the property following foreclosure. The court limited the application of its decision by holding that, “[t]he [security interest] 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.” However, the court declined to discuss the situation where the foreclosing party promptly reassigns the property. This leaves open the possibility that the secured party may be held liable for merely purchasing the property at the foreclosure sale because that is when the “security interest ripens into an investment.”

The court also cited two policy rationales for limiting the applicability of the security interest exemption. First, the insulation from liability would give the lender a competitive advantage at the foreclosure sale. Since all other prospective purchasers would be faced with potential CERCLA liability, the lender could purchase the property for a depressed price, wait for the EPA to clean up the property at taxpayer expense, and sell the property at a profit.

The second policy cited by the court in support of a narrow reading of the security interest exemption was that lenders should, and often do, routinely perform precisely the type of investigation that would lead to discovery of hazardous waste. Thus, if they are able to avoid CERCLA liability, the statute would, in essence, be “an insurance scheme” absolving secured lenders “from responsibility for their mistake in judgments.”

64. Maryland Bank, 16 Envtl. L. Rep. at 20559.
65. Id. at 20560.
66. Id. at 20559.
67. Id. at 20559 n.5.
68. Id. at 20660.
69. One commentator isolates the flaw inherent in this rationale. “While it may be inappropriate to grant a lending institution a windfall at the government’s expense, it may be equally inappropriate to penalize an innocent lending institution by imposing a liability the amount of which greatly exceeds the value of the land, even in a pristine state.” Soriano & Lockett, supra note 7, at 57-58. One suggested solution is to allow the lender to choose between forfeiting its interest in the collateral in which case its potential liability would cease, or keep the property and pay cleanup costs. Id. at 58 n.26. See infra notes 164-65 and accompanying text.
70. Maryland Bank, 16 Envtl. L. Rep. at 20560.
71. Id. For the problems with this rationale, see supra notes 118-122 and accompanying text.
IV. THE EMERGING STANDARD

While the standard is far from clear, it is possible to glean some guiding principles from the previously discussed cases. The basic principle is that for a lender to be liable as an owner under CERCLA, its involvement must be in the management of the borrower's facility, as opposed to the management of the borrower's financial affairs. The Mirabile court indicated that "it would appear that before a secured creditor such as ABT may be liable, it must, at a minimum, participate in the day-to-day operational aspects of the site."73

In addition to this general standard, the cases also isolate specific activities that are likely to subject a lender to CERCLA liability. For example, clauses, even if not exercised, that allow the lender to approve the borrower's managerial appointments, to approve major business transactions of the borrower, or to provide "management assistance" to the borrower may lead to the conclusion that the lender is an owner.74 In addition, if the lender hires a management consultant to assist the borrower in its affairs or assists in implementing manufacturing or design changes or reassigning personnel, it risks CERCLA liability. In contrast, purely financial activities such as placing caps on dividends and salaries payable to the borrower's officers, reserving the right to approve the purchase of life insurance for the borrower's employees, general involvement in the accounting and records of the borrower, or assisting the borrower with marketing or sales strategy and tactics in basic activities of the company that do not specifically involve generation, disposal, or storage of hazardous wastes will not typically subject the lender to liability.75

Despite these "guiding principles," the standard is very uncertain.76 Indeed, given the complexity of the issue and the varying degrees and types of participation by banks, it is very difficult to attain a "bright-line" standard. However, that should not deter the courts from attempting to forge a clear standard to aid lenders in avoiding those activities that will subject them to environmental liability. In

72. The text of this section relies heavily upon the principles enunciated in Berz & Sexton, supra note 7, at 41-43.
74. Berz & Sexton, supra note 7, at 41-42.
75. An in depth analysis of these activities merely gives rise to more difficult issues. For example, drawing the line between assistance in marketing or sales strategy and assistance in the management of the facility may be difficult. Similarly, while mere "suggestions" of ways to make the operation should not subject the lender to liability, it is difficult, if not impossible, to tell when a "suggestion" becomes "management assistance."
76. Berz & Sexton, supra note 7, at 43.
this regard, several issues must be resolved before a clear, usable standard becomes a reality.

One of these open issues concerns the application of the standard where the borrower is engaged solely in the disposal of hazardous waste. Indeed, the Mirabile court, in a footnote, indicates that "[i]t may be that a different test would be appropriate for financers of entities whose sole business is that of hazardous waste disposal." While this test is not discussed in the case law, it presumably would impose lender liability based on lesser involvement in the management of the facility.

Although the different standard may be justified on the basis of the higher degree of risk that the lender can uncover with a cursory examination, it is arguable that there should be no difference in the standard. The disproportionality of liability to the value of the security interest is present in this situation, just as it is when hazardous waste is an indirect effect of the productive activity. Also, limiting the available funds to those firms in the disposal industry may be counterproductive by decreasing competition among disposal companies. The result of decreased competition will be an increase in the cost of disposal. Consequently, to minimize cleanup costs, the secured creditor who loans money to a company directly involved in the waste disposal business should be treated in the same manner as a secured creditor who loans money to a company who pollutes as an effect of the manufacturing process.

The second issue that the cases leave unanswered concerns the

77. Mirabile, 15 Envtl. L. Rep. at 20996 n.5.
78. This will be the case because the business of the borrower is hazardous waste disposal. Consequently, by becoming involved in the financial activity of the borrower, the lender is directly involved in the financial aspects of hazardous waste disposal, rather than merely involved in financial activities of a business, where one of the effects of that business is the production of hazardous waste.
79. See supra note 66.
80. The argument is that imposing liability will prevent lenders from loaning money to potential polluters and thus increase the interest rate. See infra notes 115-25 and accompanying text. The effect will be particularly acute with respect to firms engaged in the disposal of hazardous waste because the risks are much more apparent.
81. Competition may decrease because the high interest rate will act as a barrier to entry. While the significance of the interest rate cannot be known without statistical analysis, there are two reasons to believe that it will be large. First, due to the high level of risk involved, the interest rate is likely to increase dramatically. Second, due to the capital intensive nature of the waste disposal industry, an increase in the interest rate will dramatically increase start-up costs for potential entrants. In addition, lending institutions might react to the higher degree of risk by limiting their lending involvement to those disposal firms with existing reputations and choose not to take a chance on a new entrant whom they perceive as more likely to make a costly mistake. For a discussion of barriers to entry, see generally J. BAIN, PRICE THEORY 193-95 (1952); J. HIRSHLEIFER, PRICE THEORY AND APPLICATIONS 262-65 (1976).
82. That a monopolized industry will charge a higher price than a competitive industry is well documented by the economic literature. E.g., J. HIRSHLEIFER, supra note 81 at 274-301.
ability of a lender to foreclose at all. Mirabile held that a lender could foreclose and still be protected by the security interest exemption. Indeed, the court specifically ruled that ABT's activities following foreclosure, taken to secure the property against vandalism and prevent further depreciation, did not constitute involvement in the normal day-to-day operation of the site and were insufficient to make ABT an owner.

However, the Maryland Bank court cast doubt on that part of the Mirabile decision. It stated that the bank took title "not to protect its security interest, but to protect its investment." The court reasoned that the security interest exemption applies only to "those persons who, at the time of the clean-up, hold indicia of ownership to protect a then-held security interest in the land." Consequently, the security interest "terminated at the foreclosure sale . . . at which time it ripened into full title." A literal reading of this language suggests that the moment the bank takes title following foreclosure, it becomes an owner under CERCLA. The fact that the court expressly refused to decide whether a prompt reassignment of the foreclosed property would preserve the security interest exemption leaves the question open whether foreclosure itself will render the lender an owner, or whether the analysis is limited to actions following foreclosure. In any event, liability for foreclosure alone is a risk that lenders will be forced to consider in the loan-making process.

- Even if the act of foreclosing on a previously-polluted site will not result in CERCLA liability, foreclosing on an active facility may well lead to liability. Where the security interest is in land that houses an active enterprise, often the best way to preserve its value is to continue the operation of the facility. The lending institution is caught in the middle: It can force the company to shut down, in which case the value of the security interest plummets, or it can continue to operate the facility.

The decision is equally difficult for the courts. Quite simply, there are no specific standards for determining the liability of a lender who forecloses on polluted property. The question is whether the lender took title to protect its security interest or as an investment.

83. Berz & Sexton, supra note 7, at 43-44.
84. Mirabile, 15 Envtl. L. Rep. at 20996 ("Regardless of the nature of the title received by ABT, its actions with respect to the foreclosure were plainly undertaken in an effort to protect its security interest in the property.").
86. Id. (emphasis added).
87. Id.
88. Berz & Sexton, supra note 7, at 44.
89. See Soriano & Lockett, supra note 7, at 59.
The answer would seem to hinge upon a determination of the intent of the foreclosing party. However, given the general expansion of liability, it seems likely that the exclusion will be construed narrowly and liability will be imposed in close cases. Consequently, the secured creditor foreclosing on an active facility faces a serious risk of CERCLA liability if it continues management operations.

Finally, although both decisions speak in terms of involvement in the "day-to-day operations of the facility," it is possible that "even conditions or restrictions on the borrower's financial affairs generally, if there are several, may be viewed cumulatively by a court as constituting sufficient involvement in the borrower's facility to warrant the imposition of Superfund liability. . . ." Since it is axiomatic that financial restrictions will have an effect on the operation of the facility, courts may impose liability where the effect of the financial restrictions on the facility is great enough to constitute involvement in the facility.

As a result of these unresolved questions, the standard is very uncertain. However, given the tenor and approach of most of the recent CERCLA cases, it seems likely that courts will expand the situations where a lender will be held liable. To determine whether this expansion of liability is a net benefit or net detriment to society, an economic analysis of the costs and benefits of the legal rule is appropriate. This economic analysis reveals that it is both inefficient and counter-productive to hold lenders liable unless the evidence clearly establishes a "joint venture" between the lender and borrower.

V. ECONOMIC ANALYSIS

A. Economics as a Paradigm

Perhaps the most appropriate paradigm to isolate the effects of a legal rule that holds lenders liable for the polluting activities of a borrower is economics. Although economic analysis is useful in a broad range of situations, it seems particularly appropriate in the present matter because of the obvious impact on businesses.

Economics measures the societal value of a legal rule by measur-
ing its relative efficiency. The concept of efficiency, as utilized in this Comment, means providing goods, services and intangible items in amounts that maximize aggregate social welfare. Since consumers are willing to pay a price for goods and services produced by polluting firms, the availability of these items obviously increases efficiency. However, consumers are also willing to "pay a price" to reduce pollution. The consequence is that the social cost of pollution must be included in the policy analysis in order to get an accurate measure of aggregate social welfare.

The tool that economics uses to find this efficient level of production is marginalist analysis. "Analyzing at the margin" requires examining the cost and benefit of each additional unit of production. If the "marginal benefit" of a given unit is greater than the "marginal cost," production of that unit will result in a net increase in social welfare. Consequently, the unit should be produced. Conversely, if the marginal benefit is less than the marginal cost, production of the given unit results in a net decrease in social welfare. Thus, the unit should not be produced. Similar analysis of each unit leads to the result that the efficient output is reached where the marginal benefit just equals the marginal cost.

Marginalist analysis indicates that the efficient level of production will be reached as a profit motivated firm makes decisions to maximize profit. The assumption is that the individual firm will calculate and consider all relevant costs. However, pollution imposes serious costs on society that are not considered by the firm. In other words, the production of the goods and services in question produces external

96. See id. at 12. Thus, "efficiency" is a function of both the goods and services produced by the polluting manufacturer and the amount of hazardous waste it generates. See also A. Feldman, Welfare Economics and Social Choice Theory 3 (1980) (defining efficiency as a "pareto optimum" — a situation where there is no alternative available that would make some people better off and no one worse off). For a list and explanation of some of the most popular notions of efficiency, see Coleman, Efficiency, Utility and Wealth Maximization, 8 Hofstra L. Rev. 509, 512-20 (1980).
97. Harrison & Rubinfeld, Hedonic Housing Prices and the Demand for Clean Air, 5 J. Envtl Econ. & Mgmt. 63 (1978).
100. Certainly some firms will "consider" the societal costs of pollution, but the assumption that firms are motivated solely by profit is reasonable and a few variants from this assumption will not alter the analysis. See R. Posner, supra note 94, at 15-17.
costs that are not a part of the firm's decision-making process. In economic terms, pollution is the classic example of an "externality."\textsuperscript{101}

The appropriate solution to an externality problem is to force the firms to include the external cost in their internal production decisions.\textsuperscript{102} This process, often called "internalization," may be accomplished by a legal rule. Indeed, the CERCLA policy of imposing liability upon those who benefit from the activity is arguably a form of internalization.\textsuperscript{103} By requiring the polluting company to pay response and cleanup costs, the business is forced to pay for the external cost of pollution.

The result of the internalization process is a reduction in productive output.\textsuperscript{104} The legal rule imposing liability on polluting businesses

\begin{figure}
\centering
\includegraphics[width=\textwidth]{diagram.png}
\caption{A simple graph illustrates this principle.}
\end{figure}

Assume a polluting business with some market power. Consequently, the firm demand curve (D) slopes downward with the marginal revenue curve (MR) placed somewhere to the left. Costs, absent internalization, are represented by ATC and MC, with ATC standing for the average total cost curve, and MC standing for the marginal cost curve. As we are taught in any intermediate economics class, the efficient level of production is found where MR = MC, or at output Q.

A law forcing internalization of external costs, such as CERCLA, has the effect of increasing the

\begin{notes}

102. G. Calabresi, \textit{The Costs of Accidents: A Legal and Economic Analysis} 212 (4th ed. 1975). Posner takes the view that "internalization" is not always the most efficient solution. Essentially, the application of his argument to environmental liability is that it may be cheaper to have the lender or consumers bear the costs of cleanup. It will be argued subsequently that the polluter itself is the least-cost avoider of pollution. Consequently, the polluter should bear the burden. See R. Posner, \textit{supra} note 94, at 54.


104. A simple graph illustrates this principle.
\end{notes}
increases the cost of operation. As costs increase, the gap between marginal benefit and marginal cost decreases and the efficient level of output gets smaller. If a certain activity is producing unaccounted-for external costs, society demands that the activity be reduced. Consequently, the internalization of external costs is merely a method of using the firm's profit-making decisions to reach the efficient result. As output is reduced, the result will likely include some firms going out of business. As internalization increases the cost of doing business, many firms will find it unprofitable to continue operating. If the expected liability increases expected costs enough, the firm would be better off to cease operations and go out of business. 105

This conclusion rests upon an assumption that the market is better able to "find" the efficient level than is government regulation. If information were perfect and costless, the government could implement and enforce regulations without costs, and the outcomes would be precisely the same. 106 However, neither of these propositions is true. Information is often unattainable. Consumers' wants and desires are often based upon unarticulable or even unknown factors. The additional "costs" of government errors are well documented. 107 Thus, the best that the government can hope to do is to approximate the societal costs associated with hazardous waste 108 and force the internalization of those costs through a legal rule.

While the above analysis reveals that the polluting firms should be held liable to force internalization of the external costs of pollution, costs of production to the firm. Graphically, this has the effect of increasing average total costs from ATC to ATC', and shifting marginal costs from MC to MC'. The efficient level is where MR = MC', or output Q'. The resulting output is lower than in the absence of internalization, at a higher price.

This graph may be found in any price-theory text book. E.g., J. Hirshleifer, supra note 81, at 274-78. The result may also be reached using mathematics. See J. Henderson & R. Quandt, Microeconomic Theory: A Mathematical Approach 42-55 (1958). For a simpler exposition, see A. Feldman, supra note 96, at 89-105.

105. These industries have some social value or they would be driven out of business. See F M Scherer, Industrial Market Structure and Economic Performance 13-14 (2d ed. 1980). While the costs of cleanup probably will force many of these firms out of business, some may bear the cost and remain viable. Thus, a complete elimination of productive output is inefficient.

106. If information were perfect, the government would set production at Q, the efficient level. However, it seems indisputable that information is not perfect. It is for this reason that we say a voluntary exchange or market is more efficient than heavy regulation. R. Posner, supra note 94, at 14 Indeed, much of the current debate in the environmental literature revolves around the use of a price mechanism in pollution control. See, e.g., Schelling, Preface to Incentives for Environmental Protection ix-xix (T. Schelling ed. 1983).


108. The best approximation will probably be the cost of cleanup. However, this is an "approximation" rather than a true measure because societal costs may be greater than the cost of cleanup. That is, consumers may wish to have the products associated with the hazardous waste production rather than forcing an elimination or decrease in the amount of available products. This possibility should be ignored since Congress has made a judgment to clean up the hazardous waste sites.
the analysis does not, thus far, justify imposing liability on lenders. Lender liability will be efficient if the benefits of additional deterrence and additional funds for cleanup outweigh the additional costs. These costs and benefits must include the effect that the rule will have on the future behavior of parties.\textsuperscript{109}

It can be argued that Congress has eliminated any such prospective effect of the rule by focusing on the cleanup at existing hazardous waste sites.\textsuperscript{110} The argument is that the Congress's concern was with the current cleanup and not with influencing future behavior. This argument is not persuasive. First, although cleanup and deterrence are distinct concepts, they are quite clearly related. Thus, a costly cleanup remedy will clearly influence the way that parties in the future behave. Consequently, any analysis of such a sweeping rule which ignores its effects on parties' future behavior is inadequate. Second, Congressional intent concerning who should pay the cost of cleanup evinces some level of concern regarding the prospective effects of the rule. Congress has made a judgment that all hazardous waste sites, now and in the future, should be cleaned up.

Furthermore, Superfund provides that those who benefit from polluting activity should pay the cost of cleanup.\textsuperscript{111} Despite this general proposition, the question of who, in fact, benefits from the activity is left for the courts. Specifically, the question of whether a lender "benefits" to the level required is left unanswered by the statute.\textsuperscript{112} In other words, Congress left the question of determining the allocation of cleanup costs to the courts. Indeed, the security interest exemption seems to represent a congressional judgment that the costs associated with lender liability are too great absent some special circumstances.\textsuperscript{113} Consequently, to resolve the questions left open by the statute, and appropriately allocate the costs of cleanup, the courts should consider the prospective benefits and costs of a legal rule imposing liability on lenders.

\textbf{B. The Cost Benefit Analysis}

While economic theory reveals that forcing polluting enterprises to internalize external costs promotes efficiency, the question remains whether a rule forcing lending institutions to do the same thing leads


\textsuperscript{112} The only relevant legislative history reveals that the security interest exemption was intended to apply to persons holding title merely to secure a loan. See H.R. Rep. No. 1016, pt. II, 96th Cong., 2d Sess. 35 (1980).

\textsuperscript{113} See Berz \& Sexton, \textit{supra} note 7, at 37.
us closer to the desired result. This Comment argues that it does not aid in leading us to the efficient result and, in all likelihood, will be a detriment.

The benefits of imposing liability on lenders are clear. The lending institution can certainly provide a “deep pocket” from which to pay the cost of cleanup.\(^\text{114}\) This imposition of liability will not only aid the cleanup of the particular site in question, but can also provide funds for future cleanups since the lender cleanup payments will help replenish the moneys in Superfund.\(^\text{115}\)

The imposition of lender liability also has deterrence benefits. Lenders will be reluctant to loan money to potential polluters unless they can contractually limit their responsibility for pollution. As the availability of funds to polluting businesses becomes more scarce, the output of the industry will decrease and, as a result, so will pollution. However, this efficient result can be reached more directly by imposing liability upon the polluting industry. That is, liability on lenders and on polluters may be substitutes for one another. However, they are not necessarily complementary policies. That is, the key question is whether imposing liability on lenders in addition to polluting industries is more efficient than limiting liability to polluting firms. This Comment argues that imposing liability on lenders, in addition to liability on the industry, will impose significant costs on the industry and cause it to reduce output below the efficient level. These costs may be conveniently, though perhaps artificially, divided into three categories: costs to the lender, costs to the borrower, and costs to third parties.\(^\text{116}\)

1. Costs to the Lender

The most obvious cost imposed upon the lender is the direct cost of cleaning up the hazardous waste. As discussed previously, these costs are often disproportionate to the value of the security interest or even the loan itself.\(^\text{117}\) As a result, the lender must somehow pay for the liability associated with the hazardous waste. Presumably, this payment will come out of the profits of the lending institution or from a contingency fund. Given the generally unstable condition of many

\(^\text{114}\) Soriano & Lockett, supra note 7, at 58 n.29.
\(^\text{115}\) The “fund” is now supplied by a tax on chemical companies. H.R. CONG. REP. NO. 962, 99th Cong., 2d Sess. 156 (1986).
\(^\text{116}\) This division is artificial since costs imposed on the lender will inevitably have an impact on the borrower and consumer through higher interest rates. Similarly, a cost imposed on the borrower will affect the lender through a lower demand for capital and the consumer through less available products. Nevertheless, the division is useful for analytical purposes.
\(^\text{117}\) See supra note 69.
banks today\textsuperscript{118} and the large liability costs associated with CERCLA, lender liability may have a significant negative impact by increasing the risk of bank failures.

Another way to view this objection is in terms of insurance. Lenders subject to potential liability may become, in essence, insurers; they offer a loan to a firm at a slightly higher than competitive rate in exchange for assuming liability for cleanup costs. The difference between the competitive rate and the rate offered can be considered an insurance premium.

In addition to the direct costs of liability, the lender will also incur many costs as it attempts to avoid liability in its role as an insurer. Lenders, as a class, are inefficient insurers. Although the 	extit{Maryland Bank} court asserted that "[f]inancial institutions are in a position to investigate and discover potential problems in their secured properties," and that "such research is routine," the court offers no support for this proposition.\textsuperscript{119} At least one commentator disagrees with this assessment, arguing that the requisite specialized, technical competence is rarely held among lending institutions.\textsuperscript{120} Consequently, lenders must expend time and resources to acquire the necessary competence, as well as the direct cost associated with performing and evaluating the tests.\textsuperscript{121}

The direct costs of testing are likely to be quite large. Estimates of the cost range from $2,000 to $3,000 for a "red flag" test to $12,000 to $20,000 when waste contamination is involved.\textsuperscript{122} Furthermore, even when a hazardous waste site is identified, the costs do not end. Before a case actually goes to trial, both the government and the potentially responsible party spend months or even years performing independent tests to determine the existence, scope, and cause of the environmental harm.\textsuperscript{123}

\begin{footnotesize}
\begin{itemize}
  \item 121. It could be argued that the cases discussed earlier in this Comment have forced lenders to develop the necessary expertise. Given that result, the costs have been sunk and it may now be efficient for them to conduct the necessary testing. However, this argument is not persuasive. First, as argued below, the variable costs will also tend to be quite large. Second, the mere fact that they have the expertise does not justify the expenses to maintain it or additional liability. See Taige, \textit{Toxic Waste Sites Prove Bank Liability Headache}, The Denver Post, Aug. 16, 1987, at G1, col. 4.
  \item 122. Id.
  \item 123. Pfeifer, supra note 120, at 1314.
\end{itemize}
\end{footnotesize}
It could be argued that the mere existence of hazardous waste should be enough to deter banks from lending money. However, if the tests are merely a litmus test or a red flag for the existence of hazardous waste, the lender may deny funds to many businesses that could remain viable despite the added cleanup costs. The result is that output is decreased below the efficient level as potentially viable businesses fail due to the excessively high cost of borrowed funds.

The better view is that actions taken by a financial institution to guarantee a valuable security interest, such as environmental testing, should not, in and of themselves, expose the institution to potential liability. Even if the lender does routinely perform some form of tests, these should not be viewed as the equivalent of tests taken pursuant to a duty owed to a third party. Positive test results will reduce the expected profit of a loan as both the borrower's ability to pay and the value of the security interest in case of default are reduced. The cost of funds to the borrower increases and output will be reduced. The result is efficient because the availability of funds will reflect the borrower's ability to pay, which, in turn, reflects the societal cost of pollution. In contrast, direct liability on the lender forces a reduction in loanable funds that is unrelated to actual market conditions, as defined by the borrower's ability to pay.

In addition to the costs associated with testing, lender liability may force the financial institution into a no-win situation. Recent expansion of lender liability outside of the environmental context seems to indicate that a bank may be held liable for not intervening to force changes in the business decisions of the borrower. Ironically, the lender may be liable for failing to take the very actions that, if affirmatively taken, would subject it to CERCLA liability. The only clear effect of these conflicting theories is that the loan becomes less profitable to the lender and less funds are available to the borrower.

The above mentioned costs will decrease the profits of the lending institution, either through direct expense or lost business as the lenders either balk at potential liability or raise their rules to protect themselves against heightened exposure. Thus, the legal rule imposes the cost arbitrarily on parties who benefit only peripherally. If the lender

124. If the financial institution refuses to lend every time test results show existence of hazardous waste, it will refuse funds to many businesses which could absorb the costs of cleanup and continue operation.

125. See Pfeiler, supra note 120.

126. See infra notes 129-34 and accompanying text.

127. This conclusion assumes that the cost of pollution is internalized due to the CERCLA liability scheme. See supra notes 100 - 103 and accompanying text.

is unable to pass on the costs associated with liability and potential liability, then the shareholders of the lender will be forced to bear them.

Imposing these costs on lenders should be contrasted with imposing the costs on the polluter itself. Since the polluting enterprise receives profits directly from the polluting activity, forcing them to pay for testing and cleanup costs is consistent with internalization. That is, these costs are appropriately regarded as a cost of doing business. In contrast, the lender benefits only indirectly. Indeed, if the policy of forcing those who benefit to pay the costs is extended to hold lenders liable, the logical result is that suppliers of materials used in the polluting production process should be held liable along with lenders since the lender is nothing more than a supplier of funds.

2. Costs to the Borrower

It is clear that some costs must be imposed on the borrower in order to force the firm to the efficient level of production. More specifically, the firm must internalize the cost of pollution. Once the internalization is completed, the natural and efficient result is a reduction in available funds. The reasons are relatively straightforward. A lender's decision to lend money is based on at least three variables. The probability of a loan is positively related to the borrower's ability to repay the loan and the value of the security interest in case of a default. That same probability is negatively related to the administrative costs associated with the loan. Given this framework, it is easy to see why efficiency results in the restriction of available funds.

Potential CERCLA liability will affect two of the three variables. The borrower's ability to repay is adversely affected. The liability restricts the firm's profits and internal funds, thus making the default more probable. Similarly, CERCLA liability reduces the value of the security interest. In other words, a piece of land is worth more without hazardous wastes than it is when pollution is present. Thus, the internalization process inevitably leads to a reduction in the supply of funds to borrowers because of risk of lending to a polluting enterprise.

When the lender considers the potential liability of the borrower

\[ \text{Lender Liability for Hazardous Waste} \]

\[ \text{LENDER LIABILITY FOR HAZARDOUS WASTE} \]

129 Since potential liability will decrease the borrower's ability to pay and the value of the security interest, the lender will not be as willing to loan and the funds available to the industry will decrease.

130 Many other factors are involved in this decision, but they are ignored for analytical ease.

131 Mathematically, this can be expressed as \( \text{LD} = (P + S + A - A) \), where \( \text{LD} \) = the decision to loan, \( P \) = ability to repay, \( S \) = value of the security interest in case of default and \( A \) = administrative costs. Consequently, as the ability to pay or the security interest increases, more funds will be granted in loans. As the administrative costs increase, the lender will become more reluctant to loan funds.
as it affects the return on the loan, the resulting constriction in the supply of funds poses no costs, except those costs which appropriately reflect market conditions.\(^{132}\) In contrast, imposing lender liability reduces the supply of funds beyond the efficient level and poses the risk of undesirable behavior. The lender still considers potential borrower liability since at the inception of a loan agreement the borrower may be held liable. However, in addition to borrower liability, the lender must also assess his own potential liability. In terms of the variables isolated above, the lender's potential liability further reduces the value of the already depressed security interest. As a result, the expected value of the security interest will often be negative.\(^{133}\) That is, the existence of a security interest may actually constitute a liability as the lender ponders the decision of whether or not to loan. Furthermore, as argued above, the administrative costs associated with the loan are likely to be high.\(^{134}\) The economic result is that funds are restricted beyond the efficient level, and, consequently, the output level is below the efficient level.

Under these circumstances, the lender may be willing to loan

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132. This may be illustrated by a graph.

The graph shows the classic supply and demand diagram for loanable funds. Given the demand for loanable funds, the effect of different liability rules is seen as a shift leftward in the supply of funds. \(S\) represents the supply of funds where there is no threat of either polluter or lender liability. \(S_{PL}\) illustrates that the supply of funds decreases, or shifts left, as liability is imposed on the polluter only. As argued above, this is efficient since it forces the polluter to pay for the cost of cleanup and internalize the external costs of pollution. See supra notes 98-108 and accompanying text. However, imposing liability on the lender, as well as the polluter, further restricts the supply of funds. This is graphically represented by \(S_{PL+LL}\). The result is a higher interest rate and a lower quantity of funds. In other words, the imposition of lender liability shifts the supply of funds too far, leading to an inefficient result.

133. This will be the case where the dollar amount of the liability is very large and the probability of liability is relatively high.

134. See supra notes 117-126 and accompanying text.
funds, but only at a higher rate of interest. A higher rate of interest will, among other things, adversely affect innovation with respect to pollution-reducing technology. Enterprises attempting to maximize profits have strong incentives to develop cost-reducing production techniques. Since CERCLA forces the internalization of the cost of pollution, firms will have a greater incentive to develop pollution reduction techniques. The higher rate of interest makes innovation more difficult. Research is not a free activity, and the availability of funds is often a key variable influencing the level of research and development. Although the results are difficult to quantify, the resultant reduction in innovative activities may render lender liability counterproductive in the long term.

Finally, the clearest result of holding lenders liable is an increase in the number of bankruptcies. While efficiency demands that some firms exit the industry, lender liability deters lending institutions from taking actions to aid potentially viable enterprises. In fact, banks may force borrowers into bankruptcy rather than risk CERCLA liability. The actions that lenders typically take to aid a faltering firm (e.g., appointing a management consultant or suggesting management changes) are precisely those sorts of activities that make CERCLA liability more likely. Thus, lenders will be less willing to help, and firm failures will increase as a result.

Imposing CERCLA liability on lenders also severely affects the borrower because banks are reluctant to give management assistance even to successful firms. The result is that the firms are less efficient, even though they remain in business. While some of these effects are attributable to the internalization process, many of the impacts go well beyond those costs associated with the movement to efficiency. Conse-

135. A cost reducing technique will lower the cost curve and increase the rectangle of profits. See J. Hirshleifer, supra note 81, at 276.

136. This incentive will exist whenever the expected cost of cleanup is greater than the cost of pollution prevention.


138. It should be noted that there is an effect which may counteract the negative effect on innovation. The higher interest rates may raise the gains from innovation and create an incentive to undertake research activities. The problem with this argument is that direct lender liability increases the interest rate beyond the efficient level. See supra notes 129-134 and accompanying text. Thus, assuming that the relevant industry is competitive, the incentive to undertake research is already appropriate, but funds must still be available to conduct these activities.


140. Soriano & Lockett, supra note 7, at 59.
quently, costs are large when compared to the corresponding benefit and should be avoided.141

3. Costs to Third Parties

All of the costs discussed above will have some impact on third parties. For example, an increase in the number of bankruptcies will adversely affect other creditors who will receive only a portion of the debt owed them. Similarly, consumers will suffer from fewer product choices because firms will exit from the industry.

Perhaps the most significant cost imposed on third parties is that lenders will have to pass on their costs associated with potential CERCLA liability. If the bank is able to, it will pass on any additional costs incurred to consumers of its services, rather than to its shareholders.142 The issue is the extent to which costs are passed to companies other than the polluter. In the absence of price discrimination, the lender will have a “pass on” mechanism built in.143 All customers will be forced to pay the higher interest rate, not just those who pollute. Even if the lender is able to engage in price discrimination and charge different rates and conditions to different borrowers, limits of that process suggest that the cost will be imposed on some innocent parties.144 The lender will limit funds to all potential polluters, which means that they will limit funds to some innocent businesses.145

VI. THE PROPOSED STANDARD

Courts should be reluctant to impose liability on the lender who only acts as the supplier of funds. At the same time, a lender who engages in a joint venture with a business will directly receive benefits from the polluting activity and should not be able to avoid liability merely because of its status as a lending institution. Consequently, the standard is simply stated. A court should hold a lender liable as an

141. These costs take the form of increased firm failures. Since these firms could be successful despite internalizing the costs, the failures of the firm are an inefficient cost. The benefit is minimal because the costs are already internalized to the polluting firm.

142. The issue is the extent to which costs are passed on to companies other than the polluters. The degree of “pass on” will depend upon the elasticity of demand for funds. See generally, J. Hirshleifer, supra note 81, at 117-23. It would be ideal to have some estimates of elasticities under various assumptions, but such an empirical study is well beyond the scope of this paper.

143. See J. Hirshleifer, supra note 81, at 290-96.

144. Id.

145. It should be noted that a certain degree of the increased cost of funds will be passed on to innocent parties even if liability is limited to the polluter. However, the argument here is that the additional interest cost associated with lender liability will also be passed on to innocent parties. The result is that efficient activities will be deterred.
owner under CERCLA only when there is clear evidence of a joint venture between the polluter and the lender.

The joint venture is a device utilized by courts to impose certain legal consequences due to the nature of the relationship between two or more parties.\textsuperscript{146} A joint venture has been defined as "an association of two or more persons to carry out a single business enterprise for profit, for which purpose they combine their property, money, efforts, skill and knowledge."\textsuperscript{147} The existence or nonexistence of a joint venture is a question of fact, but what constitutes a joint venture is a question of law.\textsuperscript{148} Most authorities agree that four elements must be present to find a joint venture. These elements are:

\begin{itemize}
  \item[(a)] Agreement (express or inferred);
  \item[(b)] Joint interest (contribution);
  \item[(c)] Sharing profits (and usually losses . . .);
  \item[(d)] Mutual right to control.\textsuperscript{149}
\end{itemize}

The first element illustrates that the essence of a joint venture is a contract and that the intent of the parties is controlling. This intent is to be gleaned from the conduct, surrounding circumstances and the transactions between the parties.\textsuperscript{150} The second element requires that there be some joint interest in the money, skill or services contributed.\textsuperscript{151} The third element requires that "some sharing of profits or other gain in the achievement of the venture and some apportionment of the risks involved must be found."\textsuperscript{152} Although most cases require a sharing of a loss, others ignore this requirement.\textsuperscript{153} The fourth element requires an equal right, express or implied, to exercise some control over the conduct of each other.\textsuperscript{154}

The joint venture standard applies to the lender/borrower relationship.\textsuperscript{155} The case of \textit{First National Bank v. Haley},\textsuperscript{156} illustrates this application. In \textit{Haley}, the First National Bank of Maryland ("the Bank") loaned money to the defendant partnership. The loan was evidenced by a promissory note. When the defendant failed to pay, the Bank sued for default. Applying the elements of a joint venture, the

\begin{itemize}
  \item Taubman, \textit{What Constitutes a Joint Venture}, 41 CORNELL L.Q. 640 (1956).
  \item Id.
  \item Grand Isle Campsites, Inc. v. Cheek, 262 La. 6, 23, 262 So. 2d 350, 357 (1972).
  \item P & M Cattle Co. v. Holler, 559 P.2d 1019, 1022 (Wyo. 1977).
  \item Taubman, \textit{supra} note 146, at 644.
  \item Usdan v. Rosenblatt, 93 N.Y.S.2d 862, 863 (Sup. Ct. 1949).
  \item Griffin v. Clark, 55 Idaho 364, 375, 42 P.2d 297, 302 (1935).
  \item See, e.g., Guilford Mortgage Co. v. Cunningham Brick Co., 331 F.2d 343 (4th Cir. 1964).
  \item No. 86 C 2951 (N.D. Ill. Dec. 1, 1986).
\end{itemize}
defendant argued that the provision in the note that provided that payments were to fluctuate with the borrower’s net income showed that the parties intended a joint venture. The defendant further argued that the Bank’s loan was actually “seed money” and satisfied the contribution requirement. The defendant argued that the Bank maintained the requisite control over the joint enterprise by virtue of certain covenants of the borrower in the document. Finally, by basing repayment on the borrower’s net income, the defendant argued that the Bank was sharing in the profits and losses. The court, however, was not persuaded. The court indicated that

[theres no control by Bank over the expenditure of the $250,000 loan. Bank has no control under the Note over the operations of the Partnership (the Borrower’s covenants are simply the standard loan covenants for the maintenance of the integrity of the property throughout the loan term). There is no provision explicitly related to the sharing of profits and losses, and finally there is no express manifestation of the Bank’s intent to be associated with the Partnership as a joint venture.157

Thus, the court found that the relationship did not constitute a joint venture and the Bank was entitled to repayment.

Haley illustrates that the typical relationship between a borrower and a lender will not create a joint venture. More specifically, the fact that a lender assists a borrower in obtaining money to pay off his loan,158 approves production plans,159 or inspects the final product160 will not create a joint venture. Interest is merely the amount paid for the use of borrowed money, not a share of the borrower’s profits.161

The application of the joint venture standard to determine whether a financial institution is an “owner” under CERCLA is economically sound. First, the standard helps solve the uncertainty problem. Even though the determination of a joint venture is a factual determination, the standard is more certain due to the existing body of explanatory law. Second, the standard makes it clear that the typical clauses in loan agreements (e.g., requiring approval of plans) will not subject an institution to CERCLA liability. The same is true of actions taken to preserve the profitability of the borrower or the value of the security interest. Under the joint venture standard, the lender will

157. Id.
160. Id.
161. Id. at 453-54, 174 S.E.2d at 233.
face the risk of liability only when it has placed itself in a position to
directly share in the gain of the enterprise. This is the efficient result
since the financial entity has essentially become the polluting entity.
The standard is also consistent with the CERCLA policy of imposing
liability on those who benefit.

Two problems remain notwithstanding the wisdom of the joint
venture standard. The first of these problems deals with the effect that
a test that shows hazardous waste will have on lender liability. As
argued above, the mere fact that a financial institution performs tests
should not create a duty to third persons, even under CERCLA.162
However, it can be argued that if a lender chooses to test and that test
shows the existence of hazardous waste, then the financial entity that
subsequently loans money is fully aware of the risk and should be re-
garded as an owner under CERCLA. Although this argument is
somewhat persuasive, it does not lead to the result that a lender should
be liable every time the tests show a hazardous waste site. Indeed, it
was argued previously that some businesses will continue to operate in
spite of the internalization. Furthermore, the restriction of funds lent
to potential polluters may decrease innovation that would decrease de-
velopment of pollution reduction technology.163 As a result, it is inef-
ficient to impose liability merely because of tests performed by the
lender.

Positive test results will still serve an important part in the joint
venture analysis. Knowledge of the existence of hazardous waste will
serve as important evidence in finding the intent to enter into the re-
quise agreement. However, this knowledge will not be dispositive.
Rather, the lender’s knowledge should be one of the surrounding facts
and circumstances that the court will examine to find an agreement.

The second problem that the joint venture does not solve is that
of the foreclosing lender who then takes the property at a foreclosure
sale.164 The joint venture standard would allow a lender to take title
to the property, hold it while the government pays the cleanup costs,
and then sell it for an unearned profit. Consequently, the joint venture
standard must be amended. One commentator suggests that once the
lender takes the property and the government decides that cleanup is
necessary, the lender should have a choice of retaining title and paying
cleanup costs or avoiding liability and abandoning the property.165

162. See supra notes 117-125 and accompanying text.
163. See supra notes 133-138 and accompanying text.
164. See supra notes 68-69 and accompanying text.
165. Soriano & Lockett, supra note 7, at 57-58.
This solution avoids the possible windfall, but limits the lender's liability to the value of lost profits on the loan.

It should be noted that potential liability will still enter the lender's calculation. However, the lender considers the potential liability of the borrower only as it affects the value of the security interest and the ability of the borrower to repay the loan. As argued previously, this is the efficient result because it internalizes the external costs of pollution.166

This amended joint venture standard isolates the type of activity that a lender can take without risking CERCLA liability. Assuming that there was no joint venture at the time of the loan, the lender may take actions to preserve the profitability of the borrower, such as making management-type decisions or sending advisors to help the business. Furthermore, the lender may take title to the property and preserve the value of the security interest in any way the financial institution sees fit. If that preservation takes the form of continuing operations, those activities will not subject the lender to CERCLA liability. Rather, the lender's decision will be to continue the operation and pay cleanup costs or cease operations altogether and absorb the loss on the loan.

VII. CONCLUSION

The conflict between economic and environmental policy is brought into sharp focus by recent decisions that impose liability on a lender as an owner or operator under CERCLA. Although it is clear that some costs must be imposed in order to accomplish the cleanup, imposing liability on lenders is too costly in comparison with the benefits received. Specifically, the efficient level of production is reached by holding the polluting firm liable, and holding the lender liable as well is both unnecessary and costly. Consequently, the courts should only hold the lender liable where it is clear that it has accepted the risk by entering into a joint venture with the polluter. In this manner, we can reach the efficient level of production at minimum cost.

John M. Church

166. See supra notes 129-134 and accompanying text.