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# Of Veils and Operators: The Liability of Parent Corporation for Clearing Up Hazardous Waste at a Site Owned by Its Subsidiary (97-454) Environmental Law

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# Case at a Glance

The United States uses cost-recovery actions under the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") to recoup cleanup costs from those responsible for releasing hazardous substances. Here, the Government says it is consistent with CERCLA's remedial purpose to hold a parent corporation liable as an operator of a subsidiary's facility if the parent participated in and exercised control over the facility. The parents disagree. Now the Supreme Court considers what test to apply in deciding whether to hold a parent corporation liable for a CERCLA cleanup at a subsidiary's facility.



# Of Veils and Operators: The Liability of a Parent Corporation for Cleaning Up Hazardous Waste at a Site Owned by Its Subsidiary

*by William L. Andreen*

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More than a decade ago, Congress enacted the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA"), commonly referred to as Superfund, to deal with the dangers presented by thousands of landfills and other facilities where hazardous substances were leaking or seeping into the environment. *See* 42 U.S.C. §§ 9601-9675 (1994). Under CERCLA, the Government has spent billions of dollars remediating hazardous conditions at hundreds of high-priority sites and performing smaller-scale cleanups at thousands of others.

These Government-initiated cleanup efforts are expensive. So, in an effort to recover as much of its costs as possible, the Government looks to those responsible for the hazardous activities. Under CERCLA, those who owned or operated a facility at the time the hazardous conditions were created are included among the liable parties.

The United States has taken the position that a parent corporation can be liable as a past operator if the parent corporation actually participated in the day-to-day operation of a subsidiary corporation that owned a facility where hazardous materials were released. However, the parent corporations in this case contend that CERCLA was not intended to overturn the principles of limited liability that are so central to corporation law. They say that under those principles, a parent corporation cannot be liable under CERCLA simply because it had involvement with its subsidiary in an effort to protect its investment. In their view, the Government must establish a parent's liability by "piercing the corporate veil," i.e., proving that a parent corporation so abused the corporate form that the separate personalities of the two corporations ceased to exist and continued adherence to the fiction of two corporations would work a fraud or other wrong.

*UNITED STATES V. CPC INTERNATIONAL, INC., ET AL.*
DOCKET NO. 97-454

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FROM: THE SIXTH CIRCUIT


The United States, on the other hand, insists that the language of CERCLA imposes liability on any operating entity regardless of corporate status. In its view, Congress intended to disregard the limitations of state corporation law and forge a new standard of federal liability based on a person's or an entity's own conduct.

These competing views are now before the Supreme Court. The case is a high-stakes battle worth hundreds of millions of dollars to corporations or to taxpayers, whichever side loses.

## ISSUE

May a parent corporation be held liable under CERCLA as an operator of a subsidiary's facility when the parent actively participated in and exercised control over the operations of the subsidiary or must sufficient cause exist to pierce the corporate veil that, under general principles of corporation law, immunizes a parent corporation for a subsidiary's conduct absent some culpable conduct by the parent such as fraud?

## FACTS

During the early 1970s, an upsurge of public concern about various pollution problems prompted Congress to enact a number of environmental programs. These initial efforts focused largely on cleaning up polluted air, rivers, and lakes.

When the risks posed by the land-based disposal of hazardous material became apparent, Congress passed the Resource Conservation and Recovery Act ("RCRA") in 1976. Codified at scattered sections of 42 U.S.C. beginning at § 6901. RCRA established an elaborate regulatory scheme to govern the future transportation, treatment, storage, and disposal of hazardous waste.

It quickly became clear that prospective regulatory programs such as RCRA were inadequate to address problems created by past environmental neglect. As the 1970s drew to a close, Congress discovered an unhappy legacy: the leaking barrels and contaminated soil at sites such as Love Canal and the Valley of the Drums created by years of unregulated disposal.

To deal with this problem, Congress enacted CERCLA, an ambitious piece of legislation, in December 1980. CERCLA was designed to give the Government the authority and funding necessary to clean up contamination at abandoned or inactive facilities caused by the past release of hazardous substances.

Congress recognized, however, that federal funds alone could not cover all of the costs associated with the Government's response actions. To address the problem, Congress included a liability provision to help the Government recoup its response costs and make those responsible bear the costs of their actions.

CERCLA's net of potential liability is cast widely. Among others, it includes (1) the present owner and operator of a facility where hazardous substances have been released and (2) "any person who at the time of disposal owned or operated" such a facility. 42 U.S.C. § 9607(a)(1),(2).

The consequences of being held responsible under CERCLA for environmental cleanup can be severe. If the United States establishes liability, the responsible parties are strictly liable — liable without fault — for the Government's cleanup costs. In addition, if the environmental harm is indivisible, the responsible parties are jointly and severally liable, i.e., each party is liable for the entire cost of cleanup. *See, e.g., United States v. Monsanto,* 858 F.2d 160 (4th Cir. 1988).

Armed with CERCLA, the Government in this case sought its cleanup costs associated with a chemical manufacturing facility located in Dalton Township, Michigan, known as the Muskegon site. The facility had a number of corporate incarnations beginning with the Ott Chemical Company ("Ott I"), which operated the Muskegon site between 1959 and 1965. During that period, Ott I discharged waste water containing hazardous substances into two unlined lagoons.

Ott I also buried drums containing hazardous materials, spilled chemicals during the loading of rail cars, and dumped still more hazardous chemicals in the woods. By 1964, the groundwater flowing beneath the Muskegon site had become contaminated.

CPC International ("CPC") bought Ott I in 1965 and then created a subsidiary that purchased Ott I's assets and took the name of Ott Chemical Company ("Ott II"). Ott II expanded the manufacturing capacity at the Muskegon site and continued to use the unlined lagoons until at least 1968, enlarging them to accommodate additional hazardous material.

During much of this time, three or more of Ott II's directors were officers of CPC, and the chairman of the board was a high-level CPC official. In addition, many of Ott II's key managers were officers of CPC, and CPC's environmental manager actively participated in and exerted control over a variety of pollution activities at Ott II.

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CPC sold Ott II to Story Chemical Company ("Story") in 1972 for approximately $10 million. Story continued to manufacture chemicals at the Muskegon site until bankruptcy ended its operations in 1977, and title passed to the bankruptcy trustee.

Recognizing that the Muskegon site posed a serious environmental threat, Michigan's Department of Natural Resources ("MDNR") tried to attract a purchaser who would help effect a cleanup. This effort led MDNR into discussions with Aerojet-General Corporation ("Aerojet").

Aerojet then formed a wholly owned subsidiary, Cordova Chemical Company ("Cordova/California"), which bought the Muskegon site from the bankruptcy trustee in 1977. As part of this arrangement, Cordova/California agreed with MDNR to perform certain cleanup activities and MDNR agreed to share in the cost. Before chemical manufacturing activities resumed, however, Cordova/California created a wholly owned Michigan subsidiary, Cordova Chemical Company of Michigan ("Cordova/Michigan"), and transferred title of the Muskegon site to the new company.

Cordova/Michigan operated the Muskegon site until 1986. While no new waste was buried or dumped during this period, the preexisting groundwater problem was not remedied and various waste drums as well as contaminated soil remained on site. During this period, the subsidiary's board was inactive, and Aerojet officials dominated its management.

The United States Environmental Protection Agency (the "EPA") identified the Muskegon site as a serious public health risk shortly after CERCLA became law. In 1982, the EPA placed the Muskegon site on its high-priority list for remediation. Since then, the EPA has incurred substantial cleanup costs while formulating and implementing a multimillion dollar plan to clean up the contaminated soil, surface water, and groundwater.

The Government later filed a cost-recovery suit in federal district court against a number of potentially responsible parties including CPC and Aerojet, two parent corporations associated with the Muskegon site. Former corporate owners — Ott I, Ott II, and Story — no longer exist.

The district court concluded that both CPC and Aerojet were liable because they had participated in the operation of the Muskegon site through their respective subsidiaries and, therefore, had been operators of the site for purposes of CERCLA. 777 F. Supp. 549 (W.D. Mich. 1991).

CPC and Aerojet appealed to the Sixth Circuit, and a three-judge panel reversed. 59 F.3d 584 (6th Cir. 1995). The United States successfully petitioned for rehearing *in banc* (*see* Glossary), but, by a vote of seven to five, the Sixth Circuit also reversed. 113 F.3d 572 (6th Cir. 1997).

The *in banc* majority held that a parent corporation is not responsible as an operator merely because it participated in and exercised some control over the management of a subsidiary's facility. In fact, said the majority, to successfully assert operator status against such a parent corporation, the United States would have to resort to traditional corporation law notions and ask a court to disregard the parent's separate corporate personality because of some sort of fraud or other misconduct.

That decision is now before the Supreme Court, which granted the petition of the United States for a writ of certiorari. 118 S. Ct. 621 (1997).

## Case Analysis

The United States contends that the Sixth Circuit majority misinterpreted CERCLA by adopting a rule freeing a parent corporation from CERCLA liability even though it had participated actively in the operation of a facility and thus shares responsibility for hazardous conditions at the site. CERCLA, notes the Government, provides that "any person" who "owned or operated" a facility at the time hazardous substances were disposed of is liable for the Government's cleanup costs. 42 U.S.C. § 9607(a).

CERCLA defines "person" broadly to include corporations as well as other business entities, 42 U.S.C. § 9601(21), but does not define the term "operate," other than providing that the owner or operator of a facility is "any person owning or operating such facility," 42 U.S.C. § 9601(20)(A)(ii), which merely begs the question. Notwithstanding CERCLA's definitional shortcomings, the Government contends that "operate" should be construed in accordance with its ordinary meaning and that meaning certainly includes directing or managing the way in which a facility works. Therefore, argues the Government, a former corporate parent may be liable as an operator if it actively participated in or exercised control over a hazardous waste facility.


The Government maintains that this reading is supported by another provision in the statute. CERCLA specifically excludes secured lenders from being treated as owners or operators, but only as long as they do not "participate in the management of a . . . facility." 42 U.S.C. § 9601(20)(E)(i).

This exception is crucial according to the Government. Congress' unwillingness to excuse from operator liability lenders who participate in managing a facility suggests that a parent corporation participating in the management of a subsidiary is potentially liable as an operator of a contaminated facility.

CPC and Aerojet respond that Congress never intended to abandon the traditional doctrine of limited liability that accompanies the corporate form in favor of some new and ill-defined concept of participation or active control. In support, one can point, as did the Sixth Circuit majority, to the different ways in which the statute defines owner or operator.

For facilities such as the Muskegon site, the statute simply refers to "any person owning or operating the facility." 42 U.S.C. § 9601(20)(A)(ii). However, for facilities that have been involuntarily conveyed to state or local governments because of abandonment or such events as tax delinquency or bankruptcy, the term means "any person who owned, operated, or otherwise controlled activities at such facility immediately [before its transfer]." 42 U.S.C. § 9601(20)(A)(iii).

The Sixth Circuit majority thus reasoned that Congress distinguished between operators and those who otherwise controlled a facility. As a result, nothing in CERCLA indicates that a parent corporation becomes an operator simply through active participation in and control over the affairs of a subsidiary.

The Government counters that the majority's reasoning is fundamentally flawed because it fails to recognize that the original purpose of the special definition was to address the problem of abandoned sites that likely had been nonoperational for some time prior to abandonment. Thus, contends the Government, it made sense for Congress to state clearly that an owner or operator of such sites could be someone who had controlled activities prior to a site's involuntary transfer through abandonment, bankruptcy, or other mechanism. According to the Government, it simply is illogical to say that an owner or operator cannot be a person or other entity that controlled operations at an active facility while acknowledging that the opposite would be true at an inactive facility.

CPC and Aerojet respond that CERCLA's language is too vague and its legislative history too sketchy to conclude that Congress meant to discard the limited-liability protection that corporations have traditionally enjoyed. If Congress had intended to do so, it would have used language clearly extending liability to parent corporations. Because no such language appears anywhere in CERCLA, courts ought not to reject the bright-line test the veil-piercing doctrine provides and replace it with some sort of nebulous control test.

The cost of abandoning traditional corporation law principles is simply too high, say CPC and Aerojet. Corporations acting in a manner consistent with their investment relationships ought to know precisely when their activity will trigger liability, perhaps of a devastating nature.

The United States replies by saying that the language of CERCLA *does* subject persons, including corporate entities, to direct liability based on their own actions in operating a facility. There is no need, therefore, to use veil-piercing doctrines to find a parent corporation liable for the actions of a subsidiary when the parent is liable directly for its own actions.

Congress imposed liability both on owners and operators to ensure that those responsible for creating hazardous conditions pay for remediation. Surely, the Government contends, it would frustrate Congress' purpose in enacting CERCLA to apply irrelevant principles drawn from state law.

The Government also disputes claims about the bright-line that veil-piercing doctrines based on state law allegedly provide. It argues that veil-piercing doctrines have not produced clear rules governing a parent corporation's liability. Accordingly, use of state-law rules would require extensive litigation concerning their application. Moreover, argues the Government, using state law to establish the CERCLA liability of a parent corporation would undermine the fairness and uniformity of the statutory program because inconsistent state-law standards would lead to different findings of liability depending on which state's law applies, the very kind of geographical disparity Congress sought to avoid.

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CPC and Aerojet counter with the suggestion that the purposes of CERCLA are better served by adopting a narrower approach to parent liability. By using traditional corporation law principles, corporations can use well-capitalized, nonfraudulent subsidiaries to purchase and rehabilitate contaminated sites without risking all of their assets. If, however, corporations are exposed to an expansive form of liability, then, as the Sixth Circuit majority asserted, fewer sites will be remediated privately because no rational corporate officer would ever accept the risk posed by the Government's active-participation-and-control test.

The United States replies by saying that its test would more likely prevent releases of hazardous substances by encouraging those actually in control to be careful. Of course, the Government points out that it really does not matter which policy argument is the more persuasive. In the final analysis, such policy judgments are for Congress to make, not the courts. Congress was entitled to enact and, according to the Government, did enact a statute imposing federal liability on those who actively participate in and exercise control over the running of a facility.

## SIGNIFICANCE

The United States does not routinely seek to hold parent corporations responsible for the hazardous conditions at facilities owned by subsidiaries. In many instances, parent corporations simply do not exercise control over or participate in the way in which such facilities are operated. However, the active-participation-and-control principle is important because exceptions do occur as illustrated by this case.

CERCLA implements the policy decision that those responsible for creating the problem, rather than the public at large, are supposed to bear the cost of cleanup. If state corporation-law principles apply, however, even parent corporations that exercise substantial control will escape liability.

The Muskegon site is one of the most severely contaminated in the nation. Its cleanup will likely cost more than $100 million. Three of the potentially responsible parties, however, no longer exist. The two parent corporations, therefore, are not only responsible in the eyes of the United States for creating the problem, they are apparently the only private parties who are financially able to contribute to the site's remediation in a meaningful way.

Large corporations in this situation do not believe they should incur liability simply because they possess deep pockets and happened to have exerted some degree of influence over a subsidiary's business. From the corporate point of view, the use of subsidiaries is a time-honored way in which larger corporations seek to reduce risk, including their exposure to liability.

It is typical, moreover, for parent corporations to take an active interest in the affairs of a subsidiary. As long as the corporate formalities are observed and no fraud or injustice results, parent corporations have been traditionally immune for the actions of their subsidiaries. If such a sensible and legitimate method for protecting corporate assets is dismissed, then, the argument goes, many contaminated sites may never be cleaned up because no well-capitalized corporation would ever agree to purchase and help remediate such sites by using a subsidiary.

The United States believes, however, that if it loses, those parent corporations that can and actually do control disposal practices at subsidiary corporations will not have such a strong reason to prevent environmental contamination. The Government also is concerned that the principle relied on by the Sixth Circuit majority may be extended to other contexts. The Sixth Circuit, for example, recently held that a sole shareholder "is not liable as an operator as defined [in CERCLA] unless circumstances justify piercing the corporate veil." *Donahey v. Bogle,* 129 F.3d 838, 843 (6th Cir. 1997), *petition for cert. filed.* Thus, if the Supreme Court affirms the Sixth Circuit in this case, the United States might encounter much greater difficulty in asserting operator liability against corporate officers, directors, and shareholders.

## Attorneys of the Parties

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## Amicus Briefs

**In support of CPC International, Inc., et al.**

Joint brief: American Forest & Paper Association, American Petroleum Institute, Grocery Manufacturers of America, Institute of Scrap Recycling Industries, National Solid Wastes Management Association, UGI Utilities, Inc., and Waste Management, Inc. (Counsel of Record: Donald B. Mitchell Jr.; Arent Fox Kintner Plotkin & Kahn; (202) 857-6172);

Atlantic Legal Foundation (Counsel of Record: Martin S. Kaufman; Atlantic Legal Foundation; (212) 537-1960);

Joint brief: Atlantic Richfield Company and Newmont Mining Corporation (Counsel of Record: Andrew M. Low; Davis Graham & Stubbs; (303) 892-9400);

Business and Industrial Council (Counsel of Record: David G. Palmer; Zevnik Horton Guibord McGovern Palmer & Fognani; (303) 382-6200);

Joint brief: National Association of Manufacturers and Chamber of Commerce of the United States (Counsel of Record: Bruce J. Ennis Jr.; Jenner & Block; (202) 639-6000);

Joint brief: Washington Legal Foundation; Allied Educational Foundation; and United States Representatives Michael G. Oxley, Joe Barton, Tom DeLay, Bill Goodling, and Bob Barr (Counsel of Record: Paul D. Kamenar; Washington Legal Foundation; (202) 588-0302).