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A Guide for Foreign Investors to Environmental Laws in the United States

SCOTT H. PETERS*

I. INTRODUCTION

Few legal restrictions inhibit foreign investment in the United States. In fact, American assets have recently been an attractive investment. Japanese investment in United States real estate in 1989 was \$14.8 billion, and it was not less than \$7 billion in any year from 1985 to 1990.¹ Of total Japanese investment, hotels and resorts accounted for approximately 36% in 1989, with office buildings representing 13%.² By the end of 1988, foreign investors held 16.4% of all United States Treasury securities.³

American businesses have also been appealing targets for foreign investment. From 1988 to 1991, more than five hundred foreign takeovers and investments in United States firms were reported to the Committee on Foreign Investment.⁴ Among these reported acquisitions were takeovers of businesses in aerospace, chemicals, computers, electronics, semiconductors, and telecommunications by companies from Japan, Taiwan, South Korea, and Australia.⁵

In the very recent past, foreign investment has become a source of

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1. L. A. Times, Nov. 14, 1990, at D1, col. 4.

2. *Id.*

3. L. A. Times, Mar. 15, 1988, at 2, col. 1.

4. Nash, *Foreign Holdings in U.S. Technology*, A.F. MAG., Oct. 1991, at 10. The Committee on Foreign Investment is charged with reviewing such acquisitions for their impact on national security.

5. *Id.*

increased political controversy. Opinion polls suggest that approximately 70% of Americans think that Japan has invested too much in the United States.⁶ Accordingly, in August, 1991, there were reportedly twenty-four bills to limit foreign investment pending in Congress.⁷

Although efforts to limit the amount or aim of foreign investment in the United States may be increasingly common, they have generally been unsuccessful. In 1988, Congress did approve a provision to require foreign investors who were buying specified amounts of real estate and business interests to register with the federal government.⁸ However, proposals to limit the amount of direct foreign investment in the United States, impose higher capital gains taxes on foreign investors, or curtail acquisitions of American firms on national security grounds have been frustrated.⁹ Federal Reserve Board Chairman Alan Greenspan has described foreign investment as a "plus."¹⁰ The Reagan and Bush Administrations have "smiled on foreign investment"¹¹ and are thought likely to veto anti-free trade legislation.¹²

Thus, the restrictions on foreign investment in the United States, to the extent they exist, appear to be economic ones. One economic factor is of particular recent concern: the cost of complying with American environmental laws and responding to American environmental litigation. This article attempts an introduction, in some detail, to the primary environmental rules and laws of special interest to potential foreign investors in the United States.

II. UNITED STATES ENVIRONMENTAL LAWS

For many years, American environmental law was almost exclusively a creature of the common law as developed in each of the several states. In the past twenty years, however, the federal and state governments have also passed a series of statutes designed to protect and to clean up the nation's air, water, and land.

Following is a discussion of the major federal environmental laws of general applicability to investors and businesses in the United

6. *Fear of Foreigners*, ECONOMIST, Aug. 10, 1991, at 15.

7. *Id.*

8. The Exon-Florio Amendment to the Defense Production Act, 50 U.S.C. § 2170(c) (1988), set up the Committee on Foreign Investment in the United States to review foreign investments that might impair "national security." Since its creation, the committee has blocked only one of the transactions reviewed, an acquisition of a United States airplane parts manufacturer by an arm of the Chinese government. Correll & Nash, *Lifelines Abroad*, A.F. MAG., Oct. 1991, at 42. That transaction had been attempted shortly after the 1989 massacre in Tiananmen Square. *Id.*

9. ECONOMIST, Aug. 10, 1991, at 15.

10. L. A. Times, Mar. 15, 1988, at 2, col. 1.

11. ECONOMIST, Aug. 10, 1991, at 15.

12. *Id.*

States. Reasons are given for their significance. The primary common law bases for liability are first introduced.¹³ The article then explains the two major federal statutes governing discharges of pollutants into air and water.¹⁴ Next, the two major federal statutes governing hazardous waste are discussed,¹⁵ with emphasis on the Comprehensive Environmental Response, Compensation, and Liability Act of 1980,¹⁶ the law with the greatest and most surprising impact on business transactions.¹⁷ Finally, this section addresses certain specific environmental problems relevant to acquisition of property or a business or operation of a business.¹⁸

However, this exposition is intended to be no more than an introduction. The importance that American environmental law plays in a decision to invest in the United States obviously depends on a number of factors, all of which cannot possibly be addressed in this format. Certain environmental laws and restrictions directed toward specific problems or industries are not examined.¹⁹ An investment in industries affected by these laws may require much more extensive and specific study. Moreover, because the federal government has generally tried to avoid preempting state statutes more restrictive than their federal counterparts,²⁰ the potential investor must be aware that any state may have environmental laws and restrictions

13. See *infra* text accompanying notes 22-45.

14. See *infra* text accompanying notes 46-77.

15. See *infra* text accompanying notes 78-256.

16. 42 U.S.C. §§ 9601-75 (1988).

17. See *infra* text accompanying notes 96-256.

18. See *infra* text accompanying notes 257-90.

19. For example, chemical manufacturers are subject to the requirements of the Toxic Substances Control Act, 15 U.S.C. §§ 2601-29 (1988). Those who manufacture pesticides must comply with the Federal Insecticide, Fungicide and Rodenticide Act, 7 U.S.C. §§ 136-136y (1988). The dumping of materials at sea is regulated by the Marine Protection, Research and Sanctuaries Act, 33 U.S.C. §§ 1401-45 (1988). The nuclear power industry must comply with the Atomic Energy Act of 1954, 42 U.S.C. §§ 2014, 2021-21a, 2022, 2111-14 (1988), and the Low Level Radioactive Waste Policy Act, 42 U.S.C. §§ 2021b-21d (1988). Certain mining activities are restricted by the Surface Mining Control and Reclamation Act of 1977, 30 U.S.C. §§ 1201-11, 1231-1328 (1988).

20. A state law is expressly preempted when a federal statute or regulation explicitly provides that federal control will be exclusive. J. NOWAK, R. ROTUNDA & J. NELSON YOUNG, *CONSTITUTIONAL LAW* 292-94 (2d ed. 1983). Even when federal law does not expressly preempt state legislation, implied preemption may be found in any of three alternative circumstances: (1) when the federal regulatory scheme is so pervasive that Congress has left no room for the states to supplement the federal scheme; (2) when the state law stands as an obstacle to the accomplishment and execution of Congress' purposes and objectives of federal law; or (3) when compliance with both federal and state law is impossible. *California Coastal Comm'n v. Granite Rock Co.*, 480 U.S. 572, 581 (1987); *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 368 (1986).

A state law may be saved from preemption by a saving proviso contained in a federal

which are more restrictive than the federal statutes addressed below.²¹ Accordingly, no promise is made here to identify or explain each of the numerous twists, turns, and traps a foreign investor may encounter when confronting United States environmental law.

A. *Common Law Enforcement of Environmental Interests*

State common law is the original tool of environmental law enforcement. The traditional causes of action, discussed below, include nuisance, trespass, negligence, and strict liability. The remedies provided by the common law include injunctive and monetary relief. The possibility of punitive damages, amounts awarded in excess of actual damages, also exists in cases of wanton behavior. Although common law develops in the individual state court systems, most common law torts vary little from state to state.

Nuisance is a primary common law cause of action for environmental torts. Nuisance is defined as "tortious conduct which produces unreasonable interference with the use and enjoyment of another's land."²² Nuisances are either private or public. A private nuisance disturbs the property rights of particular persons.²³ A public nuisance is an interference with the property rights of the community at large.²⁴ Private parties are generally prevented from suing on a public nuisance.²⁵ The common law of nuisance has provided a basis for actions to abate or recover damages for odors emanating from industrial facilities,²⁶ contamination of neighboring groundwater,²⁷ and the pollution of neighboring landowners' soil.²⁸ It is no defense that the nuisance was carried on in accordance with a permit

statute. For example, CERCLA explicitly allows states to impose additional liability requirements with respect to the release of hazardous substances. 42 U.S.C. § 9614(a) (1988).

21. For a more thorough discussion of state environmental laws, see D. SELMI & K. MANASTER, *STATE ENVIRONMENTAL LAW* (1991).

22. *RESTATEMENT (SECOND) OF TORTS* § 822 (1979).

23. To recover damages for a private nuisance, a plaintiff must show that the defendant intended to interfere with plaintiff's use and enjoyment of land, that some substantial interference has occurred of the kind intended, and that the interference was unreasonable. W. KEETON, *PROSSER AND KEETON ON THE LAW OF TORTS* § 87 (5th ed. 1984).

24. *Id.* § 90. A public nuisance is an act or omission "which obstructs or causes inconvenience or damage to the public in the exercise of rights common to all." *Id.* (quoting J. STEPHEN, *A GENERAL VIEW OF THE CRIMINAL LAW OF ENGLAND* 105 (1890)). A public nuisance might be a hog pen, the storage of explosives, gambling houses, or unlicensed prize fights. *Id.* § 90, n.19.

25. *See generally id.* § 86. A private party is generally not permitted to bring actions to abate a public nuisance unless it causes or threatens special damage to him or her apart from that to the general public. Then the private party can bring suit only to the extent necessary to protect his or her own interests. *Id.* §§ 89, 90.

26. *See, e.g., Ozark Poultry Prod. v. Garman*, 251 Ark. 389, 472 S.W.2d 714 (1971).

27. *See, e.g., Branch v. Western Petroleum Corp.*, 657 P.2d 267, 270 (Utah 1982).

because a permit does not confer a license to harm the property of another.²⁸

A second common law cause of action, trespass, is closely related to nuisance. Rather than the interference with the use and enjoyment of land that marks nuisance, trespass is an invasion of the exclusive possession of another's land.²⁹ However, trespass requires a showing neither of damage to the land nor of intent.³¹ Generally if a trespass claim is successful, liability is found in nuisance as well.³²

A third liability theory, negligence, is the breach of a legal duty owed to another which causes damages to the non-breaching party.³³ The legal duty may be conclusively mandated by a statute or rule defining a code of conduct.³⁴ The duty may vary according to the defendant's knowledge of the activity's inherent danger.³⁵ Accordingly, persons failing to exercise reasonable care in the handling or disposal of hazardous substances, or failing to meet the requirements imposed by laws governing them, may be liable to injured plaintiffs in negligence.

The common law negligence doctrine recognizes a duty to warn of danger.³⁶ If a defendant knows about a hazardous product or condition and has no reason to believe that those who will come into contact with that product or condition will know of that danger, he or

28. See, e.g., *Wilsonville v. S.C.A. Servs.*, 86 Ill. 2d 1, 426 N.E.2d 824 (1981).

29. W. KEETON, *supra* note 23, § 88B.

30. W. KEETON, *supra* note 23, § 87. "The difference is that between walking across his lawn and establishing a bawdy house next door; between felling a tree across his boundary line and keeping him awake at night with the noise of a rolling mill." *Id.*

31. RESTATEMENT (SECOND) OF TORTS § 158 (1965).

32. See, e.g., *City of Philadelphia v. Stepan Chem. Co.*, 544 F. Supp. 1135 (E.D. Pa. 1982) (applying Pennsylvania law); *Martin v. Reynolds Metal Co.*, 221 Or. 86, 342 P.2d 790 (1959).

33. W. KEETON, *supra* note 23, § 30; RESTATEMENT (SECOND) OF TORTS § 281 (1965). Liability may be imposed even though the harm was not intentional. To establish breach of a duty owed, the plaintiff must demonstrate only that the defendant failed to meet the standard of care of a "reasonable person." W. KEETON, *supra* note 23, § 32.

34. If the statute or rule is designed to protect a class of persons of which the plaintiff is part, and the harm that has occurred is the type meant to be prevented, a majority of courts hold that breach of duty owed is conclusively established under the doctrine of "negligence *per se*." W. KEETON, *supra* note 23, § 36.

35. *Reynolds Metal Co. v. Yturbide*, 258 F.2d 321 (9th Cir.), *cert. denied.*, 358 U.S. 840 (1958).

36. RESTATEMENT (SECOND) OF TORTS § 388 (1965). The Restatement provides generally that a supplier of a product to be used by a third party may be liable if the supplier:

- (a) knows or has reason to know that the chattel is or is likely to be dangerous for the use for which it is supplied, and (b) has no reason to believe that those for whose use the chattel is supplied will realize its dangerous condition, and
- (c) fails to exercise reasonable care to inform them of its dangerous condition

she must exercise reasonable care to warn them of such danger.³⁷ Thus, unreasonable failure to warn can result in negligence liability.

A fourth common law cause of action which applies to environmental torts is strict liability. It is imposed on a defendant without regard to the defendant's fault.³⁸ There are narrowly construed areas of activity to which strict liability applies. Strict liability may be imposed when "abnormally dangerous conduct"³⁹ results in injury to others.⁴⁰

Among the activities affecting the environment which have been held to give rise to strict liability are the contamination of groundwater from an underground tank,⁴¹ leaking of toxic materials from a railway car,⁴² and flooding of neighborhood lands by water from a mining operation.⁴³ Earlier cases imposed strict liability for damages from the storage of inflammable liquids, the accumulation of sewage, and the emission of creosote fumes.⁴⁴

It is important to note that under common law theories, punitive damages may be available in addition to actual or compensatory damages. Large sums may be awarded to tort plaintiffs if a court or jury finds that the defendant's wrongful conduct was willful, grossly negligent, wanton, or otherwise abhorrent.⁴⁶ The prospect of sustaining a large punitive damages award gives those whose activities may affect the environment a great incentive for carefulness.

B. Clean Air Act

The Clean Air Act,⁴⁶ which governs the discharge of pollutants into the air, was one of the first major pieces of environmental legislation passed in the United States. The Act provides comprehensive

or of the facts which make it likely to be dangerous.

Id. See *Ferebee v. Chevron Chem. Co.*, 736 F.2d 1529 (D.C. Cir.), *cert. denied*, 469 U.S. 1062 (1984) (adequacy of written warning of danger of paraquat); *Dougherty v. Hooker Chem. Corp.*, 540 F.2d 174 (3d Cir. 1976) (adequacy of warning about danger of metal cleaner is measured by danger of product, foreseeability or harm, and burden of warning).

37. *Dougherty v. Hooker Chem. Corp.*, 540 F.2d 174, 176-78 (3d Cir. 1976).

38. Strict liability is imposed on a party apart from either an intent to interfere with a legally protected interest without legal justification or a breach of duty to exercise reasonable care. W. KEETON, *supra* note 23, § 75.

39. RESTATEMENT (SECOND) OF TORTS § 519 (1976).

40. *Id.* See *Branch v. Western Petroleum, Inc.* 657 P.2d 267 (Utah 1982).

41. *Yommer v. McKenzie*, 225 Md. 220, 257 A.2d 138 (1969).

42. *Indiana Harbor Belt R.R. v. American Cyanamid Co.*, 517 F. Supp. 314 (N.D. Ill. 1981).

43. *Mowrer v. Ashland Oil & Ref. Co.*, 518 F.2d 659 (7th Cir. 1975).

44. See W. KEETON, *supra* note 23, § 78.

45. *E.g.*, *Sterling v. Velsicol Chem. Corp.*, 647 F. Supp. 303 (W.D. Tenn. 1986) (\$7.5 million in punitive damages awarded for hazardous waste disposal); *Miller v. Cudahy Co.*, 592 F. Supp. 976 (D. Kan. 1984) (awarding \$10 million in punitive damages for pollution of groundwater).

46. 42 U.S.C. §§ 7401-7642 (1988).

federal regulation of both stationary⁴⁷ and moving⁴⁸ sources of air pollution.⁴⁹ Both the Act and regulations promulgated under it are extremely complex.⁵⁰ Generally, however, investors should be aware that a business facility's air emissions may be restricted, as outlined below, to meet applicable air pollution standards.

The Act imposes three sets of air quality standards. First, the Act prescribes National Ambient Air Quality Standards (NAAQS) for primary⁵¹ and secondary⁵² pollutants.⁵³ Special location-specific restrictions apply in areas where NAAQS are being attained for the prevention of significant air quality deterioration (PSD).⁵⁴ In areas where NAAQS are not being attained, called "nonattainment areas,"⁵⁵ major new sources or modifications to existing sources must meet strict controls based on "the lowest achievable emission rate[s]."⁵⁶ Second, the Act prescribes New Source Performance Standards (NSPS). These NSPS are issued industry by industry, based on application of the "best system of continuous emissions reduction."⁵⁷ Third, the Act sets standards for hazardous air pollutants, which are most strictly regulated.⁵⁸

47. A stationary source is "any building, structure, facility or installation which emits or may emit any air pollutant." *Id.* § 7411(a)(3).

48. Moving sources, essentially motor vehicles, are governed by Subchapter II of the Clean Air Act. *Id.* §§ 7521-74.

49. *Id.* §§ 7401(a)(3), 7410(a)(1).

50. "The arcane knowledge essential to resolve . . . disputes [over appropriate air pollution control measures under the Act] is foreign to non-experts, including judges." *Delaware Valley Citizens Council for Clean Air v. Davis*, 932 F.2d 256, 260 (3d Cir. 1991).

51. Primary pollutants are those which may affect public health. 42 U.S.C. § 7409(b)(1) (1988).

52. Secondary pollutants are those which may affect the public welfare, including aesthetics. *Id.* § 7409(b)(2).

53. *Id.* § 7409. NAAQS now exist for sulfur dioxide, particulates, carbon monoxide, ozone and hydrocarbons, nitrogen dioxide, and lead. 40 C.F.R. § 50 (1988).

54. 42 U.S.C. §§ 7470-79 (1988); 40 C.F.R. §§ 51.24, 52.21 (1988). PSDs are imposed to prevent newly constructed sources or modifications to sources from causing serious decreases in air quality. *Id.*

55. 42 U.S.C. § 7407(D)(1)(A) (Supp. 1991).

56. 42 U.S.C. § 7410 (1988); 40 C.F.R. § 51.18(j)-(k), 52.24, § 51 App. S (1991). In nonattainment areas, any business proposing source construction or modification must obtain reductions from other sources that will at least offset the additional pollution it will be emitting. *Id.*

57. 42 U.S.C. § 7411 (1988).

58. *Id.* § 7412. These standards are set at levels which provide an "ample margin of safety to protect the public," 40 C.F.R. § 50.2(b) (1991), a tougher standard than the NAAQS, which are set at levels providing an "adequate margin of safety." *Id.* There are numerous hazardous pollutants, including beryllium, asbestos, mercury, vinyl chloride, benzene, inorganic arsenic, radon from underground mines, and radionuclides. 42 U.S.C. § 7412 (1988).

Enforcement of the Act is generally to be done by the states.⁵⁹ The Act authorizes both criminal and civil penalties in the event of the emission of air pollutants not permitted under the statute.⁶⁰ Monetary fines, imprisonment, or both may be imposed on "any responsible corporate officer."⁶¹ The Act also authorizes citizen suits, both against emission sources to enforce control requirements and against the Environmental Protection Agency (EPA) to enforce its non-discretionary duties.⁶²

A potential investor should consider the effects compliance with the Clean Air Act will have on business operating costs. If investment in an ongoing business is contemplated, these costs may be relatively easy to identify; however, the current degree of compliance should be examined. If planning expansion or new construction, the investor should determine if the site location is in a nonattainment area or has the PSD requirements which might affect the ability or cost of doing so. Thus, location can be very important in determining cost of compliance.⁶³

C. Federal Water Pollution and Control Act

The Federal Water Pollution and Control Act of 1972 (Clean Water Act)⁶⁴ regulates discharges of pollutants⁶⁵ into "navigable waters,"⁶⁶ defined to include the "waters of the United States."⁶⁷ Title III of the Act requires the EPA to set technology-based "effluent limitations"⁶⁸ on discharges from "point sources."⁶⁹ The EPA has

59. *Id.* §§ 7401(a)(3), 7410 (a)(1). *See also* Humphrey & Paddock, *The Federal and State Roles in Environmental Enforcement: A Proposal for a More Effective and More Efficient Relationship*, 14 HARV. ENV. L. REV. 7, 14-15 (1990).

60. 42 U.S.C. §§ 7413(c), 7420 (1988) (civil penalties); *id.* § 7413(d) (criminal penalties).

61. *Id.* § 7413(c)(3).

62. *Id.* § 7604(a).

63. *Id.* § 7420.

64. 33 U.S.C. §§ 1251-1387 (1988).

65. The Clean Water Act defines "pollutant" broadly, *id.* § 1362(6), and includes in its definition "chemical waste" and "industrial, municipal, and agricultural waste discharged into water." *Id.*

66. *See generally id.* § 1251.

67. *Id.* § 1362(7). The definition of "waters of the United States" is extremely broad. 40 C.F.R. § 122.2 (1991). The Act unquestionably covers more than waters that are navigable in fact. *See* United States v. Riverside Bayview Homes, 474 U.S. 121 (1985) (holding non-navigable wetlands covered). However, groundwaters are probably not covered. *See* Exxon Corp. v. Train, 554 F.2d 1310 (5th Cir. 1977); Kelly v. United States, 618 F. Supp. 1103 (W.D. Mich. 1985); United States v. GAF, 389 F. Supp. 1379 (S.D. Tex. 1975).

68. An "effluent limitation" is "any restriction . . . on quantities, rates, and concentrations of chemical, physical, biological, and other constituents which are discharged from point sources." 33 U.S.C. § 1362(11) (1988).

69. A "point source" is "any discernible, confined and discrete conveyance, including . . . any pipe, ditch, channel, tunnel, conduit . . . from which pollutants are or may be discharged." *Id.* § 1362(14).

issued effluent limitations for a number of pollutants.⁷⁰ Discharges of toxic pollutants are regulated under stricter standards.⁷¹ Oil spills and hazardous substance spills are also specially regulated.⁷²

Enforcement under the Clean Water Act is primarily effected through the National Pollutant Discharge Elimination System (NPDES) permit.⁷³ No discharge into waters is permitted without a NPDES permit.⁷⁴ Permitted discharges are overseen by enforcing agencies that periodically review monitoring reports,⁷⁵ but the Act also gives private citizens the right to bring civil suit on their own behalf against anyone alleged to be in violation of the Act.⁷⁶ Additionally, the EPA has the power to either issue an administrative order or seek an injunction to force compliance with effluent limitation and permit standards. The EPA may also assess civil penalties of up to \$10,000 for each day the violation continues.⁷⁷

Like the discharge restrictions of the Clean Air Act, the limitations of the Clean Water Act may impose operating costs on a business beyond those with which a foreign investor may be familiar. It is prudent to identify these costs before making an investment, particularly in a new business venture. An investor should also evaluate whether an existing target business is in compliance with discharge requirements, because failure to comply may subject the business to liability.

70. 40 C.F.R. § 401 (1991).

71. 33 U.S.C. § 1317 (1988).

72. *Id.* § 1321.

73. *Id.* § 1342. The NPDES regulations are at 40 C.F.R. §§ 121-125 (1991). *See generally* Humphrey & Paddock, *supra* note 59, at 17-18.

74. 33 U.S.C. § 1362(12) (1988). "Discharge of a pollutant" includes "(A) any addition of any pollutant to navigable waters from any point source, (B) any addition of any pollutant to the . . . ocean from any point source other than a vessel." *Id.* The scope of the Act is broad enough to cover runoff from parking lots and other open spaces as well. 40 C.F.R. § 122.26 (1991).

75. 40 C.F.R. §§ 122.41(k)(6), 122.42(a) (1991). The frequency of required reports is governed by the terms of the permit, but must be at least annual. Toxic discharges must be reported within twenty-four hours. *Id.*

76. 33 U.S.C. § 1365(a) (1988). *See, e.g.,* Chesapeake Bay Found. v. Gwaltney of Smithfield, Ltd., 484 U.S. 49 (1987); Student Pub. Interest Research Group v. AT & T Bell Labs., 617 F. Supp. 1190 (D.N.J. 1985); Legal Envtl. Assistance Found. v. Hodel, 586 F. Supp. 1163 (E.D. Tenn. 1984).

77. 33 U.S.C. § 1319(g) (1988).

D. Resource Conservation and Recovery Act

The Resource Conservation and Recovery Act of 1976 (RCRA)⁷⁸ specifically regulates the generation, storage, transportation, treatment, and disposal of hazardous waste.⁷⁹ Hazardous waste is certain listed waste or other waste which is ignitable,⁸⁰ corrosive,⁸¹ reactive,⁸² or toxic.⁸³ The RCRA requires that any person generating or transporting hazardous waste, or the owner or operator of a hazardous waste treatment, storage, or disposal facility must apply for a permit and comply with applicable requirements.⁸⁴ Generally, a generator may not accumulate hazardous waste onsite for more than ninety days before being considered the operator of a storage facility and thus subject to extensive permitting requirements.⁸⁵ All shipments of hazardous waste are tracked from generation to disposal through shipping documents known as "manifests."⁸⁶ Certain generators may be qualified as "small quantity generators,"⁸⁷ for which record keeping requirements may be relaxed.⁸⁸

RCRA requires EPA to establish standards for owners and operators of hazardous waste disposal facilities. These include requirements for financial responsibility for possible releases of hazardous waste.⁸⁹ Owners and operators of surface impoundments, landfills, and treatment facilities must maintain insurance coverage of at least \$3 million per occurrence.⁹⁰

RCRA provides various enforcement mechanisms. The Act authorizes EPA to assess civil penalties up to \$25,000 per day for each violation of the Act.⁹¹ Those receiving criminal penalties are subject

78. 42 U.S.C. §§ 6901-91i (1988).

79. *Id.*

80. 40 C.F.R. § 261.21 (1991).

81. *Id.* § 261.22.

82. *Id.* § 261.23.

83. *Id.* § 261.24.

84. 42 U.S.C. § 6925 (1988). *See* 40 C.F.R. §§ 262-265 (1990). Among the rules prescribed for generators and transporters are pre-transport requirements and rules for manifesting, record keeping and reporting, exports and imports of hazardous waste, and dealing with hazardous waste discharges. The rules for owners and operators of hazardous waste treatment, storage, and disposal facilities set forth extensive and specific requirements for record keeping, operation, and closure of such facilities.

85. 40 C.F.R. § 262.34 (1991).

86. *Id.* §§ 262(B), 263(B).

87. *Id.* § 261.5.

88. *Id.* Generally, a small quantity generator is one which generates no more than one hundred kilograms of hazardous waste in a month. *Id.*

89. 42 U.S.C. § 6924 (1988).

90. 40 C.F.R. §§ 264.147(b), 265.147(b) (1990) (requiring \$3 million coverage for "non-sudden accidental occurrences;" \$6 million for "sudden accidental occurrences").

91. 42 U.S.C. § 6928(g) (1989).

to fines of up to \$50,000 per day for first convictions as well as imprisonment.⁹² EPA can sue to immediately restrain a person contributing to the "imminent and substantial endangerment"⁹³ resulting from the handling, storage, treatment, transportation or disposal of any solid or hazardous waste, as those terms are defined by the Act.⁹⁴ RCRA also permits private parties to sue to enforce RCRA permits or standards, to enjoin RCRA violators, to seek an order that necessary action be taken by EPA or others, and to seek application of the Act's civil penalties.⁹⁵

E. The Comprehensive Environmental Response, Compensation, and Liability Act

Broadly stated, while RCRA regulates ongoing hazardous waste operations, the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA)⁹⁶ addresses the cleanup of waste from previous activities.⁹⁷ CERCLA makes available both public⁹⁸ and private⁹⁹ money to fund hazardous waste cleanup. CERCLA has spawned an industry of environmental consulting and lawyering. When confounded by various perceived mistakes and omissions in the drafting of CERCLA, judges have regularly interpreted liability expansively.¹⁰⁰

Liability under CERCLA is the most dangerous and surprising type of environmental liability, and it can be an expensive ailment. The EPA had identified 33,834 sites as potentially hazardous as of December 31, 1990.¹⁰¹ Although 1,126 of these sites have been listed on the EPA's National Priority List of contaminated sites, only

92. *Id.* § 6928(d).

93. *Id.* § 6973.

94. *See id.* §§ 6934, 6972-73.

95. *Id.* § 6972(a)(1).

96. 42 U.S.C. § 9601-75 (1988).

97. *Id.* Congress made significant changes to CERCLA in the Superfund Amendment and Reauthorization Act (SARA), Pub. L. No. 99-400, 100 Stat. 1613 (1986). Courts and practitioners sometimes refer to SARA's provisions separately. However, because it is not important for the purposes of this article to distinguish between the original CERCLA provisions and those of SARA, this article refers only to CERCLA.

98. CERCLA's Hazardous Substance Response Fund is available to pay for "governmental response costs." 42 U.S.C. § 9611(a) (1988).

99. For a discussion of the liability of private entities under CERCLA, see *infra* text accompanying notes 105-256.

100. *See, e.g., United States v. Reilly Tar & Chem. Co.*, 546 F. Supp. 1112 (D. Minn. 1982) ("CERCLA should be given a broad and liberal construction").

101. N. Y. Times, June 16, 1991, § 3, at 1.

sixty-three sites have been cleaned up.¹⁰² The EPA estimates the average cleanup cost¹⁰³ of a site to be \$30 million; as much as \$750 million may need to be spent to comply with CERCLA's standards.¹⁰⁴

1. Scope of CERCLA Liability

The broad scope of CERCLA liability makes it especially significant to potential investors. CERCLA liability attaches in the event of an actual or threatened "release"¹⁰⁵ of a "hazardous substance"¹⁰⁶ into the environment.¹⁰⁷ There is no minimum standard for a release. Any traceable amount of a hazardous substance is sufficient to support liability.¹⁰⁸ This refusal to recognize a *de minimus* exception greatly increases the likelihood that a legally significant release will occur.

Liability imposed by CERCLA is strict, without regard to fault, knowledge, or intent.¹⁰⁹ Under a strict liability standard, causation is not at issue.¹¹⁰ Instead, a party need only be within one of CERCLA's defined categories of potentially responsible parties to be liable.¹¹¹ These broad categories include past and current owners or operators of facilities at which a release has occurred,¹¹² those who arranged for the disposal of hazardous substances at the place of

102. *Id.*

103. Cleanup costs, called "response costs" in CERCLA, may include costs of monitoring, investigation, laboratory fees, and the fees of contractors and consultants. See 42 U.S.C. §§ 9601(23)-(25) (1988); *Velsicol v. Reilly Tar and Chem. Corp.*, 21 *Env't Rep. (BNA)* 2118 (E.D. Tenn. 1984). At least one court has held that attorney's fees incurred in pursuing response costs are recoverable. *General Elec. Co. v. Litton Indus. Automation Sys.*, 920 F.2d 1415 (8th Cir. 1990), *cert. denied*, 111 S. Ct. 1390 (1991). The cost of lawyers, engineering studies, and record keeping have more than doubled the cost of some cleanups. *N. Y. Times*, June 16, 1991, § 3, at 1.

104. *Id.* Just six years before, the average cleanup cost was estimated to be \$12 million. 15 *Env't Rep. (BNA)* 1395 (Dec. 21, 1984).

105. "Release" is broadly defined to include a spilling, leaking, dumping, or "disposing" into the environment. 42 U.S.C. § 9601(22) (1988). "Disposal" has been construed to include the migration or leaking of waste from its initial location. *United States v. Conservation Chem. Co.*, 619 F. Supp. 162, 200 (W.D. Mo. 1985).

106. 42 U.S.C. § 9601(14) broadly defines the term "hazardous substance." The definition includes any substance designated hazardous or toxic under the Clean Water Act, 33 U.S.C. §§ 1317(a), 1321(b)(2)(A) (1988); CERCLA, 42 U.S.C. § 9602 (1988); RCRA, 42 U.S.C. § 6921; the Clean Air Act, 42 U.S.C. § 7412; and the Toxic Substances Control Act, 15 U.S.C. § 2606 (1988). However, the definition explicitly exempts many petroleum and natural gas products. 42 U.S.C. § 9601(14).

107. 42 U.S.C. § 9604 (1988).

108. See *Eagle-Pitcher Indus. v. EPA*, 759 F.2d 922, 927-31 (D.C. Cir. 1985).

109. *E.g.*, *United States v. Monsanto Co.*, 858 F.2d 160, 167 (4th Cir. 1988); *New York v. Shore Realty Corp.*, 759 F.2d 1032, 1042 (2d Cir. 1986). Liability under CERCLA is the same as that imposed by the Clean Water Act, which imposes strict liability. 42 U.S.C. 9601(32) (1989).

110. See *supra* note 38 and accompanying text.

111. *United States v. Stringfellow*, 661 F. Supp. 1053, 1060-61 (C.D. Cal. 1987).

112. See *infra* notes 132-41 and accompanying text.

release,¹¹³ and those who transported the hazardous substances to the place of release.¹¹⁴ If either an investor or the business invested in falls within one of the enumerated categories of liable parties, the investor may be liable for at least some portion of the cleanup costs.

The liability of any responsible party is joint and several.¹¹⁵ Courts have recognized that "if there are distinct harms that are capable of division, then liability should be apportioned according to the contribution of each defendant."¹¹⁶ However, unless a defendant can meet the burden of showing a reasonable basis for apportionment,¹¹⁷ any one responsible party may be held liable for all cleanup costs incurred.¹¹⁸ An investor can thus be liable for the entire cost of cleanup if other responsible parties cannot be located or are not solvent.¹¹⁹ This puts particular pressure on the deep pocket investor to avoid liability under CERCLA.

CERCLA provides that either government¹²⁰ or private parties¹²¹ may bring actions to recover cleanup costs. Because any potentially responsible party may thus seek contribution from any other party who may be liable under section 9607(a), the harsh results of joint and several liability are somewhat mitigated.¹²² CERCLA also implicitly recognizes the validity of indemnification agreements among

113. See *infra* notes 142-48 and accompanying text.

114. 42 U.S.C. § 9607(a) (1989). For a discussion of transporters, see *infra* text accompanying notes 149-50.

115. Under joint and several, or "entire" liability, "a defendant might be liable for the entire loss sustained by the plaintiff, even though the defendant's act concurred or combined with that of another wrongdoer to produce the result . . ." W. KEETON, *supra* note 23, § 47.

116. *United States v. Stringfellow*, 661 F. Supp. 1053, 1060 (C.D. Cal. 1987).

117. *United States v. Ottati & Goss, Inc.*, 630 F. Supp. 1361, 1395 (D.N.H. 1985).

118. See, e.g., *United States v. Medley*, 25 Env't Rep. Cas. (BNA) 1315 (D.S.C. 1986); *Ottati & Goss*, 630 F. Supp. at 1395; *United States v. South Carolina Recycling and Disposal, Inc.*, 653 F. Supp. 984, 994 (D.S.C. 1986).

119. Joint and several liability has been described as EPA's "atom bomb." N. Y. Times, June 16, 1991, § 3, at 1.

120. Under § 9606, the EPA may order a responsible party to take action in certain cases in which the EPA determines that an actual or threatened release poses an imminent and substantial endangerment to the public health or welfare. 42 U.S.C. § 9606 (1989). Alternatively, the EPA can perform cleanup work itself and then seek reimbursement from responsible parties in a cost recovery action. *Id.* §§ 9604, 9607(a)(4)(A).

121. *Id.* § 9607(a)(4)(B).

122. *Id.* § 9613(f)(1). See also *Allied Corp. v. Acme Solvents Reclaiming, Inc.*, 691 F. Supp. 1100 (N.D. Ill. 1988) (listing factors considered in apportioning liability among responsible parties).

private parties.¹²³ However, these agreements do not shield any potentially liable party from suits by the government.¹²⁴

The broad scope of CERCLA makes it virtually impossible to contest liability under the EPA cleanup orders.¹²⁵ Courts cannot hear a pre-enforcement challenge to the specifics of a government-ordered cleanup.¹²⁶ Moreover, the EPA can assess stiff fines against parties refusing to comply with its cleanup orders.¹²⁷ Once a responsible party acting pursuant to a cleanup order incurs costs, it may only recover those costs to the extent it can demonstrate that the EPA's selection of the response action ordered was illegal or "arbitrary and capricious."¹²⁸

Finally, liability is retroactive.¹²⁹ The fact that CERCLA imposes liability on parties for acts occurring prior to the enactment of CERCLA has not been held to violate due process.¹³⁰ Thus, companies are liable for response costs associated with releases occurring before 1980, when CERCLA was enacted.

2. Statutorily Responsible Parties

The effect of CERCLA depends largely on the construction of the descriptions of four categories of responsible parties. Generally, responsible parties are the current and past owners or operators of facilities from which a hazardous substance has been released, those who arranged for disposal of hazardous substances at such facilities,

123. 42 U.S.C. § 9607(e) (1989).

124. *Id.*

125. *Id.* § 9606(a).

126. *See id.* § 9613(h) (codifying pre-SARA case law). Prior to 1986, courts either did not view an EPA order as a final action or held that a cost recovery action under CERCLA was an adequate remedy in court for review. *See, e.g.,* Solid State Circuits, Inc. v. EPA, 812 F.2d 383, 388-92 (8th Cir. 1987); J.V. Peters & Co. v. EPA, 767 F.2d 263 (6th Cir. 1985); United States v. Ottati & Goss, Inc., 630 F. Supp. 1361 (D.N.H. 1985).

Courts have also remarked that to permit pre-enforcement review would debilitate the primary purpose of the law, which is to assure prompt cleanups. *J.V. Peters*, 767 F.2d at 264 (citing Lone Pine Steering Comm. v. EPA, 600 F. Supp. 1487, 1495 (D.N.J. 1985)).

127. 42 U.S.C. §§ 9606(b)(1), 9607(c)(3) (1989). For example, the EPA is authorized to fine violators \$25,000 for each day the violation or failure to comply with an abatement order continues. *Id.* Additionally, a person who "fails without sufficient cause to properly provide removal or remedial action upon order of [the EPA]" may be liable for punitive damages in an amount equal to three times the EPA's costs. *Id.* § 9607(c)(3).

128. *Id.* § 9606(b)(2)(D).

129. *See, e.g.,* Schalk v. Reilly, 900 F.2d 1091, 1096 (7th Cir.), *cert. denied sub nom.*, Frey v. Reilly, 111 S. Ct. 509 (1990); United States v. Allied-Signal Corp., 736 F. Supp. 1553, 1557 (N.D. Cal. 1990).

130. *E.g.,* United States v. Northeastern Pharmaceutical & Chem. Co., 810 F.2d 726, 732-34 (8th Cir. 1986), *cert. denied*, 484 U.S. 848 (1987).

and those who transported the hazardous substances to such facilities.¹³¹ An understanding of the operation of CERCLA begins with an understanding of the individuals and entities that may be deemed responsible parties.

The current "owner or operator of a vessel or a facility . . . from which there is a release"¹³² is one of the explicitly liable parties under CERCLA.¹³³ The Act defines an "owner or operator" to be: "in the case of an onshore facility or an offshore facility, any person owning or operating such facility, and in the case of any abandoned facility, any person who owned, operated, or otherwise controlled activities at such facility immediately prior to such abandonment."¹³⁴

The ramifications of owner/operator liability can be staggering for purchasers of American real estate or businesses. Pursuant to strict liability principles,¹³⁵ the current owner or operator of a facility is liable even if it never released hazardous wastes there and even if no hazardous waste was released there during the period of current ownership or operation.¹³⁶ Section 9607(a) "does not require that the present owner contribute to the release, but merely that [the party] is the present owner of the facility where there has been a release or threat of release of a hazardous substance."¹³⁷ Accordingly, anyone buying contaminated property is a responsible party under CERCLA and is thus potentially liable for the full cost of cleanup. This is true even if the property is leased to a third party.¹³⁸

The second category of liable party under CERCLA is the owner or operator at the time of disposal.¹³⁹ On the face of the statute, those who owned or operated the facility between the disposal and the current ownership or operation would not be responsible parties.

131. 42 U.S.C. § 9607(a) (1988).

132. *Id.* § 9607(a)(1).

133. *Id.*

134. *Id.* § 9601(20)(A) (1989). "Facility" is defined to include any area where a hazardous substance is stored, disposed of, or spilled. *Id.* § 9601(9).

135. See *supra* text accompanying notes 38-44.

136. See, e.g., *United States v. Stringfellow*, 661 F. Supp. 1053, 1063 (C.D. Cal. 1987) (granting *sua sponte* partial summary judgment against present owner based on strict liability).

137. *Id.*

138. E.g., *United States v. Argent Corp.*, 14 Envtl. L. Rep. (Envtl. L. Inst.) 20616 (D.N.M. 1984) (holding lessor of facility liable because contractual relationship formed by lease precluded third party defense).

139. 42 U.S.C. § 9607(a)(2) (1989). "Any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of" is potentially liable. *Id.*

However, some courts have broadly construed the term "disposal"¹⁴⁰ to apply to the continuous, ongoing migration or leaching of hazardous substances.¹⁴¹ Thereby those courts have found every owner or operator of contaminated property between the owner or operator at the time of disposal and the current owner or operator to be liable for a release.

The third set of liable parties under CERCLA are those who "arranged for" disposal or treatment of hazardous substances.¹⁴² Arrangers liable under CERCLA have typically been generators of hazardous substances.¹⁴³ Liability attaches whether or not the arranger generated the hazardous substances.¹⁴⁴ No ownership or physical possession of the hazardous substances is required to establish arranger liability.¹⁴⁵ However, courts have generally refused to find arranger liability in limited instances when the defendant sold a useful product containing hazardous substances, and the product was later disposed of.¹⁴⁶

Potential investors should be cognizant of the possibility that they can be liable under CERCLA for cleanup costs incurred at a site other than one they own if hazardous substances they arranged to dispose of are released into the environment.¹⁴⁷ This off site liability is particularly vexing because the arranger lacks control over the circumstances leading to the release. Because CERCLA liability is strict,¹⁴⁸ the fact that the arranger may have taken precautions to

140. *Id.*

141. *E.g.*, Tanglewood E. Homeowners v. Charles-Thomas, Inc., 849 F.2d 1568, 1573 (5th Cir. 1988); United States v. Conservation Chem. Co., 619 F. Supp. 162, 185 (W.D. Mo. 1985). *But see* Ecodyne Corp. v. Shah, 718 F. Supp. 1454 (N.D. Cal. 1989) (disagreeing with "continuous release" theory).

142. 42 U.S.C. § 9607(a)(3) (1991). An arranger is: "any person who by contract, agreement, or otherwise arranged for disposal or treatment . . . of hazardous substances owned or possessed by such person, by any other party or entity, at any facility or incineration vessel owned or operated by another party or entity and containing such hazardous substances." *Id.*

143. Practitioners often use only the term "generator" to refer to this category of liable parties. However, this article uses the term "arranger" because the scope of liability under 42 U.S.C. § 9607(a)(3) (1988) is not limited to those who generate hazardous substances. *See* United States v. A & F Materials Co., 582 F. Supp. 842, 845 (S.D. Ill. 1984) (attaching liability to any party making "the crucial decision how [the hazardous waste] would be disposed of or treated, and by whom").

144. United States v. Bliss, 667 F. Supp. 1298, 1306 (E.D. Mo. 1987).

145. *See, e.g.*, United States v. N.E. Pharmaceutical & Chem Co., 810 F.2d 726, 743 (8th Cir. 1986).

146. Florida Power & Light Co. v. Allis Chalmers Corp., 893 F.2d 1313 (11th Cir. 1990) (no liability for sale of transformers which leaked PCBs 40 years later); *but see* New York v. General Elec. Co., 592 F. Supp. 291 (N.D.N.Y. 1984) (sale of transformer oil to a dragstrip for dust control not a sale of a useful product, but intended to be a disposal).

147. *E.g.*, United States v. Mottolo, 629 F. Supp. 56, 59-60 (D.N.H. 1984).

148. *See supra* text accompanying note 109.

see that the disposal was safe and legal will not be a defense to liability. While an arranger can seek contribution from the wrongdoers, those entities may be bankrupt or dissolved. CERCLA's joint and several liability can make the relatively blameless arranger the source of substantial cleanup funds.

Transporters are the fourth category of party explicitly liable under section 9607 of CERCLA.¹⁴⁹ Transporters are parties who accept hazardous substances for transport to disposal or treatment facilities. If response costs are later incurred by a release of the hazardous substance, the transporter becomes a liable party.¹⁵⁰ Perhaps because the statutory definition is very clear, there has been no reported litigation over the scope of transporter liability.

3. Judge-Made "Controller" Liability

CERCLA's identification of responsible parties, while far from plain, makes owners, operators, arrangers, and transporters liable for response costs. Through expansive interpretations of the definitions of owner, operator, and arranger, however, CERCLA liability has been imposed on parties not explicitly listed in the statute, including parent corporations;¹⁵¹ corporate stockholders, directors, and officers;¹⁵² and employees with control over disposal decisions.¹⁵³ Even lenders may be liable by virtue of their perceived control over waste

149. 42 U.S.C. § 9607(a)(4) (1991).

150. *Id.*

151. *E.g.*, State Dep't of Env'tl. Protection v. Ventron Corp., 94 N.J. 473, 468 A.2d 150 (1983) (liability against parent corporation who could have controlled conduct of 100% owned subsidiary). *But see* FMC Corp. v. Northern Pump Co., 668 F. Supp. 1285 (D. Minn. 1987) (parent ownership of all stock, common board of directors, some common officers, and lease from parent to subsidiary found insufficient to hold former parent liable as agent).

152. *E.g.*, United States v. Carolawn Co., 14 Env'tl. L. Rep. (Env'tl. L. Inst.) 20699 (D.S.C. 1984) (holding three corporate officers liable under CERCLA because they were responsible for the day to day operations of the disposal facility); United States v. Conservation Chem. Co., 628 F. Supp. 391 (W.D. Mo. 1986) (93% shareholder and president potentially liable under CERCLA because of close involvement with day to day operations at site); United States v. N.E. Pharmaceutical & Chem. Co., 810 F.2d 726 (8th Cir. 1986) (majority shareholders and officers held liable under CERCLA because they actively participated in management of facility); New York v. Shore Realty Corp., 759 F.2d 1032 (2d Cir. 1985) (owning stockholder who managed the corporation held liable under CERCLA and New York law without piercing the corporate veil).

153. *E.g.*, United States v. N.E. Pharmaceutical & Chem. Co., 810 F.2d 726, 742-44 (8th Cir. 1986) (plant supervisor who had "actual control" over generator company's hazardous substances "possessed" such substances for purposes of 42 U.S.C. § 9607(a)(3)).

disposal activities.¹⁵⁴

It is particularly important that potential investors be aware that general principles of limited corporate liability have not shielded individuals from CERCLA liability. In finding such liability, courts have not necessarily "pierced the corporate veil"¹⁵⁵ of limited liability. Rather, courts have deemed the accused individual or corporate shareholders, and corporate employees, to be directly liable as owners or operators within the meaning of CERCLA's statutory definitions.¹⁵⁶ These decisions have almost always focused on the party's degree of control over the handling or disposal of a company's hazardous substances.

A seminal decision finding such direct individual liability is *New York v. Shore Realty Corp.*¹⁵⁷ One of the defendants was Donald LeoGrande, a Shore Realty stockholder and officer.¹⁵⁸ In evaluating CERCLA's definition of "owner or operator," the court concentrated on the phrase "owned, operated or otherwise controlled activities at [the] facility."¹⁵⁹ The court interpreted this language to mean that an owning stockholder who manages a corporation, such as LeoGrande, is liable under CERCLA as an owner or operator. Furthermore, the court suggested that active management may not be necessary to trigger liability: "[I]n any event, LeoGrande is *in charge* of the operation of the facility in question, and as such is an 'operator' within the meaning of CERCLA."¹⁶⁰

Many courts, embracing the "in charge" aspect of *Shore Realty*, have held that an individual or entity may be liable for response costs incurred by a corporation solely by virtue of mere capacity to control, whatever the level of control actually exercised.¹⁶¹ Various factors have led courts to conclude that an entity or individual has the capacity to control a facility. For example, in *United States v. N.E. Pharmaceutical & Chem. Co.*,¹⁶² the Eighth Circuit court of appeals held the president of the N.E. Pharmaceutical & Chem. Co.

154. See *infra* text accompanying notes 245-56, discussing *United States v. Fleet Factors Corp.*, 901 F.2d 1550 (11th Cir.), *cert. denied*, 111 S. Ct. 752 (1991).

155. See *infra* notes 176-90 and accompanying text.

156. *United States v. Nicolet, Inc.*, 712 F. Supp. 1193, 1203 (E.D. Pa. 1989). "There is, of course, no basis, under CERCLA, to distinguish between the liability of an individual stockholder who actively participates in the management of a corporation and a corporate stockholder which so participates. Both individuals and corporations are included within the definition of 'person' under [42 U.S.C. § 9601(21)]." *Id.*

157. 759 F.2d 1032 (2d Cir. 1985).

158. *Id.* at 1052.

159. *Id.*

160. *Id.* (emphasis added).

161. *E.g.*, *Kelly v. Thomas Solvent Co.*, 727 F. Supp. 1532 (W.D. Mich. 1989); *United States v. Nicolet, Inc.*, 712 F. Supp. 1193 (E.D. Pa. 1989); *Idaho v. Bunker Hill Co.*, 635 F. Supp. 665 (D. Idaho 1986).

162. 810 F.2d 726 (8th Cir. 1986).

(NEPACCO) liable as a "contributor"¹⁶³ under RCRA. Although he was a major stockholder, he had no knowledge of a plan to dispose of hazardous waste, and he was not present at the plant during the period of waste disposal.¹⁶⁴ The court claimed to use an analysis of personal liability similar to the analysis it would apply under CERCLA. The court then held that, although the president was "not personally involved in the actual decision to transport and dispose of the hazardous substances,"¹⁶⁵ he in fact was "in charge of and directly responsible for all of NEPACCO's operations, . . . and he had the ultimate authority to control the disposal of NEPACCO's hazardous substances."¹⁶⁶

Another decision finding owner liability for a shareholder based on actual participation in management is *United States v. Kayser-Roth Corp.*¹⁶⁷ Through a merger, Kayser-Roth became the sole shareholder of Stamina Mills, a textile manufacturer that had been operating for fourteen years prior to the merger.¹⁶⁸ Stamina Mills dissolved in 1977. In the mid-1980s, the EPA brought suit against Kayser-Roth to recover cleanup costs incurred in remediating groundwater contamination at the Stamina Mills property.¹⁶⁹ Kayser-Roth attempted to escape liability by arguing that it had never been the owner or operator of the Stamina Mills plant.¹⁷⁰

The court found Kayser-Roth to be an operator because Kayser-Roth exercised control over Stamina Mills. Persuasive evidence of Kayser-Roth's control included its authority over money and budgets, its requirement that government environmental inquiries be forwarded to it, its power to disapprove real estate transaction, and the placement of Kayser-Roth personnel in almost all executive positions.¹⁷¹ Other courts have considered additional factors to find capacity to control.¹⁷²

163. *Id.* at 745-46 (citing 42 U.S.C. § 6973(a) (1986)).

164. *Id.* at 745.

165. *Id.* at 744.

166. *Id.*

167. 724 F. Supp. 15 (D.R.I. 1989).

168. *Id.* at 18.

169. *Id.* at 17.

170. *Id.* at 21.

171. *Id.*

172. These factors include: (1) ability to make timely discovery of unlawful discharges, *Idaho v. Bunker Hill Co.*, 635 F. Supp. 665, 672 (D. Idaho 1986); *United States v. Nicolet, Inc.*, 712 F. Supp. 1193 (E.D. Pa. 1989); (2) supervision of persons controlling the mechanisms which caused the pollution, *Bunker Hill*, 635 F. Supp. at 672; *Kelly v. Thomas Solvent Co.*, 727 F. Supp. 1532, 1542-44 (W.D. Mich. 1989); (3) ability to prevent or abate damages, *Bunker Hill*, 635 F. Supp. at 672; *Nicolet*, 712 F. Supp. at

Not all courts have viewed CERCLA liability so broadly.¹⁷³ However, the reliance of many courts on capacity to control can impose very broad liability and thus should be of concern to potential investors. While most courts following the capacity to control test have also cited and relied upon facts demonstrating actual control,¹⁷⁴ numerous courts have expressed the view that liability depends only upon capacity to control. Under these cases, foreign parent corporations may be liable for the CERCLA transgressions of their United States subsidiaries merely through the normal involvement of a parent in a subsidiary.¹⁷⁵ Deep pocket parent corporations, as well as individual employees and stockholders, should be aware of this potential for liability.

4. *Indirect Liability of Shareholders: Piercing the Corporate Veil*

In the cases discussed above, courts interpreted the section 9607(a) categories to include individuals or entities related to the offending corporate conduct. In other cases, courts have held corporate stockholders liable for CERCLA response costs, not because those stockholders were owners, operators or arrangers, but because the tests were met for piercing the common law protection of the "corporate veil."¹⁷⁶

Generally a stockholder, whether a corporation or individual stockholder, is not responsible for the liabilities of the corporation in

1204; *United States v. N.E. Pharmaceutical & Chem. Co.*, 579 F. Supp. 823, 849 (W.D. Mo. 1984); *Thomas Solvent*, 727 F. Supp. at 1544; (4) benefit from the waste disposal practices in effect, *Nicolet*, 712 F. Supp. at 1204; (5) presence or indicia of ownership, *id.*; (6) whether the corporation is closely held, *Quadion Corp. v. Mache*, 738 F. Supp. 270, 274 (N.D. Ill. 1990); *N.E. Pharmaceutical & Chem. Co.*, 810 F.2d at 726; and (7) whether the individual holds the position of officer or director, *Thomas Solvent*, 727 F. Supp. at 1543-44.

A closely held corporation is one in which the shares are held by a single shareholder or closely knit group of shareholders. H. HENN & J. ALEXANDER, *LAWS OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES* § 257 (3d ed. 1983). A closely held corporation offers the limited liability of a corporation while retaining some of the internal management attributes of an individual proprietorship or partnership. *Id.*

173. *E.g.*, *Joslyn Mfg. Co. v. T.L. James & Co.*, 893 F.2d 80 (5th Cir. 1990). The court held that James, the parent corporation of a party's predecessor company, was not directly liable as an "owner or operator" under 42 U.S.C. § 9607(a)(2) because "CERCLA does not define 'owners' or 'operators' as including the parent company of offending wholly-owned subsidiaries." *Id.* at 82-83. "[If] Congress [had] wanted to extend the [CERCLA] liability to parent corporations it could have done so, and it remains free to do so." *Id.* at 83.

174. *See, e.g.*, *FMC v. Northern Pump*, 668 F. Supp. 1285 (D. Minn. 1987) (refusing to impose liability on a parent corporation not involved in the day to day management or fiscal affairs of the liable subsidiary); *Vermont v. Staco, Inc.*, 684 F. Supp. 822 (D. Vt. 1988) (relying on actual, asserted control to hold individual shareholders liable).

175. *See Idaho v. Bunker Hill Co.*, 635 F. Supp. 665, 672 (D. Idaho 1986) (expressing concern over such potential liability).

176. *E.g.*, *United States v. Nicolet, Inc.*, 712 F. Supp. 1193 (E.D. Pa. 1989).

which it owns stock. Liability is limited to the assets of the corporation. However, in certain circumstances, courts are willing to disregard the corporate form, or pierce the corporation veil, for purposes of assessing liability. Then they will treat assets of the shareholders of the corporation as though they were the assets of the corporation itself.¹⁷⁷

Typically, the courts will pierce the corporate veil in two limited situations: (1) when the corporation and its stockholders share such a unity of interest that, by all objective measures, they do not exist as separate entities, and (2) when an inequitable result would follow if the acts giving rise to liability are treated as those of the corporation.¹⁷⁸ Corporate veil piercing also applies between parent corporations and their subsidiaries.¹⁷⁹ In the area of environmental tort liability, the "federal common law [of corporate veil piercing] borrows heavily from state law."¹⁸⁰

The potentially severe consequences of veil piercing for a foreign corporation are demonstrated in *United States v. Arkwright, Inc.*¹⁸¹ In *Arkwright*, the defendant foreign parent corporation moved for summary judgment of a CERCLA claim for lack of personal jurisdiction.¹⁸² Although there was an admitted absence of minimum contacts between the defendant parent corporation and the forum

177. See generally 1 W. FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 41.10 (perm. ed. rev. vol. 1990).

178. See *Orloff v. Allman*, 819 F.2d 904, 908-09 (9th Cir. 1987).

179. H. HENN & J. ALEXANDER, *supra* note 172, § 148. Corporate separateness is not recognized where:

- (a) The business transactions, property, employees, bank and other accounts and records of the corporations are intermingled;
- (b) The formalities of separate corporate procedures for each corporation are not observed;
- (c) The corporation is inadequately financed as a separate unit from the point of view of meeting its normal obligations foreseeable in a business of its size and character;
- (d) The respective enterprises are not held out to the public as separate enterprises;
- (e) The policies of the corporation are not directed to its own interests primarily but rather to those of the other corporation.

Id.

180. *United States v. Kayser-Roth Corp.*, 724 F. Supp. 15, 20 (D.R.I. 1989).

181. 697 F. Supp. 1229 (D.N.H. 1988).

182. *Id.* at 1138. The constitution protects a defendant's liberty interest in not being subject to the binding judgments of a forum with which the defendant has established no meaningful "contacts, ties or relations." *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 471-72 (1985) (quoting *International Shoe Co. v. Washington*, 326 U.S. 310, 319 (1945)). A defendant meets the minimum contacts test for personal jurisdiction if the defendant purposefully directs its activities at residents of the forum state and the litigation arises from injuries related to those activities. *Id.* at 472.

state of New Hampshire, the court found that the parent corporation, OCE Van Der Grinten N.V. (OCE), was nevertheless subject to jurisdiction. The court disregarded corporate separateness between Arkwright and OCE because: (1) OCE owned 100% of Arkwright's stock; (2) Arkwright's capital and operating budget were subject to OCE's approval; (3) OCE performed internal audits of Arkwright; (4) OCE guaranteed Arkwright's lines of credit; and (5) any significant financial decisions made by Arkwright required approval by the OCE directors who sat on Arkwright's board.¹⁸³

In contrast to judicial willingness to impose direct liability, other courts are reluctant to pierce the corporate veil. The Fifth Circuit, for example, refused to pierce the corporate veil in *Joslyn Mfg. v. T.L. James & Co.*,¹⁸⁴ stating that "veil piercing should be limited to situations in which the corporate entity is used as a *sham* to perpetrate a fraud or avoid personal liability."¹⁸⁵ Accordingly, when the district court had run through its laundry list of veil piercing factors and found that the facts did not justify piercing the corporate veil, and when the facts did not support any finding that the subsidiary was a "bogus shell"¹⁸⁶ for the parent to hide behind, no veil piercing was allowed.¹⁸⁷

In *New York v. Shore Realty Corp.*,¹⁸⁸ the Second Circuit upheld the corporate form even when it found the corporation's managing stockholder directly liable as an owner or operator.¹⁸⁹ The court stated that:

Both the New York Court of Appeals and this court have been quite insistent that the corporate form will not be disregarded unless the opposing party shows that the corporate form is being used fraudulently or as a means of carrying on business for personal rather than corporate ends. The State's claim has not at this stage risen to that level.¹⁹⁰

As a practical matter, corporate veil piercing is unlikely even in the context of expansive liability for environmental cleanup. Investors who incorporate to protect their personal assets are careful to

183. *Arkwright*, 697 F. Supp. at 1139.

184. 893 F.2d 80 (5th Cir. 1990), *cert. denied*, 111 S. Ct. 1017 (1991).

185. *Id.* at 83 (emphasis in original).

186. *Id.* at 84.

187. *Id.* In *Joslyn*, Lincoln Creosoting Co. was incorporated in 1935 under an arrangement whereby T.L. James & Co. would put up the initial capital in exchange for the stock of the company. Lincoln ran a creosoting operation from which it discharged chemicals until it was sold to Joslyn in 1950. Joslyn operated the plant until Koppers bought it in 1969. In the action before the fifth circuit, Joslyn asserted a right to sue James as an owner or operator of the plant by virtue of its stock ownership in Lincoln. *Id.*

188. 759 F.2d 1032 (2d Cir. 1985).

189. *Id.* at 1052. See *supra* text accompanying notes 157-60.

190. *Shore Realty*, 759 F.2d at 1032 (citation omitted).

observe corporate formalities. Courts are generally reluctant to disregard the function served by the corporate form of promoting business enterprises and fulfilling business expectations.

5. *Liability of Acquiring Companies in Mergers and Acquisitions*

When two companies merge through typical state law procedures, the surviving corporation retains the obligations of the merged entities.¹⁹¹ Accordingly, if a corporate investor acquires a company through merger, the surviving corporation will retain the environmental liabilities of the acquired corporation, whether those liabilities were acquired by contract, operation of common law, or statute.

The purchaser of a corporation's assets is generally treated differently. An investor who purchases assets traditionally does not assume the seller's liabilities. However, four exceptions to this rule apply when: (1) the purchasing corporation expressly or impliedly agrees to assume the seller's liability; (2) the transaction amounts to a *de facto* merger of the purchaser and seller; (3) the purchasing corporation is merely a continuation of the selling corporation; or (4) the transaction is entered into fraudulently to escape liability.¹⁹²

The first and fourth exceptions are relatively simple and require little discussion. The parties to an asset purchase are free to allocate their respective rights and obligations among themselves and the courts will respect such agreements.¹⁹³ However, when there is actual evidence of fraud, courts will not permit wrongdoers to hide behind an asset purchase to avoid liability.¹⁹⁴

The other two exceptions are more complex. The transaction will be considered a *de facto* merger when the following elements exist: (a) continuation of the management, personnel, physical locations, assets, or general business operation of the seller; (b) continuity of shareholders resulting from the purchaser paying for the acquired

191. 15 W. FLETCHER, ENCYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 7121 (1983). Virtually all United States jurisdictions recognize that:

In case of merger of one corporation into another, where one of the corporations ceases to exist and the other corporation continues in existence, the latter corporation is liable for the debts, contracts and torts of the former, at least to the extent of the property and assets received, and this liability is often expressly imposed by statute.

Id. (footnotes omitted); *Smith Land & Improvement Corp. v. Celotex Corp.*, 851 F.2d 86, 91 (3d Cir. 1988), *cert. denied*, 488 U.S. 1029 (1989) (citing W. FLETCHER, *supra*).

192. *Louisiana Pac. Corp. v. Asarco, Inc.*, 909 F.2d 1260, 1263 (9th Cir. 1990).

193. 15 W. FLETCHER, *supra* note 191, § 7330.

194. *Id.*

assets with shares of its own stock; (c) cessation of the seller corporation's original business operations accompanied by liquidation and dissolution as soon as practicably possible; and (d) assumption by the purchasing corporation of the seller's obligations which would ordinarily be necessary for the uninterrupted continuation of the seller's normal business operations.¹⁹⁵

In *Louisiana Pacific Corp. v. Asarco, Inc.*,¹⁹⁶ the Ninth Circuit refused to find a genuine issue of fact as to whether there was a *de facto* merger because the continuity of shareholders element was not present. The consideration paid by the acquiring corporation was a combination of cash, a promissory note, and payment of some debts. However, no stock of the acquiring company or its parent was exchanged as part of the sale.¹⁹⁷ There were common shareholders, but they had bought their stock on the open market, and no former shareholder owned more than two-and-one-half percent of the new company.¹⁹⁸ The court affirmed the trial court's award of summary judgment to the defendant.¹⁹⁹

When applying the exception for business enterprise continuation, courts consider several factors: (a) continuity of employees, supervisory personnel, and physical location; (b) production of the same product with the same name; (c) continuity of general business operations; and (d) purchaser holding itself out as a continuation of the seller.²⁰⁰

The court in *Louisiana Pacific* considered the exception for business enterprise continuation as well as the *de facto* merger exception when deciding liability under CERCLA. The court stated that the continuing business exception would not be operative if the new corporation did not have notice of the old corporation's CERCLA liability or if the business which generated the waste had not continued.²⁰¹

However, other states recognize more expansive continuation liability for product line successors.²⁰² Under this doctrine, a court may impose liability on the successor corporation for injuries caused by a

195. *Louisiana Pac.*, 909 F.2d at 1263; *Philadelphia Elec. Co. v. Hercules, Inc.*, 762 F.2d 303, 310 (3d. Cir. 1985), *cert. denied*, 474 U.S. 980 (1985).

196. 909 F.2d 1260 (9th Cir. 1990).

197. *Id.* at 1265.

198. *Id.*

199. *Id.* at 1262.

200. *Id.* at 1265 (citing *Mozingo v. Correct Mfg. Corp.*, 752 F.2d 168, 175 (5th Cir. 1985)); *Oner II, Inc. v. EPA*, 597 F.2d 184 (9th Cir. 1979)).

201. *Id.* at 1265-66.

202. *E.g.*, *Martin v. Abbott Labs.*, 102 Wash. 2d 581, 689 P.2d 368 (1984) (holding successor corporation liable when it acquired a manufacturing business and continued the manufacture of its line of products); *Ray v. Alad Corp.*, 19 Cal. 3d 22, 560 P.2d 3, 136 Cal. Rptr. 574 (1977) (holding that when the successor corporation acquired a manufacturing business and continued the output of its line of products, the successor corporation was liable for defects in products manufactured by the predecessor business).

defective product manufactured by the predecessor corporation. The EPA policy argues that the product line exception applies to CERCLA actions if the successor corporation acquires the assets of the predecessor corporation and substantially continues those business operations.²⁰³ This is particularly dangerous in the CERCLA context: buying the assets of a corporation and continuing to produce the same product could conceivably subject the new owner to any liability of the predecessor business.

More than one exception to the traditional rule against liability for the successor corporation can work in conjunction. In the *Acushnet River*²⁰⁴ case, the district court found a *de facto* merger when Aerovox, Inc., a wholly-owned subsidiary of RTE Corp., purchased the assets of Belleville Industries in exchange for RTE stock.²⁰⁵ Aerovox continued to manufacture the same products as Belleville had and sold them under the same name Belleville had used.²⁰⁶ The Belleville president, vice president, and treasurer all assumed the same positions at Aerovox and became Aerovox directors. Aerovox used the same banking institutions, the same insurance company, the same physical facilities and operated with the same employees.²⁰⁷ Belleville dissolved shortly after the transaction. The court found continuity of enterprise and held that Aerovox clearly assumed all of the obligations of Belleville necessary to carry on its business operations uninterrupted.²⁰⁸ Despite a question of whether there was continuity of shareholders, the court held that a *de facto* merger had taken place and that such continuity was only one factor to be considered.²⁰⁹

Such a broad construction of the *de facto* merger exception is not alone. A recent decision that rejected successor liability in a private cost recovery action, *Anspec Co. v. Johnson Controls, Inc.*,²¹⁰ was overruled by the Sixth Circuit.²¹¹ The lower court had reasoned that because CERCLA did not mention successor corporations, but did

203. Courtney M. Price, *Liability of Corporate Shareholders and Successor Corporations for Abandoned Sites under [CERCLA]* (June 13, 1984) (EPA Memorandum).

204. *In re Acushnet River & New Bedford Harbor*, 712 F. Supp. 1010 (D. Mass. 1989).

205. *Id.* at 1012.

206. *Id.* at 1015-16.

207. *Id.* at 1016.

208. *Id.* at 1017-19.

209. *Id.* at 1018.

210. 734 F. Supp. 793 (E.D. Mich. 1989), *rev'd*, 922 F.2d 1240 (6th Cir. 1991).

211. *Anspec Co. v. Johnson Controls, Inc.*, 922 F.2d 1240 (6th Cir. 1991), *rev'g* 734 F. Supp. 793 (E.D. Mich. 1989).

mention limited liability to the four section 9607(a) categories,²¹² Congress had not intended to include successor corporations within CERCLA.²¹³ The appellate court disagreed, reasoning that the ordinary meaning of the term “corporation,”²¹⁴ one of the “persons”²¹⁵ liable under CERCLA, included the successor corporation resulting from a merger.²¹⁶ The court found its broad interpretation to be consistent with the legislative intent of CERCLA to promote swift and effective response to hazardous waste sites and to charge the cost of cleanup to those responsible for the hazardous conditions.²¹⁷

6. Liability of Dissolved Corporations

Another illustration of the expanse of CERCLA liability is that even dissolved corporations may be liable for response costs. In *United States v. Sharon Steel Corp.*,²¹⁸ the court ruled that state capacity statutes were preempted by federal law to the extent they shielded a corporation otherwise liable under CERCLA. The court stated that “if the effect of a state capacity statute is to limit the liability of a party Congress meant to hold liable for cleanup costs, Congress intended CERCLA to preempt it.”²¹⁹

The reach of the holding in *Sharon Steel* is questionable. There the dissolving corporation had not completed distributing its assets.²²⁰ It is difficult to understand how a court can impose liability on a company with no remaining assets.²²¹ Some of the difficulties in imposing liability on a dead company are that it has no legal capacity to be sued and is not amenable to service of process.²²² Moreover, a corporation is an artificial person created solely by state law;²²³ if it no longer exists under state law, there is nothing left to sue.

Other courts have disagreed with the rationale in *Sharon Steel*. The Ninth Circuit has suggested that state law will be used to determine whether an entity has “capacity to be sued.”²²⁴ This was the

212. See *supra* notes 131-50 and accompanying text.

213. 922 F.2d at 1244.

214. *Id.* at 1247.

215. *Id.*

216. *Id.* at 1244.

217. *Id.* at 1247.

218. 681 F. Supp. 1492 (D. Utah 1987).

219. *Id.* at 1498.

220. *Id.* (“Here, the funeral is still going on.”)

221. See *United States v. Distler*, 741 F. Supp. 643 (W.D. Ky. 1990) (holding that a dissolved corporation was “dead and buried,” *id.* at 646, and not liable for costs related to cleanup, although its successor may be).

222. 16A W. FLETCHER, *supra* note 191, § 8142.

223. H. HENN & J. ALEXANDER, *supra* note 172, § 78.

224. *Levins Metal Corp. v. Parr Richmond Terminal Co.*, 817 F.2d 1448 (9th Cir. 1987).

same result reached by the Eighth Circuit in its *N.E. Pharmaceutical & Chem. Co.* decision.²²⁵

7. Limitations on and Defenses to Liability

a. Explicit Statutory Defenses

CERCLA provides few defenses to liability. The only explicit defenses to liability require demonstrating that a release resulted from an act of God,²²⁶ an act of war,²²⁷ or solely from an act of a third party.²²⁸ The third party defense applies to any act or omission of a third party which results in the actual or threatened release of a hazardous substance. It does not apply when the third party is an employee or agent of either the defendant or a party with whom the defendant has a "contractual relationship."²²⁹ A contractual relationship can be based on land contracts, deeds, or other instruments transferring title or possession.²³⁰ Thus, the defendant who purchased property from an entity which was solely responsible for a release on the property is not protected from liability.

b. Innocent Landowner Protections

However, CERCLA does provide a defense for "innocent"²³¹ purchasers of land through its definition of "contractual relationship."²³² This defense is available if: (1) the defendant acquired the property from which the hazardous substance was released after the disposal or placement of the hazardous substance; and (2) the defendant can demonstrate by a preponderance of the evidence that:

- (a) At the time the defendant acquired the facility the defendant did not know and had "no reason to know" after all appropriate inquiry consistent with good commercial practices that any hazardous substance which is the subject of the release was disposed of on, in, or at the facility;
- (b) The defendant is a government entity which acquired the facility by

225. 810 F.2d 726, 746 (8th Cir. 1986).

226. 42 U.S.C. § 9607(b)(1) (1988). This defense has so far proven unsuccessful. See, e.g., *United States v. Stringfellow*, 661 F. Supp. 1053 (C.D. Cal. 1987); *United States v. Multi-Chem, Inc.*, No. 84-0159 (W.D. Ky. August 1, 1989).

227. *Id.* § 9607(b)(2).

228. *Id.* § 9607(b)(3).

229. *Id.*

230. 42 U.S.C. § 9601(35)(A) (1988).

231. The term "innocent landowner" is widely used in practice, but not in the statute. See *United States v. Pacific Hide & Fur Depot, Inc.*, 716 F. Supp. 1341, 1347 (D. Idaho 1989) (using term). The term must seem ironic to many blameless but strictly liable landowners who do not qualify for the defense.

232. 42 U.S.C. § 9601(35) (1988).

escheat, or through any other involuntary transfer or acquisition, or through the exercise of eminent domain authority by purchase or condemnation; OR (c) The defendant acquired the facility by inheritance or bequest; AND (d) The defendant exercised due care with respect to the hazardous substance concerned and took precautions against foreseeable acts or omissions of any third party and the consequences that could foreseeably result from such acts or consequences.²³³

It is difficult to qualify for "innocence" under CERCLA. The concepts a nongovernmental defendant must use to demonstrate compliance, "no reason to know," "all appropriate inquiry" under the circumstances, and "due care" remain undefined.²³⁴ Nevertheless, some courts have held purchasers to be qualified for innocent landowner protection.²³⁵

c. Security Interest Protection

CERCLA explicitly exempts creditors from its "owner and operator" definition.²³⁶ The provision was intended to prevent lenders or other creditors having ownership interests such as mortgages or deeds of trust from incurring liability.²³⁷ However, the few courts addressing this issue have interpreted the exemption narrowly, leading to extensive and expensive CERCLA liability for lenders.²³⁸

In *United States v. Maryland Bank & Trust Co.*,²³⁹ the court held that a mortgage lender with a security interest in contaminated property became liable as an owner under CERCLA when it acquired the property at the foreclosure sale.²⁴⁰ Once the lender had

233. *Id.* §§ 9601(35), 9607(b)(3).

234. *Id.*

235. *E.g.*, *United States v. Pacific Hide & Fur Depot, Inc.*, 716 F. Supp. 1341 (D. Idaho 1989). In the *Pacific Hide* case, the defendants had received shares in Pacific Hide as a gift from their father, the business' founder. *Id.* at 1345. The United States sued to recoup cleanup costs incurred at a recycling yard contaminated with PCBs that was owned by Pacific Hide. *Id.* at 1343. The court found that the defendants, who had virtually no involvement with the business, had no reason to know of the release of PCBs. *Id.* at 1348-49. The court further held that the defendants had made "all appropriate inquiry" required to qualify for the innocent landowner defense, even though they had made no inquiry at all. *Id.* Because the presence of PCBs was not obvious and the defendants had no specialized knowledge or experience about PCBs or hazardous waste, their failure to inspect was reasonable. Thus, they were not liable as owners or operators. *Id.*

See also *United States v. Serafini*, 706 F. Supp. 346 (M.D. Pa. 1988).

236. 42 U.S.C. § 9601(20)(A) (1988). Exempted is any person "who, without participating in the management of a . . . facility, holds indicia of ownership primarily to protect his security interest in the . . . facility." *Id.*

237. *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573, 579-80 (D. Md. 1986) (citing S. Rep. No. 848, 96th Cong., 2d Sess. 2 (1980)).

238. The director of the Federal Deposit Insurance Corp.'s division of liquidations has stated that more than four hundred properties seized by it contain hazardous waste or asbestos, and that the liability associated with the materials could significantly increase the cost of the savings and loan bailout. N.Y. Times, July 20, 1990, at D1, col. 5.

239. 632 F. Supp. 573 (D. Md. 1986)

240. *Id.* at 575. The bank then held record title for four years before its motion for

taken title, there was no security interest left to protect. The bank thus became an owner and was liable for response costs under CERCLA.²⁴¹ Other courts have reached this result on similar facts.²⁴²

However, in *United States v. Mirabile*,²⁴³ another district court held that a foreclosing lender which did not participate in the day-to-day operations or waste disposal activities of the property would not lose the protection of the secured lender exemption. The exemption applied so long as the lender's participation was no more extensive than merely monitoring the borrower's financial affairs, even if the lender held title to the property for a short time. Although the court did enumerate specific activities that would preclude a finding that the lender was merely protecting its security interest,²⁴⁴ the difficulty inherent in determining the permitted level of lender participation and monitoring ought to be of great concern to any lender.

In fact, in *United States v. Fleet Factors Corp.*,²⁴⁵ the Eleventh Circuit interpreted lender liability much more broadly than did the court in *Mirabile*.²⁴⁶ Fleet Factors Corp. became a lender when it advanced operating funds to Swainsboro Print Works against the assignment of Swainsboro's accounts receivable.²⁴⁷ As collateral for the advances, Fleet Factors also obtained a security interest in Swainsboro's textile facility. After Swainsboro filed for bankruptcy protection under Chapter 11, Fleet advanced no more funds but continued to collect on the accounts receivable already assigned to it. Later, Fleet foreclosed on its security interest.²⁴⁸ The EPA inspected the facility and found 700 fifty-five gallon drums containing hazardous substances and asbestos on the property. Fleet subsequently incurred \$400,000 in cleanup costs.²⁴⁹

Although the court in *Fleet Factors* believed that it had settled on a middle ground between the position of the government and the

summary judgment was heard. *Id.*

241. *Id.*

242. *See, e.g.,* Guidice v. BFG Electroplating & Mfg., 732 F. Supp. 556 (W.D. Pa. 1989). In *Guidice*, the mortgagee bank held title for eight months. The court held that the security interest exemption did not apply during the time. "When a lender is the successful purchaser at a foreclosure sale, the lender should be liable [under CERCLA] to the same extent as any other bidder at the sale would have been." *Id.* at 563.

243. 15 Env'tl. L. Rep. (Env'tl. L. Inst.) 20994 (E.D. Pa. Sept. 4, 1985).

244. *Id.* Unpermitted activities included supervising the operations of the facility or insisting on manufacturing changes or reassignment of personnel. *Id.*

245. 901 F.2d 1550 (11th Cir.), *cert. denied*, 111 S. Ct. 752 (1991).

246. *Id.* at 1558.

247. *Id.* at 1552.

248. *Id.*

249. *Id.* at 1553.

lender,²⁵⁰ the court's position was in fact extreme. The court rejected as too permissive the *Mirabile* rule that "[m]ere financial ability to control waste disposal practices . . . [is not] sufficient for the imposition of liability."²⁵¹ Instead, the court adopted an expansive capacity to control test by which a "secured creditor will be liable if its involvement with the management of the facility is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose."²⁵² However, the court indicated that a lender could, without subjecting itself to liability, monitor any aspect of a debtor's business and become involved in occasional and discrete financial decisions relating to the protection of its security interest.²⁵³

Thus, in *Fleet Factors*, the lender was not held liable when it advanced funds to Swainsboro against the assignment of Swainsboro's accounts receivable, paid and arranged for security deposits for utility service, and informed the debtor that it would not advance any more money.²⁵⁴ However, *Fleet Factors* the lender did become liable when it later required the debtor:

to seek its approval before shipping its goods to customers, established the price for excess inventory, dictated when and to whom the finished goods should be shipped, determined when employees should be laid off, supervised the activity of the office administrator at the site, received and processed employment and tax forms, controlled access to the facilities, and contracted . . . to dispose of the fixtures and equipment.²⁵⁵

A disturbing aspect of the decisions in *Fleet Factors* and *Mirabile* is the difficulty in determining what participation is permitted. In neither case did the involvement giving rise to liability have an actual relationship to the handling or disposal of hazardous waste. As a practical matter, any lender making a significant loan will attain some oversight of the borrower's business and may thereby gain "capacity to influence the [borrower's] treatment of hazardous waste," which could subject it to *Fleet Factors* liability. None of the decisions provides much comfort for lenders worried about hazardous waste liabilities.²⁵⁶

250. *Id.* at 1558.

251. *Id.* at 1556 (quoting *Mirabile*, 15 *Env'tl. L. Rep.* (Env'tl. L. Inst.) at 20992).

252. *Id.* at 1558.

253. *Id.*

254. *Id.* at 1559.

255. *Id.*

256. *See also In re Bergsoe Metal Corp.*, 910 F.2d 668, 673 n.3 (9th Cir. 1990) (holding that there must be some actual management of a plant before a secured creditor can be liable, but declining to rule otherwise on control).

F. Special Problems

1. Underground Storage Tanks

In July, 1991, the EPA revised technical rules governing most underground petroleum storage tanks.²⁵⁷ These rules require that all existing tanks be replaced or upgraded to meet federal restrictions, including corrosion protection and spill and overflow protection.²⁵⁸ In addition, tank owners and operators need to employ some method of detecting releases.²⁵⁹

The EPA has also adopted rules requiring tank owners and operators to demonstrate some form of "financial responsibility."²⁶⁰ Most facilities will be required to purchase insurance, unless they can self-insure²⁶¹ in the amount of \$500,000 or more per incident.²⁶²

These rules are of concern to any investor who is considering starting or purchasing either a business which uses underground storage tanks or real estate on which such tanks are located. The cost of doing business may be significantly increased by these monitoring and financial responsibility requirements.

2. Asbestos

The presence of asbestos is a significant obstacle to the sale, leasing, and operation of buildings.²⁶³ Asbestos was routinely used in construction from the 1880s until the 1970s. The physical and chemical characteristics of asbestos fibers pose a significant health risk when in the air.²⁶⁴ Asbestos-containing material (ACM) is found in three forms: sprayed or troweled on ceilings and walls; in insulation around hot or cold pipes, ducts, and boilers; and in other products such as ceiling tiles and floorboards. However, as long as the ACM is in good condition, not "friable"²⁶⁵ and not disturbed, it probably does not pose a health risk.

OSHA contains no requirement that commercial buildings be

257. EPA Solid Waste, 40 C.F.R. § 280.10(b)(G) (1991) (excepting on-site heating oil tanks).

258. *Id.* § 280.21.

259. *Id.* § 280.40. The release detection compliance is phased in over five years. *Id.*

260. *Id.* §§ 280.90, 280.93.

261. *Id.* § 280.95.

262. *Id.* § 280.93.

263. N.Y. Times, Apr. 28 1988, at 25.

264. EPA, *Guidance for Controlling Asbestos-Containing Materials in Buildings* § 1-2 (1985).

265. "Friable" asbestos is that which can be crumbled, pulverized, or reduced to powder by hand pressure. *Id.* § 1.

tested for ACM. However, building owners should not ignore known risks. An owner or lessor of a building with friable asbestos can be in breach of the common law duty to warn.²⁶⁶

Finally, even if the ACM is currently not a threat, a potential investor must consider the effect of ACM regulations on the cost of any planned demolition or renovation.²⁶⁷ Any demolition of a building containing ACM requires advance notice to the EPA. Moreover, anyone doing demolition or renovation must both apply wet removal techniques and avoid any visible dust emissions during the removal, transport, and disposal of ACM.²⁶⁸

3. State and Federal Disclosure Requirements

Under CERCLA, any person in charge of a facility is required to notify the National Response Center as soon as he or she has knowledge of an unauthorized release of a hazardous substance in an amount greater than or equal to the reportable quantity for that substance.²⁶⁹ Reportable quantities are determined by EPA for many hazardous substances.²⁷⁰ CERCLA also contains provisions which require the formation of emergency planning systems at facilities within each state for the event of unauthorized releases of hazardous substances.²⁷¹

States may also have their own notification requirements. For example, the California Water Code requires any person who discharges certain hazardous substances into "waters of the state"²⁷² to notify the Office of Emergency Services or appropriate Regional Water Quality Control Board as soon as the person has knowledge of the discharge or possible discharge, so long as notification is possible and will not impede remediation efforts.²⁷³ California statutes also require disclosure of information about asbestos in buildings.²⁷⁴ Any owner, lessee, sublessee, or agent of an owner of a public or commercial building built prior to 1979 must notify his or her employees, lessees, and co-owners of every known location of asbestos-containing

266. See *infra* text accompanying notes 36-37.

267. 40 C.F.R. §§ 61.141-796.3320 (1991).

268. *Id.* § 61.145.

269. 42 U.S.C. § 9603(a) (1986).

270. 40 C.F.R. § 302.4 (1991). A reportable quantity is set between one pound and five thousand pounds, depending on the toxicity of the substance. The reportable quantity is measured over a twenty-four hour period. *Id.*

271. *Id.* § 300.200.

272. CAL. WATER CODE § 13050(e) (1991) defines "Waters of the state" to mean "any water, surface or underground, including saline waters, within the boundaries of the state."

273. *Id.* § 13271.

274. CAL. HEALTH & SAFETY CODE §§ 25915-25919.5 (West 1991 & Supp. 1992).

construction material.²⁷⁵ The notification standard is extremely low and may be below detection levels. Oddly, the requirement does not apply only to friable ACM and it is triggered by knowledge. However, the statute imposes no requirement of an asbestos survey.

Other states have requirements that contamination or disposal uses be disclosed to buyers prior to transfer.²⁷⁶ As a practical matter, these laws assure that contamination becomes part of the negotiation process of any acquisition or investment. Moreover, they encourage the remediation of that contamination.

OSHA contains Hazard Communication Standards applicable to manufacturing employees.²⁷⁷ Each manufacturing employer is required to establish a written comprehensive hazard communication program for its employees which explains health effects of workplace chemicals and employee training.²⁷⁸ The hazard determination for each chemical is placed on a "material safety data sheet,"²⁷⁹ which must also be provided to all other manufacturing employers to which the chemical is provided.²⁸⁰

4. *Restrictions on Transfer of Contaminated Properties*

Investors should consider whether the state in which they propose to invest may impose restrictions on transfer of contaminated properties. An example of such a restriction is New Jersey's Environmental Cleanup Responsibility Act (ECRA).²⁸¹ Under ECRA, any transfer of ownership of industrial land must be approved by the New Jersey Department of Environmental Protection.²⁸² Transfer of ownership which is subject to such approval includes statutory mergers, certain leases, and certain sales of assets. Prior to any transfer, an owner must submit either a "negative declaration,"²⁸³ assuring that there is no need for cleanup of hazardous substances at the site, or a

275. *Id.* §§ 25915, 25915.2(a), 25915.5(a). Asbestos-containing construction material is that "which contains more than one percent asbestos by weight." *Id.* § 25919.

276. CAL. HEALTH & SAFETY CODE § 25359.7 (West 1991 & Supp. 1992); MINN. STAT. § 115B.16 (1990); 35 PA. CONS. STAT. ANN. § 6018.405 (1989); W. VA. CODE § 20-5E-20 (1991).

277. 29 C.F.R. § 1910.1200 (1990).

278. *Id.* § 1910.1200(e).

279. *Id.* § 1910.1200(g).

280. *Id.* § 1910.1000.

281. N.J. REV. STAT. § 13:1K-6 (1991).

282. *Id.* § 13:1K-8(g).

283. *Id.* (defining negative declaration as a "written declaration . . . that there has been no discharge of hazardous substances or wastes on the site, or that such discharge has been cleaned up.")

remediation plan and financial assurance that such plan can and will be completed.²⁸⁴ Penalties for failure to comply include damages and civil penalties of up to \$25,000 per day.²⁸⁵

5. *Lien Laws*

CERCLA imposes a lien on property owned by the responsible party and subject to or affected by cleanup actions.²⁸⁶ It can be imposed for the amount of all costs and damages for which the party is liable to the United States.²⁸⁷ The lien arises at the later of the time the EPA first incurs cleanup costs or the time the responsible party is first notified in writing of potential liability.²⁸⁸ Generally, however, the lien is subject to state law priority rules.²⁸⁹ Many states have similar lien laws.²⁹⁰

III. RECOMMENDATIONS TO POTENTIAL INVESTORS

The cost of complying with environmental regulation in the United States is a significant consideration for potential foreign investors. While the costs imposed on any particular business cannot be identified without a specific investigation of the business and applicable regulations, there are two general ways whereby investors can minimize these costs. First, the investor can conduct a pre-investment investigation of the target business or real estate to identify known environmental risks and expected costs. Second, the investor can, through careful contract negotiation and drafting, apportion unknown risks so as to reduce future liability for environmental liability and risks.

A. *Pre-Investment Investigation*

With rare exceptions, it is advisable to investigate the environmental condition of any target business or real estate in which the party may wish to invest. Particularly under CERCLA's scheme of strict, joint and several, and retroactive liability,²⁹¹ the cost of remedying environmental contamination can dwarf the value of a business or real estate acquisition. An environmental assessment, or environmental "audit," should help inform the investor of the true value of the

284. *Id.*

285. *Id.* §§ 13:1K-13(a)-(c).

286. 42 U.S.C. § 9607(1)(1) (1990).

287. *Id.*

288. *Id.* § 9607(1)(2).

289. *Id.* § 9607(1)(3).

290. *See, e.g.*, CONN. GEN. STAT. ANN. §§ 22a-452a (West 1988 & Supp. 1991); MASS. GEN. L. ch. 21E, § 13 (West Supp. 1991); N.H. REV. STAT. ANN. § 147-B: 10-b (1990); TEX. REV. CIV. STAT. ANN. art. 4477-3a § 15 13(g)(7)(F) (West Supp. 1992).

291. *See supra* notes 109-30 and accompanying text.

contemplated acquisition. It should identify any existing claims and contamination, and it should assess the risk of future liability that might arise. The information provided by the audit is the best protection against unanticipated environmental liability.

A pre-acquisition environmental investigation can identify two potential types of problems. First, in any purchase of real estate, including purchases of businesses owning real estate, a competent assessment will identify existing environmental problems associated with the land. An experienced environmental consultant should review applicable public records for evidence of past environmental problems. The consultant should also inspect the site and may take samples of soil and groundwater to determine whether any contamination is actually present. If the real estate is owned by an operating business, the consultant should discuss the site with past or present employees, in particular to determine whether there has been any on-site waste disposal. Finally, the consultant should determine whether the real estate to be purchased is threatened by pollutants on adjoining properties; under CERCLA, a current property owner can be liable for the cleanup costs associated with pollution of his or her property, even if the pollution is caused by contamination from another site.²⁹²

Knowing whether real estate to be acquired is contaminated confers two primary benefits on an investor. First, as a practical matter, it gives a potential investor certainty in gauging the value of the contemplated investment. If the assessment determines that the property is not contaminated, the buyer is assured that the investment will not be overwhelmed by cleanup costs. If there is contamination, the buyer can demand that the risks and expected costs of the contamination be addressed in negotiation of the transaction. Second, a complete due diligence investigation provides a legal benefit. If the property is clean, the results of the investigation are evidence that at the time the investor acquired the property, he did not know and had "no reason to know," after all appropriate inquiry consistent with good commercial practices, that any hazardous substance was disposed of on, in, or at the property. These showings are required to establish the "innocent owner" defense to liability under CERCLA.²⁹³

The second line of inquiry in an environmental assessment, with respect to acquisition of an ongoing business, is the adequacy of

292. See *supra* note 136-38 and accompanying text.

293. See *supra* notes 231-35 and accompanying text.

compliance with operative environmental laws and regulations. An assessment should consider whether all permits and licenses required to carry on the activities of the business have been obtained and are current. It should identify whether the business has received notice of any alleged violations of environmental laws from any government or private claimant. The consultant should review public and company records to gauge past regulatory compliance and safety practices. The consultant should also inspect the business premises and interview current and former employees to determine whether there are past or present problems.

The primary benefit of inquiring into the environmental conduct of an ongoing business is to determine whether the business has incurred, is incurring, or is likely to incur significant environmental compliance costs. For instance, if the consultant determines that air or water discharge requirements are not being met, it may estimate what the cost consequences of remedying the noncompliance, voluntarily or involuntarily, will be. In addition, the business' past conduct itself may affect costs of compliance in the future. As a practical matter, regulatory agencies may look more charitably upon an infrequent miscue of a generally law-abiding company than another transgression in a history of corporate noncompliance.

A business' noncompliance with environmental operational rules will generally not threaten the catastrophic liability posed by CERCLA real estate cleanups. There is one major exception to this general rule, however. An environmental audit gauging compliance should pay attention to the method and location of past and present waste disposal; as generator of the waste, and the party who arranged for its disposal, the business may be strictly liable for all or a portion of the cleanup of hazardous substance releases at the business' waste disposal sites, if hazardous substances are released there.²⁹⁴ Therefore, an audit should determine as accurately as possible whether the business has disposed of its waste in full compliance with the law and at safe, preferably RCRA-permitted, disposal sites. RCRA-permitted disposal sites are subject to strict safety requirements, and their operators must provide financial assurance that proper closure of the site will be effected.²⁹⁵

B. Allocation of Risks Among Contracting Parties

The discovery of environmental problems will give the parties the opportunity to negotiate the allocation of the cost of any remedy.

294. See *supra* notes 147-48 and accompanying text.

295. See *supra* notes 78-95 and accompanying text.

Most often, known risks can be used to adjust the price of the transactions. The parties can also agree who will conduct or fund the required remedies.

Contract negotiations are especially important in allocating unknown risks. In rare cases, the parties will negotiate that the property or business to be purchased will be taken "as is," allocating all risks to the purchaser. More frequently, the parties will negotiate an agreement in which the seller will bear some of the risk.

Negotiations over risk allocation are typically based on the notion that it is fair for an investor to be defended or indemnified by a seller for environmental liabilities which the investor had no role in creating. Most often the agreement will incorporate a provision by which the seller agrees to indemnify, or defend, or both indemnify and defend the buyer against environmental liabilities the kind or magnitude of which are unknown at the time of contracting. A contractual duty to indemnify can be triggered by a number of events, including the receipt by the buyer of third party or governmental claims for cleanup costs, the future discovery of contaminants from the past business of the seller, or the breach of representations or warranties made by the seller concerning the condition or compliance of the business.

Sellers are typically unwilling to indemnify buyers against every possible future environmental liability. Therefore, it is common for the parties to allocate unknown risks based on the truth of sellers' representations and warranties. As part of a purchase and sale agreement, the seller may make a series of representations of fact about the asset or business being conveyed, including its environmental condition. If any representation proves to be false, the agreement usually confers a right of indemnity on the buyer to recover the costs or damages associated with the incorrect representation. A seller may warrant to a condition of which he or she is unsure as a way of assuming the risk that it may be false.

When negotiating environmental representations and warranties, an investor should seek disclosure of any pending claims against the business or property being acquired. The buyer should seek a representation that a business being acquired is in compliance with applicable laws and permits and that there are no leaking underground storage tanks, friable asbestos, or PCBs on the property. The investor should also seek assurance that any hazardous waste generated by the business has been properly disposed of lawfully and at a facility where it is unlikely to generate CERCLA liability. In particular,

the buyer should seek assurance that there has been no intentional waste disposal on-site.

Since the seller may have to pay money in the event a representation is false, sellers often seek to limit representations and warranties to the best of their knowledge. For example, the seller may offer to warrant only that he or she does not know of any improper disposal of waste. This may be appropriate for the sale of raw land or a long-standing company with which the warranting party has little experience. However, the investor should resist knowledge limitations because it is more difficult to gauge subjective knowledge than objective fact. Such limitations may be particularly unacceptable when the warranting party is the only reasonable source of the information.

A seller may also attempt to restrict representations according to materiality, so that every minor noncompliance is not an occasion to refund money to the buyer. For example, the seller may represent and warrant that the company is in "material compliance" with applicable environmental laws. However, the concept of materiality is not easily defined in practice. A far more practical way to address the concept of materiality is to negotiate a deductible figure, called a "skip," "basket" or "bucket," before which no recovery is allowed. For example, if a sale contract provides for a \$500,000 bucket, no recovery would be allowed for the first \$500,000 in environmental claims or damages suffered by the buyer.

Finally, a seller may seek caps, in time and/or money, on its exposure for future liability. The parties may agree to limit the length of time after an acquisition in which a claim can be brought by providing an expiration date for representations and warranties. The buyer's ability to recover for breaches of the seller's promises lasts only as long as the representations and warranties survive. Parties also frequently agree to a limit on the total dollar amount of the seller's remaining environmental liability.

Even if the investor secures the protection of indemnification based on adequate representations and warranties, he or she should be aware that an indemnification is only as good as the indemnitor's pocket is deep. A buyer who is not dealing with a known deep-pocket seller should closely examine financial statements of the indemnitor.

If the financial information does not provide assurance that the indemnitor's promise to pay is reliable, the investor may seek other or additional assurances that the seller can perform. One option is to demand that part of the purchase price or investment be held for some period of time in escrow in order to fund future problems. However, escrows are extremely troublesome to negotiate because it is difficult for parties to agree on the length of time the escrow should last and the circumstances under which deductions can be

made. Therefore, significant escrows are almost never feasible, except in rare instances of a discrete environmental problem which can be remedied in a short period of time, where the end point of the remedy can be easily identified.

IV. CONCLUSION

The environmental laws that may affect a decision to invest in the United States are numerous and perplexing. These laws impose two types of costs. Laws such as the Clean Air Act or the Clean Water Act impose costs of compliance which may significantly increase the cost of operating a business. Common law claims and CERCLA are the source of more sudden shocks to investors, who may be ambushed with strict liability for the cost of expensive cleanups. Accordingly, it is vital that an investor take whatever steps are available to identify and guard against environmental liability through pre-investment and contractual risk allocation.

