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Successor Liability under CERCLA: Whither Substantial Continuity

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Articles

Successor Liability Under CERCLA: Whither Substantial Continuity?

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I. Introduction

"Successor liability" has long been one of my favorite topics in environmental litigation, for reasons beyond the deliciously ironic notion that any aspect of environmental litigation could resemble "success." At one level, there is the clash between the venerable norms of corporate law and the modern liability scheme of the federal Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA").[1] Lurking beneath are conflicts between state and federal common law as well as the relative importance of business expectations versus governmental policy. At bottom, the fundamental dispute is often who must pay for the cleanup of a contaminated property—will it be the putative successor corporation which, by definition, would not otherwise be liable if not for having purchased assets from the liable seller, or will

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1. 42 U.S.C. §§ 9601-9675 (2002).

it be the public or another non-culpable party which has been ensnared by CERCLA's wide web of liability?

A longstanding principle of corporate law is that where one corporation buys the assets of another, the buyer does not assume the liabilities of the seller. Four traditional exceptions to this general rule of non-liability for asset purchasers are well-established: assumption of liability, fraud, de facto merger and mere continuation. Federal courts of appeals are split over whether a fifth exception, known as "substantial continuity," should apply when determining an asset purchaser's liability in CERCLA cases. More than a decade ago, two circuits recognized this more relaxed exception, which has the effect of making more asset purchasers subject to CERCLA liability. Since then, however, five circuits—most recently, the Third Circuit—have rejected the substantial continuity exception.

This Article respectfully submits that the trend away from recognizing the substantial continuity exception is misguided. Courts can and should apply the substantial continuity exception to determine successor liability under CERCLA, but in a manner that honors both the expectations created by traditional corporate principles and the statutory goals of CERCLA.

II. Background

A. Corporate Principles

A number of well-settled principles of corporate law inform the doctrine of successor liability, both within and outside the context of environmental law. Traditionally, in the event of a merger or consolidation where one company ceases to exist and another company continues in existence, the latter company is liable for the debts, contracts and torts of the former company.[2] Where there is a sale of a corporation's stock, the corporation's liabilities remain with the corporation, notwithstanding the change in ownership. That is, consistent with the general principle that the corporation is a distinct entity apart from its owners, the former owners of the corporation do not retain the corporation's liabilities.[3]

By contrast, a corporation that purchases all or substantially all of the assets of another corporation generally does not assume the liabilities of the selling corporation.[4] Accordingly, many business acquisitions are

2. 15 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 7121 (perm. ed., rev. vol. 1999) [hereinafter "FLETCHER"].

3. 18A AM. JUR. 2D *Corporations* § 724 (2004).

4. Dawejko v. Jorgensen Steel Co., 434 A.2d 106 (Pa. Super. Ct. 1981); FLETCHER,

structured as asset purchases rather than mergers or stock purchases even where virtually the entire business is being acquired.

The general rule of non-liability for asset purchasers has the potential for abuse, in that legitimate claims against the seller could be effectively cut off via the legal formalities of an asset sale. Accordingly, courts have used their equitable powers to craft four traditional and widely recognized, judicially created exceptions to the rule of non-liability for asset purchasers:

(1) the purchaser of assets expressly or impliedly agrees to assume obligations of the seller;
(2) the transaction is for the fraudulent purpose of escaping liability;
(3) the transaction amounts to a de facto merger; or
(4) the purchaser's business is a mere continuation of the seller's business.[5]

B. CERCLA

CERCLA, enacted in 1980 and commonly referred to as "Superfund," is a powerful tool to force liable persons to pay for the costs of investigating and cleaning up contaminated sites. CERCLA makes four categories of persons expressly liable: (1) current owners or operators of the site; (2) owners or operators at the time hazardous substances were disposed of at the site; (3) generators or others who arrange for the disposal of hazardous substances at the site; and (4) transporters of hazardous substances to the site.[6] These "responsible persons" are liable, without fault, for costs incurred in response to releases of hazardous substances.[7] CERCLA liability is retroactive,[8] and its statutes of limitations[9] generally do not begin to run until response actions are underway, thus rendering corporations potentially liable to suit under CERCLA for events that occurred many decades ago. Because many corporations which existed at the time of the events giving rise to liability no longer exist today, the issue of whether an

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supra note 2, at § 7122.

5. *See, e.g.*, Phila. Elec. Co. v. Hercules, Inc., 762 F.2d 303, 309 (3d Cir. 1985) (reviewing Pennsylvania law); N. Shore Gas Co. v. Salomon Inc., 152 F.3d 642, 651 (7th Cir. 1998); FLETCHER, *supra* note 2, at § 7122.

6. 42 U.S.C. § 9607(a)(1)-(4) (2002).

7. The elements of a CERCLA claim for response costs are set forth at 42 U.S.C. § 9607(a) (2002). The statute adopts the strict liability standard of the Clean Water Act, 33 U.S.C. § 1321. 42 U.S.C. § 9601(32). *See* New York v. Shore Realty Corp., 759 F.2d 1042 (2d Cir. 1985). Defenses to CERCLA liability are few and narrow. 42 U.S.C. § 9607(b).

8. *See* United States v. Ne. Pharm. & Chem. Co., 810 F.2d 726 (8th Cir. 1986).

9. 42 U.S.C. § 9613(g) (2002).

existing corporation is a successor to a corporation which existed during those long-ago events is a recurring, critical issue in CERCLA litigation.

Corporations are "persons" within the definition of the statute.[10] However, CERCLA is silent with respect to the liability of corporations affiliated with corporations that fall within the four categories of responsible persons. Specifically, there is no discussion of successor liability in CERCLA. Despite the absence of express statutory language that successor corporations are subject to CERCLA liability, courts have readily held that the CERCLA liabilities of a predecessor corporation are assumed by a successor, via merger or via purchase of the predecessor corporation's assets where one of the four traditional common law exceptions is established.[11] Furthermore, some federal courts have broadened the "mere continuation" exception in CERCLA cases so that the asset purchaser has successor liability where there is "substantial continuity" between the predecessor and successor corporations.[12] Each of the four traditional exceptions and the "substantial continuity" exception, also known as the "continuity of enterprise" exception, are discussed in more detail below.

III. The Four Traditional Exceptions

A. Express or Implied Agreement to Assume the Seller's Liabilities

Where the asset purchaser either expressly or implicitly agrees to assume the environmental liabilities of the seller, a buyer who is otherwise completely unrelated to the seller can be subject to successor liability under CERCLA.[13] Courts are somewhat reluctant to find that the language of an asset purchase agreement abrogates the common law rule against holding an asset purchaser responsible for the liabilities of the asset seller. Typically, successor liability will be found only where the assumption or indemnification provisions of the asset purchase agreement contain broad language that the buyer assumes all liabilities of

10. 42 U.S.C. § 9601(21) (2002).

11. *See, e.g.*, N. Shore Gas Co. v. Salomon Inc., 152 F.3d 642, 649 (7th Cir. 1998); La.-Pac. Corp. v. Asarco, Inc., 909 F.2d 1260 (9th Cir. 1990); Smith Land & Improvement Corp. v. Celotex., 851 F.2d 86, 91-92 (3d Cir. 1988), *cert. denied*, 488 U.S. 1029 (1989). It should be noted that at least one early district court opinion held that a successor corporation (by merger) could not be a responsible party in the absence of express statutory language in CERCLA so providing. Anspec Co. v. Johnson Controls, Inc., 734 F. Supp. 793, 795-96 (E.D. Mich. 1989), *rev'd*, 922 F.2d 1240, 1246 (6th Cir. 1991).

12. *See, e.g.*, United States v. Carolina Transformer Co., 978 F.2d 832 (4th Cir. 1992); Pa. Dep't of Envtl. Prot. v. Concept Sciences, Inc., 232 F. Supp.2d 454 (E.D. Pa. 2002).

13. *See Smith Land*, 851 F.2d at 91.

the seller or specifically provide that the purchaser assumes the environmental liabilities of the seller.[14]

B. Fraud

An asset purchaser may be liable under CERCLA if the transaction with the seller was fraudulently entered into in order to escape liability to the seller's creditors.[15] Key factors in determining whether fraud exists include (a) insolvency or indebtedness of the seller, and (b) inadequate consideration paid by the buyer.[16] Other more secondary indicia of fraud include the pendency or threat of litigation against the seller.[17]

C. De Facto Merger

The "de facto merger" exception arises where the parties have styled the deal as an asset purchase but the transaction in substance nonetheless resembles a statutory merger or consolidation.[18] In determining whether a particular transaction amounts to a de facto merger, courts generally consider the following four factors: (1) there is a continuation of the enterprise of the seller corporation by the buyer, so that there is continuity of management, personnel, physical location, assets and general business operations; (2) there is a continuity of shareholders which results from the purchasing corporation paying for the acquired assets with shares of its own stock, this stock ultimately coming to be held by the shareholders of the seller corporation so that they become a constituent part of the purchasing corporation; (3) the seller corporation ceases its ordinary business operations, liquidates and dissolves as soon as legally and practically possible; and (4) the purchasing corporation assumes those obligations of the seller ordinarily necessary for the uninterrupted continuation of normal business

14. *See, e.g.*, HRW Systems, Inc. v. Washington Gas Light Co., 823 F. Supp. 318 (D. Md. 1993) (successor corporation was liable under CERCLA because it contractually assumed all liabilities and obligations of seller); John S. Boyd Co. v. Boston Gas Co., 992 F.2d 401 (1st Cir. 1993) (purchaser did not succeed to seller's CERCLA liabilities because transactional contracts did not specifically call for assumption of future contingent environmental liabilities).

15. FLETCHER, *supra* note 2, at § 7125.

16. *See* Atchison, Topeka & Santa Fe Ry. v. Brown & Bryant, Inc., 159 F.3d 358 (9th Cir. 1998); *see generally* Uniform Fraudulent Conveyance Act, 12 PA. CONS. STAT. ANN. §§ 5101-5110 (West 2005).

17. *See* United States v. Vertac Chem. Corp., 671 F. Supp. 595 (E.D. Ark. 1987), *vacated in part*, 855 F.2d 856 (8th Cir. 1988).

18. *Boston Gas*, 992 F.2d at 408-09; Phila. Elec. Co. v. Hercules, Inc., 762 F.2d 303, 310 (3d Cir. 1985); *In re* Acushnet River & New Bedford Harbor, 712 F. Supp. 1010 (D. Mass. 1989).

operations of the seller corporation.[19]

Although it is often said that no single factor is necessary or sufficient for a transaction to establish successor liability under this exception,[20] the key element to establishing the existence of a de facto merger is the second factor—i.e., there must be some continuity of shareholders between the purchasing corporation and the selling corporation. Absent a transfer of stock of the buyer corporation to owners of the seller corporation, a de facto merger typically will not be found.[21]

D. Mere Continuation

The "mere continuation" exception applies when the purchasing corporation is merely a continued or reorganized version of the seller corporation, rather than a truly distinct business entity.[22] Courts will look to several factors to evaluate whether the buyer's business is a mere continuation of the seller's business, including whether the same employees are using the same assets to produce the same products at the same location.[23] However, common identity of officers, directors and stockholders between the selling and purchasing corporations is the key element of a mere continuation.[24] In other words, for the mere continuation exception to apply, the purchasing corporation must be merely a "new hat" for the seller, with the same or similar management and ownership.[25]

IV. Substantial Continuity

In addition to the four traditional exceptions to the rule of non-liability for asset purchasers, a number of courts in CERCLA cases have applied a fifth exception. The "substantial continuity" exception, also

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19. *See, e.g., Phila. Elec. Co.*, 762 F.2d at 310; N. Shore Gas Co. v. Salomon Inc., 152 F.3d 642, 652-53 (7th Cir. 1998).

20. FLETCHER, *supra* note 2, at § 7124.50.

21. *See* United States v. Keystone Sanitation Co., No. Civ.A 1:CV-93-1482, 1996 WL 672891 at *4 (M.D. Pa. Aug. 22, 1996); La.-Pac. Corp. v. Asarco, Inc., 909 F.2d 1260, 1264-65 (9th Cir. 1990).

22. *N. Shore Gas*, 152 F.3d at 654; United States v. Carolina Transformer Co., 978 F.2d 832, 838 (4th Cir. 1992).

23. Kelley v. Thomas Solvent Co., 725 F. Supp. 1446, 1458 (W.D. Mich. 1988); *N. Shore Gas*, 152 F.3d at 654-55.

24. United States v. Mexico Feed & Seed Co., 980 F.2d 478, 487 (8th Cir. 1992); *Carolina Transformer*, 978 F.2d at 838.

25. *N. Shore Gas*, 152 F.3d at 654. *See generally* FLETCHER, *supra* note 2, at § 7124.10. By contrast, continuity rather than identity of shareholders would suffice for the de facto merger exception. *See also* United States v. General Battery Corp., 423 F.3d 294 (3d Cir. 2005).

known as the "continuity of enterprise" exception, is generally viewed as an expansion of the mere continuation exception.[26] The key difference is that under the substantial continuity exception, unlike mere continuation, there need not be identity of shareholders between the buyer and seller corporations.

A. History

The substantial continuity exception has its roots in labor and product liability law. Rather than allowing aggrieved workers or injured consumers to be left without a remedy, some courts relaxed the mere continuation exception and applied a less rigid test based on a broader range of circumstances.[27] The focus of the substantial continuity test is whether the same business is continuing (albeit with different shareholders) under circumstances in which the liabilities should stay with the business. Only a minority of states have recognized the substantial continuity exception to the general rule of non-liability for asset purchasers, typically in the context of product liability cases.[28]

In the early 1990s, some federal courts began to apply the substantial continuity test in CERCLA cases. Two of the leading cases were the Fourth Circuit opinion in *United States v. Carolina Transformer Co.*,[29] and the Eighth Circuit decision in *United States v. Mexico Feed and Seed Co.*[30] Both illustrate how courts have tended to invoke federal common law and point to the broad goals of CERCLA in order to justify expansion of the mere continuation exception.[31]

In *Carolina Transformer*, the government sued under CERCLA to recover the costs of cleaning up a transformer salvage site. The government alleged that FayTran Co. was liable as the successor to Carolina Transformer Co., which owned and contaminated the site. FayTran had purchased virtually all of the assets from Carolina Transformer, except for the contaminated site itself.[32] The Fourth Circuit recognized that FayTran could not be considered liable as a successor to

26. *See, e.g., Mexico Feed*, 980 F.2d at 487; Gould v. A&M Battery & Tire Service, 950 F. Supp. 653, 656-57 (M.D. Pa. 1997).

27. *See, e.g.*, Fall River Dyeing & Finishing Corp. v. NLRB, 482 U.S. 27 (1987); Mozingo v. Correct Mfg. Corp., 752 F.2d 168 (5th Cir. 1985); Turner v. Bituminous Casualty Co., 244 N.W.2d 873 (Mich. 1976).

28. *See* FLETCHER, *supra* note 2, at § 4892.75; New York v. National Services Industries, Inc., 352 F.3d 682, 687 (2d Cir. 2003). Pennsylvania law has not recognized the substantial continuity exception.

29. 978 F.2d 832.

30. 980 F.2d 478.

31. A more local example is Atl. Richfield Co. v. Blosenski, 847 F. Supp. 1261, 1283-95 (E.D. Pa. 1994).

32. *Carolina Transformer*, 978 F.2d at 834-36.

Carolina Transformer under the traditional mere continuation exception because there was no overlap of stock ownership between Carolina Transformer and FayTran.[33] Nevertheless, the Fourth Circuit followed the approach of the trial court and held FayTran liable based on the substantial continuity exception. The *Carolina Transformer* court invoked both federal common law and CERCLA's purpose in deciding to apply the substantial continuity test:

> In adopting a rule of successor liability in this case we "must consider traditional and evolving principles of federal common law, which Congress has left to the courts to supply interstitially." We are reminded that since CERCLA is a remedial statute, its provisions should be construed broadly to avoid frustrating the legislative purpose.[34]

Relying largely on labor and product liability law precedents, the Fourth Circuit set forth the following eight factors for determining whether the asset purchasing corporation is the successor to the seller for purposes of CERCLA liability:

1) retention of same employees,
2) retention of same supervisory personnel,
3) retention of same production facilities at same location,
4) production of same product,
5) retention of same name,
6) continuity of assets,
7) continuity of general business operations, and
8) holding itself out as continuation of previous enterprise.[35]

Applying this multi-factor substantial continuity test, the Fourth Circuit held FayTran liable under CERCLA as the successor to Carolina Transformer.[36]

In *Mexico Feed*, the Eighth Circuit likewise adopted the substantial continuity test, but ultimately held that the facts in its case did not meet the test's criteria for imposing CERCLA liability upon the asset purchaser.[37] The government sued under CERCLA to recover the costs of remedying the so-called Covington site, which had been contaminated

33. *Id.* at 838.
34. *Id.* at 837-38 (citations omitted).
35. *Id.* at 838. Among the authorities cited by the *Carolina Transformer* court were *Mozingo* and *Fall River Dyeing*. Mozingo v. Correct Mfg. Corp., 752 F.2d 168 (5th Cir. 1985) (product liability); Fall River Dyeing & Finishing Corp. v. NLRB, 428 U.S. 27 (labor).
36. *Carolina Transformer*, 978 F.2d at 840-41.
37. 980 F.2d at 489-90.

by leaks from waste oil storage tanks. Among the defendants was Moreco Energy, which the government alleged was liable as successor to the corporation that had leased and operated the leaking tanks, Pierce Waste Oil Service ("PWOS"). Moreco had purchased PWOS's assets, including numerous storage tanks, but did not acquire the tanks at the Covington site. PWOS had ceased leasing and using the tanks at the Covington site several years before Moreco's asset purchase in 1983 and the discovery of contamination at the Covington site by the government in 1984.[38]

The Eighth Circuit acknowledged that Moreco could not be a successor to PWOS under the mere continuation exception because there was no identity of officers, directors or shareholders between seller PWOS and buyer Moreco,[39] but the appeals court affirmed the trial court's use of the substantial continuity test.[40] Pointing to labor and product liability cases as well as CERCLA opinions such as *Carolina Transformer*,[41] the Eighth Circuit emphasized that CERCLA's public policy of imposing cleanup costs upon those responsible for the contamination justified making certain asset purchasers liable where they would not be under the traditional exceptions:

> CERCLA is aimed at imposing clean up costs on the parties responsible for the creation or maintenance of hazardous waste sites. Therefore, in the CERCLA context, the imposition of successor liability under the "substantial continuation" test is justified by a showing that in substance, if not in form, the successor is a responsible party.[42]

Although the Eighth Circuit recited essentially the same eight factors as the Fourth Circuit did in *Carolina Transformer*, the *Mexico Feed* court also noted the substantial continuity test considered, "but not determinatively," whether there was an identity of shareholders and officers between the buyer and seller of assets.[43] Applying the substantial continuity test, the Eighth Circuit found that the facts did not support a finding that Moreco was a successor to PWOS.[44]

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38. *Mexico Feed*, 980 F.2d at 482-83.
39. *Id.* at 487.
40. *Id.* at 489.
41. *Id.* at 487-88.
42. *Id.* at 488. Although the *Mexico Feed* court did not squarely decide whether to apply state or federal common law to analyze successor liability because the issue was not raised by the litigants, the Eighth Circuit noted that "considering the national application of CERCLA and fairness to similarly situated parties, the district court was probably correct in applying federal law." *Id.* at 487.
43. *Id.* at 488 n.10.
44. *Id.* at 489-90.

Not surprisingly, the U.S. Environmental Protection Agency ("EPA") historically advocated expansion of the scope of successor liability under CERCLA to include the substantial continuity exception in order to broaden the number of persons potentially responsible for response costs at Superfund sites.[45]

B. Other Circuits

Courts of appeals are split regarding the applicability of the substantial continuity test to determine successor liability under CERCLA in the context of asset purchases. As discussed above, the Fourth and Eighth Circuits adopted the substantial continuity exception in 1992.[46] Some circuits—including the Fifth, Seventh, Tenth, Eleventh and District of Columbia—have not yet squarely addressed the issue under CERCLA. The trend in more recent appellate decisions, though, is to reject the substantial continuity test in CERCLA cases. The First, Second, Sixth and Ninth Circuits, and most recently the Third Circuit, have held that the substantial continuity exception is not applicable to determine successor liability of asset purchasers under CERCLA.[47]

Some of the courts which have refused to apply the substantial continuity exception have rejected the application of federal common law to the question of successor liability under CERCLA. Instead, when evaluating CERCLA successor liability, these courts have looked to state common law, which did not recognize the substantial continuity test.[48]

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45. Courtney Price, Assistant Administrator for Enforcement and Compliance Monitoring, "Liability of Corporate Shareholders and Successor Corporations for Abandoned Sites Under CERCLA" (EPA Directive No. 9832.10) (June 13, 1984). The directive also urged adoption of the non-traditional "product line" exception in CERCLA cases.

46. United States v. Carolina Transformer Co., 978 F.2d 832 (4th Cir. 1992) (buyer corporation liable as successor); *Mexico Feed*, 980 F.2d 478 (buyer corporation not liable as successor).

47. United States v. Davis, 261 F.3d 1 (1st Cir. 2001); New York v. Nat'l Serv. Indus., Inc., 352 F.3d 682 (2d Cir. 2003); City Mgmt. Corp. v. United States Chem. Co., 43 F.3d 244 (6th Cir. 1994); Atchison, Topeka & Santa Fe Ry. v. Brown & Bryant, Inc., 159 F.3d 358 (9th Cir. 1998); United States v. General Battery Corp., 423 F.3d 294 (3d Cir. 2005).

48. *Davis*, 261 F.3d at 53-54 (applying Connecticut law); *City Mgmt. Corp.*, 43 F.3d at 252-53 (applying Michigan law). Interestingly, the Sixth Circuit recognized that Michigan had adopted the substantial continuity test in product liability cases, but held that Michigan law otherwise did not recognize the substantial continuity test. *Id.* The Ninth Circuit in *Atchison* strongly indicated that state common law should determine issues of successor liability under CERCLA, and noted that California common law did not recognize the substantial continuity exception. *Atchison, Topeka & Santa Fe*, 159 F.3d 358. But the Ninth Circuit ultimately did not decide whether state or federal common law should determine successor liability under CERCLA, because it held that federal common law also should reject the substantial continuity test. *Id.* at 364.

The Second Circuit is unique in that it originally adopted the substantial continuity test in a CERCLA case, but more recently in *New York v. National Services Industries, Inc.* (*NSI*),[49] reversed itself and held that the substantial continuity test could not be used to determine successor liability under CERCLA.[50] The *NSI* opinion also is of particular interest because of its heavy reliance upon a U.S. Supreme Court CERCLA precedent, *United States v. Bestfoods*,[51] to support its conclusion that application of federal common law does not permit recognition of the substantial continuity exception in a CERCLA case.

In 1996, the Second Circuit adopted the substantial continuity exception in *B.F. Goodrich v. Betkowski*.[52] *Betkowski* was a multi-party CERCLA case arising out of a landfill in Connecticut where the federal and state governments, plus defendants that had already settled with the governments, were pursuing a number of non-settlors who claimed that they were not liable because they were merely asset purchasers from predecessor corporations that had sent wastes to the landfill. The district court found that the non-settlors were not subject to successor liability, since none of the traditional exceptions were satisfied. However, the Second Circuit reversed, adopting the substantial continuity test.[53] In so doing, the Second Circuit specifically noted that the substantial continuity exception was more consistent with CERCLA's remedial goals than the traditional mere continuation exception which required identity of shareholders between the seller and buyer corporations.[54]

Just seven years later, however, in *NSI*, the Second Circuit saw things differently and held that substantial continuity was no longer good law under CERCLA. In *NSI*, the Second Circuit vacated a district court decision that had employed the substantial continuity test and granted summary judgment for the plaintiff-state against NSI. NSI's putative predecessor had sent drums of used cleaning solvent to the landfill. NSI bought all of the predecessor's assets, including its name, and continued the same business with the same assets, employees, location, letterhead

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49. 352 F.3d 682 (2d Cir. 2003).

50. The Ninth Circuit entertained the prospect of adopting the substantial continuity exception for CERCLA in Louisiana-Pacific Corp. v. Asarco, Inc., 909 F.2d 1260, 1265-66 (9th Cir. 1990), but did not squarely do so. Subsequently, the Ninth Circuit rejected the substantial continuity exception in another CERCLA case. *Atchison*, 159 F.3d at 364.

51. 524 U.S. 51 (1998).

52. 99 F.3d 505 (2d Cir. 1996). In denying a petition for rehearing, the Second Circuit clarified its prior opinion at 112 F.3d 88 (2d Cir. 1997).

53. *Betkowski*, 99 F.3d at 518-20.

54. *Id.* at 519. As described by the *Betkowski* court, CERCLA's goals include assuring that those responsible for pollution bear the cost of remediation rather than the public, such that its liability provisions should be liberally construed. *Id.* at 514. *See also* 112 F.3d at 90-91 (opinion denying rehearing but clarifying prior opinion).

and phone number. The predecessor company had liquidated and dissolved.[55] In short, all of the elements of the mere continuation exception seemed to be met except one—there was no evidence that the shareholders of NSI were the same as the shareholders of the asset seller corporation.

Although New York State seemed well positioned to prevail on a substantial continuity exception before the Second Circuit, as it had before the district court, the Second Circuit refused to employ the substantial continuity test. Ruling in favor of the defendant asset purchaser, the Second Circuit in *NSI* pointed primarily to the U.S. Supreme Court decision in *United States v. Bestfoods*,[56] which was decided in 1998, two years after the Second Circuit's decision in *Betkowski*.

Bestfoods was not a successor liability case. Rather, in *Bestfoods* the Supreme Court dealt with the circumstances under which a parent corporation could be liable under CERCLA. In short, the *Bestfoods* Court held that a parent corporation could be directly liable as an operator of its subsidiary's plant where the employees or agents of the parent actually managed or directed activities at the plant.[57] The Court also held that a parent could be derivatively liable for the subsidiary's acts or omissions under CERCLA only where the law justified piercing the corporate veil of the subsidiary.[58] The Supreme Court emphasized in *Bestfoods* that courts could not apply special rules for piercing the corporate veil under CERCLA that disregarded common law principles.[59]

The Second Circuit in *NSI* seized upon the aforementioned lesson from *Bestfoods* to hold that it should not apply a CERCLA-specific rule for successor liability that departs from traditional common law.[60] The *NSI* court examined the common law of successor liability and ruled that, although there was some support for the substantial continuity exception in labor and product liability law, the substantial continuity test was not sufficiently part of the common law to justify its application as part of federal common law.[61] Accordingly, the Second Circuit's ultimate decision in *NSI* was that it had been wrong seven years earlier in *Betkowski*, that the substantial continuity exception was not part of federal common law, and therefore the substantial continuity test should

55. New York v. Nat'l Serv. Indus., Inc., 352 F.3d 682, 683-84 (2d Cir. 2003).
56. 524 U.S. 51 (1998).
57. *Id.* at 70-72.
58. *Id.* at 63-64.
59. *Id.* at 62-63.
60. *National Services Industries,* 352 F.3d at 685.
61. *Id.* at 686-87.

not apply in CERCLA successor liability cases.[62]

C. *The Third Circuit*

The Third Circuit first addressed successor liability under CERCLA almost twenty years ago. In *Smith Land & Improvement Corp. v. Celotex Corp.*,[63] the Third Circuit, in 1986, became one of the first appellate courts to recognize the doctrine of successor liability under CERCLA, despite the absence of any provision in the statute expressly identifying successor corporations as responsible parties.[64] In so doing, the Third Circuit held that federal common law should govern issues of successor liability in CERCLA cases, rather than state common law, because of the importance of national uniformity of law to promote CERCLA's aims.[65]

Subsequently, Pennsylvania district courts regularly used the substantial continuity test in evaluating successor liability in CERCLA cases. Some applied the substantial continuity test and found the asset buyer liable for the seller's CERCLA liability.[66] Others applied the substantial continuity test but did not find the buyer liable under CERCLA as successor to the asset seller.[67] In only two reported cases

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62. *Id.* at 687.

63. 851 F.2d 86 (3d Cir.), *cert. denied*, 488 U.S. 1029 (1989).

64. *Id.*

65. "In resolving the successor liability issues here, the district court must consider national uniformity; otherwise, CERCLA aims may be evaded easily by a responsible party's choice to arrange a merger or consolidation under the laws of particular states which unduly restrict successor liability. The general doctrine of successor liability in operation in most states should guide the court's decision rather than the excessively narrow statutes which might apply in only a few states." *Smith Land*, 851 F.2d at 92 (citations omitted).

It also should be noted that the Third Circuit in another CERCLA case unrelated to successor liability ruled that state law should govern interpretation of an indemnity provision rather than federal common law, but only so long as the state law was not hostile to the aims of CERCLA. Beazer East, Inc. v. Mead Corp., 34 F.3d 206, 211-15 (3d Cir. 1994). The Third Circuit took pains to distinguish between interpretation of a private contract, to which it applied state common law, and questions of liability under CERCLA. The *Beazer East, Inc. v. Mead Corp.* opinion stressed several circuits apply state common law to construe private contractual terms in CERCLA cases but nevertheless use federal common law to decide CERCLA liability issues such as successor liability. *Id.* at 212 n.2 (collecting cases). CERCLA liability issues, emphasized the Third Circuit, must be decided by federal common law, citing *Smith Land* and *Lansford-Coaldale Joint Water Auth. v. Tonolli Corp.*, 4 F.3d 1209 (3d Cir. 1993), in which the court had applied federal common law to govern when veil-piercing was justified under CERCLA.

66. Gould v. A&M Battery & Tire Service, 950 F. Supp. 653 (M.D. Pa. 1997); Atl. Richfield Co. v. Blosenski, 847 F. Supp. 1261 (E.D. Pa. 1994).

67. Andritz Sprout-Bauer, Inc. v. Beazer East, Inc., 12 F. Supp.2d 391 (M.D. Pa. 1998); Elf Atochem N. America v. United States, 908 F. Supp. 275 (E.D. Pa. 1995).

did a Pennsylvania district court expressly decline to apply the substantial continuity test when evaluating successor liability of an asset purchaser under CERCLA.[68]

Just prior to publication of this article, the Third Circuit for the first time addressed the substantial continuity exception when evaluating the CERCLA liability of an asset purchaser. In *United States v. General Battery Corp.*,[69] the Third Circuit held, after lengthy analysis, that federal common law governed issues of successor liability under CERCLA and upheld the district court's finding that the defendant asset purchaser was liable under the de facto merger exception. Almost in passing, the Third Circuit also ruled that the substantial continuity exception could not be applied in a CERCLA case.[70]

In *General Battery*, Price Battery had disposed of spent battery casings decades ago, at sites now being cleaned up by EPA. In 1966, General Battery, a publicly held corporation, bought all of the assets of Price Battery. Price Battery's sole shareholder received $2.95 million in cash and 100,000 shares of General Battery stock in the transaction, becoming a 4.5% owner of General Battery stock. General Battery assumed all of Price Battery's disclosed liabilities, indemnified Price Battery for all other claims, and continued operating the same business as Price Battery with the same employees and equipment, at the same location, providing the same products for the same customers. Price Battery immediately changed its name after the sale, and liquidated within a year. The district court held that General Battery was subject to CERCLA successor liability under both the de facto merger and substantial continuity exceptions.[71]

As a threshold issue on appeal, the Third Circuit decided to apply federal common law, rather than state common law, in evaluating successor liability under CERCLA.[72] While noting that it had already decided this issue in *Smith Land*, the Third Circuit went on to reject defendant's contention that intervening U.S. Supreme Court precedent mandated the application of state common law.[73] The *General Battery*

68. United States v. Atlas Minerals & Chem., Inc., 824 F. Supp. 46 (E.D. Pa. 1993); Action Mfg. Co. v. Simon Wrecking Co., No. Civ.A. 02-CV-8964, 2005 WL 2104310 (E.D. Pa. Aug. 31, 2005).

69. 423 F.3d 294 (3d Cir. 2005).

70. *Id.* at 309. The title of this article as originally written was "Successor Liability Under CERCLA: Whither *the Third Circuit on* Substantial Continuity?" Since the *General Battery* opinion largely ended the suspense of where the Third Circuit was going on substantial continuity shortly before this article was published, the article was revised to incorporate the *General Battery* opinion and re-titled.

71. *General Battery*, 423 F.3d at 296-97.

72. *Id.* at 298-304.

73. *Id.* at 298-301.

court distinguished non-CERCLA Supreme Court cases which held state common law should apply, cited other non-CERCLA Supreme Court cases that held federal common law should apply, and found that *Bestfoods* "cuts in favor of a uniform federal standard" because the Court had applied fundamental hornbook principles to evaluate parent liability under CERCLA rather than Michigan common law as the Sixth Circuit had done.[74] The Third Circuit particularly emphasized the importance of a uniform federal standard for determining successor liability under CERCLA as necessary to advance the statute's remedial objectives, including encouraging settlements, assuring that responsible parties pay for cleanups, and facilitating a fluid market in corporate and brownfield assets.[75] Additionally, emphasizing respect for commercial relationships, the Third Circuit held that the federal common law to be applied was "the general doctrine of successor liability in operation in most states."[76] Applying the de facto merger test applicable in most states, the Third Circuit held that all four de facto merger factors were met and that General Battery was liable as the successor to Price Battery.[77]

Although the plaintiff-government in *General Battery* did not seek affirmance on the basis of substantial continuity and did not brief the issue on appeal,[78] the Third Circuit nevertheless elected to "briefly address" the substantial continuity exception.[79] Noting that substantial continuity is not accepted in most states, the Third Circuit found that substantial continuity is inconsistent with *Bestfoods*, which instructed that CERCLA does not abrogate fundamental common law principles of indirect corporate liability.[80] Relying primarily on *NSI* and *Bestfoods*,

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74. *Id.* at 298-305.

75. *Id.* at 301-303. The *General Battery* court also reasoned that federal law rather than state law should govern successor liability under CERCLA because it was engaging in interpretation of the term "corporation" under the statute. *Id.* at 305, citing 42 U.S.C. § 9601(21).

In a partially dissenting opinion, Judge Rendell argued, principally in reliance on *O'Melveny & Myers v. FDIC*, 512 U.S. 79 (1994), *Atherton v. FDIC*, 519 U.S. 213 (1994), and *United States v. Bestfoods*, 524 U.S. 51 (1998), that state common law should apply to determinations of successor liability under CERCLA, absent evidence that the law of Pennsylvania frustrated CERCLA's purpose of holding responsible persons liable for cleanup costs. *General Battery*, 423 F.3d at 309-18, (Rendell, J., concurring in part and dissenting in part).

76. *General Battery*, 423 F.3d at 303, quoting Smith Land & Improvement Corp. v. Celotex., 851 F.2d 86, 92 (3d Cir. 1988), *cert. denied*, 488 U.S. 1029 (1989).

77. *General Battery*, 423 F.3d at 305-09.

78. *Id.* at 309 n.11.

79. *Id.*

80. "We briefly address the District Court's alternative holding that Exide is liable under CERCLA on a 'substantial continuity' theory of successor liability. Prior to *Bestfoods*, several courts adopted the 'substantial continuity' test as a basis for CERCLA successor liability. 'Substantial continuity' eliminates certain elements of the de facto merger analysis—including the continuity of ownership requirement—and in effect

the Third Circuit concluded its one-paragraph analysis by holding that "'substantial continuity' is untenable as a basis for successor liability under CERCLA."[81]

As discussed above, a few circuits have rejected the substantial continuity exception based upon their determination that state common law did not recognize the exception.[82] The common law of most states does not recognize the substantial continuity exception to the general rule that asset purchasers are not responsible for the liabilities of asset sellers.[83] If the Second and Third Circuits are correct that the substantial continuity test is not part of federal common law either, then there is little chance that a federal court could or would apply the substantial continuity exception in a CERCLA case.

In light of these recent appellate decisions by the Second and Third Circuits rejecting the substantial continuity exception, and especially their views about federal common law and the Supreme Court's decision in *Bestfoods*, it is an appropriate time to analyze (a) whether a court *can* apply the substantial continuity exception for purposes of successor

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creates a more expansive rule of liability than is accepted in most states. Recently, however, several courts of appeals have rejected the doctrine as inconsistent with *Bestfoods*. We agree *Bestfoods* held that CERCLA does not, *sub silentio*, abrogate fundamental common law principles of indirect corporate liability. Accordingly, 'substantial continuity' is untenable as a basis for successor liability under CERCLA." *General Battery*, 423 F.3d at 309 (citations omitted).

It should be noted that in *Polius v. Clark Equipment Co.*, the Third Circuit rejected use of the "continuity of enterprise" exception in a products liability case decided under Virgin Island law. 802 F.2d 75, 80 (3d Cir. 1986). The *Polius* decision seemed to be based primarily on a view that Section 402A of the Restatement (Second) of Torts was not sufficiently different from traditional negligence law so as to justify an extension of the traditional mere continuation exception that would impose liability upon a party which had no connection to the acts causing injury. *Id.* at 81. Judge Mansmann in a concurring opinion urged adoption of the substantial continuity exception. *Id.* at 94 (Mansmann, J., concurring). *See also* Atl. Richfield Co. v. Blosenski, 847 F. Supp. 1261, 1285-86 (E.D. Pa. 1994) (distinguishing *Polius* en route to applying substantial continuity exception in CERCLA case).

81. *General Battery*, 423 F.3d at 309.

82. United States v. Davis, 261 F.3d 1, 53-54 (1st Cir. 2001) (applying Connecticut law); City Mgmt. Corp. v. United States Chem. Co., 43 F.3d 244, 252-53 (6th Cir. 1994) (applying Michigan law). Interestingly, the Sixth Circuit recognized that Michigan had adopted the substantial continuity test in product liability cases, but held that Michigan law otherwise did not recognize the substantial continuity test. *Id.* The Ninth Circuit in *Atchison* strongly indicated that state common law should determine issues of successor liability under CERCLA, and noted that California common law did not recognize the substantial continuity exception. Atchison, Topeka & Santa Fe Ry. v. Brown & Bryant, Inc., 159 F.3d 358, 364 (9th Cir. 1998). But the Ninth Circuit ultimately did not decide whether state or federal common law should determine successor liability under CERCLA, because it held that federal common law also should reject the substantial continuity test. *Id.*

83. FLETCHER, *supra* note 2, at § 4892.75; New York v. Nat'l Serv. Indus., Inc., 352 F.3d 682, 687 (2d Cir. 2003).

liability under CERCLA, and (b) whether a court *should* apply the substantial continuity exception for determining the liability of an asset purchaser under CERCLA.

V. Can a Court Apply the Substantial Continuity Test?

A. Federal Common Law Should Apply Rather than State Common Law.

A preliminary question to whether a court can apply the substantial continuity test is which common law informs issues of successor liability under CERCLA—federal or state? As discussed above, the substantial continuity exception is recognized in only a small number of states,[84] and federal courts applying the substantial continuity test generally have invoked federal common law to justify doing so.[85] Thus, if a court were required to apply state common law to successor liability under CERCLA, it is unlikely that the substantial continuity exception would be employed.[86] Indeed, as noted above, some of the courts that have rejected the substantial continuity exception in CERCLA cases have done so on the basis that the state law at issue did not recognize the substantial continuity exception.[87]

With all due respect to those courts that have applied state law to evaluate successor liability under CERCLA, neither authority nor reason instructs that a court should apply state common law to determine whether a corporation is liable under CERCLA as a successor to another corporation. First, the U. S. Supreme Court in *Bestfoods*—the Court's most recent case addressing the interface of CERCLA liability and common law—expressly did not decide whether federal or state common law should be employed in construing liability under CERCLA.[88]

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84. FLETCHER at § 4892.75; *National Services Industries*, 352 F.3d at 687.

85. *See, e.g.*, United States v. Carolina Transformer Co., 978 F.2d 832, 837-38 (4th Cir. 1992); *Blosenski*, 847 F. Supp. at 1283.

86. Pennsylvania recognizes the four traditional exceptions to the general rule of non-liability for asset purchasers. In addition, Pennsylvania law has recognized a fifth exception: whether the purchase was made without adequate consideration and provisions were not made for creditors of the seller. *See* Phila. Elec. Co. v. Hercules, Inc., 762 F.2d 303, 308-09 (3d Cir. 1985). The Pennsylvania Superior Court also has recognized the "product line" exception in product liability cases. Dawejko v. Jorgenson Steel Co., 434 A.2d 106 (Pa. Super. Ct. 1981). But Pennsylvania courts have not adopted the substantial continuity exception.

87. *See Davis*, 261 F.3d 1; *City Mgmt. Corp.*, 43 F.3d 244.

88. United States v. Bestfoods, 524 U.S. 51, 64 n.9 (1998) (The Court noted there is "significant disagreement among courts and commentators" regarding whether courts should employ state common law or federal common law of veil piercing, but found that it need not address the issue.).

Second, Supreme Court precedents outside the context of CERCLA permit, if not mandate, the application of federal common law rather than state common law to determine successor liability in CERCLA cases. In *United States v. Kimbell Foods, Inc.*,[89] the Supreme Court identified three factors for determining whether a federal court should apply a uniform federal common law or refer to state common law when evaluating issues related to a federal program: (1) the need for national uniformity in carrying out the federal program, (2) whether application of state law would frustrate specific objectives of the federal program, and (3) whether a uniform federal rule would disrupt commercial relationships predicated on state law.[90] Subsequent Supreme Court cases, particularly *O'Melveny & Myers v. FDIC*[91] and *Atherton v. FDIC*,[92] emphasized the second factor—federal common law should not be employed absent a showing that state law would significantly conflict with specific objectives of the federal program. All three factors seem to favor a uniform federal rule to determine successor liability under CERCLA rather than looking to the various state common law rules.

It remains just as important today as it was in 1986, when *Smith Land* was decided, that a uniform body of federal law be applied when determining liability under CERCLA. The legislative history of CERCLA indicates that Congress intended the statute to be interpreted in accordance with evolving principles of federal common law.[93] CERCLA established a unique liability scheme specifically designed so that broad

89. 440 U.S. 714 (1979).
90. *Id.* at 728-29.
91. 512 U.S. 79 (1994).
92. 519 U.S. 213 (1994).
93. As Rep. James Florio (D-N.J.) stated during the final Superfund debates:

> [CERCLA] sets forth the classes of persons (for example, owners, operators, generators) who are liable for all costs of removal or remedial action, other necessary costs of response, and damages to natural resources. Rather than announce the standard [of liability], and then cut back on its applicability, this bill refers to section 311 of the Clean Water Act and to *traditional and evolving principles of common law* in determining the liability of such joint tortfeasors. *To insure the development of a uniform rule of law*, and to discourage business dealing in hazardous substances from locating primarily in States with more lenient laws, *the bill will encourage the further development of a federal common law in this area.*

126 Cong. Rec. 31, 965 (1980) (statement of Rep. Florio) (emphasis added). *See also* 126 Cong. Rec. 30, 932 (1980) (statement of Sen. Randolph) ("It is intended that issues of liability not resolved by this act, if any, shall be governed by *traditional and evolving principles of common law.*") (emphasis added). *See also* Smith Land & Improvement Corp. v. Celotex., 851 F.2d 86, 91 (3d Cir. 1988), *cert. denied*, 488 U.S. 1029 (1989) ("It is not surprising that, as a hastily conceived and briefly debated piece of legislation, CERCLA failed to address many important issues, including corporate successor liability. The meager legislative history available indicates that Congress expected the courts to develop a federal common law to supplement the statute.").

categories of responsible parties would pay for the cost of cleaning up contaminated sites rather than the taxpaying public.[94] To make that unique federal liability scheme dependent upon the vagaries of state law could frustrate this key "polluter pays" objective.[95] Moreover, CERCLA cases, particularly those arising from landfills, often involve numerous defendants and third-party defendants, many of whom may be located (or may have engaged in asset purchases) in different states. The potential for multiple state common law standards of successor liability in the same case would not only be a potential nightmare for the trial judge, but disparate treatment of otherwise like parties would contravene CERCLA's goal of making responsible persons pay and its statutory directive to allocate response costs among liable parties equitably.[96]

Further, CERCLA's broad, strict liability scheme has drastically affected commercial relationships since its enactment twenty-five years ago, such that virtually no transaction involving real estate, industry or hazardous substances is unaffected by potential CERCLA liability ramifications. To suggest that application of federal common law to interpret some of CERCLA's gaps would disrupt commercial relationships predicated on state law seems almost quaint.[97] Accordingly, under *Kimbell Foods* and its progeny, a court could and should employ federal common law when evaluating successor liability under CERCLA. As discussed above, both the Second and Third Circuits, post-*Bestfoods*, have analyzed the Supreme Court precedents and concluded that federal common law should apply for purposes of determining successor liability under CERCLA.[98]

B. Federal Common Law Recognizes the Substantial Continuity Exception.

Although a court could apply federal common law when evaluating

94. *See Smith Land*, 851 F.2d at 91-92.

95. *Id.* at 92; United States v. General Battery Corp., 423 F.3d 294, 298-304 (3d Cir. 2005).

96. *See* 42 U.S.C. § 9613(f)(1) (2000). Alternatively, if the laws of forum states were applied, the same asset transfer transaction could result in CERCLA successor liability in one court but no such liability in another district.

97. *See General Battery*, 423 F.3d at 308-09 (noting CERCLA by its nature, including retroactive liability, upsets expectations of buyers and sellers of corporate assets).

98. Only one other appellate decision has addressed substantial continuity post-*Bestfoods* in a CERCLA case. In *United States v. Davis*, the First Circuit applying Connecticut law refused to use the substantial continuity test. 261 F.3d 1 (1st Cir. 2001). The *Davis* court relied not only upon *Bestfoods*, but upon *Boston Gas*, a First Circuit precedent which had applied state common law in interpreting an indemnity provision in a CERCLA case. *Id.* at 54; John S. Boyd Co. v. Boston Gas Co., 992 F.2d 401 (1st Cir. 1993).

successor liability under CERCLA, that does not necessarily mean it could apply the substantial continuity test. In *NSI* and *General Battery*, the Second and Third Circuits, respectively, applied federal common law but held that the substantial continuity test was not part of federal common law and thus could not be invoked for purposes of determining successor liability under CERCLA.[99]

In my view, however, both the Second and Third Circuits have misread *Bestfoods* as dictating that federal common law must be equivalent to the majority view. *Bestfoods* says no such thing. The *Bestfoods* Court recognized that courts and commentators were split over whether to apply federal or state common law to issues such as parent liability under CERCLA.[100] The Supreme Court, though, expressly withheld judgment on whether lower courts should apply federal or state common law when construing liability under CERCLA.[101] The Court in *Bestfoods* simply made clear that courts must not disregard the common law—whether it be state or federal—when construing CERCLA.[102]

Rather, once it is determined that a uniform federal common law should apply, federal courts have fairly broad latitude to choose what that federal common law should be.[103] It is not—and should not—be an exercise in weighing which particular test is most widely established in the federal or state common law. If majority rule were the lone criterion, the first courts deciding an issue would set and fix the course of federal common law forever. Later courts, in other jurisdictions, would be bound to follow this majority rule, and federal common law would never change. While this approach might result in uniformity, uniformity for uniformity's sake is not the purpose of federal common law.[104] Judges must be permitted to function as judges, not scorekeepers, and federal common law must have the opportunity to grow and evolve.

Although the Supreme Court in *Bestfoods* instructed that a court must not ignore common law in fashioning law applicable to CERCLA

99. New York v. Nat'l Serv. Indus., Inc., 352 F.3d 682, 687 (2d Cir. 2003); *General Battery*, 423 F.3d at 309. The Ninth Circuit in *Atchison, Topeka & Santa Fe Railroad v. Brown & Bryant, Inc.* also chose not to use the substantial continuity test under federal common law without deciding whether state or federal common law should apply. 159 F.3d 358, 364 (9th Cir. 1998).

100. United States v. Bestfoods, 524 U.S. 51, 63 n.9 (1998).

101. *Id.*

102. *Id.* at 62-63.

103. *See* 19 CHARLES ALAN WRIGHT, ARTHUR MILLER, & EDWARD H. COOPER, FEDERAL PRACTICE AND PROCEDURE: JURISDICTION § 4518 (2d ed.); La. Acorn Fair Housing v. LeBlanc, 211 F.3d 298, 303 (5th Cir. 2000) (adopting own rule in Fair Housing Act case after noting circuit split).

104. *See General Battery*, 423 F.3d at 313 (Rendell, J., concurring in part, dissenting in part).

liability, and that it must not create a test specifically for CERCLA,[105] the Court in no way indicated that a court cannot choose to apply a common law test that is not widely accepted. Indeed, the Supreme Court previously has recognized that federal common law need not comport with the rule of law followed by most jurisdictions.[106] In fashioning federal common law, a court should give considerable weight to the test which best implements the underlying federal policy evinced by the statute.[107]

The substantial continuity test clearly has a foothold in federal common law by virtue of labor and product liability cases,[108] as well as decisions of various courts in CERCLA successor liability cases.[109] If a court were to decide that application of the substantial continuity test was important to promoting CERCLA's purposes, the court could do so, irrespective that the substantial continuity test is not the majority rule in federal or state common law.

VI. Should a Court Apply the Substantial Continuity Test?

Although there should be no precedential barrier to invoking federal common law to employ the substantial continuity test, the question remains whether the a court *should* use the substantial continuity test for purposes of evaluating successor liability under CERCLA.

A. Yes, but . . .

Certainly, the identity-of-shareholders requirement of the mere continuation exception, under some circumstances, seems to exalt form over substance and could allow responsible parties to evade CERCLA liability on corporate technicalities. The identity-of-shareholders requirement can be circumvented relatively easily. For example, assume

105. *Bestfoods*, 524 U.S. at 62-63.

106. O'Melveny & Myers v. FDIC, 512 U.S. 79, 84 (1994) (no reason why federal common law must conform to the law followed by most jurisdictions).

107. *See* WRIGHT & MILLER, *supra note 103*, at n.4 (collecting cases). *See also* Smith Land & Improvement Corp. v. Celotex., 851 F.2d 86, 91-92 (3d Cir. 1988), *cert. denied*, 488 U.S. 1029 (1989).

108. *See, e.g.*, Fall River Dyeing & Finishing Corp. v. NLRB, 482 U.S. 27 (1987); Mozingo v. Correct Mfg. Corp., 752 F.2d 168 (5th Cir. 1985).

109. *See* United States v. Carolina Transformer Co., 978 F.2d 832 (4th Cir. 1992); United States v. Mexico Feed & Seed Co., 980 F.2d 478 (8th Cir. 1992). At least three Pennsylvania district court opinions applied the substantial continuity exception post-*Bestfoods*. Andritz Sprout-Bauer, Inc. v. Beazer East, Inc., 12 F. Supp.2d 391, 405-06 (M.D. Pa. 1998); Pennsylvania Dep't of Envtl. Protection v. Concept Sciences, Inc., 232 F. Supp.2d 454, 457-59 (E.D. Pa. 2002); United States v. Exide Corp., No. Civ.A 00-CV-3057, 2002 WL 319940 at *10-12 (E.D. Pa. Feb. 27, 2002), *rev'd in part sub nom. General Battery*, 423 F.3d 294.

Corporation A dumped hazardous substances at a landfill. Corporation A subsequently sold all of its assets to Corporation B, which continued the same business under the same name, at the same location, using the same assets, employees and supervisors, and providing the same products for the same customers. Corporation A then dissolved, shortly before the government discovered contamination at the landfill. All of the elements of the mere continuation exception are present to make Corporation B liable as a successor, except for the identity-of-shareholders requirement: Corporation A's stock was 100% owned by the grandfather of the sole shareholder of Corporation B. The grandfather and granddaughter were involved in the management of both Corporations A and B. Under the circumstances, Corporation B would not bear CERCLA liability for the contaminating acts of Corporation A under the mere continuation exception because identity of shareholders is lacking, and the cost of cleaning up the site would have to be borne by the public or unrelated parties since Corporation A no longer exists.

On the other hand, focusing solely on the eight factors commonly held to be indicative of substantial continuity could lead to the exception swallowing the rule of non-liability for asset purchasers. It is not uncommon for a purchaser to acquire business assets and basically continue the same business under new ownership. Treating relatively routine asset purchases equivalent to stock purchases, for liability purposes, could significantly upset traditional corporate law, cause asset purchasers to take on liabilities they never foresaw or factored into their purchase decision and price, and impose CERCLA liability upon innocent persons who neither caused nor benefited from the pollution.

For example, this time assume Y Corporation is a publicly owned entity, and its lone Pennsylvania plant dumped hazardous substances at a landfill decades ago. Shortly thereafter, Y Corporation closed its Pennsylvania plant and sold the plant realty. Several years later, Corporation Z, another publicly owned company, acquired most of the then-current assets of Y Corporation, and essentially continued Y Corporation's business as a division of Corporation Z, using the same assets, employees, supervisors, locations and producing the same goods for the same customers. Corporation Z purchased the assets of Y Corporation, rather than the stock, in part to avoid the prospect of successor liability for contracts and torts and in part because Y Corporation wanted to continue doing business in a new field. Despite rather intensive pre-acquisition due diligence, Corporation Z was unaware of Y Corporation's potential CERCLA liability at the Pennsylvania landfill and did not factor that into its purchase decision or price. Yet, looking solely to the eight factors commonly associated with the substantial continuity test, Corporation Z could well be held liable for

Y Corporation's CERCLA liability at the landfill.

B. Substantial Continuity "Plus"

It is tempting to say that a "new and improved" substantial continuity test is desirable—one that would honor both the broad remedial purpose of CERCLA and the traditional principles and expectations of corporate law. In my view, however, it is more accurate to say that courts should look to the roots and purpose of the substantial continuity exception to fashion a refined test. My "substantial continuity plus" test would retain the oft-cited eight factors but would also require the existence of one or more "plus" factors: (a) the seller corporation has gone out of business, liquidated and dissolved following the asset sale, (b) there is a substantial overlap of or relationship between the owners of the seller and buyer corporations, and (c) the buyer knew that the seller was subject to CERCLA liability and factored that potential liability into the asset purchase price.

All of the traditional exceptions to the rule of non-liability for asset purchasers are grounded in the equitable principle that liabilities should not be evaded through transactional technicalities.[110] Similarly, one of the main principles underlying CERCLA's expansive liability scheme is that responsible parties should bear CERCLA response costs.[111]

Where the seller corporation remains in existence and is capable of living up to its CERCLA liability obligations, the asset transfer does not result in any shedding or evasion of CERCLA liabilities, and the seller-polluter will still be paying for the cleanup costs. Under these circumstances, there is less reason to impose CERCLA liability upon the asset purchaser as well. By contrast, if the seller corporation goes out of business, liquidates and dissolves following the asset transfer, the CERCLA liability of the seller corporation may well have to be borne by the public or unrelated parties unless the buyer is held liable as its successor. Under such circumstances, courts should more carefully scrutinize whether the buyer corporation effectively has participated in the evasion of CERCLA liability via transactional technicalities and whether it should be equitably viewed as the substitute responsible party for purposes of successor liability under CERCLA. The importance to successor liability of whether a seller remains viable after the asset sale is reflected by the fact that one of the main factors in the traditional de facto merger exception is the seller ceasing operations, liquidating and

110. *Mexico Feed*, 980 F.2d at 487; N. Shore Gas Co. v. Salomon Inc., 152 F.3d 642, 651 (7th Cir. 1998).

111. *Smith Land*, 851 F.2d at 91-92.

dissolving soon after the asset sale.[112] In short, where the predecessor is viable, an asset buyer should be less susceptible to successor liability.

If the purchaser is unrelated to the seller and engages in an arm's length transaction to acquire assets, it is more difficult to argue that the seller and purchaser are trying to evade CERCLA liabilities via transactional technicalities or that the purchaser should be viewed the same as the polluter-seller under CERCLA's liability scheme. By contrast, where shareholders of both the buyer and seller are substantially the same (albeit not identical), or are substantially related, the purposes of both the exception to the rule of asset purchaser non-liability and CERCLA's liability scheme are advanced. That is, the asset transfer can be viewed as a mechanism designed to allow the seller to shed and the buyer to evade CERCLA liability via a transactional technicality, even if certain elements of fraud are lacking. Where the owners of the buyer corporation are substantially related to the owners of the seller corporation, it is much easier to view the buyer as a "new hat" for the seller and it may be equitable to treat them as the same for CERCLA liability purposes, even though the corporate entities technically are different.[113]

The third plus factor, "knowledge," at first blush may seem like a strange concept to consider in the context of a strict liability statute such as CERCLA. Indeed, an asset purchaser's "knowledge" should not be viewed as a prerequisite to its liability under the substantial continuity exception. Conversely, that an asset purchaser has "knowledge" of the seller's potential CERCLA liability should not automatically make the buyer liable, even where the other eight factors of the substantial continuity test are met. For example, a buyer may become aware pre-acquisition that a seller is liable for disposing of waste years ago at a dumpsite and take pains to contractually make clear that the buyer is not

112. *See, e.g.,* Phila. Elec. Co. v. Hercules, Inc., 762 F.2d 303, 310 (3d Cir. 1985). Dissolution of the seller as a factor has a history under the substantial continuity exception as applied to product liability cases, too. *See* Turner v. Bituminous Casualty Co., 244 N.W.2d 873, 883-84 (Mich. 1976) (in this pioneering case applying the "continuity of enterprise" exception in a product liability context, the Michigan Supreme Court required that the seller dissolve soon after the sale in order to justify the exception).

113. Precisely how substantially related the seller and buyer corporation shareholders must be under this plus factor probably is incapable of a bright-line formulation applicable in all cases. But all of the exceptions to the rule of asset purchaser non-liability are equitable in nature and imprecise in definition and application. The oft-cited, eight-factor test for substantial continuity depends upon judicial judgment both with respect to each factor individually and with respect to the weight accorded to the various factors collectively. There is little precision, as well, about what constitutes fraud or the existence and weight of factors in the traditional de facto merger and mere continuation exceptions. Lack of precision in the formulation of this plus factor should not tarnish its utility.

assuming such liability, that the liability stays with the seller, and that the price paid for the assets does not reflect any of that liability. Under such a scenario, where the polluter-seller retains the CERCLA liability, and a viable seller remains subject to CERCLA liability, there may be little justification for imposing liability upon the asset purchaser even though the buyer has "knowledge" of the seller's CERCLA liability.

However, there are circumstances where a buyer's knowledge of a seller's CERCLA liability should make a difference. Where the buyer knew of the seller's CERCLA liability, and the buyer benefited from that knowledge because the purchase price was discounted by the prospect of that CERCLA liability, it seems equitable to impose that CERCLA liability upon the asset buyer, too. In this scenario, making the asset buyer liable as successor to the seller does not contravene legitimate business expectations.

Another look at two of the leading substantial continuity CERCLA cases illustrates the importance and appropriateness of such "plus" factors. In *Carolina Transformer*, the Fourth Circuit listed the oft-cited, eight-factor test for substantial continuity.[114] But the Fourth Circuit also indicated that other factors were important to the determination of whether an asset purchaser should be responsible for the CERCLA liabilities of the seller corporation. The court expressly stated that "if the transfer to the new corporation was part of an effort to continue the business of the former corporation yet avoid its existing or potential state or federal environmental liability, of course that should be considered also."[115]

FayTran was formed shortly after pollution was discovered at the Carolina Transformer site, and FayTran acquired virtually all of the assets of Carolina Transformer except for the contaminated realty, leaving Carolina Transformer unable to satisfy its CERCLA obligations.[116] FayTran continued a substantially similar transformer business at a nearby location, using largely the same employees and supervisors, using the same equipment, producing similar products, serving the same customers, and holding itself out as the same company with a different name.[117] The Fourth Circuit's holding of successor liability was undoubtedly strongly influenced by the fact that, although there was technically no overlap of ownership between the seller and buyer corporations, their respective owners were related and there was an overlap of management. FayTran's shareholders were the son and

114. 978 F.2d at 838.
115. *Carolina Transformer,* 978 F.2d at 838.
116. *Id.* at 835, 839.
117. *Id.* at 840-41.

daughter of Carolina Transformer's sole shareholder, both the son and daughter had been officers of Carolina Transformer, and the father remained involved in the business of FayTran.[118] In the Fourth Circuit's view, "the record as a whole leaves the unmistakable impression that the transfer of the Carolina Transformer business to FayTran was part of an effort to continue the business in all material respects yet avoid the environmental liability arising from the PCB contamination at the [Carolina Transformer] site."[119]

In *Mexico Feed*, the Eighth Circuit recited essentially the same eight-factor test as the Fourth Circuit did in *Carolina Transformer*.[120] But the *Mexico Feed* court plainly found the absence of certain other factors to be important to its holding that the asset purchaser Moreco did not succeed to the CERCLA liabilities of the seller PWOS. In particular, the Eighth Circuit seemed primarily persuaded by the facts that (a) the sale was an arm's length transaction to an unrelated large, pre-existing buyer which was a competitor of the seller corporation; and (b) the buyer had no notice of the seller's potential liability at the time of the asset purchase, since the seller had divested itself of any involvement with the site in question years before the asset purchase and the government's discovery of contamination at the site, and there was no allegation that the buyer had received a discount purchase price.[121]

Closer to home, there are hints of these "plus" factors in some of the district court opinions within the Third Circuit dealing with the substantial continuity exception. In *United States v. Atlas Minerals & Chemicals, Inc.*,[122] Judge Cahn rejected the substantial continuity test in favor of the traditional mere continuation test, ultimately finding that since there was no identity of stockholders and directors between the seller and buyer of the electroplating assets, the buyer could not be liable for the seller's CERCLA liability as generator of waste disposed at a landfill. Judge Cahn, though, indicated that the substantial continuity test could be applied to hold an asset purchaser liable under certain circumstances, even without identity of shareholders and directors with the seller. Following an analysis of *Carolina Transformer*, *Mexico Feed* and some district court opinions from other circuits, Judge Cahn opined that, in limited circumstances where the buyer had "substantial ties" to the seller, or knowledge of the seller's CERCLA liability, the substantial continuity test could be applied to avoid frustrating the remedial goal of

118. *Id.* at 835.
119. *Id.* at 841.
120. United States v. Mexico Feed & Seed Co., 980 F.2d 478, 488 n.10 (8th Cir. 1992).
121. *Id.* at 489-90.
122. 824 F. Supp. 46 (E.D. Pa. 1993).

CERCLA to have responsible parties contribute to the cleanup costs.[123] Recently in *Action Manufacturing v. Simon Wrecking*,[124] Judge Brody also rejected the substantial continuity exception. But following an analysis of *Carolina Transformer* and *Mexico Feed*, the court further instructed that the substantial continuity exception would not have been met in *Action Manufacturing, inter alia*, because the asset buyer had neither knowledge of the seller's CERCLA liability nor substantial ties to the seller.[125]

Other Pennsylvania district court opinions have largely rejected such additional requirements for the substantial continuity test.[126] But even some of the opinions holding that "knowledge" and "substantial ties" are not required for substantial continuity have seemed to recognize that exclusive focus upon the eight factors may not be appropriate. In *Andritz Sprout-Bauer, Inc. v. Beazer East, Inc.*,[127] and *Elf Atochem North America v. United States*,[128] the courts stated that the buyer simply continuing the seller's business is not enough to merit an exception to the rule of non-liability for asset purchasers.[129] Although the *Gould, Inc. v. A&M Battery and Tire Service*[130] opinion made clear that the buyer's knowledge of the seller's CERCLA liability was not a requisite of the substantial continuity exception, the court noted that such knowledge could be a relevant factor to consider when applying the test.[131] The *Elf Atochem* opinion noted that the substantial continuity test is rarely satisfied absent such knowledge and a substantial relationship between the seller and buyer.[132] The fact that the seller continued in business and the asset sale was an arm's length transaction seemed important to the *Andritz* court in deciding that the asset buyer was not subject to successor liability.[133]

Even the *NSI* decision provides some support for the "plus" factors.

123. *Id.* at 50-51.

124. No. Civ.A. 02-CV-8964, 2005 WL 2104310 (E.D. Pa. Aug. 31, 2005).

125. *Id.* at *16, 18. The court decided that the substantial continuity test did not apply, even though both sides briefed and argued the case as though the substantial continuity exception applied. *Id.* at *3 n.7. The opinion, issued one week before the Third Circuit's *General Battery* decision, held that federal common law governed determination of successor liability under CERCLA, but the substantial continuity exception could not apply because it was not recognized in most jurisdictions and was an expansion of traditional common law. *Id.* at *6-12.

126. *See* Gould v. A&M Battery & Tire Service, 950 F. Supp. 653 (M.D. Pa. 1997); Andritz Sprout-Bauer, Inc. v. Beazer East, Inc., 12 F. Supp.2d 391 (M.D. Pa. 1998).

127. 12 F. Supp.2d 391.

128. 908 F. Supp. 275 (E.D. Pa. 1995).

129. *Andritz*, 12 F. Supp. 2d at 406; *Elf Atochem*, 908 F. Supp. at 282.

130. 950 F. Supp. 653 (M.D. Pa. 1997).

131. *Id.* at 657.

132. *Elf Atochem*, 908 F. Supp at 282-83.

133. *Andritz*, 12 F. Supp. 2d at 404.

In a lengthy concurring opinion, Judge Leval offered guidance for applying the substantial continuity test, in the event the Supreme Court or the legislature decided that the substantial continuity test should be used in CERCLA successor liability determinations. In particular, Judge Leval emphasized that factors beyond the oft-cited eight factors must be present:

> In conclusion, both the governing caselaw and good sense teach that, as to CERCLA liability, the so-called "substantial continuity" test for successor liability requires more than substantial continuity in the seller's business operations. It requires also the presence of factors justifying the conclusion that the objectives of CERCLA would be improperly circumvented if such liability were not imposed. * * * * If the so-called "substantial continuity" test should either survive *Bestfoods* or be reincarnated in new legislation, it is of great importance that it be correctly understood as requiring not merely continuity but also the presence of such CERCLA-defeating conduct as justified imposition of liability in *Carolina Transformer* and guided the refusal to impose liability in *Mexico Feed.*[134]

I respectfully submit that the three "plus" factors I propose, which are guided by *Carolina Transformer* and *Mexico Feed*, ensure that merely continuing aspects of the seller's business is not enough to impose successor liability. Rather, the presence of one or more of these three factors can serve to justify a conclusion that CERCLA's objectives would be improperly circumvented if successor liability were not imposed.

VII. Conclusion

A court can and should apply the substantial continuity test to evaluate successor liability for asset purchasers in CERCLA cases. Far from prohibiting the application of federal common law or the substantial continuity exception, Supreme Court precedents teach that courts should apply federal common law and may apply the substantial continuity exception in the CERCLA context.

Courts, however, should not focus exclusively upon the oft-cited eight factors typically associated with the substantial continuity exception. Rather, in order to promote both the broad remedial purpose of CERCLA and traditional principles of corporate law, the court should look to three other important "plus" factors as well: (1) the seller corporation is no longer viable after the asset sale; (2) there is an overlap

134. New York v. Nat'l Serv. Indus., Inc., 352 F.3d 682, 694 (2d Cir. 2003) (Leval, J. concurring).

of, or relationship between, the owners of the seller and buyer corporation; and (3) the buyer knew that the seller may be subject to CERCLA liability and factored that potential into the asset purchase price. Each of these "plus" factors, rooted in the leading substantial continuity cases under CERCLA, should sharpen the application of the substantial continuity test so that it does not permit liabilities to be avoided simply due to a lack of identity of shareholders, but yet does not impose liability upon asset purchasers who simply continue aspects of the seller's business.