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Minimizing Exposure to Environmental Liabilities for Corporate Officers, Directors, Shareholders and Successors

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Editor's note: The necessary and frequent use of hazardous substances by the high technology industry today poses a substantial threat of liability for environmental harm. Increasing attention paid by government and individuals to hazardous waste clean up and prevention makes it imperative that the industry be aware of recurring issues in environmental litigation. The following two articles by Mr. O'Hara and by Mr. Mays present an overview of several important developments in environmental law which directly affect the high technology community.

ARTICLES

MINIMIZING EXPOSURE TO ENVIRONMENTAL LIABILITIES FOR CORPORATE OFFICERS, DIRECTORS, SHAREHOLDERS AND SUCCESSORS

Gregory P. O'Hara†

I. INTRODUCTION

Companies operating in the high technology market must be constantly vigilant against exposure to environmental liabilities. While each segment of American industry has an area of legal liability with which it is principally concerned, environmental liability has increasingly become the bane of the high technology marketplace. The increasing concern with environmental liability can be attributed to the fact that high technology companies frequently use chemicals and hazardous substances in their processes and because environmental liabilities, once established, are extremely costly.

The most alarming characteristic of environmental liability is that it can reach far beyond the protection of the corporate shell and reach parent corporations and individual officers, directors and shareholders. Certain cases have established extremely liberal rules for imposing successor liability for environmental harm on corpora-

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tions which acquire the assets of a predecessor corporation, even if the successor did not participate in the operations of the predecessor corporation. Because environmental liabilities can be so expansive and extensive, it is imperative that every high technology company remain constantly vigilant against transgressions within its organization, and implement prophylactic measures to avoid succeeding to the environmental liabilities of another corporation it subsequently acquires.

II. ENVIRONMENTAL LIABILITY OF OFFICERS, DIRECTORS, SHAREHOLDERS, AND PARENT CORPORATIONS

Historically, a shareholder was liable for the obligations of the corporation only to the extent of the shareholder's investment. Thus, the “corporate veil” protected the shareholder individually against the obligations of the corporation. The parent corporation, being a shareholder of the subsidiary, was likewise protected against the obligations of the subsidiary by virtue of the corporate veil.

At common law, there developed the doctrine of “piercing the corporate veil” in certain limited circumstances, thereby exposing the shareholder to individual liability. A federal common law rule evolved for piercing the corporate veil when a federal statute is involved. The federal common law rule for piercing the corporate veil is far more liberal than that of the general common law.

The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) has brought about a dramatic change in the common law rule of limited shareholder liability. In recent cases, personal liability has been imposed directly on officers, employees and shareholders, including parent corporations, without piercing the corporate veil. The Environmental Protection Agency (EPA) has also taken a very aggressive stand with regard to the personal liability of officers and active shareholders. The EPA has announced that it will seek to impose liability on individual officers and shareholders in the following order of preference:

1. Direct personal liability under CERCLA;
2. Indirect personal liability using the liberal federal rule for piercing the corporate veil;
3. Indirect personal liability using the traditional common

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1. See infra pp. 18-19.
3. See infra note 7 and accompanying text.
law test for piercing the corporate veil.  

A. *The Traditional Common Law Doctrine for Piercing the Corporate Veil*

The traditional common law doctrine for piercing the corporate veil generally requires a finding of two elements:

1. the corporation and the shareholder share such a unity of interest and ownership between them that the two no longer exist as separate entities; and

2. inequity would result by the court’s failure to disregard the corporate form.

The first element of the traditional test is established by a showing of excessive control or domination such that the corporation has no separate mind, will or existence of its own. In determining whether the first element has been established, courts will look to a variety of factors. Specific factors considered relevant by the courts have included:

1. A failure to maintain adequate corporate and financial records;
2. Commingling of corporate funds with personal funds;
3. Transacting business in the individual’s name rather than the corporate name; and
4. Use of corporate assets for personal benefit.

The second element necessary to pierce the corporate veil under the traditional doctrine is an inequitable result would obtain by the court’s failure to disregard the corporate form. It is established by a showing that a failure to pierce the veil would result in fraud or injustice to the plaintiff, as where the corporation is not adequately capitalized or the corporate form has been used to defraud the plaintiff.

State courts, and federal courts in diversity actions, have traditionally been reluctant to pierce the corporate veil. Instead, they

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8. See, e.g., Labadie Coal Co. v. Black, 672 F.2d 92, 97-98 (D.C. Cir. 1982). See also Dudley v. Smith, 504 F.2d 979 (5th Cir. 1974).
9. See Anderson v. Abbot, 381 U.S. 349 (1965); FMC Finance Corp. v. Murphy, 632 F.2d 413 (5th Cir. 1980); Price, *supra* note 5.
have preferred to maintain the protection of shareholders and the fundamental policy of limited liability.¹⁰

B. The Federal Common Law Doctrine for Piercing the Corporate Veil

Federal courts have fashioned a more liberal test for piercing the corporate veil when a federal statute is involved. Simply stated, the federal common law rule for piercing the corporate veil is "a corporate entity may be disregarded in the interest of public convenience, fairness and equity."¹¹ The federal rule for piercing the corporate veil is "an inquiry that usually gives less respect to the corporate form than does the strict common law alter ego doctrine . . ."¹² The federal rule avoids the necessity of specific findings that the corporation and the shareholder share a unity of interest and that a failure to disregard the corporate form would result in fraud or injustice to the plaintiff. In fact, a sympathetic federal court need not go far to make a general finding of "public convenience, fairness and equity."

The federal common law rule does not entirely abandon the traditional common law rule, but it relaxes the burden of proof. Particularly noteworthy about the federal rule are the absence of specific elements required to pierce the corporate veil, and the broad discretion vested in the court.

The federal rule for piercing the corporate veil has evolved from the general policy of giving deference to the intent of Congress and effect to federal statutes. Generally, the court will look closely at the statutory purpose and scheme in order to determine whether the particular statute weighs in favor of protecting the corporate form.¹³ Thus, in environmental litigation involving any one of a number of federal statutes,¹⁴ the court will look to the language and purpose of the statute in determining whether Congressional intent

¹⁰. See generally 1 W. Fletcher, supra note 2, §§ 38-41 (discussing the general corporate entity or personality); Berger Columbia Broadcasting System, Inc., 453 F.2d 991.
¹². Id.
favors protection of the corporate form, and on that basis decide whether to pierce the corporate veil.

C. **Direct Liability Under CERCLA**

Armed with the plain language of CERCLA and the strong federal interest in abatement of toxic waste sites, the courts have repeatedly imposed liability directly on officers, employees and shareholders without piercing the corporate veil. While an individual may claim that he should not be held personally liable for committing authorized acts within the course and scope of his employment, the courts have consistently held that an individual is not protected from liability merely because he acted on behalf of the corporation if he participates in or sanctions the wrongful act.15

The courts rely on the unambiguous language of CERCLA to define who shall be liable under that act. CERCLA provides that any person who is within one of four classes of potentially responsible parties shall be liable for all costs of removal or remedial action incurred in abatement of the hazardous waste site. The four classes of persons who are potentially responsible are:

1. The current owner and operator of the hazardous waste facility;16
2. Any person who at the time of disposal of hazardous substances owned or operated the facility;17
3. Any person who arranged for disposal or treatment, or arranged with a transporter for transport for disposal or treatment, of hazardous substances;18 and
4. Any person who accepts hazardous substances for transport to a disposal or treatment facility.19 The four classes of persons potentially liable under CERCLA are generally referred to as owners, operators, generators and transporters.

The critical language in section 107 of CERCLA20 is the term “any person.” The term includes an individual, firm, corporation, joint venture and governmental entities.21 The significance of the

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term is that it reaches beyond the protection of the corporate shell and attaches liability to any person, whether individual or corporate, that fits within the class made potentially liable.

Courts have never waivered in their construction of CERCLA as imposing liability on individual officers and employees of corporations who fit within one of the four classes of potentially responsible parties. One of the leading cases in this area is United States v. Northeastern Pharmaceutical & Chemical Company, Inc. (NEPACCO). In NEPACCO, the United States brought a cost recovery action against a chemical company, the transporter of the waste products, and certain employees of the corporate defendants. Defendant Lee was a major stockholder and vice president of NEPACCO, supervisor of the subject facility, and was directly responsible for arranging the disposal of the hazardous wastes. As to Lee, the court noted that corporate officers are normally not personally liable for acts of the corporate entity and conceded that Lee was not the legal owner of the hazardous waste. The court nonetheless imposed personal liability on Lee, ruling that Lee need not be the legal owner of the hazardous waste to be liable as a transporter. Additionally, the court stated that Lee's unique position as vice president, supervisor of the facility, and major stockholder was sufficient to classify him as both an owner and operator under CERCLA.

In reaching its decision, the court expressly relied on the literal language of CERCLA and congressional intent.

Other cases dealing with the issue of personal liability of corporate officials, employees, and shareholders, have come to the same conclusion. In United States v. Carolawn, the court imposed personal liability on corporate officials, noting that "CERCLA contemplates personal liability of corporate officials... who are responsible for the day-to-day operations of a hazardous waste disposal business." The Carolawn court stated that a person who has control

23. Id. at 847-48.
24. Id. at 848.
25. Id. ("The statute literally reads that a person who owns interest [sic] in a facility and is actively participating in its management can be held liable for the disposal of hazardous waste. [footnote omitted] Such a construction appears to be supported by the intent of Congress."). Id. The NEPACCO court also noted that the owner and operator need not be the same person and if they are distinct entities, both are potentially liable. Id. at 848 n.29.
27. Id. at 2131. Cf. United States v. Carolawn Co., 698 F. Supp. 616 (D.S.C. 1987), aff'd, 847 F.2d 144 (4th Cir. 1988) (In a related case, Carolawn filed a third-party complaint against South Carolina Department of Health and Environmental Control alleging that it was also a responsible party under the Act because of its alleged act of participation in the opera-
or authority over the activities at a facility or participates in the management of the facility may be liable.\textsuperscript{28} The broad statement of the Carolawn court extends liability beyond the “front line” managers dealing with day-to-day operations.

In \textit{New York v. Shore Realty},\textsuperscript{29} the court illustrated the contrast between finding individual liability through the indirect route of piercing the corporate veil and direct liability under CERCLA. In holding that an officer and shareholder were directly and personally liable under CERCLA for the costs of response to environmental contamination, the court stated that the individual parties would be liable even though it was “debatable whether a New York court would hold Leo Grande personally liable by piercing the corporate veil.”\textsuperscript{30}

Parent corporations, being shareholders, are likewise subject to direct liability under CERCLA. In \textit{Idaho vs. Bunker Hill Company},\textsuperscript{31} the court held that the evidence presented was sufficient to hold the parent corporation liable, as an owner or operator under CERCLA, for its subsidiary’s hazardous substance practices and the clean-up of the subsidiary’s facilities. In making its finding, the court did not rely on the doctrine of piercing the corporate veil. Instead, the \textit{Bunker Hill} court adopted the NEPA/CCO test in determining when a corporation is liable as an owner or operator of its subsidiary’s facilities.\textsuperscript{32} The \textit{Bunker Hill} court considered the following factors relevant in its determination:

1. The parent corporation was in a position to be, and was, intimately familiar with the hazardous waste disposal at the facility;
2. The parent corporation had the \textit{capacity to control} hazardous waste disposal;
3. The parent corporation had the \textit{capacity to make decisions} to prevent damage caused by hazardous waste disposal;
4. The parent corporation had to approve expenditures for pollution matters exceeding $500;
5. The parent corporation controlled a majority of the board of directors of the subsidiary;
6. The parent corporation received weekly reports on the subsidiary’s operations;

\textsuperscript{28} Id.
\textsuperscript{29} 759 F.2d 1032 (2d Cir. 1985).
\textsuperscript{30} Id. at 1052.
\textsuperscript{31} 635 F. Supp. 665 (D. Idaho 1986).
\textsuperscript{32} See, e.g., id. at 671-72.
(7) The subsidiary’s authorized capital was a “mere” $1,100 while the parent corporation received approximately $27 million in dividends; and

(8) The parent corporation fully owned the subsidiary.\(^{33}\)

Although the several factors relied on by the Bunker Hill court are also relevant to the test for piercing the corporate veil, the court relied on those factors in finding that the parent corporation was directly liable as an owner and operator under CERCLA.\(^{34}\)

While the trend has been to impose liability directly on officers and shareholders, at least one court has ruled that CERCLA does not impose direct liability on officers of corporations. In Joslyn Corporation v. T.L. James & Company, Inc.,\(^{35}\) the court specifically declined to follow the analysis in several leading cases, including New York v. Shore Realty,\(^{36}\) United States v. Mottolo,\(^{37}\) and United States v. Conservation Chemical Company,\(^{38}\) concluding that those courts had chosen to ignore the corporate form without an express congressional directive.\(^{39}\) However, the Joslyn court also noted that it would have nonetheless imposed liability in Shore Realty, Mottolo, and Conservation Chemical under applicable corporate law because the defendants in those cases had personally participated in the illegal disposal of hazardous waste.\(^{40}\) It is unlikely that Joslyn will be followed by other districts in light of the overwhelming case authority favoring the contrary rule. [Author's Note: On January 29, 1990, the Fifth Circuit Court of Appeals affirmed the District Court’s Ruling in Joslyn Manufacturing Co. v. T.L. James and Co., Inc., 893 F.2d 80 (5th Cir. 1990).]

In a recent decision, a district court demonstrated the ease with which federal courts will impose personal liability directly or by piercing the corporate veil. In United States v. Nicolet, Inc.,\(^{41}\) the United States sought to recover response costs incurred by the EPA in abating the release of asbestos from two waste disposal sites.

\(^{33}\) Id. at 672.


\(^{36}\) 759 F.2d 1032 (2d Cir. 1985).

\(^{37}\) 629 F. Supp. 56.

\(^{38}\) 628 F. Supp. 391.

\(^{39}\) 696 F. Supp. at 224-25.

\(^{40}\) Id. at 232 n.20.

Nicolet had purchased the manufacturing facility and waste disposal sites from Keasbey & Mattison Company in 1962. T&N had been the sole shareholder of Keasbey & Mattison Company from 1938 until 1967, when Keasbey & Mattison Company was dissolved. The United States sought to impose liability on T&N for the waste disposal practices of its subsidiary, Keasbey & Mattison, on several theories of "alter ego" liability, and also as the owner/operator of the hazardous waste site under CERCLA Section 107(a)(2).

T&N moved to dismiss the United States' claim. The court denied T&N's motion and, in so doing, enunciated a federal rule of decision regarding the direct liability of parent corporations and shareholders who may be liable for response costs. Stating that it is desirable to have uniform application among the districts of liability under CERCLA, the court fashioned the following rule concerning alter ego liability in CERCLA cases:

Where a subsidiary is or was at the relevant time a member of one of the classes of persons potentially liable under CERCLA; and the parent had a substantial financial or ownership interest in the subsidiary; and the parent corporation controls or at the relevant time controlled the management and operations of the subsidiary, the parent's separate corporate existence may be disregarded.

The court stated that alter ego liability should attach to parent corporations to prevent fraud, illegality or injustice, or when recognition of the corporate veil would defeat public policy. However, the court did not include any such finding as a necessary element for imposition of parent corporation liability under its federal rule of decision. The rule enunciated by the district court requires only that:

1. The subsidiary be potentially liable under CERCLA;
2. The parent corporation have a substantial financial or ownership interest in the subsidiary; and
3. The parent corporation control the management and operations of the subsidiary at the relevant time.

Consistent with the decisions in NEPACCO and its progeny, the Nicolet court ruled that shareholders and parent corporations who participate in the management of a facility may be directly lia-
ble as owners and operators of the facility operated by the subsidiary. Reasoning that there is no basis to distinguish between the *individual* stockholder and the *corporate* stockholder, the *Nicolet* court held that a corporate stockholder who actively participates in the management of the corporation can be held liable for clean-up costs incurred as a result of the subsidiary's practices.  

More importantly, the *Nicolet* court adopted the government's argument that T&N was directly liable as a former owner and operator of the waste disposal site because T&N was familiar with its subsidiary's waste disposal practices, had the *capacity to control* the disposal practices and abate damage from releases, and benefited from the subsidiary's waste disposal practices. Although not fully developed by the court, this view appears to require only a showing that a parent corporation have the *capacity to control* the disposal practices of its subsidiary, rather than actual participation in the management of the subsidiary. If the capacity to control disposal practices is all that is required, *Nicolet* establishes an open channel of liability for every corporate parent which can influence the disposal practices of its subsidiary.

The *Nicolet* decision confirms the potential liability of a parent corporation that has the *capacity to control* the disposal practices of the subsidiary. The *Nicolet* decision also indicates that federal courts may tend to adopt a liberal uniform federal rule of decision for imposing alter ego liability in CERCLA cases. A company that relies on the traditional common law doctrine for piercing the corporate veil may expose itself to liability for response costs incurred as a result of activities by its subsidiary.

In addition to civil liability, officers, directors, and employees who have the authority to regulate the use, storage, and disposal of hazardous substances may also be subject to direct criminal liability. In *United States v. Dee*, three managers of the chemical research and development engineering center at the United States Army Aberdeen Proving Ground were convicted of criminal violations of the Resource Conservation and Recovery Act ("RCRA").

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46. *Id.* at 1203.
47. *Id.* at 1203-04.
48. Criminal liability for environmental violations is mentioned briefly to provide a complete overview of potential exposure to individuals. An in-depth discussion of criminal liability is beyond the scope of this article. For further discussion, see Seymour, *Civil and Criminal Liability of Corporate Officers Under Federal Environmental Laws*, 20 ENVTL. REPORTER (BNA) No. 6, at 337-48 (June 9, 1989).
Similarly, in *United States v. Johnson & Towers, Inc.*,\(^1\) individual corporate officials were also convicted of criminal violations of RCRA.

In light of the present legal environment and ever increasing judicial willingness to impose individual liability, companies using hazardous substances in their processes, or those having subsidiaries using hazardous substances in their processes, must be aware of the potential liability to individuals and parent corporations. The EPA has issued a memorandum stating the position that it will seek to impose liability on individuals and parent corporations in the following order of preference:

1. Direct liability under CERCLA;
2. Indirect liability by piercing the corporate veil using the liberal federal rule; and
3. Indirect liability by piercing the corporate veil under the traditional common law theory.\(^2\) The EPA will undoubtedly latch onto the *Nicolet* decision and advocate the adoption of a uniform federal rule for imposing liability on individuals and parent corporations in CERCLA cases.

D. Minimizing the Risk of Exposure for Parent Corporations

Under either the theory of piercing the corporate veil or the theory of direct liability under CERCLA, a court will look to certain similar factors to determine whether the parent corporation is involved in the management and control of the subsidiary. Under the traditional common law rule for piercing the corporate veil, the control and management of day-to-day operations is relevant to a determination that the corporation and the shareholder share such a unity of interest and ownership between them that the two no longer exist as separate entities. These same factors are relevant in determining whether the interests of public convenience, fairness and equity warrant the piercing of the corporate veil under the federal rule. The degree of control and management by the parent corporation is also relevant in determining whether the parent corporation is the owner or operator of the hazardous waste facility for a finding of direct liability under CERCLA.

A corporation can implement measures to minimize the risk of exposure for the waste disposal activities of its subsidiary. The opinions in *NEPACCO,*\(^3\) *Bunker Hill*\(^4\) and their progeny are in-

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2. See Price, supra note 5.
structive in defining those factors considered relevant by the courts in imposing liability. At a minimum, the parent corporation should:

1. Maintain the separate identities of the parent corporation and the subsidiary, i.e., maintain separate books and finances, and avoid common directors, officers and employees;
2. Provide for adequate capitalization and insurance of the subsidiary;
3. Avoid control over the decision-making process regarding day-to-day operations of the subsidiary, particularly with regard to the use, storage and disposal of hazardous substances; and
4. Allow the subsidiary to dictate its own policies and procedures regarding operations and avoid any sort of veto power over the decision-making process of the subsidiary. While such measures will naturally wrest control from the hands of the parent corporation, this lack of control is precisely what courts will consider relevant.

Of course, this is not an exhaustive list of measures to minimize the risk of exposure. Naturally, the steps necessary to obtain optimum protection depends critically on the facts of each case. Any parent corporation whose subsidiary uses hazardous substances in its processes must determine how the parent corporation can best be sheltered from potential CERCLA liability.

E. Minimizing the Risk of Liability for Individuals

In light of such cases as NEPACCO and Carolawn, corporate employees and officials must remain extremely vigilant over the practices of their employer with regard to the use, storage and disposal of hazardous substances. As a practical matter, the first step in minimizing the risk of exposure is to ensure compliance with all environmental laws and regulations. Aside from ensuring compliance, there is little that an individual employee can do to minimize his personal exposure if he is in a position to control the use, storage or disposal of hazardous substances. The corporate official or employee cannot rid himself of potential liability by delegating to another employee specific tasks regarding hazardous substance control. He will remain personally liable to the extent that he has

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the capacity to control the hazardous substance activities at the facility.58

Beyond taking affirmative steps to minimize exposure to legal liability, insurance, if available, is one way to obtain a measure of security. While insurance does not affect the legal liability of the individual, it does provide some security against the financial risks to which the individual may be exposed. However, if the personal liability exceeds the limits of the insurance coverage, the individual will be responsible for the remainder. Although this may appear to be a sound alternative, in practicality insurance coverage for environmental liabilities is rare and, when available, very expensive.

Aside from insurance, a second alternative is to obtain an indemnity agreement from the employer. Assuming the individual can obtain an indemnity agreement, it is likely to be enforceable only for negligent acts of the employee and not intentional or criminal acts. Like an insurance policy, an indemnity agreement does not affect the legal liability of the individual, but provides a measure of financial security against such liability. Furthermore, an indemnity agreement will only provide financial security to the extent of the indemnitee's solvency.

As a general rule, the EPA will pursue the company first and will seek response costs from individual corporate officials and employees if the corporate entity itself is insolvent and not in a position to satisfy a judgment. In effect, this means that if the company is solvent, the EPA is not likely to bring an action against the individual; and if the company is insolvent, the indemnity which the individual has obtained provides little or no financial security. Therefore, indemnity agreements are likely to be of little practical value.

In order to avoid this paradox, the individual may demand an indemnity agreement from a parent corporation. But if the parent corporation grants indemnity to the individual corporate official of its subsidiary, it has, in effect, opened a direct channel of liability from the subsidiary to the parent corporation. The parent corporation would thereby frustrate all of its attempts to minimize the risk of assuming the environmental liabilities of its subsidiaries.

III. SUCCESSOR LIABILITY UNDER CERCLA

In the previous section of this article, the four classes of persons potentially responsible for response costs under the express

language of CERCLA were identified. There is one more class of persons potentially responsible under CERCLA which is not defined or even mentioned in the act. That class of persons is successor corporations who are deemed to assume the environmental liabilities of their predecessor corporations. Successors are here considered an independent class of potentially responsible parties because they can be strictly liable under CERCLA for response costs without being an owner, operator, generator or transporter as defined in CERCLA.

Historically, the doctrine of successor liability allowed a court to impose on a successor corporation the liability of its predecessor corporation. The doctrine of successor liability developed most prominently in the products liability area. Recently, both federal and state courts have expanded the application of the doctrine of successor liability to other areas of law and have relaxed the findings required to impose successor liability. Following this trend, several federal courts have recently applied the doctrine of successor liability in the environmental context. The key area of inquiry in deciding whether to impose successor liability, and therefore the key area of inquiry in avoiding the imposition of strict liability, lies in the structure of the transaction by which the successor corporation acquired the assets of the predecessor corporation.

This section will discuss the historical and current developments of the doctrine of successor liability and, particularly, the development of the doctrine of successor liability in the environmental context. This section will conclude with recommendations for minimizing the risk of successor liability in corporate transactions.

A. Strict Liability Under CERCLA

The primary motivating factor for avoiding successor liability in a CERCLA action is that CERCLA imposes strict liability on each potentially responsible party. While CERCLA does not expressly provide for strict liability, the legislative history of CERCLA supports the imposition of strict liability and, more importantly, courts have repeatedly held that liability under CERCLA is strict.

61. See 126 CONG. REC. H11773-803 (daily ed. Dec. 3, 1980) (Statement by Representative Florio that while CERCLA does not refer specifically to strict liability, that standard of liability is preserved in the Act.).
Strict liability is liability without fault and attaches as a result of status or relationship without regard to culpable conduct. Where the contamination caused by two or more people is indivisible, the liability may be joint and several.\(^6^3\)

B. The Development of the Successor Liability Doctrine

Under traditional common law principles, a merger results in the successor corporation assuming all liabilities of the predecessor corporation.\(^6^4\) However, under these same principles, the purchase of assets alone does not subject the purchaser to the liabilities of the seller.\(^6^5\)

Contrary to the general rule that an asset acquisition alone does not subject the purchaser to the liabilities of the seller, there developed at common law four well-established exceptions. Liability may be imposed on the purchaser where:

1. There is an implied or express assumption of liabilities by the purchaser;
2. The transaction amounts to a \textit{de facto} merger or consolidation;
3. The successor corporation is deemed to be a "mere continuation" of the predecessor corporation; or
4. The transaction was entered into for fraudulent purposes.\(^6^6\)

The exception for implied or express assumption of liabilities and the exception for fraudulent transactions warrant little or no discussion here. For purposes of this article, only the exceptions for \textit{de facto} merger and mere continuation will be discussed because they contain the most troublesome pitfalls for corporations and because they provide the foundation from which has evolved more liberal theories in recent years.

C. De Facto Merger

A \textit{de facto} merger occurs where:

1. There is a continuation of the enterprise of the predecessor—
sor in the successor so that there is continuity of management, personnel, physical location, assets, and general business operations;

(2) There is continuity of shareholders which results from the purchasing corporation paying for the acquired assets with shares of its stock;

(3) The seller ceases its ordinary business operations, liquidates, and dissolves as soon as legally and practically possible; and

(4) The purchasing corporation assumed those liabilities and obligations of the selling corporation ordinarily necessary for the uninterrupted continuation of normal business operations. 67

The courts utilize these factors to determine whether there has been a de facto merger by looking at the substance of the transaction rather than its form. 68 From a review of the case law, it is not clear whether all courts will require a positive finding to each of the four inquiries. However, the element of continuity of shareholders is so critical that without a stock transfer there can be no finding of a de facto merger. 69

D. The Mere Continuation Exception

In order to determine whether the purchasing corporation is the mere continuation of the selling corporation, the court must first find that:

(1) There is a common identity of stock, stockholders, and directors between the two corporations; and

(2) Only one corporation remains. 70

Furthermore, one leading case on successor liability, Ray v. Alad, stated, at a minimum, there must be a showing that:

(1) There was no adequate consideration given for the predecessor's assets and made available for creditors of the predecessor;

(2) There is one or more common officer, director, or shareholder. 71


Other courts have expanded the mere continuation exception and will consider other factors in determining whether the purchasing corporation is the mere continuation of the selling corporation. Other factors considered by the courts include:

1. Use by the purchaser of the same physical location of the seller;
2. Use by the purchaser of the same employees of the seller;
3. Continuity of product manufactured by the seller;
4. Use by the purchaser of the same assets, i.e., machinery and equipment, of the seller;
5. Continuity of general business operations between the seller and the purchaser;
6. Whether the purchaser holds itself out to the public as a continuation of the seller's enterprise; and
7. Continuity of name between the seller and purchaser.

In a recent case, a federal district court held that neither insubstantial changes in the type of product being manufactured, nor the deletion of some product lines and addition of other product lines, will preclude a finding of mere continuation where the "primary business" of the predecessor corporation continues in the successor corporation.

E. Continuity of Enterprise Exception

A recent development in the doctrine of successor liability is the emergence of the "continuity of enterprise" theory. The continuity of enterprise exception to non-liability evolved from the mere continuation theory. While the tests for the continuity of enterprise exception have not been clearly developed or delineated in case law, it is clear that this theory requires a lesser showing than the mere continuation exception. The most significant aspect of the continuity of enterprise exception is that a showing of continuity of shareholders, officers or directors is not required to trigger the exception. So long as the party can show a continuity of physical plant, employees, supervisors, and product, he can establish the continuity of enterprise exception.

72. See, e.g., Cyr v. G. Offen & Co., 501 F.2d 1145, 1153-54 (1st Cir. 1974); Mozingo, 752 F.2d at 175.
73. Acushnet River, supra note 66, at 1015-16.
74. See Cyr, 501 F.2d at 1145; Mozingo, 752 F.2d at 168; Ramirez v. Amsted Indus., Inc., 86 N.J. 332, 431 A.2d 811 (1981).
F. The Product Line Exception

The most liberal exception to non-liability for an asset acquisition is the "product line" exception. The product line exception was developed in *Ray v. Alad*, and requires an even lesser showing than that required by the continuity of enterprise exception. The product line exception provides that if a purchaser of assets continues the product line of the seller, it may be liable to a plaintiff injured by the seller's product. The product line theory is based on the public policy of protecting injured plaintiffs whose remedies against the predecessor corporation have been destroyed by virtue of the purchaser's acquisition of the business. The product line exception has been adopted in California and New Jersey in products liability cases.

Each of the exceptions discussed above was developed primarily in strict products liability cases. Because CERCLA also imposes strict liability, the above exceptions to non-liability for the acquisition of assets are employed in environmental litigation with increasing frequency.

G. Successor Liability in Environmental Cases

It is well-established that the doctrine of successor liability will be applied in environmental cases. The first inquiry in any given case is to determine which exceptions to the general rule of non-liability will apply. Each state has its own established common law with regard to successor liability. While most states recognize the four traditional exceptions to non-liability, only certain states have adopted the continuity of enterprise theory and the product line theory. Furthermore, federal courts are not bound by state law with regard to successor liability and are at liberty to develop federal common law with regard to successor liability in cases that pose federal questions.

The question of which law, state or federal, applies in determining successor liability was raised in *United States v. Bliss*. In determining the applicable rules for successor liability, the *Bliss*
court stated, "the courts have concluded that Congress intended the
courts to apply federal common law principles to fill in the gaps in
CERCLA's statutory scheme."\textsuperscript{81} As a concession to state law, the
court stated that it would look to state common law for guidance in
fashioning federal law as long as it was compatible with the pur-
poses of CERCLA.\textsuperscript{82}

The federal courts are still developing a federal rule for succes-
sor liability and no uniform common law rule has yet evolved.
However, one federal court has stated a federal rule of successor
liability based on business continuity.\textsuperscript{83} Although \textit{Oner II} was de-
cided under the Federal Insecticide, Fungicide, and Rodenticide
Act,\textsuperscript{84} it is highly likely that its ruling will be applied in CERCLA
actions. The rule developed by \textit{Oner II} is akin to the mere continu-
ation and continuity of enterprise exceptions. The \textit{Oner II} rule
makes it possible for a finding of successor liability based on a con-
tinuity of "business."\textsuperscript{85}

At least one state court has applied the product line exception
and found successor liability in the environmental context.\textsuperscript{86} That
court imposed liability on the successor corporation under a New
Jersey state statute similar to CERCLA. Borrowing the product
line exception from the products liability area, the court applied the
liberal test and found that the successor corporation was liable for
the obligations of its predecessor.\textsuperscript{87}

Not surprisingly, the EPA favors the liberal approach of the
continuity of enterprise theory. The EPA has indicated that it in-
tends to pursue the application of the "continuity of business opera-
tion" approach adopted in \textit{Oner II}.\textsuperscript{88}

In light of the clear congressional intent to abate hazardous
waste facilities, the EPA's aggressive advocacy of the "continuity of business operation" approach, and the federal courts' liberal discre-
tion to develop federal common law, it is likely that the federal rule
for successor liability, when completely evolved, will be quite simi-
lar to the mere continuation exception or continuity of enterprise

\textsuperscript{81} \textit{Id.} In reaching this conclusion, the Bliss Court Relied on Smith Land and Im-
provement Corp. v. Celotex Corp., 851 F.2d 86 and United States v. Chem-Dyne, 572 F.
Supp. 802.
\textsuperscript{82} Bliss, supra note 80. \textit{See also} Acushnet River, supra note 66.
\textsuperscript{83} See \textit{Oner II}, Inc. v. EPA, 597 F.2d 184 (9th Cir. 1979).
\textsuperscript{85} See \textit{Oner II}, Inc., 597 F.2d at 186-87.
\textsuperscript{86} See Department of Transp. of N.J. v. PSC Resources, Inc., 175 N.J. Super. 447, 419
A.2d 1151 (1980).
\textsuperscript{87} 419 A.2d at 1163-64.
\textsuperscript{88} See Price, supra note 5.
exception developed by some states. In light of this trend in both the state and federal courts, it has become imperative for a company to examine closely each corporate transaction it enters in order to minimize its exposure to the environmental liabilities of the selling corporation.

H. Minimizing Environmental Liabilities in Corporate Transactions

1. Due Diligence

Because the courts will look to the substance of a transaction rather than its form, there is no simple solution to avoiding the environmental liabilities of another corporation. However, every company can undertake certain measures in order to minimize the risk of a subsequent finding of successor liability. The first step in any transaction is to conduct due diligence even if no acquisition of real property is planned. If potential environmental liabilities are discovered during due diligence, the company must then perform a risk analysis to determine whether it is willing to accept the potential risk. The identification of potential environmental liabilities may also be used to negotiate with the selling corporation in order to shift those liabilities to a willing party or provide an escrow fund to answer for future environmental liabilities. At a minimum, due diligence will make the purchasing decision an informed one and, if no potential environmental liabilities are identified, due diligence may be cited as an equitable factor to a court when it is time for the court to allocate response costs among various parties.

2. Structuring the Transaction

In structuring the transaction, it is imperative to avoid a stock for assets transaction because the transfer of stock (i.e., commonality of shareholders) is a key element in triggering the de facto merger and mere continuation exceptions. While this preventative measure inherently changes the fundamental structure of the particular transaction, it is a required measure to avoid a finding of de facto merger or mere continuation. It is prudent to keep in mind that the courts are concerned with the substance of a transaction rather than its form. Superficial or inconsequential modifications to

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89. For a discussion of environmental due diligence in real estate transactions, see Mays, A Practical Guide to Due Diligence in Real Estate Transactions, 10 HAZARDOUS WASTE REPORT, No. 14, at 11 (March 13, 1989).

90. See supra note 69 and accompanying text.
change the appearance of a transaction, without changing the form of the transaction, will be of no avail.

While using a cash for assets transaction should defeat a claim of successor liability under the four traditional exceptions, a cash for assets transaction will not defeat a claim of successor liability if the federal courts adopt the “continuity of business operation” test advocated by the EPA. Nonetheless, a cash for assets transaction will be a relevant factor in making the determination of successor liability even under the liberal test advocated by the EPA.

In structuring the transaction, the purchaser should strive to avoid the following factors which are cited by the EPA in its memorandum on successor liability:

1. A substantial continuation of the seller’s business operations by the purchaser;
2. Retention by the purchaser of the seller’s supervisory personnel;
3. The inability of the seller to answer for its liabilities (i.e., provide an escrow fund to provide for the liabilities of the seller);
4. The purchaser’s continuation of the seller’s business at the same facility;
5. Use by the purchaser of the same machinery, equipment, and methods of production as that of the seller; and
6. The purchaser’s production of the same product and/or product line as the seller.

To the extent possible, the purchaser corporation should also structure the transaction to avoid the following factors which were cited by the court in *New Jersey Department of Transportation v. PSC Resources, Inc.* in finding successor liability under the product line exception:

1. The purchase of all of the seller’s assets;
2. The use of the seller’s name;
3. The use of the same operating personnel and management as that of the seller;
4. The use of the same facility as that of the seller; and
5. The continuation of the same waste disposal practices as that of the seller.

The purchasing corporation should attempt to incorporate as many of the following measures as possible into the structure of the transaction:

1. Allocate risks in the transaction documents;

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91. 175 N.J. Super. 447, 419 A.2d 1151.
(2) Acquire less than all of the seller's assets;
(3) Install new officers and directors to operate the new facilities;
(4) Move equipment and machinery to a new location;
(5) Do not require in the transaction documents that the seller dissolve;
(6) Require the seller to provide an escrow fund to answer for the claims of third parties; and
(7) Assume no liabilities of the seller.\(^2\)

As to the last item, the balance sheet liabilities that remain on the books can be provided for in an escrow fund to be managed by the seller.

IV. CONCLUSION

The inherent nature of the high technology industry requires the use of chemicals and hazardous substances in the manufacturing process. As environmental concerns mount and environmental litigation proliferates, high technology companies will more frequently find themselves defending claims for response costs. Thus, companies, particularly those in the high technology industry, need to be aware of the potential liabilities that exist and the transactions which give rise to them. While many companies and corporate officials mistakenly believe that only the corporation may be liable, and then only for its own activities, the federal courts have continually dispelled that notion.

It has become increasingly well established that corporate officers, directors and employees can be held personally liable for the activities of the corporation. Furthermore, through the doctrine of successor liability, and the liberal trend in the federal courts today, a corporation may find that it is liable for the activities of another corporation from whom it has acquired assets. In order to minimize the risks of assuming environmental liabilities, corporations must remain ever vigilant to ensure compliance with the myriad of environmental laws on the books today. Furthermore, in structuring its corporate transactions with other corporations, the purchasing corporation must make itself aware of the current status of the federal rule of successor liability and structure its transactions accordingly in order to avoid successor liability.