Limited Liability in Environmental Law

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INTRODUCTION

The costs of repairing environmental damage often exceed the polluter's ability to pay. Government then seeks out others to help finance the bill. When the polluter is an insolvent corporation, attention naturally falls on its controlling person, especially if the controlling person is a parent corporation. The obstacle to recovery is a long-standing hallmark of corporate law, the principle of limited liability. Traditionally, shareholders, officers, and others affiliated with a corporation have not been held liable for the corporation's debts. Limited liability always has been controversial. In America, unlike many other countries, courts always have been willing to "pierce the corporate veil" under certain circumstances. The problem is defining the special circumstances that justify piercing. Commentators have pored over limited liability for contract obligations but have generally ignored its logic for tort liability.

The social importance and immense costs of pollution make environmental law an ideal arena for reconsidering theories of limited liability for tort. This article examines the question in the context of the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA).[1] Part I reviews the text and legislative history of the Act. Part II analyzes the CERCLA case law on the liability of controlling persons, especially those involving parent corporations. Part III discusses the general theory of limited liability and its exceptions. Part IV applies this general theory to CERCLA and finds that its special features call for distinctive approaches. Part V advocates an approach to controlling person liability that furthers the purposes of the Act without impairing other important policies.

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1. Pub. L. No. 96-510, 94 Stat. 2767 (1980). The Act was amended by the Superfund Amendments and Reauthorization Act of 1986 (SARA), Pub. L. No. 99-499, 100 Stat. 1613 (codified as amended at 42 U.S.C. §§ 9601-9675 (1988).

I. THE TEXT AND LEGISLATIVE HISTORY OF CERCLA

A. *The Structure of the Act*

Congress enacted CERCLA to tackle the herculean task of cleaning up hazardous waste throughout the country.[2] The Act authorizes the Environmental Protection Agency (the EPA) to arrange for such cleanups.[3] The EPA may, but need not, permit the owner or operator to perform the cleanup.[4] If the government performs the cleanup, it may use money from the hazardous substance "Superfund." The Superfund was created by CERCLA for the purpose of cleaning up such waste dumps.[5] The EPA may in turn recover the cleanup costs from those "responsible persons"[6] who disposed, transported, or arranged for the disposal or transportation of the hazardous waste. Further, CERCLA authorizes recovery of cleanup costs from those who own or operate a facility containing hazardous waste, or who owned or operated the facility at the time of a release.[7]

CERCLA response costs include all costs of a cleanup, even if the costs exceed the benefits of the cleanup.[8] Although the statute does not

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2. By early 1990 about 1,200 sites had been named for cleanup, "and estimates of the total cleanup bill go as high as $700 billion." Sommerfield, *Going Bare*, INSTITUTIONAL INVESTOR 99, 102 (Mar. 1990). The contamination of Love Canal alone triggered claims totalling over $2 billion. S. EPSTEIN, L. BROWN & C. POPE, HAZARDOUS WASTE IN AMERICA 360 (1982).

3. 42 U.S.C. § 9604(a)(1) (1988). The EPA acts under statutory authority delegated by the President. *Id.* Under section 9606(a) the EPA may also "secure such relief as may be necessary to abate" any "imminent and substantial endangerment to the public health or welfare or the environment because of an actual or threatened release of a hazardous substance . . . ." 42 U.S.C. § 9606(a) (1988).

4. 42 U.S.C. § 9604(a)(1) (1988).

5. 42 U.S.C. § 9631 (1988).

6. Although the Act does not define this term, it uses "responsible person" to refer to any person liable under the Act. *See, e.g.*, 42 U.S.C. § 9607(c) (1988).

7. 42 U.S.C. § 9607(a) (1988). The EPA has preferred this approach to having the owner or operator perform the cleanup. *See infra* note 31.

8. Section 9607(a)(4) requires payment of:

> (A) all costs of removal or remedial action incurred by the United States Government or a State or an Indian tribe not inconsistent with the national contingency plan;
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> (B) any other necessary costs of response incurred by any other person consistent with the national contingency plan; [and]
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> (C) damages for injury to, destruction of, or loss of natural resources . . . .

42 U.S.C. § 9607(a)(4) (1988). Section 9604(a)(1)(B) requires that any cleanup ordered or arranged by the President be "consistent with the national contingency plan" and that "[t]he President shall give primary attention to those releases which the President deems may present a public health threat." The national contingency plan, created under 33 U.S.C. § 1321(c) (1988), is contained in 40 C.F.R. § 300 (1989). Section 9621(a) instructs the President to select remedial actions "which provide for cost-effective response." 42 U.S.C. § 9621(a) (1988).

Although these clauses might give the President discretion to consider cost effectiveness in deciding when and how far to order a cleanup, they provide no defense to a responsible person on grounds that the costs of the cleanup exceed the benefits. Liability apparently can be limited only if the government's action is arbitrary or capricious (*see generally* United States v. Ottati & Goss, 694 F. Supp. 977 (D.N.H. 1988), *modified*, 900 F.2d 429 (1st Cir.

specifically decree joint and several liability in cases involving several responsible persons, the courts have regularly imposed it unless a defendant can demonstrate that the damage is divisible.[9] Proving divisibility is practically impossible.[10] However, the Act does encourage reasonable settlements with de minimis contributors.[11] Further, CERCLA generally permits actions for contribution[12] based on each defendant's relative degree of fault.[13] A party that settles with the government, though, is not liable for contribution to other defendants.[14]

CERCLA is often described as imposing strict liability. In many respects this description is justified. To prove liability the plaintiff need not show fault on the part of the defendant, and proof of the defendant's care or lack of fault is often not a defense.[15] One can even incur liability without knowing that one was handling hazardous wastes.[16] For example, one employer was held liable for illegal releases by its employees even though

1990)); or inconsistent with the national contingency plan (*see generally* United States v. Northernaire Plating Co., 685 F. Supp. 1410 (W.D. Mich. 1988), *aff'd sub nom.*, United States v. Meyer, 889 F.2d 1497 (6th Cir. 1989), *cert. denied*, 110 S. Ct. 1527 (1990)).

9. *See, e.g.*, O'Neil v. Picillo, 883 F.2d 176, 178 (1st Cir. 1989); United States v. Monsanto Co., 858 F.2d 160, 171 (4th Cir. 1988), *cert. denied*, 109 S. Ct. 3156 (1989); United States v. Northeastern Pharm. & Chem. Co., 810 F.2d 726, 732 n.3 (8th Cir. 1986), *cert. denied*, 484 U.S. 848 (1987); New York v. Shore Realty Corp., 759 F.2d 1032, 1042 n.13 (2d Cir. 1985).

10. To prove divisibility, a defendant must show a reasonable basis for apportionment of the harm. *See* O'Neil v. Picillo, 883 F.2d 176, 178-79 (1st Cir. 1989). In United States v. Monsanto Co., 858 F.2d 160, 171-72 (4th Cir. 1988), *cert. denied*, 109 S. Ct. 3156 (1989), the Fourth Circuit rejected the defendant's attempt to prove the portion of the waste that it had deposited because the defendant did not show "the individual and interactive qualities of" the wastes deposited or "a relationship between waste volume, the release of hazardous substances, and the harm at the site." *Accord*, United States v. Ottati & Goss, Inc., 630 F. Supp. 1361, 1396 (D.N.H. 1985), *modified*, 900 F.2d 429 (1st Cir. 1990). *See also* Barr, *CERCLA Made Simple: An Analysis of the Cases under the Comprehensive Environmental Response, Compensation and Liability Act of 1980*, 45 BUS. LAW. 923, 977-79 (1990) [hereinafter Barr].

11. 42 U.S.C. § 9622(g) (1988).

12. 42 U.S.C. § 9613(f) (1988).

13. *See* United States v. Monsanto Co., 858 F.2d 160, 168 n.13 (4th Cir. 1988), *cert. denied*, 109 S. Ct. 3156 (1989); Barr, *supra* note 10, at 992-93.

14. 42 U.S.C. § 9622(C) (1988).

15. *See, e.g.*, United States v. Monsanto Co., 858 F.2d 160, 167 n.11 (4th Cir. 1988), *cert. denied*, 109 S. Ct. 3156 (1989); New York v. Shore Realty Corp., 759 F.2d 1032, 1042 (2d Cir. 1985); Missouri v. Independent Petrochem. Corp., 610 F. Supp. 4 (E.D. Mo. 1985) (defendant who properly disposed of waste held liable for removal of the waste by a third party regardless of whether the removal was foreseeable). *But cf.* Florida Power & Light Co. v. Allis Chalmers Corp., 893 F.2d 1313, 1318-19 (11th Cir. 1990) (mere sale of hazardous substances does not incur CERCLA liability if seller was not arranging for disposal of substances). Congress believes that handling hazardous wastes is an ultrahazardous activity. *See* 126 Cong. Rec. 31,964-65 (1980) (statement of Rep. Florio); 126 Cong. Rec. 31,978 (1980) (statement of Rep. Jeffords); 126 Cong. Rec. 30,932 (1980) (statement of Sen. Randolph); S. Rep. No. 848, 96th Cong., 2d Sess. 12-15, 31-34 (1980); Barr, *supra* note 10, at 976-77.

16. *See generally* United States v. Dickerson, 640 F. Supp. 448 (D. Md. 1986) (ignorance that materials were hazardous is not defense).

the employees took bribes and violated the employer's rules in so doing.[17] Strict liability extends to acts of others with whom one has contracted. Thus, the generator who contracts to have toxic waste disposed of by another is liable if the disposer fails to do the job properly. The degree of care with which the generator chose and monitored the disposer is irrelevant.[18] Contractual waivers or limitations on liability may bind the contracting parties but are void as against the government.[19] Liability is retroactive. Accordingly, it is no defense that the acts for which liability is alleged were committed or the response costs incurred before CERCLA was enacted.[20]

However, the Act does permit defenses for, among other things, acts of God, acts of war, and acts by third persons with whom the defendant has no employment or other contractual relationship.[21] It also exculpates the purchaser of a contaminated facility who "did not know and had no reason to know" of the toxic waste despite "all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability."[22] Although a few courts have permitted defendants to plead equitable defenses such as estoppel, waiver, and release, so far no equitable defense has been sustained.[23] Thus, although CERCLA often imposes strict liability, Congress chose not to inflict liability on many defendants who are without fault.

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17. City of Philadelphia v. Stepan Chem. Co., 18 Envtl. L. Rep. (Envtl. L. Inst.) 20133 (E.D. Pa. July 28, 1987) (LEXIS, Genfed Library, Dist. file, 7058).

18. For a discussion of the responsibility of generators, see *infra* notes 130-31 and accompanying text.

19. 42 U.S.C. § 9607(e) (1988).

20. *See* United States v. Northeastern Pharm. & Chem. Co., 810 F.2d 726, 732-37 (8th Cir. 1986), *cert. denied*, 484 U.S. 848 (1987).

21. Section 9607(b) precludes liability for a defendant "who can establish by a preponderance of the evidence" that the release was "caused solely by . . . (1) an act of God" or "(2) an act of war" or:

> (3) an act or omission of a third party other than an employee or agent of the defendant, or than one whose act or omission occurs in connection with a contractual relationship . . . if the defendant establishes by a preponderance of the evidence that (a) he exercised due care with respect to the hazardous substance concerned and (b) he took precautions against foreseeable acts or omissions of any such third party and the consequences that could foreseeably result from such acts or omissions . . . .

42 U.S.C. § 9607(b) (1988). The third-party defense has often been narrowly construed. *See* Missouri v. Independent Petrochem. Corp., 610 F. Supp. 4, 5 (E.D. Mo. 1985) (defense not available to generator even though contract with transporter expressly provided that waste would be disposed of at a different site). The Act also excludes liability for federally permitted releases, 42 U.S.C. § 9607(j) (1988); and for damages described in an environmental impact statement that was approved, 42 U.S.C. § 9607(f)(1) (1988).

22. 42 U.S.C. § 9601(35) (1988). Even before this amendment was added to the statute some courts recognized the problems of imposing liability on an innocent purchaser. *See In re* Acushnet River & New Bedford Harbor Proceedings, 675 F. Supp. 22, 32 (D. Mass. 1987) (excessive parent liability could discourage corporations from purchasing contaminated facilities through a well-capitalized subsidiary and cleaning them up).

23. *See* Barr, *supra* note 10, at 991-92.

In addition to civil CERCLA liability, hazardous waste releases can lead to penalties and fines under CERCLA and other laws. Willful violation of an abatement order can be punished with a fine of up to $25,000 per day.[24] Failure "without sufficient cause to properly provide removal or remedial action upon order of the President" can result in punitive damages of up to three times the costs incurred by Superfund as a result of the failure.[25] Civil penalties of up to $25,000 per day can be levied for violation of the notice, record-keeping, financial responsibility regulations, or orders relating to any settlement agreements or administrative orders under the Act.[26] Moreover, state laws impose additional fines, penalties, and punitive damages.

In order to further discourage hazardous waste releases by persons who cannot pay the resulting cleanup costs, Congress authorized the President to adopt regulations to assure the financial responsibility of facilities handling hazardous wastes.[27] Congress also exempted from state insurance laws "risk retention groups" that cover pollution liability only.[28] Thus, Congress facilitated the availability of cleanup insurance and aided chemical firms in meeting CERCLA's response costs.[29]

In specifying the scope of cleanups under CERCLA, Congress has not gone as far as it might have. The statute requires only what is "practicable."[30] To determine what is practicable, the EPA employs a cost-benefit analysis. However, the EPA is not required to and does not consistently apply the analysis.[31]

Although CERCLA's provisions are elaborate, they contain many drafting gaps. Congress intended the federal courts to fill these gaps through federal common law.[32]

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24. 42 U.S.C. § 9606(b)(1) (1988).

25. 42 U.S.C. § 9607(c)(3) (1988).

26. 42 U.S.C. § 9609 (1988).

27. 42 U.S.C. § 9608 (1988). Similar provision is made for financial responsibility of owners of ships carrying hazardous substances by 33 U.S.C. § 1321(p) (1988). Regulations under the Resource Conservation and Recovery Act of 1976, 42 U.S.C. §§ 6901-91 (1988), require owners and operators of treatment, storage and disposal facilities to demonstrate financial responsibility. 40 C.F.R. §§ 264.111-.120, .142-.147, .151, 265.111-.117, .142-.147 (1989).

28. 42 U.S.C. §§ 9671-75 (1988).

29. *Id.*

30. 42 U.S.C. § 9621 (1988).

31. *See* Barr, *supra* note 10, at 931. Problems may arise in the EPA's choice of remedies. The EPA may either clean up a waste site and pursue responsible parties for the resulting costs, or it may sue to compel responsible parties to clean up the site. *See supra* note 7 and accompanying text. In practice, it usually does the former. *See* Note, *The Threat to Investment in the Hazardous Waste Industry: An Analysis of Individual and Corporate Shareholder Liability Under CERCLA*, 1987 UTAH L. REV. 585, 590-93. Since the government may not be as efficient or cost-conscious in the cleanup as a responsible private party would, this practice may ultimately increase the costs of cleanups.

32. Federal common law was needed to achieve a uniformity that would not be possible if federal courts filled the gaps in CERCLA by resorting to state law. *See* 126 Cong. Rec. 31,965 (1980) (statement of Rep. Florio). *See, e.g.*, United States v. Monsanto Co., 858 F.2d 160, 171 (4th Cir. 1988), *cert. denied*, 109 S. Ct. 3156 (1989); Smith Land & Improv. Corp. v.

B. *Controlling Person Liability and the Text of CERCLA*

Some courts have imposed CERCLA liability on parents and other controlling persons of responsible corporations on the grounds that Congress intended the Act "to encourage maximum care and responsibility in the handling of hazardous wastes."[33] This reasoning is dubious. Although many provisions of CERCLA are relatively broad, Congress did not give the Act the maximum possible reach.

CERCLA's definitions of responsible persons, especially for the term "owner or operator,"[34] are broad but conventional. Under the principle of limited liability, legal references to a corporation do not ordinarily include its shareholders or other controlling persons.[35] Accordingly, a plain reading of the statute suggests that controlling persons are not responsible for a corporation's obligations under section 9607. The breadth of the statutory definitions actually supports this view. Clearly, Congress gave great thought to the definitions. Thus, the failure to include controlling persons does not appear to be a mere oversight.

This interpretation is reinforced by Congress' express imposition of liability on controlling persons in other legislation. The federal securities laws, for example, explicitly make controlling persons liable for corporate violations.[36] More important, Congress did expressly impose controlling person liability for some CERCLA violations. In the very section defining "owner or operator," Congress *did* include controlling persons, but only in the subsection relating to facilities conveyed to local governments in bankruptcy or similar circumstances.[37] If Congress intended to hold controlling persons, including parent corporations, liable in other instances, it would have inserted a broader definition of controlling person.[38] CER-

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Celotex Corp., 851 F.2d 86, 91 (3d Cir. 1988), *cert. denied*, 109 S. Ct. 837 (1989); Barr, *supra* note 10, 925-26; Note, *Liability of Parent Corporations for Hazardous Waste Cleanup and Damages*, 99 HARV. L. REV. 986, 999-1001 (1986) [hereinafter Note, *Parent Liability*].

33. Chemical Waste Mgmt., Inc. v. Armstrong World Indus., Inc., 669 F. Supp. 1285, 1290 n.6 (E.D. Pa. 1987). *See also* United States v. Reilly Tar & Chem. Corp., 546 F. Supp. 1100, 1112 (D. Minn. 1982) (CERCLA liability "should be given a broad and liberal construction" and "should not be narrowly interpreted.").

34. 42 U.S.C. § 9601(20)(A) (1988).

35. For a discussion of the general rule of limited liability, see *infra* notes 45-51 and accompanying text.

36. Securities Act of 1933, § 15, 15 U.S.C. § 77o (1988); Securities Exchange Act of 1934, § 20, 15 U.S.C. § 78(t) (1988).

37. 42 U.S.C. § 9601(20)(A)(iii) (1988) ("any person who owned, operated *or otherwise controlled* activities at such facility immediately beforehand") (emphasis added). The Fifth Circuit relied on this difference between facilities conveyed to local governments and other cases in Joslyn Mfg. Corp. v. T.L. James & Co., 893 F.2d 80 (5th Cir. 1990), *petition for cert. filed*, 59 U.S.L.W. 3001 (U.S. July 3, 1990) (No. 89-1973).

38. The Supreme Court has followed this reasoning in refusing to approve implied private damage actions under federal statutes. In Touche Ross & Co. v. Redington, 442 U.S. 560, 572 (1979), the Court, noting the absence of a provision for private damage actions in the statute in question, stated "when Congress wished to provide a private damage remedy, it knew how to do so and did so expressly." *See also* Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 19 (1979) ("It is an elemental canon of statutory construction that where a statute expressly provides a particular remedy or remedies, a court must be chary of

CLA also fails to mention liability of contributors or aiders and abettors. Again, the omission indicates Congress' intent because Congress expressly imposed liability on such persons under other statutes, including other environmental laws.[39]

Instead, CERCLA expressly absolves from liability certain persons who may possess some control. For example, it excludes from the definition of "owner or operator" one who, "without participating in the management of a . . . facility, holds indicia of ownership primarily to protect his security interest in the . . . facility."[40] The statute also fails to name directors, officers, other employees, suppliers, or customers, and expressly excludes innocent purchasers of contaminated facilities as responsible persons.[41]

In addition to limits on the scope of responsible persons, CERCLA stops short of the maximum possible reach in certain other respects. For example, some damages from hazardous waste disposal are not recoverable under CERCLA,[42] and in certain situations state governments are liable only for "gross negligence or intentional misconduct."[43] Some express defenses to CERCLA liability have been previously mentioned.[44]

This does not mean that CERCLA liability is not broad; obviously it is. However, questions of CERCLA's reach cannot be resolved simply by resorting to the language and legislative history of the Act, or by incanting that CERCLA should be given the broadest possible interpretation.

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reading others into it.").

39. *E.g.*, Resource Conservation and Recovery Act of 1976 § 7003(a), 42 U.S.C. § 6973(a) (1988) (imposing liability on "contributors" to the disposal of hazardous substances).

40. 42 U.S.C. § 9601(20)(A) (1988). Courts disagree over the liability of lenders who do not hold indicia of ownership or who do exercise some control. *See infra* notes 70-80 and accompanying text.

41. For a discussion of the innocent purchaser defense, see *supra* note 22 and accompanying text.

42. These include diminution of property values, economic loss, and lost income or profits. *See* Artesian Water Co. v. Government of New Castle County, 851 F.2d 643, 650-51 (3d Cir. 1988) (damage to artesian wells not recoverable); Wehner v. Syntex Corp., 681 F. Supp. 651, 653 (N.D. Cal. 1987) (recovery for the lost value of a home is economic loss and not reasonable under CERCLA); Allied Towing Corp. v. Great Eastern Petroleum Corp., 642 F. Supp. 1339, 1348 (E.D. Va. 1986) (CERCLA does not provide remedy for plaintiff to recoup business losses); Barr, *supra* note 10, at 971. Recovery of litigation costs and attorneys' fees by private plaintiffs remains an unsettled issue. *See also* General Elec. Co. v. Litton Bus. Sys., Inc., 715 F. Supp. 949, 958-59 (W.D. Mo. 1989) (legal fees recoverable under CERCLA).

43. 42 U.S.C. § 9607(d)(2) (1988). Similarly, punitive damages cannot be imposed for refusal to comply with a government order under CERCLA if it is made in good faith. *See* Aminoil, Inc. v. United States, 646 F. Supp. 294, 299 (C.D. Cal. 1986); Wagner Elec. Corp. v. Thomas, 612 F. Supp. 736, 742-45 (D. Kan. 1985); United States v. Reilly Tar & Chem. Corp., 606 F. Supp. 412, 419-20 (D. Minn. 1985).

44. For a discussion of various defenses, see *supra* notes 10, 21-22 and accompanying text.

II. The Rule of Limited Liability and Experience Under CERCLA

The traditional rule of American law is that, with some important exceptions, shareholders, officers and creditors of a corporation are not liable for corporate debts. Since CERCLA's adoption eleven years ago, the federal courts have decided many cases dealing directly and indirectly with the liability of controlling persons for response costs, but they have failed to agree on standards for such liability.

A. *The General Rule of Limited Liability*

A shareholder is generally not liable for the debts of a corporation beyond the shareholder's investment in that corporation.[45] Although a parent corporation—a corporation that owns all or most of the stock of another corporation—is arguably different from an individual minority shareholder, the law generally affords limited liability to parents.[46] Exceptions to this general rule have long been recognized, but the parameters of these exceptions are hazy. Some courts vaguely state that piercing the corporate veil is appropriate "whenever necessary to prevent fraud or achieve equity."[47] Other formulations are hardly more helpful. A parent may be held liable when it "dominates" or is the "alter ego" of the subsidiary.[48] Disregard of corporate formalities is common in piercing cases but does not appear to be a necessary or sufficient condition for piercing.[49] Courts frequently mention inadequate capital in piercing cases, but capital deficiency alone almost never triggers piercing.[50] A parent may also be liable for participating in the commission of a tort by its subsidiary. It is unclear, however, when a parent so far exceeds ordinary oversight by a controlling shareholder as to become a "participant."[51]

Because these liability standards are so vague, piercing cases are heavily fact-oriented. Further, although courts often use the same verbal

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45. *See* Rev. Model Bus. Corp. Act § 6.22; H. Henn & J. Alexander, Laws of Corporations § 73, at 130-31 (3d ed. 1983) [hereinafter H. Henn & J. Alexander]. This rule of limited liability is firmly established and has even been called "the greatest single discovery of modern times" by former Columbia University president Nicholas Murray Butler. Meiners, Mofsky & Tollison, *Piercing the Veil of Limited Liability*, 4 Del. J. Corp. L. 351, 351 (1979).

46. *See* H. Henn & J. Alexander, *supra* note 45, § 148, at 355.

47. Walkovszky v. Carlton, 18 N.Y.2d 414, 417, 223 N.E.2d 6, 7, 276 N.Y.S.2d 585, 587 (1966) (quoting International Aircraft Trading Co. v. Manufacturers Trust Co., 279 N.Y. 285, 292, 79 N.E.2d 249, 252 (1948)).

48. *See* H. Henn & J. Alexander, *supra* note 45, § 146, at 344 n.2; R. Clark, Corporate Law § 2.4, at 71-72 (2d ed. 1986) [hereinafter R. Clark].

49. *See* H. Henn & J. Alexander, *supra* note 45, § 146, at 347; R. Clark, *supra* note 48, § 2.4, at 72-73 n.4.

50. *See* R. Clark, *supra* note 48, § 2.4.1, at 74.

51. "An officer who commits or participates in the commission of a tort is, of course, personally liable to the victim for any resulting damage." H. Henn & J. Alexander, *supra* note 45, § 230, at 608. This is an example of the general rule that people are liable for torts they commit or in which they participate, even though they are acting on behalf of, or together with, others. Thus, the general rule applies to shareholders who participate in the commission of torts by a corporation.

standards in piercing cases, some courts are quicker than others to hold shareholders liable. Therefore, the outcome of a particular case is difficult to predict without detailed knowledge of the facts and of the attitudes of those on the court. In fact, prediction can be difficult even when these factors are known.

B. *The Case Law Under CERCLA*

The CERCLA cases concur that controlling person liability is a question of federal law.[52] Beyond that there is little agreement. The cases often use the traditional vocabulary of piercing, but also frequently mention the legislative concerns underlying the statute. As a result, controlling person liability under CERCLA is broader than in most other areas. Results, however, still depend on the facts of each case and the attitudes of each court.

1. *Parent corporation liability*

Several cases hold that normal parent-subsidiary relationships alone do not render a parent liable for a subsidiary's CERCLA obligations.[53] Other cases state that a parent is liable if it has "capacity to control" the subsidiary.[54] This standard would nearly always lead to liability because, by definition, a parent can control its subsidiary. The facts of most cases purporting to embrace the capacity-to-control standard, however, could warrant piercing under more traditional standards.[55] In contrast, some courts expressly reject the capacity-to-control test.[56]

Some courts appear to base CERCLA liability only on a parent's ac-

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52. For a discussion of federal common law in CERCLA cases, see *supra* note 32 and accompanying text.

53. *See generally* Joslyn Mfg. Corp. v. T.L. James & Co., 893 F.2d 80 (5th Cir. 1990) (liability denied after applying traditional piercing criteria); Wehner v. Syntex Agribusiness, Inc., 616 F. Supp. 27 (E.D. Mo. 1985) (court refused to assert jurisdiction over parent whose control over its subsidiary did not exceed normal activities of parent); *Accord* United States v. Bliss, 108 F.R.D. 127 (E.D. Mo. 1985). Similarly, some courts state that mere ability to control a facility does not make one a CERCLA "operator"; there must be actual control. For a discussion of cases requiring more than ability to control, see *infra* note 56.

54. The capacity to control standard was first adopted by the District Court in United States v. Northeastern Pharm. & Chem. Corp., 579 F. Supp. 823 (W.D. Mo. 1984), *modified*, 810 F.2d 726 (8th Cir. 1986), *cert. denied*, 484 U.S. 848 (1987). A few other courts also followed that decision. *See* Idaho v. Bunker Hill Co., 635 F. Supp. 665 (D. Idaho 1986); United States v. Nicolet, Inc., 712 F. Supp. 1193, 1202-04 (E.D. Pa. 1989) (denying summary judgment for defendant).

55. *See, e.g.*, Idaho v. Bunker Hill Co., 635 F. Supp. 665, 672 (D. Idaho 1986) (subsidiary was undercapitalized and parent's approval was necessary for pollution control expenses over $500).

56. *See* United States v. Kayser-Roth Corp., 910 F.2d 24, 27 (1st Cir. 1990) (parent liability "requires more than merely complete ownership and the concomitant general authority or ability to control"); Rockwell Int'l Corp. v. IU Int'l Corp., 702 F. Supp 1384, 1390 (N.D. Ill. 1988); United States v. Mirabile, 15 Envtl. L. Rep. (Envtl. L. Inst.) 20992, 21995-97 (E.D. Pa. 1985); *In re* Acushnet River & New Bedford Harbor Proceedings, 675 F. Supp. 22, 32-33 (D. Mass. 1987).

tive control of the subsidiary.[57] Although this standard seems more restrained than the capacity-to-control test, its scope is even more vague. It is unclear, for example, whether "active control" includes the routine activities of parents, such as electing directors, consulting with managers, and monitoring performance, or whether greater involvement is required. Whether active control could apply to a minority shareholder if that shareholder exercised significant control over the affairs of a responsible corporation is also unsettled.[58]

A parent corporation can also be liable for directly participating in CERCLA violations.[59] In theory, this differs from liability under piercing because the parent is held directly liable for its own actions or status as owner and is not vicariously liable for the actions or status of its subsidiary. In practice, however, the two can be hard to distinguish. The kind of participation in a CERCLA violation necessary to establish direct liability may differ little from the kind of involvement in the subsidiary's affairs necessary to pierce the veil.[60]

2. *Liability of individual controlling shareholders*

The controlling shareholder of a responsible corporation may be an individual, or individuals, rather than another corporation. A parent corporation may also be controlled by one or a few individuals. In either case, the individual shareholders could incur CERCLA liability. In all such cases to date, the individuals have also been officers and directors of the corporation. Thus, discussion of these cases is deferred to the section on officers and directors. However, a few courts have said in dictum that an individual shareholder should be treated the same as a corporate shareholder under CERCLA.[61]

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57. *See* United States v. Nicolet, Inc., 712 F. Supp. 1193, 1203 (E.D. Pa. 1989). In *Nicolet*, the court reasoned that if the subsidiary is an "owner or operator" and the parent actively participates in the management of the subsidiary while the toxic substances are being handled, the parent is also an owner or operator. *See also* United States v. Kayser-Roth Corp., 724 F. Supp. 15, 22-23 (D.R.I. 1989), *aff'd*, 910 F.2d 24 (1st Cir. 1990) (parent exercised pervasive control, including approval of system that used toxic substance); Rockwell Int'l Corp. v. IU Int'l Corp., 702 F. Supp. 1384, 1390 (N.D. Ill. 1988) (parent monitored and approved subsidiary's compliance with environmental laws). *Cf. In re* Acushnet River & New Bedford Harbor Proceedings, 675 F. Supp. 22, 32-33 (D. Mass. 1987) (parent liability rejected because pervasive control lacking).

58. *See* United States v. McGraw-Edison Co., 718 F. Supp. 154, 156-58 (W.D.N.Y. 1989) (denying summary judgment for 49% shareholder).

59. *See* Idaho v. Bunker Hill Co., 635 F. Supp. 665, 671-72 (D. Idaho 1986).

60. *See id.* In *Bunker Hill*, the court relied on the fact that the parent had to approve all of the subsidiary's capital expenditures for pollution controls in excess of $500. However, liability could have been based on the fact that the subsidiary was so undercapitalized as to possibly justify piercing even under traditional criteria.

61. *See* New York v. Shore Realty Corp., 759 F.2d 1032, 1052 (2d Cir. 1985).

3. *Officer and director liability*

Corporations are controlled by their officers as well as their shareholders, but the types of control differ. Shareholders, in theory, enjoy ultimate control by electing corporate directors who in turn select the corporate officers. After election of directors, however, the shareholders' power to interfere in the firm's business is severely limited as authority to manage the company then passes to the board and the officers.[62] In practice, this separation of powers is even sharper. In the public corporation, control generally rests with the executive officers, who dominate the board rather than being dominated by it. Further, these officers are largely immune from interference by the shareholders even in the election of directors.[63]

Although corporate officers often control their firms, standards for their liability for the firm's debts are ill-defined both in general law and under CERCLA. It is well settled that an officer, or other employee, who commits a tort is not exempt from suit simply because he acted as an employee.[64] Difficult questions can arise, however, in determining whether an officer authorized or proximately caused a tort. This determination is especially problematic when the participation consists of inadequately supervising subordinate employees.[65] The law here is particularly unsettled because plaintiffs rarely sue individual officers.

The difficulties of officer and employee liability are compounded by the application of CERCLA's strict liability and joint and several liability. At worst, an employee could be liable for a huge sum even though he was not negligent and did not participate in the CERCLA violation. Most courts have, however, rejected this draconian result. A majority of officers who have been held personally liable for CERCLA violations had actively participated in the violation or were clearly negligent.[66] If not active par-

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62. *See* E. FOLK III, THE DELAWARE GENERAL CORPORATION LAW 611-13 (1972). The shareholders' powers differ from state to state, but are almost always indirect. Shareholders can remove directors for cause, or sometimes without cause, and can amend the corporate by-laws and charter. In most states, however, a board resolution is a prerequisite to charter amendment. Shareholder approval is also often required for organic changes, such as mergers and firm asset sales. Shareholders rarely can interfere directly with the day-to-day operations of the company. In general, the "business and affairs" of a corporation "shall be managed by or under the direction of a board of directors." DEL. CODE ANN. tit. 8, § 141(a) (1983).

63. *See* Dent, *Toward Unifying Ownership and Control in the Public Corporation*, 1989 WIS. L. REV. 881, 883-92.

64. *See* RESTATEMENT (SECOND) OF AGENCY § 343 (1958); J. BISHOP, LAW OF CORPORATE OFFICERS AND DIRECTORS: INDEMNIFICATION AND INSURANCE ¶ 3.13 (1982); Tundermann, *Personal Liability for Corporate Directors, Officers, Employees and Controlling Shareholders Under State and Federal Environmental Laws*, 31 ROCKY MTN. L. INST. 2-1, 2-4-6 (1985).

65. *See* 2 F. HARPER & F. JAMES, THE LAW OF TORTS § 26.3, at 1366-69 (1956).

66. *See* United States v. Northeastern Pharm. & Chem. Co., 810 F.2d 726, 744 (8th Cir. 1986), *cert. denied*, 484 U.S. 848 (1987) (imposing liability for participation on vice president who knew about and supervised disposal of wastes); United States v. Northernaire Plating Co., 670 F. Supp. 742, 748 (W.D. Mich. 1987) (president and sole shareholder held liable because he was responsible for disposal); United States v. Bliss, 667 F. Supp. 1298,

ticipants in the CERCLA violation, officers held liable have generally been dominant shareholders active in the management of the responsible corporation.[67] In these cases, officer status may have made little or no difference in determining liability. One court, however, has stated in dictum that an officer can be liable simply because he had the power or authority to prevent or abate the release.[68]

4. *Lender liability*

Control of a corporation can be exerted by means other than stock ownership, corporate offices and directorships. A dominant customer, supplier, or labor union, for example, can enjoy influence tantamount to control. Lenders are most frequently accused of external control. CERCLA defines "owner or operator" to exclude "a person who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility."[69] Without this provision, the pledgee or mortgagee of a facility might be considered its owner and thus liable under CERCLA even if it played no role in managing the firm.

The statute does not dictate how much participation is necessary to lose this exemption. It also leaves unclear the status of a lender who participates in management but does not "hold indicia of ownership." The typical loan agreement imposes many restrictions on borrowers, but these restrictions rarely deal directly with waste disposal. Covenants often do

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1306 (E.D. Mo. 1987) (both plant supervisor and CEO had ultimate control over toxic disposal and held liable); United States v. Ward, 618 F. Supp. 884, 891-95 (E.D.N.C. 1985) (president and principal shareholder held liable although officer did not initially know of illegal dumping contrary to his instructions, but allowed it to continue after he learned of practice); United States v. Wade, 577 F. Supp. 1326, 1341 (E.D. Pa. 1983) (individual officers may be liable if they participate in CERCLA violations although defendants in case did not do so); Comment, *Corporate Officer Liability for Hazardous Waste Disposal: What Are the Consequences?*, 38 MERCER L. REV. 677 (1987).

67. *See* New York v. Shore Realty Corp., 759 F.2d 1032, 1038-52 (2d Cir. 1985) (sole officer, shareholder, and decisionmaker held liable as "operator" under CERCLA); United States v. Mottolo, 695 F. Supp. 615, 623-24 (D.N.H. 1988) (president held liable as owner of waste site and could not escape liability by incorporating his business). *See also* United States v. Pollution Abatement Servs., Inc., 763 F.2d 133, 134-35 (2d Cir.), *cert. denied*, 474 U.S. 1037 (1985) (two of four shareholder-officers held liable under Rivers and Harbors Appropriations Act because they personally controlled firm's operations, including illegal dumping and storage activities); United States v. Conservation Chem. Co., 619 F. Supp. 162, 187-88 (W.D. Mo. 1985) (vice-president and major shareholder found liable based on personal involvement in waste disposal); United States v. Carolawn, 21 Env. Rep. Cas. (BNA) 2124, 2127 (D.S.C. 1984) (summary judgment for officers denied because of personal involvement in disposals). *But cf.* United States v. Sexton Cove Estates, Inc., 526 F.2d 1293, 1300-01 (5th Cir. 1976) (rejecting individual liability of officers under Rivers and Harbors Act because traditional piercing criteria not met); United States v. Joseph G. Moretti, Inc., 526 F.2d 1306, 1310 (5th Cir. 1976) (officer not held personally liable under Rivers and Harbors Act).

68. Kelley *ex rel.* Michigan Natural Resources Comm'n v. ARCO Indus. Corp., 723 F. Supp. 1214, 1219-20 (W.D. Mich. 1989).

69. 42 U.S.C. § 9601(20)(A) (1988).

require adherence to the law, however. These covenants should encourage sound hazardous waste disposal.

Other common covenants require a borrower to maintain compliance with financial tests. These covenants could help assure the firm's ability to shoulder CERCLA costs. However, they could also prevent expenditures needed to avoid or remedy toxic releases. It seems unlikely that this effect of financial covenants alone should render lenders liable. In *United States v. Mirabile* the court held that a lender's involvement in the financial aspects of a borrower's business, in contrast with its day-to-day affairs, would not lead to liability.[70]

In *United States v. Fleet Factors*,[71] the Eleventh Circuit went further. Although conceding that a mortgagee is not automatically an operator, the court stated that a lender's intervention in a borrower's business could render it liable as an owner even if the activity were not sufficient to make it an operator. The court stated that participation need only indicate "a capacity to influence the corporation's treatment of hazardous wastes"; the secured creditor need not "actually involve itself in the day-to-day operations of the facility."[72] Fleet Factors' involvement in the debtor's business was limited to the usual lender activities until financial difficulties forced the borrower to cease operations. The *Fleet Factors* court did not specify when the lender became a CERCLA owner or operator.[73] However, even if the CERCLA owner or operator did not assume responsibility until after operations ceased, the decision poses great risks because lenders routinely intervene when borrowers hit financial difficulties.

In re Bergsoe Metal Corp.[74] takes a position quite different from *Fleet Factors*. The court noted the extensive rights of the secured credi-

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70. 15 Envtl. L. Rep. (Envtl. L. Inst.) 20992, 20995 (E.D. Pa. 1985). However, one creditor who had more actively participated in the management of the debtor was denied summary judgment on the issue of CERCLA liability. *See also* Guidice v. BFG Electroplating & Mfg. Co., 732 F. Supp. 556, 561-62 (W.D. Pa. 1989) (lender-bank not liable for involvement in financial affairs to protect its security interest); United States v. Nicolet, Inc., 712 F. Supp. 1193, 1204-05 (E.D. Pa. 1989) (mortgagee can be liable if it participates in the management and operations of the facility); Rockwell Int'l Corp. v. IU Int'l Corp., 702 F. Supp. 1384, 1390 (N.D. Ill. 1988) (no lender liability absent exercise of actual control); *In re* T.P. Long Chem. Inc., 45 Bankr. 278, 288 (N.D. Ohio 1985) (creditor not liable if he "holds indicia of ownership primarily to protect his security").

71. 901 F.2d 1550 (11th Cir. 1990), *cert. denied*, 1991 WL 139893 (US) (US, Jan. 14, 1991) (No. 9-504).

72. *Fleet Factors*, 901 F.2d at 1557. Under the facts of the case it was unnecessary to determine liability solely on the basis of financial involvement because the lender took part in operational decisions, including waste disposal, after the debtor had ceased to do business and began to wind down its operations. *See also* Tanglewood East Homeowners v. Charles-Thomas, Inc., 849 F.2d 1568, 1572-73 (5th Cir. 1988) (court affirmed denial of summary judgment to defendant alleged to be "owner" solely because it was lender); United States v. Maryland Bank & Trust Co., 632 F. Supp. 573, 576 (D. Md. 1986) (secured creditor exemption should be construed narrowly).

73. *Fleet Factors*, 901 F.2d at 1555.

74. 910 F.2d 668 (9th Cir. 1990).

tor, but added that "nearly all secured creditors have these rights."[75] The court said: "What is critical is not what rights the [creditor] had, but what it did . . . . Regardless of what rights the [creditor] may have had, it cannot have participated in management if it never exercised them."[76] This standard leaves unclear the status of a creditor forced by the debtor's difficulties to exercise its rights; creditors' rights are illusory if they cannot be exercised without incurring CERCLA liability. But if *Bergsoe* is followed, it at least relieves the creditor who does not exercise these rights.

New issues arise if the creditor seizes the debtor's property. *Mirabile* held that a mortgagee does not become an "owner" for purposes of CERCLA when it purchases property on which it had foreclosed after operations had ceased and then merely protects the property against further decline.[77] *Fleet Factors* rejected this analysis. In *Fleet Factors*, the court ruled that "[w]hat is relevant is the nature and extent of the creditor's involvement with the facility, not its motive."[78] Seizing a facility alone seems to entail the degree of involvement necessary for owner status under *Fleet Factors*. Moreover, *Mirabile* ignores the plain meaning of CERCLA imposing liability on an "owner"[79] because the contractual relationship with the borrower seems to preclude any CERCLA third-party defense.[80]

III. Torts and the Received Theory of Limited Liability

The general rule excusing shareholders from liability for the debts of a corporation and the exceptions to that rule are both of long standing. Only recently have commentators scrutinized the economic wisdom of

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75. *Id.* at 672.

76. *Id.* at 672-73.

77. 15 Envtl. L. Rep. (Envtl. L. Inst.) at 20994-97.

78. 901 F.2d at 1560.

79. A lender who forecloses on property would seem no longer to satisfy the exception in 42 U.S.C. § 9601(20)(A) (1988) for one who "holds indicia of ownership primarily to protect his security interest in the . . . facility." After foreclosure the lender becomes the full owner. The 1986 amendments to CERCLA exculpate an owner who acquires a facility after a release and, after "all appropriate inquiry," has no knowledge or reason to know toxic wastes are present. 42 U.S.C. § 9601(35) (1988). A lender who forecloses a mortgage generally knows too much about the borrower to deny it had reason to know of its toxic wastes. *See also* United States v. Maryland Bank & Trust Co., 632 F. Supp. 573, 580 (D. Md. 1986) (statutory exception does not cover mortgagee who purchases mortgaged property at foreclosure sale).

80. United States v. Maryland Bank & Trust Co., 632 F. Supp. 573, 580 (D. Md. 1986), held it an issue of fact whether this defense applied to a mortgagee who purchased the mortgaged property at a foreclosure sale. The material issues of fact involved the relationship between the bank and the borrower as well as the reasonableness of the bank's conduct. The bank's undeniable contractual relationship with the borrower seems to preclude the third-party defense. However, *Maryland Bank & Trust* suggests that the contractual relationship may end with foreclosure. *Id.* at 581. Even if these defenses are available, the mortgagee-purchaser would have to show that after purchase of the property it "exercised due care with respect to the hazardous substance concerned." 42 U.S.C. § 9607(b)(3)(a) (1988).

these positions. Most of that scrutiny has focused on contract debts. Deeper analysis of immunity from tort liability is needed.

Limited shareholder liability is frequently explained as the optimal hypothetical bargain; that is, the bargain that most creditors and shareholders would strike if they could negotiate at no cost.[81] Under this view, limited liability spreads risks among risk-averse participants: Shareholders risk their investment while creditors shoulder the remaining risk. Creditors benefit from this because shareholders are encouraged to seek credit. Theoretically, the creditors' gain in profitable transactions outweighs the costs of not being able to sue shareholders personally when the corporation cannot pay its debts. If creditors fear the risk is too great in a particular case, they can demand security, such as a shareholder guaranty, which in effect waives limited liability, or deny credit.

This rationale fails in the tort context, however. Most potential tort victims, including victims of toxic spills, have no opportunity to negotiate with potential tortfeasors. Not surprisingly, courts prefer to pierce the corporate veil in tort cases rather than in contract cases.[82]

There are also affirmative reasons for shareholder liability for a corporation's torts. First, liability deters negligence. Those who are not liable for injuries they cause have no economic incentive to be prudent and may inflict serious avoidable injuries. If liable for the injuries they inflict, rational people exercise reasonable care to avoid causing harm.[83] Similarly, imposing liability for injuries one causes promotes allocative efficiency. If such liability is not imposed, activities do not bear their costs and will be overutilized. For example, if coal powered generators produce more pollution than nuclear generators, but operators are not liable for the pollution's damages, there will be more coal and fewer nuclear generators than is economically desirable.[84]

Limited shareholder liability engenders these same problems. Shareholders can enjoy profits from an enterprise yet avoid its debts if tort liability bankrupts the firm. Shareholders thus have an inadequate incentive to make sure the corporation is reasonably cautious and financially sound. Likewise, activity by such corporations will be too risky. Limited liability also encourages shareholders to drain capital from a corporation

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81. *See* Easterbrook & Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 702-03 (1982) [hereinafter Easterbrook & Fischel, *Corporate Control*].

82. *See, e.g.*, Edwards Co. v. Monogram Indus., Inc., 730 F.2d 977, 980-84 (5th Cir. 1984) (en banc); Easterbrook & Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 112 (1985); Roe, *Corporate Strategic Reaction to Mass Tort*, 72 VA. L. REV. 1, 42 n.118 (1986) [hereinafter Roe]. *But see* H. HENN & J. ALEXANDER, *supra* note 45, § 146, at 348 ("[c]ourts usually cite contract and tort cases indiscriminately as precedents").

83. Negligence and its complement, reasonable prudence, are usually determined in economic terms according to whether "the expected damage outweighs the costs of prevention." Roe, *supra* note 79, at 45. *See also* Schwartz, *Products Liability, Corporate Structure and Bankruptcy: Toxic Substances and the Remote Risk Relationship*, 14 J. LEGAL STUD. 689, 692-705 (1985) [hereinafter Schwartz].

84. *See* A. POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 89-91 (1983) [hereinafter A. POLINSKY]. Correlatively, if producers are charged for excessive liability, their goods or services will be overpriced and underconsumed.

and then take risky actions. A company can take opportunities with negative net present value because the shareholders will enjoy gains if the venture succeeds. The firm's creditors, however, will bear most of the loss if the venture fails. Because such behavior is inefficient, commentators would withdraw limited liability in such cases.[85]

Second, broad liability is preferred in order to spread the risks of loss. Many people each paying a little can more easily bear the cost of injuries than the few who are injured.[86] Similarly, liability should fall on the party best able to insure because insurance broadly spreads the risk of loss.[87] Firms that cause accidents generally can insure more easily than potential victims. Limited liability undermines these principles. Because a corporation and its shareholders escape liability when the firm becomes bankrupt, firms have inadequate incentives to build the costs of either reserving or insuring against tort liability into the prices they charge. Firms reserving such costs would suffer a competitive disadvantage.[88] Holding shareholders liable prevents them from leaving victims remediless, thereby restoring the incentive to insure. The costs of accidents are then built into the firm's prices and spread as widely as possible.

Limited shareholder liability is also explained as facilitating public investment, diversification of portfolios, and transferability of stock.[89] These arguments are irrelevant for majority shareholders, who are not passive public investors, do not seek maximum diversification of portfolios, and do not trade their stock in impersonal markets. The cases seem to recognize that controlling shareholders should be treated differently for purposes of limited liability. Majority owners are often held liable for corporate debts; however, minority shareholders are almost never held liable for corporate debts.[90] Some commentators question whether limited

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85. *See* Easterbrook & Fischel, *Corporate Control*, *supra* note 81, at 113.

86. *See* G. CALABRESI, THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS 35-129 (1970); Smith, *Frolic and Detour*, 23 COLUM. L. REV. 444, 450-60 (1923) [hereinafter Smith].

87. *See* Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 YALE L.J. 499, 500-02, 543-44 (1961); Smith, *supra* note 86, at 456-60.

88. To some extent this effect is countered by the spreading of risks to creditors under limited liability. Further, some creditors can monitor the corporation and curb its risky behavior better than public shareholders. This is true only for contract creditors. Leaving the claims of tort victims unsatisfied generally reduces risk-spreading, and tort victims usually cannot monitor or influence a corporation's risky behavior. Conversely, controlling shareholders can monitor and influence the company's risk-taking better than tort victims.

89. *See* Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499, 502-13 (1976); Easterbrook & Fischel, *Corporate Control*, *supra* note 81, at 89-97. Easterbrook and Fischel argue that limited liability reduces the investor's need to monitor because only his investment, not his entire wealth, is at risk. *Id.* at 94-95. Diversification is promoted because additional investments reduce rather than increase risk. By contrast, under unlimited liability each new investment would add a threat to the investor's entire fortune. *Id.* at 96-97.

90. The corporations' codes generally make no distinction between majority and minority shareholders. Courts, however, do not pierce unless the shareholder exerts domination which is "substantially more than the control which would be exercised by any majority shareholder." Krendl & Krendl, *Piercing the Corporate Veil: Focusing the Inquiry*, 55 DEN.

liability should extend to corporate as well as individual shareholders. They view a parent and its subsidiaries as a single economic enterprise. Treating them as legally separate entities facilitates shareholder opportunism at the expense of the creditors. Accordingly, these commentators argue that the law should generally treat a parent and its subsidiaries as one.[91] The argument in favor of treating parents and subsidiaries as one is not persuasive. Because most corporations are risk averse,[92] they may forgo opportunities with positive net present value[93] if they must place the entire firm at risk. A company will take such an opportunity, however, if it can isolate the risk in a subsidiary. Moreover, denying limited liability to parent corporations would create an anomaly: An individual majority shareholder would enjoy limited liability, but that immunity would vanish if control were sold to a corporation. Thus, stripping corporate parents of limited liability would discourage economically beneficial sales of assets. Therefore, individuals and corporate shareholders are equally deserving of limited liability.

The limited liability of corporate officers, directors, and lenders for tort receives even less attention than that of shareholders, probably because these parties are so rarely sued individually. Although executives and lenders can be liable for active participation in corporate torts,[94] tort victims generally refuse to sue them. The corporation usually has insurance and deeper pockets than the executives. Thus, suing the individuals is superfluous. Further, lenders rarely participate in the commission of torts by borrowers. Executives and lenders have been sued in many CERCLA cases. However, most are sued because of their control of the company rather than their participation in the violation.[95] The immensity of CERCLA liabilities and deliberately meager resources of many responsible corporations explains many of these suits.

The reasons for exempting executives and lenders from liability unless they have participated in a tort are not immediately apparent. The corporation's legal separateness is only a fiction. Shareholder liability in the piercing cases shows that courts sometimes disregard that fiction. Executives and lenders as well as shareholders can control a company. Indeed, the executives' cooperation is indispensable to corporate action.

L.J. 1, 16, 25-27 (1978).

91. *See generally* Landers, *Another Word on Parents, Subsidiaries and Affiliates in Bankruptcy*, 43 U. CHI. L. REV. 527 (1976); Landers, *A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy*, 42 U. CHI. L. REV. 589 (1975). When limited liability began, state laws forbade corporations to own stock. Once corporate share ownership was permitted, however, limited liability followed without much thought or debate. *See* Roe, *supra* note 82, at 46-48.

92. For a discussion of risk aversion, see *infra* note 117.

93. For an explanation of the concepts of present value and net present value, see R. BREALY & S. MYERS, PRINCIPLES OF CORPORATE FINANCE 12-14 (1981) [hereinafter R. BREALY & S. MEYERS].

94. For a discussion of officer liability, see *supra* notes 64-68 and accompanying text.

95. For a discussion of ownership for CERCLA purposes, see *supra* notes 44, 70, 72-80 and accompanying text.

Executives and lenders also share the firm's profits with the stockholders. If shareholders should be liable for a corporation's CERCLA obligations, arguably the officers, directors, and lenders also should be liable.

In sum, the theory of limited liability does not encompass majority shareholders, officers, directors, or lenders of companies with tort liabilities. Rather, the goals of loss-spreading and deterring torts, including toxic spills, argue for liability of all those who share in the corporation's income and can influence its activities. Therefore, it is not surprising that courts have forced CERCLA liability upon these parties despite the absence of clear statutory authority. If CERCLA liability for all who exercise some control is not to be the general rule, new reasons for limiting liability must be developed.

IV. Limited Liability Under CERCLA

Although liability in tort for controlling shareholders, executives, and lenders may be wise, several distinct features of the environmental laws suggest a measure of immunity.

A. *Excessive Liability and Distorted Corporate Incentives*

The first of the two principal arguments against limited liability in tort is that it distorts incentives, inviting enterprises to be negligent. If owners are not liable for a firm's debts, they can minimize the firm's capital and disregard the potential costs of accidents to the extent that these costs exceed the firm's net worth. This is possible because accident costs will be borne by the victims, not by the owners. Any firm that pays more for safety will suffer a competitive disadvantage. Limited liability also causes allocative distortions by "encourag[ing] investment in inefficient ventures"[96] and stimulating excessive investment in industries that escape the costs of accidents they cause. Shareholder liability, however, makes owners bear the costs of accidents and thus creates the incentives to invest in safety until the costs of additional investments equal the costs of injuries avoided.

The distorted-incentives analysis assumes that unlimited liability compels the enterprise and its owners to pay for injuries caused by their activities but not more. The assumption is crucial because efficiency requires that activities bear only their costs. Imposing liability for more than the damage caused is inefficient because it deters enterprises from undertaking transactions that are economically beneficial.[97]

CERCLA, like other environmental laws, often imposes excessive liability. First, CERCLA liability is measured not according to the environmental damage done by a toxic spill, but according to the cost of cleaning it up.[98] Thus, the EPA may order a cleanup even if the benefits of

96. Note, *Parent Liability*, *supra* note 32, at 989.

97. "Efficient" behavior is generally defined as "behavior that maximizes aggregate benefits less aggregate costs." A. Polinsky, *supra* note 84, at 117.

98. For a discussion of cleanup costs, see *supra* notes 3, 8.

cleanup do not exceed the costs.[99] The EPA may, therefore, demand a costly cleanup for a spill that threatens very little actual damage.

CERCLA liability is also joint and several.[100] One who contributes only a fraction of a release may have to pay a much larger share, or even the entire cost, of a cleanup.[101] This problem is aggravated by CERCLA's provisions barring contribution in some cases.[102] CERCLA defendants can also incur substantial litigation costs, even if the defendant is exonerated.[103] Further, civil liability and litigation costs under CERCLA are not the only sanction for causing environmental harm. Many state and federal environmental laws impose fines and penalties upon responsible parties.[104] Thus a firm's liability may far exceed the harm it causes by any release of wastes. This liability leads industrial enterprises to be overly cautious. Firms will also reject undertakings in the United States[105] that would be profitable but for the threat of excessive CERCLA liability.

CERCLA imposes liability for toxic spills that occurred before the firm owned or operated the relevant facility.[106] This successor liability cannot be justified as deterring the release because the purchaser had no control over it. Does purchaser liability improve incentives in other ways? If a purchaser knows how much CERCLA liability will be, it can reduce the purchase price for the facility by that amount. The cleanup cost is then properly borne by the owner at the time of the release. However, the purchaser may not know of the extent or even the existence of CERCLA liability. Further, a buyer cannot exempt itself from liability in the purchase contract.[107] A right of indemnity from the seller is also meaningless if the seller is dead, defunct, or unable to pay.

Purchaser liability can make desirable transactions economically difficult or impossible. If the CERCLA cleanup costs exceed a facility's eco-

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99. Although the EPA uses some form of cost-benefit analysis in handling toxic spills, it need not and does not always do so. *See supra* note 8.

100. For a discussion of damage divisibility, see *supra* notes 9-10.

101. Joint and several liability complicates insurance against environmental liabilities by making it virtually impossible for an insurer to measure an insured's potential liability. *See* Note, *Encouraging Safety Through Insurance-Based Incentives: Financial Responsibility for Hazardous Wastes*, 96 YALE L.J. 403, 419 (1986). Even if the insured generates little hazardous waste, it could incur huge liability if that waste is improperly disposed of at a facility containing other hazardous wastes.

102. Parties who settle with the government are exempt from actions for contribution. 42 U.S.C. § 9622(b)(4) (1988). Hence, a party that does not settle may be held liable for a disproportionate share of the cleanup costs and yet have no right of contribution from other defendants.

103. CERCLA litigation often includes both defending suits for reponse costs and defending actions for contribution or indemnification.

104. For a discussion of potential penalties and fines under CERCLA, see *supra* notes 24-26 and accompanying text.

105. Excessive liability encourages the chemical industry to avoid CERCLA by moving to other countries.

106. For a discussion of potential innocent purchaser liability, see *supra* note 22 and accompanying text.

107. CERCLA provides that any such exemption from liability is void and unenforceable. *See* 42 U.S.C. § 9607(e) (1988).

nomic value, no rational buyer will purchase it, even though society might benefit from a sale. Fortunately, CERCLA now provides a defense for an innocent purchaser.[108] If this defense requires only a reasonable investigation by the purchaser, it goes far toward solving the problem of excessive liability for potential buyers. However, the statute which sets forth the defense indicates that the defense is narrow. The statute requires not just a reasonable investigation but "all appropriate inquiry." The tendency of courts to read CERCLA liability as broadly as possible further suggests that the defense will be read narrowly.[109]

Is it wise to demand a careful investigation by an acquirer? The benefit of such an inquiry is that it may prevent an owner who knows about a spill from selling to an unknowing purchaser and then disappearing. If the acquirer is not liable, the government may have to bear the loss. Even without CERCLA, an acquirer has some incentive to investigate in order to avoid purchasing contaminated facilities. Apart from preventing a seller from escaping CERCLA liability, any additional caution motivated by fear of CERCLA liability generates no social benefit. Since the likelihood of such a benefit is small,[110] any additional investigation is likely to be wasteful.

Further, CERCLA's innocent purchaser exemption does not help where the purchaser knows of the contamination and knows that the cost of cleaning it up exceeds the value of the property. The Act in effect forbids a sale in such cases, although such a prohibition creates no benefit.

Joint and several liability, purchaser liability, and the absence of cost-benefit limits on cleanups are not necessary features of a reasonable scheme of toxic waste regulation. The proposed European Community standards on toxic wastes dispense with or curtail all these features.[111]

So far the problem of excessive caution has been discussed in the context of firm liability. Controlling person immunity confines the risk of liability to the firm's equity. This equity can be drained to a minimum, thereby vitiating the deterrent threat of liability. Even if CERCLA imposes excessive liability, control persons will still cause the firm to be imprudent if they are personally immune from liability. Thus, controlling person immunity is arguably unwise even if CERCLA imposes excessive liability.

Controlling person liability exacerbates the problems of excessive lia-

108. For a discussion of potential innocent purchaser liability, see *supra* note 22.

109. Compare, for example, the narrow reading of the exception for mortgage lenders. *See supra* notes 69-80 and accompanying text.

110. More precisely, the anticipated benefit is the product of (1) the probability that the facility has toxic waste, (2) the CERCLA response costs if the property is contaminated, (3) the probability that the seller will avoid the CERCLA liability, and (4) the probability that additional investigation by the buyer will discover the forgoing. Although the anticipated benefit will then vary depending on what the purchaser knows in each case, in most cases the anticipated benefit will be very small.

111. *See* Freeman & McSlarrow, *The Proposed European Community Directive on Civil Liability for Waste—The Implications for U.S. Superfund Reauthorization in 1991*, 46 BUS. LAW. 1, 5-7, 20 (1990).

bility. If control persons can avoid excessive liability by incorporating, the problem of excessive caution will be small. Holding control persons liable, though, discourages economically desirable activity and distorts the structure of firms in the relevant industry.[112]

Similarly, controlling person liability aggravates the problem of purchaser liability. With limited liability, a facility can be purchased through a thinly capitalized subsidiary. Thus, the assets of the parent are not at risk for any unknown CERCLA liability. Shareholder liability forces the owners to accept the risk of CERCLA response costs. If these costs are unknown and possibly excessive, the purchase may not be made even though the transaction would be economically beneficial to society.

Both excessive liability and insufficient liability are threats. Which threat is greater is uncertain. The huge estimates of potential CERCLA liability suggest that the problems of excessive liability may well outweigh the benefits to firms of evading liability.[113] Moreover, critics of limited liability improperly assume that the possibility of ducking CERCLA liability affects everyone equally. Legitimate, risk-averse businesses do not readily evade the law. Evasion of CERCLA liability will be exploited primarily by criminal enterprises. Thus, CERCLA will invite penetration of the chemical industry by criminals. Indeed, it has already done so.[114]

B. *Risk-Spreading, Risk-Aversion, and Insurance*

The second principal argument for shareholder liability for torts is that the costs of accidents should be spread as widely as possible.[115] Holding shareholders liable encourages them to insure either personally or through the firm.[116] The costs of liability or insurance are then built into the prices that firms in each industry charge for their goods and services. The risk-spreading analysis goes beyond the argument that shareholder liability induces reasonable caution. Under a risk-spreading theory, a firm is liable for costs even when it exercises reasonable caution. The firm's superior ability to spread costs justifies the theory. This leads to strict liability under some environmental laws, including CERCLA.

Risk-spreading improves efficiency if investors are risk-neutral or if they can insure against the risk. However, investors are risk-averse,[117] and

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112. For a discussion of shareholder liability, see *infra* notes 122-24 and accompanying text.

113. For a discussion of the extent of liability, see *supra* notes 2, 24-26 and accompanying text.

114. For a discussion of criminal involvement in waste disposal, see *infra* note 132 and accompanying text.

115. For a discussion of risk spreading, see *supra* notes 86-88 and accompanying text.

116. For a discussion of shareholders' incentive to insure, see *supra* text accompanying notes 87-88.

117. *See* Note, *Parental Liability*, *supra* note 32, at 989 n.3 (citing K. ARROW, ESSAYS IN THE THEORY OF RISK-BEARING 90-120 (1971)). It is sometimes argued that corporations are not risk averse. *Id* at 989. Perhaps corporations *should* be risk neutral on the theory that investors can avoid risk if they wish by diversifying their own portfolios. *See* R. BREALY & S. MYERS, *supra* note 90, at 22. However, corporations in fact are risk averse, as demonstrated

currently insurance for CERCLA and similar liability is not widely available. Huge potential CERCLA liability may frighten investors away from opportunities with positive net present value. Consider, for example, the CEO of a $250 million firm weighing the acquisition of a company that is worth $50 million but for a 10% chance that it will incur a $300 million CERCLA liability. A risk-neutral investor would value this risk probabilistically at $30 million, and thus would pay up to $20 million for the company. A diversified investor may weigh this risk neutrally, but most executives will not. If the $300 million CERCLA liability occurs it will bankrupt the acquiring firm. This means a 10% chance that the executive's stock in the acquiring firm, probably a large part of his personal wealth, will be eliminated and his compensation radically reduced. The CEO also risks the loss of his job. Although this opportunity would appeal to diversified investors, it would repel the CEO personally, even if he were personally risk-neutral. Like most rational people, the executive probably is not risk-neutral, but is risk-averse.[118]

Extending liability to controlling persons aggravates this problem. If the executive can be personally liable for the CERCLA cleanup because of her office or shareholdings, she risks not only her compensation, the value of her stock, and possibly her job, but also personal liability far beyond her means. Few rational people will knowingly take that risk.

A solution to the executive's dilemma would be to acquire the company and insure against the CERCLA liability. However, if CERCLA insurance is available at all its expense may render such an acquisition unprofitable. Further, CERCLA insurance is often unavailable at any price. The lack of insurance is especially problematic because CERCLA liability can be so large. Owners may accept uninsured risks of moderate size even if they are mildly risk-averse. Few investors, however, will accept the risk of uninsured CERCLA liability.

The problem of risk-aversion may be manageable when a firm's risks are reasonably ascertainable.[119] The risks of waste disposal are notori-

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by their inclination to insure and to undertake mergers that do not increase the firm's value in order to reduce risk through diversification. Perhaps companies can diversify more inexpensively and more effectively than individual shareholders. *See* R. Gilson, The Law and Finance of Corporate Acquisitions 352 (1986). Even if this explanation is not persuasive, corporate officers do seek to reduce risk at the company level because their fortunes are closely tied to the firm's.

118. It is sometimes suggested that "the effect of managers' risk aversion on corporate decisionmaking is constrained by the disciplinary actions of shareholders, the labor market, and the capital market." Note, *Parental Liability*, *supra* note 32, at 990 n.27 (citing Fama, *Agency Problems and the Theory of the Firm*, 88 J. Pol. Econ. 288, 291-92 (1980)). These constraints are deeply flawed, however, and leave managers considerable discretion. *See* Dent, *supra* note 63, at 884-90. *See also* S. Shavell, Economic Analysis of Accident Law 189-90 (1987) [hereinafter S. Shavell] (diversified shareholders may be risk-neutral, but others in firms are not).

119. Professor Schwartz defines a "knowable risk" as a "risk that a product is as dangerous as a firm would predict on the basis of doing the cost-effective amount of research, or less dangerous." Schwartz, *supra* note 83, at 691.

ously unpredictable, however.[120] Theoretically, the executive in the hypothetical might take the opportunity if her company were larger and the opportunity sufficiently profitable. If the company is large, it can take many *known* risks and accurately predict how many of these risks will produce losses. If the probability of each risk is *unknown*, overall predictions become impossible. Even if risks are unpredictable, a risk-neutral investor might accept the uncertainty in exchange for the possibility of high returns. Like most people, however, the executive is risk-averse. She will probably shun the risks of any activity that might incur CERCLA liability.[121]

The uncertainty of environmental liability is compounded by the fear that Congress will not only change the rules but change them retroactively. CERCLA liability is now retroactive.[122] This may be unfair because retroactive liability cannot deter behavior that has already occurred. By imposing retroactive liability once, however, Congress and the courts have instilled anxiety that they will do so again. Entrepreneurs should realize that actions legal today may subject them to liability tomorrow. This inherent possibility cannot be quantified.

Although uncertainty is a problem even under limited liability, shareholder liability accentuates this problem. With limited liability the controlling person's uncertainty is limited to his investment in the firm. Although the probability of loss is not known, the amount of loss is capped. Shareholders can shrink the uncertainty by reducing the firm's equity. Holding shareholders liable forecloses this approach, forcing them to abandon opportunities with high risk and uncertainty.

How much the uncertainty bred by CERCLA liability discourages activity in the chemical industry cannot be determined precisely, but the disappearance of environmental insurance is telling. Insurers absorb a risk by spreading it over so many policies that the total uncertainty for most kinds of risks is reduced almost to zero. Only in rare cases is uncertainty so great that insurers will not pay for it. CERCLA presents such a rare case.

Although the forgoing discussion demonstrates that shareholder liability spreads the risks of CERCLA costs imperfectly, shareholder liability still might be better than forcing cleanup costs on the victims of contamination. If firms and controlling shareholders are imperfect risk-spreaders, they still are better risk-spreaders than most victims.[123] Under

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120. *See id.* at 690 (the "existence and extent of the harms [of toxic risks] are difficult to predict").

121. This might not be true if the executive were confident that CERCLA cleanup action would not occur for many years. Managers sometimes take unreasonable risks if they believe that losses will not be incurred until after they have retired. Schwartz, *supra* note 83, at 712. Although CERCLA liability can be delayed, a manager cannot safely predict such a delay.

122. For a discussion of CERCLA's retroactivity, see *supra* note 20.

123. This assumption is not always valid. For many environmental injuries the victims are numerous. In certain cases, the shareholders of a firm held liable may be less numerous (and no more wealthy), than the victims. Liability could turn on the number of sharehold-

CERCLA, the alternative to shareholder liability is EPA payment of the costs of cleanup. The federal government is a better risk-spreader than even the largest firm.

Government payment for CERCLA cleanups may be politically unacceptable. It is also allocatively inefficient because it frees the chemical industry of the costs of its own activities. As an alternative, the EPA could run an insurance program by paying CERCLA costs from a special tax on the chemical industry. This approach solves the problems of the unavailability of private insurance and of the allocative inefficiency of government payment of CERCLA costs. It is also eminently feasible because CERCLA provides for just such a tax.[124] Thus, the risk-spreading argument for shareholder liability under CERCLA seems to collapse completely.

C. *Limited Liability and Firm Structure*

The argument that shareholder liability encourages prudence and spreads the costs of accidents assumes that shareholder liability does not alter the financial structure of firms. That is, it assumes that firms will remain as solvent as under limited liability and that shareholders simply will be added as a new source of liability.

These assumptions are false. Even if shareholders are liable, their risk is limited by insolvency. They still can escape liability by declaring bankruptcy.[125] This creates an incentive to vest chemical firms in less wealthy hands. Consider an undertaking that eventually may incur large CERCLA liability. To a group of individuals of modest means, the threat of CERCLA liability is relatively unimportant. If held liable, they can declare bankruptcy without great hardship because most of their belongings will be exempt from creditors.[126] Even if insurance were available, they might forgo it because they have little to protect.[127]

A large company considering the same opportunity could not disregard CERCLA liability so easily. It must weigh that liability to the point of its own bankruptcy; that is, up to its net worth. Further, because of joint and several liability and the EPA's practice of pursuing deep pockets, the large firm must anticipate that it will probably have to bear more than its share of a major spill, while the impecunious firm may reasonably

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ers, but that would further discourage participation by large firms in the industries subject to CERCLA liability. *See supra* note 76 and accompanying text.

124. Under 26 U.S.C. § 9507 (1988) the Hazardous Substance Superfund is funded by among other sources, taxes imposed on the production and importation of oil and petroleum and chemical products under 26 U.S.C. §§ 4611, 4661, and 4671 (1988).

125. *See* Ohio v. Kovacs, 469 U.S. 274, 278-84 (1985) (liability to pay money under federal environmental laws can be discharged in bankruptcy). *Compare* Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494, 507 (1986) (bankruptcy trustee held forbidden to abandon property in contravention of state law).

126. *See* S. SHAVELL, *supra* note 118, at 167 (tortfeasors consider liability only to the extent of their assets).

127. S. SHAVELL, *supra* note 118 at 240 (people may not insure if their assets are less than the liability they may incur).

expect that it will have to pay little or not be sued at all. Moreover, the threat to management's compensation and job security may make a large, stable firm shun even profitable opportunities.[128] With unlimited liability, the firm could not avoid this risk by placing the opportunity in a subsidiary.

Similarly, shareholder liability encourages owners of a firm fearing large liability to siphon off and spend firm assets before that liability materializes. The owners' CERCLA liability is limited by bankruptcy. Therefore, money already spent or transformed into exempt assets ordinarily cannot be reached.[129] At least the shareholders are no worse off for siphoning assets from the firm. CERCLA encourages this behavior more than other liability risks because it is often of large magnitude and usually is incurred long after a release. Thus, after a spill, a firm's owners may have years to drain and spend assets before facing liability.

Congress apparently recognized the problem of asset draining and tried to counter it with broad joint and several liability. Generators of toxic waste have reason to see that those hired to transport and dispose of toxic waste do the job properly and are financially responsible because generators share the liability for any spill.[130] However, generators have difficulty efficiently monitoring disposers. Overseeing disposal is challenging and costly. Further, ensuring the continuing financial responsibility of the disposer long after the disposal is virtually impossible. Therefore, Congress' attempt to assure prudence and financial responsibility by having different firms monitor each other appears to fail. Unfortunately, this threat of uncontrollable liability for acts of others operates in favor of financially irresponsible firms.

If this critique is accurate, one would predict that an abnormally large number of firms with potential CERCLA liability would be small and financially weak. One would further assume that these firms would make large payouts, then dissolve and abandon contaminated facilities. In practice, this seems to be what is happening.[131]

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128. For a discussion of risk aversion, see *supra* notes 117-21 and accompanying text.

129. A trustee in bankruptcy may avoid any transfer: made "with actual intent to hinder, delay, or defraud" creditors, made for "less than a reasonably equivalent value" when the debtor was insolvent or had "an unreasonably small capital," or made when the debtor expected to "incur . . . debts that would be beyond the debtor's ability to pay as such debts matured." 11 U.S.C. § 548(a) (1990). It can be difficult to prove that a transfer falls within this provision, however. *See* Shanker, *What Every Lawyer Should Know About the Law of Fraudulent Transfers*, 31 PRAC. LAW. 43, 48-55 (1985).

130. For a discussion of those liable under CERCLA, see *supra* notes 6-7, 18 and accompanying text. Liability for a spill extends not only to the generator's waste but also to any waste others mix with it. *See supra* notes 9-10, 39 and accompanying text.

131. *See* COUNCIL ON ENVIRONMENTAL QUALITY, TENTH ANNUAL REPORT 174 (1979) (500-800 waste sites have been abandoned); Note, *Cleaning Up Bankruptcy: Curbing the Abuse of the Federal Bankruptcy Code by Industrial Polluters*, 85 COLUM. L. REV. 870, 871 n.14 (1985) (with increasing frequency bankruptcy has been used to avoid environmental liabilities). *Cf.* Schwartz, *supra* note 80, at 724 (discussing high dividend payouts by Johns-Manville, apparently to evade future asbestosis claims). This analysis might also predict that an inordinate number of publicly held companies would incur CERCLA liability on the

Criminal involvement is a related problem. Proper toxic waste disposal primarily benefits the public, not the payor. The legal difficulties and high costs of waste disposal attract criminals who take high fees and do the job inexpensively and illegally. Potential civil liability is a cost for law-abiding, well-financed firms, but not for criminals who conspire to evade such liability. As a result, legitimate firms suffer a competitive disadvantage. The larger the CERCLA liability, the larger the disadvantage for honest firms. Shareholder liability increases this disadvantage by extending the risk to law-abiding owners. Evidence suggests that these results have occurred. Organized crime, and perhaps unorganized crime as well, has heavily infiltrated the toxic waste disposal industry.[132] CERCLA liability, although intended to deter polluters, may very well defeat its own purposes by forcing legitimate firms out of the chemical industry in favor of illegitimate, criminally-controlled firms.

D. *Controlling Person Liability and the Volume of Litigation*

Proponents of controlling person liability argue that it reduces litigation by providing government a deep pocket from which to recover response costs and facilitating settlement of CERCLA claims.[133] Although the government may find it convenient to pursue controlling persons as deep pockets, the latter may take steps to avoid liability. These steps could make CERCLA recovery more difficult than under traditional standards of piercing. As previously explained, holding controlling persons liable may encourage them to drain firm assets or shift ownership to criminal owners or owners who are less financially responsible.[134] Further, controlling person liability would spawn additional litigation among responsible parties over contribution.

Controlling person liability could also cause satellite litigation between control persons and the firm over the apportionment of liability. If

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theory that controlling shareholder liability could be avoided by having a firm with no controlling shareholder. However, if there is no controlling shareholder, liability can be imposed on controlling officers. *See supra* notes 35-40, 66-67 and accompanying text. If there is always some control person potentially liable, it is logical for that person to reap the advantages of owning a majority of the stock together with his burden of liability.

132. *See, e.g.*, Egan, *New York Mob Views Recycling and Turns Green*, N.Y. Times, Nov. 28, 1990, at C20, col. 1; Blumenthal, *Illegal Dumping of Toxins Laid to Organized Crime*, N.Y. Times, June 5, 1983, § 1, at 1, col. 1 ("[g]arbage companies dominated by organized crime have been secretly and illegally dumping vast quantites of dangerous chemicals throughout the New York area"); Clay, *Cleaning Up Superfund's Incentive Structure*, STAN. L. & POLICY REV. 180, 184 (Spring 1990) ("'midnight dumping' and other improper forms of disposal appear to increase proportionately with costs of legal disposal"); Cook, *The Garbage Game*, FORBES, Oct. 21, 1985, at 12. Other laws may accentuate this effect. For example, local laws requiring governmental bodies to accept the lowest bid for services have forced some to contract waste disposal to firms with criminal connections and histories of shoddy disposal.

133. *See Note, Parent Liability*, *supra* note 32, at 997 (parental liability facilitates settlement by avoiding disputes that arise under traditional piercing criteria).

134. For a discussion of the problems associated with shareholder liability, see *supra* notes 130-32 and accompanying text.

control persons are liable, plaintiffs will frequently pursue them first because they frequently have the deeper pockets. If the controlling person owns all of the firm's stock, little difference exists between pursuing either the firm or the controlling persons. If the firm has minority shareholders, however, one who has been held liable may sue the firm and other shareholders and officers for contribution. The novelty of such suits would make them difficult to resolve.[135] Thus controlling person liability would reduce litigation minimally, if at all.[136]

E. *Lender Liability*

The fear that lenders cannot interfere with a debtor's business or seize collateral without risking CERCLA liability will deter them from making loans in industries dealing with hazardous chemicals. *Fleet Factors* dismissed this concern, claiming that its ruling would "encourage potential creditors to investigate thoroughly the waste treatment systems and policies of potential debtors."[137] Investigating and monitoring are expensive, however, and monitoring is useless unless the lender can stop any improper activities it finds. If the lender contracts for power to control borrower activities, though the lender is clearly an owner under *Fleet Factors*,[138] and thus subject to liability.

Although the potential liability of lenders will promote caution, the additional caution may not be beneficial. As a CERCLA owner, the lender is liable even for disposals it could not prevent. Because of joint and several liability, a lender's exposure could far exceed any damage done by its borrower. Moreover, many lenders are financial institutions that are required to avoid risky loans even if they can charge an interest rate commensurate with the risk. Should the institution attempt to charge such an increased rate, the practice may be prevented by usury laws. Hence, the threat of liability to lenders may, by drying up credit or inflating its cost, impose costs far greater than the benefits of increased care in waste disposal.[139] Lender liability may not profit the government even in the short

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135. Because majority and minority shareholders share profits pro rata, perhaps they should likewise share liabilities. That would mean that the firm should be entirely liable—i.e., should indemnify the majority shareholder if it can. However, minority shareholders will argue that they are innocent and the majority shareholder should bear all liability because of his control. Thus, the results in such suits are hard to predict.

136. *See* S. SHAVELL, *supra* note 118, at 174 (vicarious liability increases dispute resolution costs).

137. 901 F.2d 1550, 1558 (11th Cir. 1990). *See also* United States v. Maryland Bank & Trust Co., 632 F. Supp. 573, 580 (D. Md. 1986).

138. For a discussion of a lender's status as owner, see *supra* note 40 and accompanying text. To some extent it is appropriate that the foreclosing mortgagee bear the cost of the cleanup. As recognized in United States v. Maryland Bank & Trust Co., 632 F. Supp. 573, 579 (D. Md. 1986), if the mortgagee-owner does not pay for the cleanup, the government may have to pay the cost while the mortgagee-owner realizes a windfall from the enhanced value of the cleaned up property. However, this windfall is unfair only to the extent that it leaves the mortgagee better off than it would have been had the debt to it been paid in full. Such a result appears extremely unlikely.

139. *See* Guidice v. BFG Electro. & Mfg. Co., 732 F. Supp. 556, 561-62 (W.D. Pa.

term. By forcing cleanup costs on lenders, the courts have exacerbated another problem: The CERCLA liability of banks is increasing the cost of the savings and loan bailout.[140]

Recognizing that these problems exist, the EPA has recently proposed to absolve a lending institution from CERCLA liability if it sells contaminated property within six months of foreclosure.[141] Although this is a welcome step, it hardly remedies the problem.

V. Toward a More Fruitful Approach

So far this article has established that automatic liability of controlling persons under CERCLA is unwise. That does not mean that strict adherence to the canons of limited liability is ideal; the critique of limited liability is actually strong. To absolve those who are negligent gives rise to too many accidents and excessive engagement in risky activities. To impose liability on those who are prudent, however, promotes excessive caution, underutilization of desirable activities, and inadequate spreading of costs. The proper goal is reasonable prudence. Prudence here means the exercise of caution to the point where the costs of additional caution would outweigh the benefits of such caution.[142]

Defining reasonable prudence for controlling persons poses three conceptual difficulties. First, how actively must controlling persons intrude into corporate affairs to establish reasonable prudence? Second, what standards of financial responsibility must they maintain? Third, what is the relationship between oversight and financial responsibility in establishing prudence?

Critics charge that limited liability breeds negligence because a firm and its owners do not bear the full costs of the injuries they cause. Thus, as a condition to limited liability, controlling shareholders should be expected to make reasonable efforts to see that the firm is not negligent. In general, this should not require monitoring the day-to-day activities of the firm. That job is properly reserved for corporate officers. Rather, controlling shareholders should see that the firm retains competent officers who install a reasonable program to prevent hazardous waste release. Closer monitoring should be required only when the shareholder has reason to know that the firm's waste control program may not be adequate. The occurrence of accidents that lead or could have led to toxic releases should warn of a need for closer monitoring. To prevent willful ignorance, controlling shareholders should receive reports from the firm about the waste control program with such frequency and in such detail as are appropriate for other matters of comparable importance.

1989) ("a high liability threshold will enhance dual purposes of protecting bank's investments and promoting CERCLA policy goals").

140. *See EPA Proposal Could Ease Lender Liability*, Wall St. J., Oct. 10, 1990, at B6, col. 1.

141. *See id.*

142. For a discussion of cost-benefit analysis and its application, see *supra* notes 8, 31, 96-97 and accompanying text.

This standard treats the controlling persons as corporate law often treats boards of directors: It requires them to institute proper oversight programs. Further involvement is not required unless controlling persons know that a program is not working properly.[143] This similarity is intended. Corporate law has long recognized that controlling shareholders and officers occupy a position similar to that of directors and should often be held to similar standards.[144] Indeed, individual shareholders frequently serve as directors. Further, parent corporations nominate individual directors who also serve as the parent's agents for receiving information and transmitting instructions. Therefore, it is appropriate to treat the shareholders like directors for purposes of liability.[145]

This standard avoids many problems of the traditional piercing doctrine, which often relies on unclear metaphors, such as domination and alter ego, and irrelevancies such as observance of corporate formalities. It also avoids the problems created by some CERCLA cases holding parents liable where they exercised close control over a subsidiary.[146] These holdings encourage a parent purposefully to ignore the activities of its subsidiaries, which as a result may become less environmentally responsible. The proposed standard rewards reasonable diligence by imposing liability only for negligence.

Defining a controlling person's responsibility to assure the firm's financial soundness is conceptually more difficult. Too low a financial standard allows owners to escape liability too inexpensively. A standard that is too high discriminates against smaller firms and their owners and might create detrimental barriers to entry in an industry.[147] Drawing the line separately for each firm would be impossibly complex, while drawing

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143. *See Corporate Director's Guidebook*, 33 BUS. LAW. 1595, 1602-03 (1978) ("board of directors is not expected to operate the business . . . . The responsibility of the board is limited to overseeing [each] operation.").

144. *See* R. CLARK, *supra* note 48, at 141: "Directors, officers, and, in some situations, controlling shareholders owe their corporations, and sometimes other shareholders and investors, a fiduciary duty of loyalty."

145. This position does not constitute an endorsement of corporate law's treatment of directors. The directors' standard of care is often too low. *See* Dent, *The Revolution in Corporate Governance, the Monitoring Board, and the Director's Duty of Care*, 61 B.U.L. REV. 623, 644-54 (1981). The American Law Institute's Corporate Governance Project has made a good effort to define the directors' duty of care. *See* ALI, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01 (Tent. Draft No. 1, 1982). For a discussion of the director's duties, see *Corporate Director's Guidebook*, 33 BUS. LAW 1595, 1599-1618 (1978).

146. For a discussion of parental liability, see *supra* notes 53-60 and accompanying text.

147. To fulfill the financial requirements, smaller companies would have to obtain insurance, but most small companies find it hard to pay high premiums and to cover large deductibles. Larger companies could fulfill the requirement with financial reserves. In effect, larger companies could be self-insuring, thereby enjoying a competitive advantage by avoiding costly outside insurance. *See* Sommerfield, *Going Bare*, INSTITUT. INVESTOR, Mar., 1989 at 99, 100. Perhaps self-insurance is desirable since one goal of CERCLA is to ensure the financial responsibility of polluters. However, the resulting detriment to small businesses has some negative consequences. *See* S. SHAVELL, *supra* note 118, at 169.

the line for different groups of companies would create problems of properly categorizing each company. However, this administrative problem does not seem insuperable.

Fortunately, Congress recognized the problem of financial responsibility and provided for a plan to define financial responsibility within CERCLA. Section 108 of the Act requires the President to establish types and levels of financial responsibility for vessels and facilities.[148] Unfortunately, the President has not yet discharged this duty. Until the adoption of such standards is complete, courts must do their best to define them. Although a precise formula may be impossible, several factors are relevant. Financial responsibility should be proportionate to the firm's risks based on the types of hazardous substances handled, the use to which those substances are put, and the history of toxic spills in the firm and in other firms in the same industry. If the firm is uninsured, the court should inquire whether insurance was reasonably available, or whether the firm simply decided to forgo insurance.

Even with the piercing and financial responsibility standards suggested above, the public will have to pay for many hazardous waste cleanups. Public payment violates the rule of efficiency that activities should bear their costs. This problem could be avoided by financing Superfund with a special tax on the chemical industry. In fact, Congress has done just that.[149] This tax serves as a government mandated and operated insurance plan. However, the tax does lack some benefits of private insurance plans. For example, the tax is not adjusted according to the unique risks posed by individual companies. On the other hand, the government arguably can monitor and regulate each company's compliance with environmental safety laws better than the private insurance industry. In certain circumstances, private insurance might be superior to the industry tax. However, given the limited availability of private insurance for toxic spills, an industry tax is preferable.

To encourage reasonable diligence, when courts hold a controlling person liable, they should avoid excessive liability. In particular, joint and several liability should not be used to impose liability disproportionate to the owner's negligence or the responsible firm's contribution to the release. The statute exacerbates this problem of excessive liability by barring actions for contribution in certain cases.[150] Again, the statute may dictate the fate of responsible firms, but it does not dictate the treatment of controlling persons. The treatment of controlling persons must be determined by the courts. Under both traditional piercing criteria and the special standards for controlling person liability applied in CERCLA cases, the touchstones have been equity and public policy. Courts may

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148. 42 U.S.C. § 9608 (1988). Similar requirements are imposed by the Solid Waste Disposal Act, 42 U.S.C. § 6921 (1988); and by the Resource Conservation Recovery Act, 42 U.S.C. § 6973 (1988).

149. *See* 26 U.S.C. §§ 4611, 4661 (1988).

150. For a discussion of contribution for CERCLA liability, see *supra* note 39 and accompanying text.

reject or limit the liability of controlling persons where equity and public policy so demand.[151]

The proposed standard does not contradict the strict liability imposed by CERCLA. Strict liability extends only to owners and operators. It does not extend to controlling persons.[152] Since controlling person liability was not defined by Congress, it must be fashioned by the courts.

This analysis suggests why the different standard proposed by Professor Alan Schwartz is somewhat imperfect. Professor Schwartz would pierce the corporate veil "if, when a firm's assets, including insurance assets, are insufficient to satisfy tort claims, . . . the firm knew or should have known that it faced a positive probability of incurring a tort liability that would exceed its wealth."[153] Schwartz's proposal incorrectly assumes the availability of insurance at reasonable premiums and ignores the possibility of excessive tort liability. Firms should be required to insure only if insurance is available at premiums that reflect risks. Uncertainty or the magnitude of the potential loss often make CERCLA insurance unavailable at reasonable premiums.

This article's proposed standard resembles the corporate law standard of care for directors. It follows that the standard for liability of directors under CERCLA should be the same as for controlling shareholders. The standards for non-director officers should be somewhat different. Officers are supposed to oversee the day-to-day affairs of the business and, therefore, should be held liable for accidents that they should have prevented in the reasonable discharge of their duties. This premise should hold true even though the directors and controlling shareholders who are not officers might not be liable.[154] Officers do not, however, have the general power to determine the firm's hazardous waste treatment or its capital structure. Therefore, officers should not be held liable for shortcomings in these areas unless they personally caused the problem. Moreover, individual officers have reason to be cautious without having to worry about CERCLA liability.[155] Thus, courts should hesitate to hold them personally liable.

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151. Holding a controlling person partially liable for a firm's obligations is unusual. Secondary liability has generally been an all-or-nothing proposition. However, the special features of CERCLA—such as strict liability, joint and several liability, limitations on the right of contribution, retroactive liability, and immense, uninsurable damages—justify novel approaches. Neither equity nor public policy precludes holding a controlling person liable for some but less than all of a firm's CERCLA obligations.

152. For a discussion of controlling person liability, see *supra* notes 33-44 and accompanying text.

153. Schwartz, *supra* note 83, at 716-17.

154. Again, this position does not constitute an endorsement of the law's treatment of officer liability. Corporate law has improperly ignored the duties of officers and focused on the duties of directors. Occasionally, however, the law—including criminal law—has imposed harsh, unfair and unrealistic demands on corporate officers. *See generally* United States v. Park, 421 U.S. 658 (1975) (chief executive officer of corporation with 36,000 employees and 900 facilities held criminally liable for unsanitary conditions in one facility).

155. For a discussion of individual officer liability, see *supra* notes 60-68 and accompanying text.

Lenders have good reason to review a borrower's potential liabilities before extending credit and to require covenants to comply with the law once credit is granted. Generally, lenders cannot efficiently contribute efforts other than these to prevent toxic spills. Courts should, therefore, hesitate to demand any more from lenders and should hold lenders liable only under rare circumstances. Exceptions should include cases where a lender insists that a debtor in financial trouble make payments that hamper the debtor's ability to comply with the law, including CERCLA. Beyond such exceptional circumstances, the costs of additional lender liability would be substantial and the benefits small.

Conclusion

This article originated with a desire to question the wisdom of limited shareholder liability. The argument against limited liability at first seems powerful. A closer analysis, however, reveals that the argument weakens considerably in the CERCLA context. The same would seem true in other areas of environmental law. What this suggests for limited liability in other areas of tort law is not at all clear. Therefore, we should hesitate to accept broad answers and should continue to study limited liability in environmental law.