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## Parent Corporation's Liability under CERCLA Section 107 for the Environmental Violations of Their Subsidiaries

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# NOTES & COMMENTS

## PARENT CORPORATION'S LIABILITY UNDER CERCLA SECTION 107 FOR THE ENVIRONMENTAL VIOLATIONS OF THEIR SUBSIDIARIES

### I. INTRODUCTION

In 1980, Congress enacted the Comprehensive Environmental Response, Compensation, and Liability Act<sup>1</sup> (CERCLA) in response to several environmental disasters, such as Valley of the Drums<sup>2</sup> and Love Canal.<sup>3</sup> The purpose of CERCLA is "to address the increasing environmental and health problems associated with inactive hazardous waste sites" by ensuring that the responsible parties are held accountable for the environmental clean-up costs.<sup>4</sup> In contrast to its predecessor statutes,<sup>5</sup> "CERCLA is a remedial statute . . . designed primarily to rectify environmental problems posed by hazardous waste produced and abandoned in the past, rather than operating prospectively to prevent future problems."<sup>6</sup> CERCLA, referred to by one commentator as "perhaps the most radical environmental statute

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1. 42 U.S.C. §§ 9601-9674 (1988 & Supp. V 1993).

2. See H.R. REP. NO. 1016, 96th Cong., 2d Sess., pt. 1, at 18-19 (1980), reprinted in 1980 U.S.C.C.A.N. 6119, 6121. Valley of the Drums was described as follows: "At the Valley of the Drums [located in Kentucky], thousands of barrels were stacked illegally in the hauler's backyard . . . in a seriously deteriorating state . . . [S]ome have already burst and spilled their contents on the ground." *Id.*

3. Note, *Using RCRA's Imminent Hazard Provision in Hazardous Waste Emergencies*, 9 *ECOLOGY* L.Q. 599 n.2 (1981) (Love Canal was originally dug as a canal to connect the Niagara River and Lake Ontario. However, it ended up as a dumpsite for more than eighty deadly chemicals.).

4. *Nurad, Inc. v. William E. Hooper & Sons Co.*, 966 F.2d 837, 841 (4th Cir. 1992).

5. See, e.g., Resource Conservation & Recovery Act of 1976, codified at 42 U.S.C. §§ 6901-92k (1988 & Supp. III 1993); H.R. REP. NO. 1016, 96th Cong., 2d Sess., pt. 1, at 22 (1980), reprinted in 1980 U.S.C.C.A.N. 6119, 6125 (RCRA, the principal statute dealing with environmental disposal issues prior to CERCLA, "is prospective and applies to past sites only").

6. Lynda J. Oswald, *Bifurcation of the Owner and Operator Analysis Under CERCLA: Finding Order In The Chaos Of Pervasive Control*, 72 *WASH. U. L.Q.* 223, 229 (1994) [hereafter *Bifurcation*] (citing *United States v. Shell Oil Co.*, 605 F. Supp. 1064, 1072 (D. Colo. 1985) (CERCLA "is by its very nature backward looking. Many of the human acts that have caused the pollution already had taken place before its enactment.")).

in American history,"<sup>7</sup> assesses liability for clean-up costs on a broad category of potentially responsible parties. This Comment addresses the question of whether parent corporations are liable under CERCLA section 107 as potentially responsible parties for the hazardous waste violations of their subsidiaries.

Potentially responsible parties include: (1) the present "owner and operator" of the facility;<sup>8</sup> (2) any person who "owned or operated" the facility when the hazardous substance was disposed of;<sup>9</sup> (3) any person who "arranged . . . for disposal or treatment" of hazardous waste at the facility;<sup>10</sup> and (4) any person who accepted hazardous waste "for transport to disposal or treatment facilities."<sup>11</sup> CERCLA imposes strict liability on responsible parties for the clean-up costs incurred in responding to hazardous waste problems at the facility.<sup>12</sup>

Individual shareholders, corporate directors, officers, and successor corporations may be liable as potentially responsible parties under CERCLA section 107.<sup>13</sup> However, it is unclear whether parent corporations can be held liable as potentially responsible parties for the acts of their subsidiary corporations<sup>14</sup> because CERCLA never expressly refers to parent or subsidiary corporations.<sup>15</sup> As a consequence, courts determine a parent corporation's liability under CERCLA section 107 by examining the plain language of the statute and applying traditional notions of corporate law liability.<sup>16</sup> This approach has resulted in inconsistent interpretations by the courts.<sup>17</sup>

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7. Note, *Developments in the Law — Toxic Waste Litigation*, 99 HARV. L. REV. 1458, 1465 (1986).

8. 42 U.S.C. § 9607(a)(1) (1988).

9. *Id.* § 9607(a)(2) (1988).

10. *Id.* § 9607(a)(3) (1988).

11. *Id.* § 9607(a)(4) (1988).

12. *United States v. Monsanto Co.*, 858 F.2d 160, 167 (4th Cir. 1988) ("We agree with the overwhelming body of precedent that has interpreted section 107(a) as establishing a strict liability scheme.") (citations omitted).

13. See *New York v. Shore Realty Corp.*, 759 F.2d 1032, 1052 (2d Cir. 1985) (holding stockholders and officers liable as operators under CERCLA); *United States v. Mottolo*, 695 F. Supp. 615, 623-24 (D. N.H. 1988) (holding shareholder liable as an owner under CERCLA section 107); *Smith Land & Improvement Corp. v. Celotex Corp.*, 851 F.2d 86, 90-92 (3d Cir. 1988), *cert. denied*, 488 U.S. 1029 (1989) (holding successor corporation liable under CERCLA section 107); *Anspec Co. v. Johnson Controls, Inc.*, 922 F.2d 1240, 1247-48 (6th Cir. 1991) (a successor corporation may be a liable "person" under CERCLA).

14. Comment, *Redefining "Owner Or Operator" Under CERCLA To Preserve Traditional Notions of Corporate Law*, 43 EMORY L.J. 771, 774 (1994) [hereafter *Redefining*].

15. *Id.*

16. *Id.*

17. This is illustrated by two prominent circuit court cases in this area. Compare *Joslyn Mfg. v. T.L. James & Co.*, 893 F.2d 80 (5th Cir. 1990) (concluding that a parent corporation may be held only indirectly liable under CERCLA) with *United States v. Kayser-Roth Corp.*, 910

Courts are basing their approach of a parent corporation's liability under CERCLA section 107 for the hazardous waste violations of their subsidiaries on one of two legal theories. Under the "direct liability" theory, courts determine whether the parent corporation can be directly liable under the plain language of CERCLA.<sup>18</sup> This requires that courts determine whether the parent has exercised sufficient control over its subsidiary to classify the parent as an "operator" under CERCLA section 107.<sup>19</sup> Under the "indirect liability" theory, courts determine whether the subsidiary is merely a "sham" corporation, meaning the subsidiary is the "instrumentality" or "alter ego" of the parent corporation.<sup>20</sup> Courts finding indirect liability are doing so by "piercing the corporate veil," thus disregarding the corporate form of the subsidiary to hold the parent corporation liable.

This Comment begins with a discussion of the problem the courts face when applying CERCLA. Part II examines CERCLA, focusing on section 107, the section describing potentially responsible parties. Part III examines the liability of parent corporations under CERCLA case law by examining cases dealing with both direct and indirect liability. Part IV proposes changes that could be implemented to improve the resolution of this issue. The author advocates the application of a new test by the courts to address a parent corporation's liability for the acts of their subsidiaries under CERCLA section 107. Part V discusses the effect of the proposed changes by examining the expected benefits, anticipated resistances, and possible future problems. Part VI discusses how parent corporations may handle liability problems if the present scheme is adhered to by the courts. Finally, Part VII summarizes the analysis and conclusions of this Comment.

## II. STATEMENT OF THE PROBLEM

CERCLA section 107 establishes four groups of parties responsible for the clean-up costs of hazardous substance violations covered under CERCLA. These four groups are otherwise known as potentially responsible parties (PRPs). The four groups of PRPs are: (1)

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F.2d 24 (1st Cir. 1990) *cert. denied*, 111 S. Ct. 957 (1991)(concluding that a parent corporation may be held both directly and indirectly liable under CERCLA).

18. *See Kayser-Roth Corp.*, 901 F.2d at 24.

19. *Id.* at 27 (to classify a parent corporation as an operator of a subsidiary corporation for liability purposes under CERCLA requires active involvement by the parent in the activities of the subsidiary).

20. *Joslyn Mfg.*, 893 F.2d at 83.

present owners and operators of the facility in question; (2) any person who formerly owned or operated the facility during the disposal of any hazardous substance; (3) generators of hazardous substances; and (4) those persons who transport hazardous waste.<sup>21</sup> Notwithstanding the authority of section 107, it is unclear whether parent corporations are liable as either owners or operators for the hazardous waste violations of their subsidiary corporations.

The phrase "owner or operator" is defined in CERCLA to mean "any person owning or operating a facility."<sup>22</sup> "Person" is defined to include individuals and corporations,<sup>23</sup> but does not expressly refer to parent corporations. Courts examining whether parent corporations are owners or operators under section 107 are doing so based on the

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21. 42 U.S.C. § 9607(a) (1988). CERCLA § 107(a) states, in relevant part:

(a) Notwithstanding any other provision or rule of law, and subject only to the defenses set forth in subsection (b) of this section —

(1) the owner and operator of a vessel or a facility,

(2) any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of,

(3) any person who by contract, agreement, or otherwise arranged for disposal or treatment, or arranged with a transporter for transport for disposal or treatment, of hazardous substances owned or possessed by such person, by any other party or entity, at any facility or incineration vessel owned or operated by another party or entity and containing such hazardous substances, and

(4) any person who accepts or accepted any hazardous substances for transport to disposal or treatment facilities, incineration vessels or sites selected by such person, from which there is a release, or a threatened release which causes the incurrence of response costs, of a hazardous substance, shall be liable for —

(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;

(B) any other necessary costs of response incurred by any other person consistent with the national contingency plan;

(C) damages for injury to, destruction of, or loss of natural resources, including the reasonable costs of assessing such injury, destruction, or loss resulting from such release; and

(D) the costs of any health assessment or health effects study carried out under section 9604(i) of this title.

22. 42 U.S.C. § 9601(20)(A) (1988) defines "owner or operator" in the following terms:

The term "owner or operator" means (i) in the case of a vessel, any person owning, operating, or chartering by demise, such vessel, (ii) in the case of an onshore facility or an offshore facility, any person owning or operating such facility, and (iii) in the case of any facility, title or control of which was conveyed due to bankruptcy, foreclosure, tax delinquency, abandonment, or similar means to a unit of State or local government, any person who owned, operated, or otherwise controlled activities at such facility immediately beforehand. Such term does not include 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.

23. 42 U.S.C. § 9601(21) (1988) (defining person as "[a]n individual, firm, corporation, association, partnership, consortium, joint venture, commercial entity, United States Government, State, municipality, commission, political subdivision of a State, or any interstate body.").

plain language of the statute and traditional common law notions of corporate law.<sup>24</sup>

Traditionally, corporations have relied on the corporate law principle of limited shareholder liability as protection from creditor's claims.<sup>25</sup> The principle of limited shareholder liability is that a shareholder's liability is ordinarily limited to the amount the shareholder invested in the corporation.<sup>26</sup> "Beyond that, a corporate creditor has recourse only against the corporate entity incurring the liability, not against individual or corporate shareholders."<sup>27</sup>

In the parent/subsidiary context, the parent is treated similarly to the shareholder. The parent corporation, like the shareholder, ordinarily is not liable for its subsidiary's debts beyond the amount it invested in the subsidiary. A third-party wanting to hold someone liable beyond that amount must look directly to the subsidiary itself. Recently, however, third-parties have decided to look directly to the parent corporation because "[i]n many cases, the assets of the corporation immediately responsible for the hazardous waste problems have proven inadequate to pay for the necessary clean-up at the site."<sup>28</sup>

Although limited liability has traditionally shielded parent corporations from liability for the acts of their subsidiaries, "with increasing frequency parents are finding themselves personally liable for clean up costs resulting from contamination their subsidiaries have caused."<sup>29</sup> Courts have circumvented the limited liability principle using one of two methods. First, courts are holding parent corporations directly liable as operators under CERCLA's liability standards.<sup>30</sup> Second, courts are holding parent corporations indirectly liable as owners through traditional corporate law exceptions to the limited liability principle.<sup>31</sup> The major corporate law exception is known as the

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24. *Redefining*, *supra* note 14, at 774.

25. *Id.* at 774-75.

26. See A. CONARD, CORPORATIONS IN PERSPECTIVE § 270 (1976).

27. Evelyn F. Heidelberg, Comment, *Parent Corporation Liability Under CERCLA: Toward a Uniform Federal Rule of Decision*, 22 PAC. L.J. 854, 871 (1991) (citations omitted) [hereafter *Uniform Federal Rule*].

28. Ronald G. Aronovsky & Lynn D. Fuller, *Liability of Parent Corporations for Hazardous Substance Releases Under CERCLA*, 24 U.S.F. L. REV. 421, 422 (1990) [hereafter *Liability*].

29. James A. King, *Kayser-Roth, Joslyn, and the Problem of Parent Corporation Liability Under CERCLA*, 25 AKRON L. REV. 123 (1991) (citations omitted) [hereafter *Problem*].

30. CPC Int'l, Inc. v. Aerojet-General Corp., 777 F. Supp. 549, 572 (W.D. Mich. 1991), *aff'd in part, rev'd in part*, 59 F.3d 584 (6th Cir. 1995).

31. *Id.*

corporate veil piercing doctrine. The court in *United States v. Milwaukee Refrigerator Transit Co.*<sup>32</sup> explained the veil piercing exception in the following terms:

[A] corporation will be looked upon as a legal entity as a general rule, and until sufficient reason to the contrary appears; but, when the notion of the legal entity is used to defeat public convenience, justify wrong, protect fraud, or defend crime, the law will regard the corporation as an association of persons.<sup>33</sup>

Both the direct liability and indirect liability methods have led to inconsistent interpretations by the courts.

### III. DISCUSSION OF THE PROBLEM

Neither the plain language nor the legislative history of CERCLA addresses whether parent corporations may be held liable for the clean-up costs of their subsidiary's hazardous waste violations. Nevertheless, some courts have found parent corporations liable based on one of two theories.

Some courts have found parent corporations liable under the "direct liability" theory, which holds parent corporations directly liable under CERCLA based on their level of involvement in the subsidiary corporation or in operations at the subsidiary's facility.<sup>34</sup> However, courts are in conflict about the level of involvement the parent corporation must exercise over the subsidiary. Some courts hold that a parent's capacity to control the subsidiary's activities is enough while others hold that the parent must exercise actual control over the subsidiary.<sup>35</sup>

In contrast to the direct liability theory, other courts have found parent corporations liable using the "indirect liability" theory. Under the indirect liability theory, courts apply the "alter ego"<sup>36</sup> or "mere

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32. 142 F. 247 (E.D. Wis. 1905).

33. *Id.* at 255.

34. *See* *United States v. Kayser-Roth Corp.*, 910 F.2d 24, 27 (1st Cir. 1990), *cert. denied*, 111 S. Ct. 957 (1991).

35. *Compare* *Idaho v. Bunker Hill Company*, 635 F. Supp. 665 (D. Idaho 1986) (holding the parent corporation liable under section 107 because the parent had the capacity to control the hazardous waste practices of the subsidiary) *with* *United States v. Kayser-Roth Corp.*, 910 F.2d 24 (1st Cir. 1990) (holding the parent corporation liable under section 107 because the parent had exercised actual control over the hazardous waste practices of the subsidiary).

36. The alter ego doctrine examines: (1) whether there is "such unity of interest and ownership that the separate personalities of the [parent and subsidiary] corporation . . . no longer exist;" and (2) "that, if the acts are treated as those of the corporation alone, an inequitable result will follow." *Automotriz del Golfo de California v. Resnick*, 306 P.2d 1, 3 (Cal. 1957) (citations omitted).

instrumentality"<sup>37</sup> doctrine to "determine whether the facts warrant piercing the corporate veil [of the subsidiary corporation] to impose CERCLA liability on parent corporations."<sup>38</sup>

### A. *Direct Liability Under CERCLA*

Direct liability is "[t]he most common type of liability imposed [on PRPs] under CERCLA."<sup>39</sup> Under the direct liability theory, a parent corporation is liable if it was found to be directly involved in the activities giving rise to the claim against the subsidiary.<sup>40</sup> Whether courts should "[e]xpos[e] parent[ ] [corporations] . . . to direct liability implicates a variety of competing policy considerations."<sup>41</sup>

Policy considerations militating against direct parent liability are threefold. First, Congress, not the courts, should authorize holding parent corporations liable for the hazardous waste violations of their subsidiaries.<sup>42</sup> Second, it is unnecessary to abandon the limited liability concept to finance cleanups necessitated by subsidiary corporation's hazardous waste violations because other sources (i.e. - other PRPs, taxpayers and insurance companies) can provide clean-up funds.<sup>43</sup> Finally, imposing liability on parent corporations "presents serious economic policy concerns" such as increased prices to consumers and increased litigation expenses.<sup>44</sup>

Policy considerations favoring direct parent liability are also threefold. First, Congress intended that CERCLA be given broad interpretation,<sup>45</sup> and CERCLA does not preclude a parent corporation's liability for the environmental waste violations of their

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37. The mere instrumentality doctrine examines: (1) whether the parent exercises excessive control over the subsidiary; (2) whether wrongful or inequitable conduct was present; and (3) whether there is a causal relationship to the plaintiff's loss. FREDERICK J. POWELL, PARENT AND SUBSIDIARY CORPORATIONS §6, at 9 (1931) [hereafter *Parent Corporations*].

38. *Id.*

39. *Redefining*, *supra* note 14, at 800.

40. Lynda J. Oswald, *Corporate Parent Responsibility for Environmental Liability of the Subsidiary*, 785 PLI/Corp. 107 (1992) [hereafter *Corporate Parent Liability*].

41. *Liability*, *supra* note 28, at 436.

42. *Joslyn Mfg. v. T.L. James & Co.*, 893 F.2d 80, 83 (5th Cir. 1990); *see also*, *Liability*, *supra* note 28, at 436.

43. *Liability*, *supra* note 28, at 436.

44. *Id.*

45. *See United States v. Reilly Tar & Chem. Corp.*, 546 F. Supp. 1100, 1112 (D. Minn. 1982) ("CERCLA should be given a broad and liberal construction. The statute should not be narrowly interpreted to frustrate the government's ability to respond promptly and effectively, or to limit the liability of those responsible for cleanup costs beyond the limits expressly provided.").



subsidiary.<sup>46</sup> Second, direct liability allows courts to hold parent corporations liable “without having to disregard the separate legal existence” of the subsidiary.<sup>47</sup> Finally, the entities best suited to prevent the harm should be burdened with the costs of clean-up instead of other sources, such as other PRPs, taxpayers and insurance companies, who can have little or no control over the subsidiary corporation’s waste management activities.<sup>48</sup>

Direct liability is based on the theory that the parent corporation is the “operator” of the facility where the hazardous waste is located.<sup>49</sup> Courts have articulated two tests to determine whether a parent corporation is an operator under CERCLA section 107: (1) the capacity to control test,<sup>50</sup> and (2) the actual exercise of control test.<sup>51</sup>

### 1. The Capacity to Control Test

The capacity to control test is “based upon mere status as opposed to affirmative acts.”<sup>52</sup> It is an inquiry as to whether the parent corporation had the capacity to control the hazardous waste practices at its subsidiary corporation.<sup>53</sup> Numerous federal district courts have recognized the capacity to control test as the requisite level of involvement; however, no federal appellate courts have recognized the capacity to control test in the parent/subsidiary context.<sup>54</sup>

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46. *Liability*, *supra* note 28, at 437.

47. *Id.* at 437.

48. *Id.* at 437-38.

49. *See* *United States v. Kayser-Roth Corp.*, 910 F.2d 24, 27 (1st Cir. 1990), *cert. denied*, 111 S. Ct. 957 (1991) (“[w]e believe that a fair reading of CERCLA allows a parent corporation to be held [directly] liable as an operator of a subsidiary corporation.”).

50. *See* *Idaho v. Bunker Hill Co.*, 635 F. Supp. 665 (D. Idaho 1986) (holding the parent corporation liable under section 107 because the parent had the capacity to control the hazardous waste practices of the subsidiary).

51. *See* *United States v. Kayser-Roth Corp.*, 910 F.2d 24 (1st Cir. 1990), *cert. denied*, 111 S. Ct. 957 (1991) (holding the parent corporation liable under section 107 because the parent had exercised actual control over the hazardous waste practices of the subsidiary).

52. *Bifurcation*, *supra* note 6, at 260.

53. *See* *Idaho v. Bunker Hill Co.*, 635 F. Supp. 665 (D. Idaho 1986).

54. One federal circuit has adopted the capacity to control test, but in the context of a lessor/lessee and not a parent/subsidiary. *See* *Nurad, Inc. v. William E. Hooper & Sons*, 966 F.2d 837, 842 (4th Cir. 1992) (Fourth Circuit determined that the focus is not whether the party actually controlled the subsidiary, but rather whether the party had the capacity to control the subsidiary’s environmental decisions at the site.) It is inferable that the Fourth Circuit would apply the capacity to control test to the parent/subsidiary context as well because it states “[t]his is the definition of the word ‘operator’ that most courts have adopted.” *Id.*; Another federal circuit court has recognized the capacity to control test in dicta. In *Kaiser Aluminum & Chem. Corp. v. Catellus Dev. Corp.*, 976 F.2d 1338, 1341 (9th Cir. 1992), the Ninth Circuit identified “[capacity] to control the cause of the contamination” as the applicable standard.

*Idaho v. Bunker Hill Company*<sup>55</sup> was the first federal case to apply the capacity to control test in assessing direct parent corporation liability. The court concluded that Gulf Resources & Chemical Corporation (Gulf), the parent corporation of Bunker Hill Company, was a past "owner or operator" under section 107(a)(2) of CERCLA because Gulf had the capacity to control the hazardous waste practices of Bunker Hill.<sup>56</sup>

The *Bunker Hill* court interpreted "owner or operator" to mean one who "has [the] power to direct the activities of persons who control the mechanisms causing the pollution . . . [thus having] the capacity to prevent and abate damage."<sup>57</sup> The court then applied this test to the parent/subsidiary relationship at issue in *Bunker Hill*. The court was particularly persuaded by the fact that the parent had at times controlled the subsidiary's board of directors; had received weekly reports of the subsidiary's daily operations; that the subsidiary could not spend in excess of \$500 on pollution problems without the parent corporation's approval; and that the subsidiary had limited capitalization of only \$1,100 while the parent received in excess of \$27 million in dividends.<sup>58</sup> The *Bunker Hill* court thus concluded that Gulf was "intimately familiar with hazardous waste disposal and releases at the . . . [subsidiary's] facility [and] had the capacity to control such disposal and releases."<sup>59</sup>

The merits of the *Bunker Hill* decision are debatable for two reasons. First, the facts of the case suggest that besides having the capacity to control the subsidiary, the parent corporation actually retained control in excess of that normally equated with parental oversight.<sup>60</sup> Thus, the court could have adopted the narrower actual exercise of control test, but instead elected to adopt the much broader capacity to control test.<sup>61</sup> Choosing the capacity to control test was questionable because the test reshapes traditional notions of corporate liability.<sup>62</sup> This reshaping takes place because the capacity to control test is easily

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55. 635 F. Supp. 665 (D. Idaho 1986).

56. *Id.*

57. *Id.* at 672 (quoting *United States v. Northeastern Pharmaceutical and Chem. Co.*, 579 F. Supp. 823, 848-49 (W.D. Mo. 1984)).

58. *Id.*

59. *Id.*

60. *Bifurcation*, *supra* note 6, at 262 & n.182.

61. *Id.* at 262.

62. *Id.* at 260.

satisfied, thus rendering limited liability for the parent corporation essentially nonexistent. One scholarly commentator has explained the ease of meeting the capacity to control test as:

Every parent corporation, by virtue of the power it wields over its subsidiary, could control that subsidiary's activities, including those activities relating to its environmental matters and the operation of a facility. A literal application of the capacity to control test would thus lead to a finding of parent liability in every case involving a CERCLA violation by a subsidiary.<sup>63</sup>

Second, the *Bunker Hill* court failed to distinguish whether it was holding the parent liable under CERCLA section 107 as an owner or as an operator.<sup>64</sup> Instead, the court merely stated that it was holding the parent liable as an owner or operator, in essence using the terms interchangeably.<sup>65</sup> However, the terms are not interchangeable. Operator liability is direct liability, and owner liability is indirect liability.<sup>66</sup> Thus, because the court applied the direct liability theory, the parent could only be liable as an operator.<sup>67</sup> The *Bunker Hill* court's failure to articulate whether it was holding the parent liable as an owner or as an operator when it clearly had to be holding the parent liable as an operator illustrates the confusion among the courts regarding parent liability under section 107.<sup>68</sup> This confusion demonstrates the need for clarification by either the Supreme Court, the EPA, or Congress.

The district court in *Colorado v. Idarado Mining Co.*<sup>69</sup> adopted a modified version of the capacity to control test. Its modified version included several new criteria, including "the percentage of the subsidiary's stock owned by the parent, whether and to what extent the parent controls the subsidiary's marketing [and] whether the parent has or exercises authority to execute contracts on behalf of the subsidiary."<sup>70</sup> The *Idarado Mining* court decided that the parent corporation

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63. *Id.*

64. *Id.* at 262.

65. *Bunker Hill*, 635 F. Supp at 671-72.

66. *Bifurcation*, *supra* note 6, at 235, 244-46, 257-58.

67. *Id.* at 263.

68. *See id.* at 262 n. 184.

69. 1987 U.S. Dist. LEXIS 14254 (E.D. Colo. 1987), *rev'd on other grounds*, 916 F.2d 1486 (10th Cir. 1990), *cert. denied*, 499 U.S. 960 (1991).

70. *Id.* at \*3 (citing *United States v. Conservation Chem. Co.*, 628 F. Supp. 391, 416-20 (W.D. Mo. 1985)).

had enough knowledge of and control over the subsidiary's environmental matters to "justify categorizing [the parent] as an owner or operator."<sup>71</sup>

The merits of the *Idarado Mining* decision are also questionable. First, the court acknowledged that the parent exercised "hands-on control" over the subsidiary's actions.<sup>72</sup> This acknowledgment indicates that the court was really applying the actual control test rather than the capacity to control test.<sup>73</sup> Second, the court's analysis seems to indicate it "was actually engaged in a piercing the veil inquiry under the guise of direct liability . . . [but] . . . failed to make its purpose clear."<sup>74</sup> Finally, as one commentator has argued, the criteria identified by the *Idarado Mining* court focuses on the parent corporation's involvement in the subsidiary itself, not in the facility operated by the subsidiary, as CERCLA requires.<sup>75</sup> According to this commentator, not requiring the focus to be on the facility leaves open the door "for future courts to find [direct] parent liability in inappropriate circumstances."<sup>76</sup> Thus, the *Idarado Mining* decision failed to provide reasonable support for finding parent corporations directly liable as operators under CERCLA section 107.

## 2. The Actual Exercise of Control Test

A majority of the cases examining a parent corporation's liability under the direct liability theory have adopted the narrower actual exercise of control test.<sup>77</sup> The actual exercise of control test involves examining the relationship between the parent and the subsidiary in order to determine the level of the parent corporation's involvement in the subsidiary's environmental affairs.<sup>78</sup>

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71. *Id.* at \*5.

72. *Redefining*, *supra* note 14, at 808 (citing *Idarado Mining*, 1987 U.S. Dist. LEXIS 14254, at \*8).

73. *Id.*

74. *Id.*

75. *Bifurcation*, *supra* note 6, at 264.

76. *Id.* at 265.

77. See *Corporate Parent Liability*, *supra* note 40.

78. *John S. Boyd Co. v. Boston Gas Co.*, 992 F.2d 401, 408 (1st Cir. 1993). The court in *City of New York v. Exxon Corp.*, 112 B.R. 540, 548 n.9 (Bankr. S.D.N.Y. 1990) couched it in the following terms:

[T]he mere capacity to control the affairs of a subsidiary is not a sufficient basis on which to predicate direct liability under Section 107(a) of CERCLA. We believe that some degree of active participation in and actual control over the affairs of the subsidiary is necessary. . . . [T]he corporation must [actually] exercise . . . control [over] its subsidiary in order to be held liable under section 107(a).

The actual exercise of control test was originally formulated in *United States v. Kayser-Roth Corporation*.<sup>79</sup> In *Kayser-Roth*, the First Circuit found Kayser-Roth Corporation directly liable for the clean-up costs of its wholly-owned subsidiary, holding Kayser-Roth Corporation to be an operator under CERCLA section 107.<sup>80</sup>

The court determined that to be an operator under CERCLA section 107 the parent corporation must "at a minimum [be] active[ly] involve[d] in the activities of the subsidiary."<sup>81</sup> The court concluded that Kayser-Roth exercised actual control over the activities of its subsidiary and thus should be held directly liable as an operator.<sup>82</sup> The court's decision was supported by evidence showing that: (1) Kayser-Roth totally controlled its subsidiary's budget, capital and real estate transactions; (2) Kayser-Roth required that its subsidiary direct all environmental matters to Kayser-Roth; (3) Kayser-Roth controlled its subsidiary's officers and directors; and (4) Kayser-Roth required that any expenditure over \$5,000 must be approved by Kayser-Roth.<sup>83</sup>

Other courts have also adopted the actual exercise of control test.<sup>84</sup> In *Rockwell Int'l Corp. v. IU Int'l Corp.*,<sup>85</sup> the United States District Court for the Northern District of Illinois determined that mere capacity to control is not enough to impose liability on a parent corporation for its subsidiary's hazardous waste violations.<sup>86</sup> Rather, the parent must actually exercise control over the subsidiary's facility to be held liable.<sup>87</sup> The district court then listed the following factors supporting such liability: (1) the parent hired or approved hiring some of the subsidiary's officers; (2) certain officers of the parent were also officers of the subsidiary; (3) the parent's auditors recommended to the subsidiary how to handle hazardous waste disposal; (4) the parent

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79. 910 F.2d 24 (1st Cir. 1990), *cert. denied*, 498 U.S. 1084 (1991). In *John S. Boyd Co. v. Boston Gas Co.*, 992 F.2d 401 (1st Cir. 1993), the First Circuit concurred with its *Kayser-Roth* holding.

80. *Kayser-Roth*, 910 F.2d at 25-26.

81. *Id.* at 27.

82. *Id.* at 27-28.

83. *Id.*

84. See *Lansford-Coal Dale Joint Water Auth. v. Tonolli Corp.*, 4 F.3d 1209, 1222 n.13 (3d Cir. 1993) (Third Circuit followed the *Kayser-Roth* standard, stating that "operator liability may be established even without evidence that a [parent] corporation controlled the environmental decisions of an affiliated corporation so long as there exist other factors which sufficiently demonstrate pervasive control."); *Jacksonville Elec. Auth. v. Bernuth Corp.*, 996 F.2d 1107, 1110 (11th Cir. 1993) (Eleventh Circuit concluded that the test for direct parent corporation liability as an operator was whether the parent "exercises actual and pervasive control of the subsidiary to the extent of actually involving itself in the daily operations of the subsidiary.").

85. 702 F. Supp. 1384 (N.D. Ill. 1988).

86. *Id.* at 1390.

87. *Id.*

reviewed the subsidiary's environmental purchases; (5) the parent controlled and monitored the subsidiary's operational plans and procedures; and (6) the parent publicly announced that it operated the subsidiary's facility.<sup>88</sup>

### B. *No Direct Liability Under CERCLA*

In contrast to those cases imposing direct liability on parent corporations as operators,<sup>89</sup> the Fifth Circuit in *Joslyn Manufacturing Co. v. T.L. James & Co.*<sup>90</sup> refused to expand the definition of "owner and operator" to include direct liability of parent corporations.<sup>91</sup> The *Joslyn* court reasoned as follows. First, the definitional section in CERCLA failed to include the parent corporation of the subsidiary.<sup>92</sup> "CERCLA does not define 'owners' or 'operators' as including the parent company of offending wholly-owned subsidiaries."<sup>93</sup> Thus, if Congress intended parent corporations to be liable as owners or operators under CERCLA section 107, Congress would have included parent corporations in the section defining owner or operator.<sup>94</sup>

Second, the *Joslyn* court determined that the legislative history of CERCLA failed to show "Congress['] intent[ ] to alter so substantially [the] basic tenet of corporat[e] law" that there is limited liability for shareholders, including parent corporations.<sup>95</sup> Imposing direct liability on parent corporations would alter the limited liability protection parent corporations receive.<sup>96</sup> Imposing direct liability on parent corporations would make parent corporations liable for their subsidiary's

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88. *Id.* at 1390-91.

89. See notes 39-88 and accompanying text.

90. 893 F.2d 80 (5th Cir. 1990), *cert. denied*, 111 S. Ct. 1017 (1991). *Kayser-Roth* rejected the *Joslyn* decision by asserting that the *Joslyn* court declined to hold the parent corporation directly liable as an owner and not as an operator. The *Kayser-Roth* court maintained that operator liability is a direct liability action and owner liability is an indirect liability action. *Kayser-Roth*, 910 F.2d at 27. Thus, the *Kayser-Roth* court felt that *Joslyn* was only addressing owner liability, which is indirect liability, and not operator liability, which is direct liability. *Id.*

91. *Joslyn*, 893 F.2d at 82; It has been argued that the Fifth Circuit, in *Riverside Market Dev. Corp v. Int'l Bldg. Products, Inc.*, 931 F.2d 327 (5th Cir. 1991), retracted from its *Joslyn* holding. See *Jacksonville Elec. Auth. v. Eppinger & Russell Co.*, 776 F. Supp. 1542, 1546-48 (M.D. Fla. 1991); However, the Fifth Circuit does not expressly overrule *Joslyn* and never even cites *Joslyn* in its *Riverside Market* decision. *Redefining*, *supra* note 14, at 804; One commentator stated the best way to reconcile *Riverside Market* with *Joslyn* is to treat the language in *Riverside Market* as mere dicta, and then to assume that the language is not controlling because *Riverside Market*, unlike *Joslyn*, was not considering the liability of a parent corporation. *Redefining*, *supra* note 14, at 804.

92. *Joslyn*, 893 F.2d at 82.

93. *Id.*

94. *Id.* at 82-83.

95. *Id.*

96. *Id.* at 83.

hazardous waste violations beyond the amount the parent invested in the subsidiary.

Finally, the *Joslyn* court concluded that Congress is capable of passing a statute holding parent corporations liable.<sup>97</sup> As an example the court pointed to 42 U.S.C. § 9601 (20)(A)(iii), the subsection immediately following section 107,<sup>98</sup> which includes a control test.<sup>99</sup> The court determined that if Congress intended that parent corporations be held liable under section 107, then Congress would have adopted a control test in section 107 like Congress did in section 9601 (20)(A)(iii).<sup>100</sup> Thus, because Congress never adopted a control test in section 107, CERCLA does not impose direct liability on parent corporations for their subsidiary's environmental violations.<sup>101</sup> According to *Joslyn*, the imposition of liability on parent corporations for their subsidiary's hazardous waste violations must be done indirectly through piercing the corporate veil.

### C. *Indirect Liability*

To hold a parent corporation indirectly liable as an owner under section 107 of CERCLA for the acts of their subsidiaries, courts must pierce the corporate veil of the subsidiary.<sup>102</sup> Piercing the corporate veil has been defined as "[t]he doctrine which holds that the corporate structure with its attendant limited liability of stockholders may be disregarded and personal liability imposed on stockholders, officers and directors."<sup>103</sup>

No specific rule which states when a court will pierce the corporate veil exists. However, the general rule is that the following two requirements must be met before a court will pierce the corporate veil: (1) such unity of interest and ownership exists that it can be said that the subsidiary may be classified as the mere instrumentality or alter ego of the parent corporation; and (2) adherence to the separate corporate existence of the parent and subsidiary would promote fraud

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97. *Id.*

98. 42 U.S.C. § 9601(20)(A)(iii) (1988). Section 9601(20)(A)(iii) reads as follows: "in the case of any facility, title or control of which was conveyed due to bankruptcy, foreclosure, tax delinquency, abandonment, or similar means to a unit of State or local government, any person who owned, operated, or otherwise controlled activities at such facility immediately beforehand [shall be liable]."

99. *Joslyn*, 893 F.2d at 83.

100. *Id.*

101. *Id.* at 82.

102. See *Jacksonville Elec. Auth. v. Bernuth Corp.*, 996 F.2d 1107, 1109 n.1 (11th Cir. 1993).

103. BLACK'S LAW DICTIONARY 1148 (6th ed. 1990).

or injustice.<sup>104</sup> Courts also consider other factors when determining whether to pierce the corporate veil.<sup>105</sup> These other factors can vary depending on whether courts apply federal or state veil piercing standards.

The following factors are representative when applying federal veil piercing standards:

- (1) inadequate capitalization in light of the purposes for which the corporation was organized;
- (2) extensive or pervasive control by the shareholder or shareholders;
- (3) intermingling of the corporation's properties or accounts with those of its owner;
- (4) failure to observe corporate formalities and separateness;
- (5) siphoning of funds from the corporation;
- (6) absence of corporate records; and
- (7) nonfunctioning officers or directors.<sup>106</sup>

No one factor is more important than any other, and the decision is made upon an equitable determination based on the facts of the particular case.<sup>107</sup>

The following factors are representative when applying state veil piercing standards:

- (a) the parent corporation owns all or most of the capital stock of the subsidiary;
- (b) the parent and subsidiary corporations have common directors or officers;
- (c) the parent corporation finances the subsidiary;
- (d) the parent corporation subscribes to all the capital stock of the subsidiary or otherwise causes its incorporation;
- (e) the subsidiary has grossly inadequate capital;
- (f) the parent corporation pays the salaries and other expenses or losses of the subsidiary;
- (g) the subsidiary has substantially no business except with the parent corporation or no assets except those conveyed to it by the parent corporation;
- (h) in the papers of the parent corporation or in the statements of its officers, the subsidiary is described as a department or division of the parent corporation, or its business or financial responsibility is referred to as the parent corporation's own;

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104. *United States v. Cordova Chemical*, 59 F.3d 584, 591 (6th Cir. 1995).

105. See *infra* notes 106-110 and accompanying text.

106. *In Re Acushnet River & New Bedford Harbor*, 675 F. Supp. 22, 33 (D. Mass. 1987) (citing *Anderson v. Abbott*, 321 U.S. 349, 362 (1944); *Seymour v. Hull & Moreland Eng'g*, 605 F.2d 1105, 1109-1111 (9th Cir. 1979)).

107. *In Re Acushnet*, 675 F. Supp. at 33.



- (i) the parent corporation uses the property of the subsidiary as its own;
- (j) the directors or executives of the subsidiary do not act independently in the interest of the subsidiary but take their orders from the parent corporation in the latter's interest;
- (k) the formal legal requirements of the subsidiary are not observed.<sup>108</sup>

The veil piercing doctrine is recognized by both state and federal courts.<sup>109</sup> An immediate decision that courts must address when assessing indirect liability under CERCLA is whether to apply state or federal veil piercing standards.<sup>110</sup> Most courts have applied federal standards;<sup>111</sup> however, some courts have applied state standards.<sup>112</sup>

Controversy over whether to apply state or federal veil piercing standards exists because CERCLA's liability provisions are vague.<sup>113</sup> In cases initiated under federal statutes, federal courts are free to formulate federal common law.<sup>114</sup> If the federal statute designates which law to follow, then courts must follow the law so designated.<sup>115</sup> However, if the federal statute fails to address the issue, then the court may determine whether to apply state or federal standards.<sup>116</sup> According to *United States v. Kimbell Foods, Inc.*,<sup>117</sup> courts must consider both state and federal concerns when deciding whether to apply state or federal veil piercing standards.<sup>118</sup>

As a practical matter, it should make little difference which veil piercing standard is applied, since both contain essentially the same factors.<sup>119</sup> For example, the Fifth Circuit in *Joslyn* never stated

108. *Parent Corporations*, *supra* note 37, § 6, at 9.

109. See Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 *CORNELL L. REV.* 1036 (1991).

110. *Bifurcation*, *supra* note 6, at 247.

111. In *Re Acushnet River & New Bedford Harbor*, 675 F. Supp. 22, 31 (D. Mass. 1987); see also *Bifurcation*, *supra* note 6, at 247.

112. See *United States v. Cordova Chemical Co.*, 59 F.3d 584, 591 (6th Cir. 1995) ("In determining whether the circumstances in this case warrant a piercing of the corporate veil . . . we look to state law.").

113. *Redefining*, *supra* note 14, at 795.

114. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 726 (1979) (quoting *Clearfield Trust Co. v. United States*, 318 U.S. 363, 366-67 (1943)).

115. *Anderson v. Abbott*, 321 U.S. 349, 364-65 (1944).

116. *Bifurcation*, *supra* note 6, at 247.

117. 440 U.S. 715 (1979).

118. *Id.* at 728-29 (Factors to consider include: (1) whether application of state law would frustrate the objectives of the federal statute; (2) the need for national uniformity on the issue; and (3) the extent to which a federal rule would disrupt commercial relationships predicated on state law.)

119. *Redefining*, *supra* note 14, at 795 (quoting *In Re Acushnet River & New Bedford Harbor*, 675 F. Supp. 22, 33 (D. Mass. 1987) ("[N]oting that between state and federal law for CERCLA, the choice is of 'little practical significance.'"). *Id.* at 795 n.129.

whether it was applying state or federal veil piercing standards. It applied a veil piercing standard it had applied in a previous case, in which it stated

[w]e find no need to determine whether a uniform federal [veil piercing standard] is required, since the federal and state . . . tests are essentially the same. Our non-diversity [veil piercing] cases have rarely stated whether they were applying a federal or state standard, and have cited federal and state cases interchangeably.<sup>120</sup>

Nevertheless, courts should articulate one federal test setting forth the factors to be applied when disregarding the parent corporation's limited liability by piercing the corporate veil. One federal test is recommended because the requirements for veil piercing vary from state to state.<sup>121</sup> The court in *In Re Acushnet River & New Bedford Harbor*<sup>122</sup> couched the need for a uniform federal rule in the following terms: "[t]he need for a uniform federal rule is especially great for questions of piercing the corporate veil, since liability under the statute must not depend on the particular state in which a defendant happens to reside."<sup>123</sup>

Few cases have dealt with indirect liability under CERCLA.<sup>124</sup> Only two federal appellate courts have even addressed this issue, and neither court actually pierced the corporate veil.<sup>125</sup> Slightly more federal district courts have addressed this issue in the context of CERCLA.<sup>126</sup>

In *Joslyn* the Fifth Circuit refused to pierce the corporate veil of the subsidiary to reach the parent corporation. The court concluded that "[v]eil piercing should be limited to situations in which the [subsidiary was found to be a mere] sham [corporation allowing the parent to commit] a fraud or avoid personal liability."<sup>127</sup> The *Joslyn* court determined that there was not enough evidence present to justify piercing the corporate veil. The subsidiary kept its own books and

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120. *United States v. Jon-T Chems., Inc.*, 768 F.2d 686, 690 n.6 (5th Cir. 1985).

121. *Redefining*, *supra* note 14, at 811-12.

122. 675 F. Supp. 22 (D. Mass. 1987).

123. *Id.* at 31.

124. *Bifurcation*, *supra* note 6, at 249.

125. See *Joslyn*, 893 F.2d at 80; *United States v. Cordova Chemical Co.*, 59 F.3d 584 (6th Cir. 1995).

126. See *CPC Int'l, Inc. v. Aerojet-General Corp.*, 777 F. Supp. 549 (W.D. Mich. 1991), *aff'd in part, rev'd in part*, 59 F.3d 584 (6th Cir. 1995); *Trinity Indus., Inc. v. Dixie Carriers, Inc.*, No. 90-2349, 1992 U.S. Dist. LEXIS 9540, (E.D. La. June 24, 1992); *In Re Acushnet River & New Bedford Harbor*, 675 F. Supp. 22 (D. Mass. 1987); *Wehner v. Syntex Agribusiness, Inc.*, 616 F. Supp. 27 (E.D. Mo. 1985); *United States v. Bliss*, 108 F.R.D. 127 (E.D. Mo. 1985).

127. *Joslyn*, 893 F.2d at 83.

records; frequently held shareholder meetings; and the daily operations of the parent and subsidiary corporation were separate.<sup>128</sup> Thus, the subsidiary was not a mere sham corporation.

Recently, in *United States v. Cordova Chemical Co.*,<sup>129</sup> the Sixth Circuit also refused to pierce the corporate veil in order to hold the parent corporation liable for its subsidiary's hazardous waste violations.<sup>130</sup> In the lower court decision, the parent corporation was found to be directly liable as an operator because it was determined that the parent corporation exercised significant control over the subsidiary's activities.<sup>131</sup> The district court based its decision on the control exerted by the parent over the policy decisions of the subsidiary and the parent's participation on the subsidiary's board of directors.<sup>132</sup>

The *Cordova Chemical* court reversed in part the district court's opinion, concluding that the district court's opinion was flawed.<sup>133</sup> The court determined that the district court was wrong in determining that a parent corporation is directly liable as an operator if it exercises significant control over the subsidiary's environmental activities.<sup>134</sup> The court concluded that a parent corporation incurs operator liability only if the requirements of veil piercing are met, and not if the parent exercises control over the subsidiary's environmental activities.<sup>135</sup>

However, it is actually the *Cordova Chemical* court's decision that is problematic and flawed. The court's conclusion that "a parent corporation incurs *operator* liability pursuant to section 107(a)(2) of CERCLA, for the conduct of its subsidiary corporation, *only when the requirements necessary to pierce the corporate veil are met*"<sup>136</sup> is wrong. The court's conclusion is wrong because a parent corporation is either directly liable as an operator or indirectly liable as an owner. However, the *Cordova Chemical* court equated operator liability with indirect liability.<sup>137</sup> Thus, the court was confused about the difference between owner liability and operator liability, as illustrated by its use

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128. *Id.*

129. 59 F.3d 584 (6th Cir. 1995).

130. *Id.*

131. *Cordova Chemical*, 777 F. Supp. 549, 578-81 (W.D. Mich 1991).

132. *Id.*

133. *Cordova Chemical*, 59 F.3d at 590.

134. *Id.*

135. *Id.*

136. *Id.* (emphasis added)

137. *Id.* at 592.

of the terms interchangeably.<sup>138</sup> This confusion and misapplication leaves open the possibility for future courts to find indirect liability in inappropriate circumstances. This confusion further demonstrates the need for a change in how parental liability under CERCLA section 107 is addressed.

#### IV. STATEMENT OF PROPOSED CHANGE

Courts have used three approaches to address a parent corporation's liability under CERCLA section 107. All three approaches focus on either direct or indirect liability. Some courts have analyzed parent liability indirectly as owners.<sup>139</sup> Other courts have analyzed parent liability directly as operators.<sup>140</sup> This direct liability approach has created confusion about whether a parent corporation's actual control or capacity to control its subsidiary is enough involvement to impose liability.<sup>141</sup> Finally, still another court has analyzed parent liability indirectly as an operator.<sup>142</sup> The courts' use of three different approaches to analyze the same issue, and the resulting unsettled case law<sup>143</sup> illustrates the confusion and inadequacy of the direct/indirect liability distinction in its present state.

Four possible solutions to this confusion and inadequacy exist. First, courts could recognize that there is a difference between owner liability and operator liability and set forth the tests to be used for each.<sup>144</sup> If this approach is chosen, then courts must clearly articulate which test is being applied so that they may apply the appropriate standards of that test.<sup>145</sup> Second, Congress could amend CERCLA to address a parent corporation's liability for the environmental violations of its subsidiary. Third, courts could hold parent corporations liable for their subsidiary's environmental violations under a negligent supervision standard.<sup>146</sup> Finally, courts could concentrate their efforts on either direct or indirect liability, thus providing one common test.

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138. The Sixth Circuit addressed operator liability indirectly through the piercing the corporate veil doctrine. It also addressed owner liability indirectly through the piercing the corporate veil doctrine. *Cordova Chemical*, 59 F.3d at 592.

139. *See, Joslyn*, 893 F.2d at 80, 82-83.

140. *Bunker Hill*, 635 F. Supp. at 665, 671-72 (the court applied the capacity to control test); *Kayser-Roth*, 910 F.2d at 24, 27 (the court applied the actual control test).

141. *Bunker Hill*, 635 F. Supp. at 665.

142. *See Cordova Chemical*, 59 F.3d at 584.

143. *See supra* note 35 and accompanying text.

144. *Bifurcation*, *supra* note 6, at 281.

145. *Id.*

146. George W. Dent, Jr., *Limited Liability in Environmental Law*, 26 WAKE FOREST L. REV. 151, 178 (1991) [hereafter *Dent*].

Owner liability is indirect liability based on the traditional corporate law doctrine of piercing the corporate veil. Although not mandatory, courts would be wise to articulate one set of federal factors to apply when piercing the corporate veil. A single set of federal factors would minimize the confusion found in the case law by providing uniformity. Instead of some courts applying state standards for veil piercing and other courts applying federal standards for veil piercing, all courts would now apply the same standards, resulting in uniformity. Also, a uniform federal standard would eliminate forum shopping because it would eliminate the benefit of considering each forum's veil piercing standards before deciding where to file suit.

In contrast to owner liability, operator liability is direct liability which arises from the language of CERCLA itself.<sup>147</sup> The two tests for direct liability, both of which are inadequate, are the "capacity to control" and "actual control tests." "[T]he capacity to control test is an unduly broad test" as it merely requires that the parent had the capacity to control the subsidiary, not that it ever did control the subsidiary.<sup>148</sup> Thus, the capacity to control test is "overinclusive; snaring corporations which could possibly exercise control because of the investment relationship, but have not."<sup>149</sup> Although narrower than the capacity to control test, the actual control test is also broad. The actual control test does not require actual control over the subsidiary's facility itself; the parent's control over the subsidiary's business activities has been held to be enough.<sup>150</sup> Also, unlike the indirect liability standard, the actual control test fails to consider equity or fairness.<sup>151</sup>

Rather than hoping courts will recognize the difference between owner liability and operator liability, Congress could amend CERCLA to address a parent corporation's liability for the hazardous waste of its subsidiary. Congress could implement one or both of two possible approaches. It could redefine "owner and operator" as it is found in 42 U.S.C. § 9601(20)(A).<sup>152</sup> Separate definitions for "owner" and "operator" are recommended if this approach is chosen.<sup>153</sup> Alternatively, Congress could add a section to CERCLA making the parent

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147. 42 U.S.C. §§ 9601(20)(A), 9607 (1988).

148. *Redefining, supra* note 14, at 810.

149. *Id.*

150. *See, United States v. Kayser-Roth Corp.*, 910 F.2d 24 (1st Cir. 1990), *cert. denied*, 111 S. Ct. 957 (1991).

151. *Redefining, supra* note 14, at 809.

152. *Id.* at 812.

153. *Id.*

corporation liable if it established the subsidiary for the mere reason of avoiding liability.<sup>154</sup>

If Congress chooses to bifurcate the definitions of owner and operator, the amended definition of owner should be broad enough to include parent corporations who take an active interest in their subsidiary's business activities.<sup>155</sup> The following is a suggested definition of owner:

An owner is a person, as defined by this statute, who possesses a controlling interest in a facility from which hazardous waste materials now require removal or possessed a controlling interest in such facility when the hazardous waste materials were originally released, either as a sole proprietor, partnership, corporation, or other association, or through a corporation, partnership, or other association and exercises control over the business to such an extent as to make it equitable that this person should be liable under this statute. This does not include a person who holds indicia of ownership primarily to protect a security interest in the facility and who does not exercise control over the business to such an extent as to make it equitable to hold this person liable under the statute.<sup>156</sup>

This definition would technically eliminate indirect liability because owner liability would also be direct under the statutory language.<sup>157</sup> However, the veil piercing factors used for indirect liability would still be applicable in determining whether the parent exercised enough of an interest in the subsidiary corporation to justify holding it liable for the subsidiary's hazardous waste violations.

To distinguish it from the amended definition of owner, the amended definition of operator should focus on who has ultimate control over the subsidiary's hazardous waste practices.<sup>158</sup> The following is a suggested definition of operator:

An operator is a person as defined by this statute, who controls or who exerts power or influence over the activities which led to the hazardous substance(s) now requiring removal or recovery being originally released. An operator must be directly liable, not as a result of vicarious liability or for costs better attributable to one who exercised immediate influence over the activities which led to the hazardous substance contamination, but as a result of a breach of a duty owed by it. This does not include a person who holds indicia of ownership primarily to protect a security interest in the

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154. *Id.* at 813.

155. *Id.* at 812.

156. *Id.*

157. *Id.*

158. *Id.*

facility and who does not exercise control over the business to such an extent as to make it equitable to hold this person liable under the statute.<sup>159</sup>

This definition confirms that it is owner liability, and not operator liability, that is concerned with the business and financial activities of the subsidiary.<sup>160</sup>

To fully include parent corporations, the definition of "person" in CERCLA should be amended to include the phrase "parent corporation."<sup>161</sup> Amending the definition of person would leave no doubt that Congress intended that parent corporations be held liable for their subsidiary's hazardous waste violations, providing they met the definition of either owner or operator.<sup>162</sup>

Instead of redefining "owner and operator" Congress could add a section to CERCLA expressly stating that any parent corporation establishing a subsidiary merely to avoid liability is, nonetheless, liable for the clean-up costs incurred from the subsidiary's hazardous waste violations.<sup>163</sup> This new section would make the "deep pocket" accessible in cases where the subsidiary could not pay for the clean up of the hazardous substance, and the parent misused corporate law.<sup>164</sup> This new section would also protect from liability those corporations that legitimately incorporated the subsidiary.<sup>165</sup>

The third alternative requires courts to impose liability on those parent corporations that negligently supervise their subsidiary's environmental activities.<sup>166</sup> Unlike the other alternatives, this alternative actually encourages active involvement by the parent corporation in the subsidiary's environmental activities.<sup>167</sup> Under this alternative, prudent parent corporations who actively participate in their subsidiary's environmental activities receive the protection of limited liability.<sup>168</sup>

To absolve those who are negligent gives rise to too many accidents and excessive engagement in risky activities. To impose liability on

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159. *Id.*

160. *Id.*

161. *Id.* at 812 n.221.

162. *See Id.*

163. *Id.* at 813.

164. *Id.* at 813-14.

165. *Id.* at 814.

166. Note, Richard S. Farmer, *Parent Corporation Responsibility for the Environmental Liabilities of the Subsidiary: A Search for the Appropriate Standard*, 19 J. CORP. L. 769, 799 (1994) [hereafter *Parent Corporation Responsibility*] (citing *Dent, supra* note 146, at 178).

167. *Id.*

168. *Dent, supra* note 146, at 178.

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.<sup>169</sup>

Prudent measures include receiving reports about the subsidiary's environmental waste activities on a regular basis, employing officers "who install a reasonable program to prevent hazardous waste release,"<sup>170</sup> and assuring that the subsidiary is financially sound.<sup>171</sup>

Finally, in lieu of the preceding three alternatives, courts could disregard either direct or indirect liability. This author recommends that courts concentrate their efforts on direct liability as an "operator" by applying a control/knowledge test.<sup>172</sup> Under the control/knowledge test, parent corporations are held directly liable for their subsidiary's hazardous waste violations if the parent (1) has actually controlled the subsidiary's hazardous waste practices, and (2) is knowledgeable about or has reason to know about the subsidiary's hazardous waste disposal practices.<sup>173</sup> The control/knowledge test does not require Congress to amend CERCLA; rather, it requires that courts apply a new test to hold parent corporations directly liable as operators under CERCLA section 107.

## V. DISCUSSION OF PROPOSED CHANGE

Four approaches may be implemented to address whether parent corporations are liable for the hazardous waste violations of their subsidiaries. All are laden with expected benefits and anticipated resistances.

First, if the present "owner or operator" liability scheme is maintained, then courts must recognize the difference between owner liability and operator liability. Such recognition is not a given, as illustrated by the Sixth Circuit's decision in *Cordova Chemical*.<sup>174</sup> The

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169. *Id.* (citation omitted).

170. *Id.*

171. *Id.* at 179-180.

172. The authors in *Liability, supra* note 28, include as another factor capacity to control the hazardous waste practices of the subsidiary. This author finds such a requirement peculiar and unnecessary and does not include it in his control/knowledge standard. To be liable under this standard the parent corporation must have actually controlled the subsidiary's hazardous waste practices and if the parent has actually controlled them then it must have the capacity to control the procedures also. Thus, the capacity to control factor is unnecessarily redundant. It would be necessary if the actual control factor was not included.

173. *See id.* at 461.

174. *See supra*, note 129 and accompanying text.



*Cordova Chemical* court concluded that for a parent corporation to be liable as an operator for the acts of its subsidiary, the requirements of veil piercing must be met.<sup>175</sup> By applying veil piercing requirements the court equated operator liability with indirect liability. The problem with the *Cordova Chemical* decision is that a parent corporation is either directly liable as an operator or indirectly liable as an owner. Thus, veil piercing is applied under owner liability and not operator liability.

This misapplication of owner and operator liability by the *Cordova Chemical* court poses a serious future implication. It leaves open the possibility that future courts will impose the wrong type of liability on parent corporations. Courts must impose liability based on the correct standard; otherwise, innocent parties may be held liable in situations where the law never designated them to be held liable. Thus, if courts are going to adhere to the present owner or operator liability scheme, it is imperative that they recognize that operator liability is direct and owner liability is indirect, and then apply the correct test.

A second approach is for Congress to amend CERCLA to address a parent corporation's liability under CERCLA. At least one court agrees that Congress should be the one to address this issue. In *Joslyn*, the court determined that CERCLA does not directly impose liability on parent corporations, and "[i]f Congress [intended] to extend liability to parent corporations it could have done so, and it remains free to do so."<sup>176</sup>

Resistance to a Congressional amendment would no doubt come from corporations. Corporations would argue that a Congressional amendment would alter the traditional corporate law notion of limited liability because it would provide for parent liability beyond the amount the parent invested in the subsidiary corporation. Corporations would then argue that unlimited liability denies them the beneficial economic effects associated with limited liability. One commentator described the denial of beneficial economic effects of limited liability for parent corporations in the following terms:

The argument in favor of treating parents and subsidiaries as one is not persuasive. Because most corporations are risk averse, they may forgo opportunities with positive net present value 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,

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175. *Cordova*, 59 F.3d at 590.

176. *Joslyn*, 893 F.2d at 83.

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.<sup>177</sup>

Congress, the EPA, and environmentalists would counter by stating that the proposed Congressional amendment would not entirely deny parent corporations limited liability. Only those parent corporations meeting either the proposed definition of owner or the proposed definition of operator would lose the protection of limited liability. Thus, those parent corporations who do not actively participate in their subsidiary's business activities<sup>178</sup> and who do not exercise ultimate control over their subsidiary's hazardous waste practices<sup>179</sup> would still enjoy the protection of limited liability.

A third approach is for courts to impose liability on those parent corporations negligently supervising their subsidiary's environmental activities.<sup>180</sup> This negligent supervision standard is in sharp contrast to the limited liability doctrine.<sup>181</sup> Unlike limited liability, the negligent supervision standard *encourages* active parental involvement in their subsidiary's environmental activities.<sup>182</sup> Under the negligent supervision standard a parent corporation may actively participate in its subsidiary's environmental activities, so long as at least one of two requirements is satisfied.<sup>183</sup> First, the parent has attempted to make the subsidiary's environmental activities safer, or second, the parent has ensured that the subsidiary can pay for any liabilities imposed for environmental harms.<sup>184</sup>

The negligent supervision standard promotes fairness because parent corporations are shielded from liability so long as they take steps to prevent environmental violations by their subsidiaries.<sup>185</sup> The negligent supervision standard also promotes safety because parent corporations will carefully monitor and improve the safety of their subsidiary's environmental operations.<sup>186</sup> However, the negligent supervision standard is not without its problems. A negligence standard

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177. *Dent, supra* note 146, at 167 (citations omitted).

178. *See supra* note 156 and accompanying text.

179. *See supra* note 159 and accompanying text.

180. *See supra* note 166 and accompanying text.

181. *Parent Corporation Responsibility, supra* note 166, at 801.

182. *Id.*

183. *Id.*

184. *Id.*

185. *Id.*

186. *Id.* at 800.

such as this one presents judicial manageability problems because of the many factual considerations involved.<sup>187</sup> These judicial manageability problems present concerns about consistent and predictable decisions.<sup>188</sup>

A final method to resolve whether parent corporations are liable under CERCLA section 107 for the hazardous waste violations of their subsidiaries, would require courts to concentrate their efforts on either direct or indirect liability, and disregard the other. Two benefits accrue from choosing either the direct or indirect method and disregarding the other. First, applying only one of the theories will promote uniformity. There will no longer be disagreement about which theory applies because there would only be one theory that courts could use. Second, limiting the inquiry to one theory allows corporations to better protect themselves because they now know exactly what is required of them. For example, if indirect liability were chosen, parent corporations would be sure to avoid the veil piercing factors in order to escape the clean-up costs of their subsidiary's hazardous waste violations. Likewise, if the capacity to control test were chosen, parent corporations would know to avoid demonstrating a capacity to control their subsidiary's environmental practices. Finally, if the actual control test were chosen, parent corporations would know not to demonstrate actual control over the subsidiary's environmental practices.

Merely choosing one theory and disregarding the other is, however, not enough. For this method to be effective, there must be a similar application of the standards of the theory. Similar application is not a given as illustrated by the courts different applications of veil piercing. Courts have tailored the veil piercing test in different ways to accommodate the purposes of CERCLA as they understand those purposes. Some courts have tailored the veil piercing test by lowering the degree of control necessary, and by removing any requirement that the parent must use its control for improper motives. The *United States v. Nicolet, Inc.*<sup>189</sup> and *Kayser-Roth* trial courts formulated their veil piercing standards in this manner. Other courts have strictly applied the traditional veil piercing standards. The *Acushnet River* and

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187. *Id.* at 801.

188. *Id.* "[T]he presence of many factual considerations concerning the control factor of the traditional corporate veil piercing doctrine makes the doctrine difficult to apply and, therefore, unpredictable in practice." *Id.* at 801 n.226.

189. 712 F. Supp. 1193 (E.D. Pa. 1989).

*Joslyn* courts formulated their veil piercing standards this way. To ensure a uniform application, courts should articulate one set of federal veil piercing standards.

Choosing either direct liability or indirect liability and disregarding the other is not without anticipated resistances. If courts choose indirect liability and adhere to the *Acushnet River* and *Joslyn* courts strict application approach, then resistance by the EPA and other sources would be likely. Sources such as other PRPs, taxpayers and insurance companies, who can have little or no control over the subsidiary corporation's waste management activities, would likely resist. The higher standard may well result in less veil piercing, which would result in less parent corporations being held liable for the clean-up costs of their subsidiary's hazardous waste violations. As a result, the EPA would either have to pay for the clean-up costs out of "Superfund,"<sup>190</sup> or look to other sources for the clean-up costs, or choose not to clean up the hazardous waste at all.

In contrast to the strict application approach, if courts adhere to the *Nicolet* and *Kayser-Roth* trial courts lower standard of veil piercing, it would likely be met with resistance from corporations. Corporations would resist because the lower standard would result in more veil piercing. The increased veil-piercing would translate into more parent corporations being held liable for the clean-up costs of their subsidiary's hazardous waste violations.

This increased liability would likely have two major results. First, litigation over whether the subsidiary corporation's veil should be pierced would increase. It would likely increase because if the lower standard were chosen then the EPA would likely try to hold more parent corporations liable. Thus, there would be more parent corporations fighting liability in the courts. The problem with this increase in litigation is that extremely large amounts of money<sup>191</sup> and time would be spent in the courts, instead of cleaning up hazardous waste. Second, corporations might pass on the costs of the clean up, in terms of higher prices, to the consumer.

If courts focus their attention on direct liability instead of indirect liability, then to promote uniformity they must still determine whether to apply the capacity to control test or the actual control test. The benefits and resistances are similar to those previously discussed for piercing the corporate veil. Uniformity and more thorough protection

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190. Environmental Response Act of 1980, Pub. L. No. 96-510, § 221, 94 Stat. 2801 (1980).

191. See *Redefining*, *supra* note 14, at 774 n.8 (citations omitted).

are the expected benefits of choosing either the actual control test or the capacity to control test. If the broader capacity to control test were chosen then the resistances are similar to those discussed previously if the *Nicolet* and *Kayser-Roth* trial courts lower veil piercing standard was chosen. On the other hand, if the actual control test were chosen, the resistances would be similar to those if the *Acushnet River* and *Joslyn* courts stricter veil piercing standard was chosen.

Direct liability is imposed most commonly on PRPs under CERCLA.<sup>192</sup> Since courts typically hold PRPs directly liable, this author recommends that courts impose direct liability on parent corporations as operators using a control/knowledge test.<sup>193</sup> Under this test, a parent corporation is directly liable under CERCLA section 107 as an "operator" if (1) it has actually controlled the subsidiary's hazardous waste practices, and (2) is knowledgeable about the subsidiary's hazardous waste disposal practices or "has reason to know of" the subsidiary's hazardous waste disposal practices.<sup>194</sup> As will be demonstrated below, this control/knowledge test is consistent with the policy promoted by CERCLA, and is consistent with the traditional corporate law notion of limited liability.

Actual control was chosen over capacity to control because "[e]very parent corporation, by virtue of the power it wields over its subsidiary, could control that subsidiary's activities . . . relating to its environmental matters and the operation of a facility."<sup>195</sup> Thus, the relative ease of meeting the capacity to control test makes the actual control test much more acceptable. Also, a level of involvement greater than mere passive ownership should be necessary to hold a parent corporation liable for the clean-up costs of its subsidiary's hazardous waste, and the actual control standard promotes a level greater than mere passive ownership.<sup>196</sup>

The knowledge or "reason to know of" the subsidiary's hazardous waste disposal practices standard is included to protect those parent corporations who "unwittingly played some active role in the affairs of the subsidiary that affected hazardous waste disposal."<sup>197</sup> A

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192. See *supra* note 39 and accompanying text.

193. See *supra* note 172.

194. *Id.*

195. *Bifurcation*, *supra* note 6, at 260 (citations omitted).

196. *Liability*, *supra* note 28, at 462.

197. *Id.* (emphasis added).

parent corporation should not be labelled an operator when it participates in corporate activities, but does not have knowledge of, or "reason to know of," the implications its decisions have on the subsidiary's hazardous waste disposal practices.<sup>198</sup> Instead, a parent corporation should be held liable as an operator only when it has knowledge of, or "reason to know of" the subsidiary's hazardous waste disposal practices and is actually involved in those disposal practices.<sup>199</sup> "Reason to know of" is included in this standard so that parent corporations who have reason to know of, but through avoidance do not participate in, their subsidiary's hazardous waste disposal practices are still held liable for clean-up costs.<sup>200</sup>

This knowledge or "reason to know of" standard promotes fairness and efficiency because it encourages parent corporations to discover risks that the subsidiary's hazardous waste disposal practices pose; otherwise, parent corporations will be liable for those risks they should have known about. The objective is to prevent parent corporations from escaping liability by shielding themselves from any knowledge about their subsidiary's disposal practices. The knowledge or "reason to know of" standard does, however, have a definite drawback. It requires courts to make the difficult determination of whether a parent corporation had knowledge or "reason to know of" its subsidiary's disposal practices.

The proposed control/knowledge test furthers the goals of CERCLA because it will protect the public's health and safety by forcing parent corporations with actual control and knowledge to use more prudent measures in regulating the hazardous waste practices of their subsidiaries.<sup>201</sup> It will also enlarge the pool of resources available for investigation and remediation of possible leaking hazardous waste facilities because "Superfund" will not have to fund the clean-up costs itself.<sup>202</sup> Additionally, the risk of liability under the control/knowledge test may well promote more settlement negotiations by parent corporations, thus resulting in quicker resolutions and cleanup of the hazardous waste.<sup>203</sup>

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198. *Id.*

199. *Id.*

200. *Id.*

201. *Id.* at 463.

202. *Id.*

203. *Id.*

Resistance would come from parent corporations, who would argue that the control/knowledge test denies them the traditional corporate law notion of limited liability. Parent corporations would argue that if they met the control/knowledge test then they would be liable for their subsidiary's hazardous waste violations. If they are liable for their subsidiary's hazardous waste violations then they are denied the benefits of limited liability, which ordinarily limits the parent's liability to the amount it invested in the subsidiary corporation.

However, the control/knowledge test actually promotes limited liability because passive parent corporations are not held liable for clean-up costs under this standard. However, parent corporations with control and knowledge do not receive, and do not deserve, the limited liability benefit because they have the ability to avoid paying for clean-up costs by handling the hazardous wastes in a safer manner so that cleanup is unnecessary.<sup>204</sup>

Resistance would also come from those courts believing that CERCLA does not impose direct liability on parent corporations for the clean-up costs resulting from their subsidiary's hazardous waste practices.<sup>205</sup> According to these courts, it is irrelevant what type of test a court applies for direct liability under CERCLA because CERCLA does not allow for the direct liability of parent corporations.

These courts point out that the plain language of the statute does not include parent corporations of offending subsidiary corporations.<sup>206</sup> The legislative history also does not indicate that Congress intended that courts alter the basic corporate law notion of limited liability.<sup>207</sup> However, finding parent corporations directly liable would alter this basic notion of limited liability, and the alteration of corporate law is best left to Congress.<sup>208</sup> Thus, according to these courts, if Congress wished to hold parent corporations directly liable, it would have done so, or is still free to do so.<sup>209</sup>

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204. *Id.*

205. *See Joslyn*, 893 F.2d at 80.

206. *Id.* at 82.

207. *Id.*

208. *Id.* at 82-83.

209. *Id.*

VI. RECOMMENDATIONS FOR PARENT CORPORATIONS TO AVOID  
LIABILITY FOR CLEAN-UP COSTS IF THE PRESENT  
SCHEME IS ADHERED TO

Based upon the cases addressing this issue, there are certain steps that parent corporations may take to avoid, or at the least, minimize their liability under CERCLA section 107 for the environmental violations of their subsidiaries.

With regard to direct liability as operators, the parent corporation must minimize or avoid controlling those aspects of its subsidiary "which invite CERCLA scrutiny."<sup>210</sup> For example, the subsidiary's board of directors or officers, not the parent corporations, should make decisions regarding environmental matters of the subsidiary.<sup>211</sup> Also, when clean-up becomes necessary, the parent corporation should allow the subsidiary to determine what action to take, and to coordinate that action with government officials.<sup>212</sup> Thus, the parent corporation must not exercise actual control, or demonstrate the capacity to control the subsidiary's environmental affairs.

With regard to indirect liability as owners, the subsidiary corporation should make sure that it does not fall within the veil piercing factors. Thus, the subsidiary corporation should have adequate capitalization; there should not be any intermingling of the subsidiary corporation's properties with those held by the parent corporation; the subsidiary must observe the corporate formalities and separateness; the parent must not siphon funds from the subsidiary corporation; the subsidiary should keep its own corporate records; the subsidiary should have its own officers and board of directors; and the parent should not own all the capital stock of the subsidiary.<sup>213</sup> In short, the parent and subsidiary corporations must make every effort to make sure that the subsidiary does not look like a mere sham corporation set up by the parent merely to avoid CERCLA liability.

VII. CONCLUSION

The liability of parent corporations for the hazardous waste violations of their subsidiaries is in an evolving state. Based on the plain language of CERCLA, and on case law interpreting CERCLA, it is

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210. John S. G. Worden, *CERCLA Liability Of Parent Corporations For The Acts Of Their Subsidiaries*, 30 IDAHO L. REV. 73, 87 (1993-94).

211. *Id.*

212. *Id.*

213. *Id.*



unclear whether parent corporations may be held liable for the hazardous waste violations of their subsidiaries. While it appears that parent corporations may be directly liable as operators, or indirectly liable as owners via veil piercing, courts appear confused about the operator liability and owner liability distinction.

The best solution would be for Congress to amend CERCLA to expressly deal with a parent corporation's liability for the hazardous waste violations of its subsidiary. However, if Congress is unwilling to amend CERCLA, then the courts must come up with a new test to address this issue. The proposed control/knowledge test adequately addresses this issue by providing uniformity and removing the confusion created by the courts by mandating only one test to apply.

The control/knowledge test is necessary to guarantee that parent corporations are not held liable for their subsidiary's hazardous waste violations in inappropriate situations. The control/knowledge standard furthers the purposes of CERCLA and promotes limited liability, while still ensuring that responsible corporations are held liable for their subsidiary's hazardous waste violations.

However, until either Congress or the courts address this issue, the present case law serves to shed some light on what parent corporations may do to avoid CERCLA liability. First, the parent will not be subject to direct liability as an operator if it does not demonstrate the capacity to control or exercise actual control over its subsidiary's environmental affairs. Second, the parent will not be subject to indirect liability as an owner through veil piercing if the subsidiary does not meet any of the veil piercing requirements.

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