Legal Lookout: When a Parent's Involvement May Be Too Much

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Parent corporations may be held liable for the transgressions of their corporate subsidiaries, and it is important to know how to structure environmental management systems (EMS) to avoid unintended consequences. This column surveys some of the key issues in the area of parent/subsidiary liability.

Types of parent liability

Parent corporations may be held liable for the environmental indiscretions of their corporate children or subsidiaries under two legal theories. First, a parent may be held directly liable for its direct conduct in the activities of the subsidiary that the government or other entity claims caused the harm. For example, under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), commonly known as Superfund, a parent corporation may be held responsible for cleanup costs resulting from the manufacturing operations of its subsidiary on grounds that the parent was the operator of the subsidiary if the parent engaged directly in activities giving rise to the harm. The seminal case in this area is United States vs. Bestfoods, where the Supreme Court clarified in 1998 that parent corporations may be held liable for their subsidiaries' environmental transgressions only when the parents "manage, direct or conduct operations specifically related to pollution, that is operations having to do with the leakage or disposal of hazardous waste or decisions about compliance with environmental regulations."[1]

Bestfoods specifically addressed CERCLA liability. Many believed, however, that its holding was equally applicable to other statutes, including the Clean Air Act and the Resource Conservation and Recovery Act (RCRA). Since 1998, Bestfoods has been applied by other courts to find principals of parent corporations directly liable for their corporate subsidiary operations. It was widely believed that the finding of direct parent liability in Bestfoods will be applied to find direct parent liability in other environmental areas.

The other theory that imposes liability on corporate parents for their subsidiaries' harms was based on indirect liability and relies upon the traditional doctrine of "piercing the corporate veil." Under traditional common law, a subsidiary, albeit a corporate child of a parent, is nonetheless a separate corporate entity and its separateness entitles it to be regarded as a corporate entity that is solely responsible for its own wrongdoings. The veil piercing reflects the idea that because the separate corporate existence of a subsidiary can be more illusion than real, the corporate veil around the parent that would otherwise shield it from the liability of its subsidiary should be pierced to impose liability on to the parent. In other words, the parent should not be entitled to hide behind the liability shield otherwise offered by corporate formalities if in fact those formalities are not being honored.

The piercing concept arose from common law disputes involving tort and contract claims. Courts looked to a variety of factors to assess whether the subsidiary's operations were sufficiently separate,

legitimate and robust to consider the subsidiary a separate legal entity for purposes of limiting liability. Among the traditional considerations looked to are whether the subsidiary was formed with the requisite level of formality, whether it was adequately capitalized in light of the purposes for which the corporation was formed, and whether shareholders exercise pervasive and unreasonable control over the subsidiary company's operations.

Piercing theories have been used in CERCLA and related environmental law cases for several reasons. First, the government typically sought to interpret laws such as CERCLA as broadly as possible. This would provide its agency's maximum flexibility to pursue a large pool of entities as potentially responsible parties for cleanup costs. Second, early on, the government wished to give expression to the underlying intent of CERCLA to find as many solvent parties as possible to pay for the cost of cleanup, so that these costs did not deplete the Superfund at the government's expense. In situations where a broad public policy was believed to be served, such as in cleanup actions, a court would be more inclined to pierce the corporate veil and assert liability against a corporate parent for the environmental misdeeds of its subsidiary to give expression to the broad policy goal of cleaning up contaminated property, even if the specific elements of common law piercing are not strictly met in all cases.

The court in Bestfoods specifically held that a parent should be held derivatively liable only if the traditional elements of veil piercing had been satisfied. While people may disagree, state courts may well give more deference to the broad public policy goals underlying environmental laws and be more inclined to impose indirect liability on parent corporations regardless of whether the corporate formalities of separateness and related elements common law standards have been met.

What does this mean for EMS programs?

In these days of corporate consolidation and the relentless drive to keep costs down and profit margins up, care must be taken to structure EMS programs in such a way that avoids tripping over any traps that might arise from the direct and indirect liability theories set forth above, as interpreted by the court in Bestfoods. First, centralized corporate EHS departments offer considerable value for large companies with many subsidiaries. Centralizing certain EHS functions saves time and money and minimizes opportunities for inconsistent corporate responses among related corporate affiliates.

Under Bestfoods, provided the corporate subsidiaries are properly created and managed separately with the appropriate level of formality, a parent can comfortably provide routine supervision in environmental matters for its subsidiaries without triggering liability. The important caveat is that the parent cannot actually engage in the operations of the subsidiary that give rise to allegations of liability. If the parent actually engages in the day to day environmental operations of the subsidiary's environmental matters – making decisions, directing operations and related direct actions – the parent runs the risk of tripping the Bestfoods wire and being held directly liable for the environmental indiscretions of its subsidiaries. Typically, this will not be an issue if the subsidiary is a robust

corporate entity fully capable of discharging its environmental responsibilities. If, however, the subsidiary is compromised, under-funded and financially unable to shoulder substantial costs, i.e., expensive CERCLA cleanup costs, there will be some temptation in certain circumstances for the government to cast about for other financially viable entities to pay the way. This is where the specific facts of a parent-subsidiary relationship will be closely scrutinized. To give expression to Congress' goal of holding parties responsible for environmental cleanup actions, courts will be inclined to find a corporate parent liable for its subsidiary's environmental wrongdoings in these instances. Similarly, under Bestfoods, parent companies can avoid indirect liability by maintaining all requisite corporate formalities to avoid veil piercing.

The best defense to liability is a good offense. Avoiding behaviors and activities that invite assertions of liability is the best way to avoid paying for costly mistakes. We live in an imperfect world, however, and mistakes happen. The best way to ensure that the liability for those mistakes stays where it belongs is to be careful not to trip the Bestfoods liability wire, and keep corporate parents out of areas where they just don't belong. ***PE***

REFERENCES

1) 524 U.S. 51, at 67 (1998)

ADDITIONAL INFORMATION

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