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The Prevention Test: Promoting High-Level Management, Shareholder, and Lender Participation in Environmental Decision Making under CERCLA

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The Prevention Test: Promoting High-Level Management, Shareholder, and Lender Participation in Environmental Decision Making Under CERCLA

Lauri A. Newton*

CONTENTS

Introduction ............................................. 313
I. Statutory and Common Law Theories of CERCLA Liability . 316
   A. Derivative Liability .................................. 317
   B. Direct Statutory Liability ............................. 319
      1. Individual Liability ............................... 320
      2. Parent Corporation Liability ....................... 321
      3. Lender Liability ................................... 324
II. The Prevention Test ..................................... 332
   A. Development of the Prevention Test ................. 332
   B. Analysis of the Prevention Test ...................... 335
   C. Practical Application of the Prevention Test ........ 340
Conclusion ................................................ 344

INTRODUCTION

In 1980, Congress enacted the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA)1 to address the growing number of uncontrolled, inactive hazardous waste sites and to remedy the severe environmental problems caused by negligent hazardous waste disposal practices.2 Section 107(a) of CERCLA3 imposes strict liability on four classes of parties:

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The owners and operators of facilities at which there is a release or threatened release of hazardous substances;

(2) Any person who owned or operated such a facility at any time in the past when hazardous substances were disposed of;

(3) Any person who "arranged for" the treatment or disposal of a hazardous substance at the facility; and

(4) Any person who transported hazardous substances to the facility.

Unfortunately, CERCLA has little definitive legislative history to aid courts in interpreting these ambiguous liability provisions. 4

Courts interpreting CERCLA have struggled to reconcile the Act and its goals with corporate law doctrine, which generally recognizes corporations as separate from their officers and shareholders and limits corporate liability to the corporation's assets. 5 Corporate shareholders, officers, and lenders encounter a threat of personal liability under CERCLA which they would not face under tort law or traditional corporate law doctrine. 6 These entities may develop a hands-off approach to operations connected to hazardous sites in order to distance themselves from potentially great liability under the Act. 7

Courts use varying approaches to impose CERCLA liability on these entities and individuals. Some courts have held parent corporations and individual shareholders of closely-held corporations derivatively liable, 8 independent of CERCLA’s liability scheme, by piercing the corporate veil. 9

Other courts have held corporate shareholders, corporate officers, parent corporations, and lenders directly liable under the terms of the statute itself, without piercing the corporate veil. These courts have

4. See Dedham Water Co. v. Cumberland Farms Dairy, Inc., 805 F.2d 1074, 1080-81 (1st Cir. 1986). The court commented that " 'CERCLA has acquired a well-deserved notoriety for vaguely drafted provisions and an indefinite, if not contradictory, legislative history. . . . CERCLA’s legislative history is shrouded with mystery . . . .' " Id. (quoting United States v. Mottolo, 605 F. Supp. 898, 902 (D.N.H. 1985)).

5. See infra notes 22-24 and accompanying text.

6. See infra part I.


found such parties directly liable under CERCLA section 107(a) as operators, owners, or arrangers for disposal, based upon their personal participation in the operations of the related corporation.10

Several courts have even imposed liability on shareholders and lenders based merely on their "capacity to control" the corporation's operations.11 For example, the Eleventh Circuit in United States v. Fleet Factors12 held that a lender may be liable for its borrower's environmental damage if the lender's "involvement with the management of the facility is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose."13

Because most lenders recognized that they have the leverage to affect hazardous waste decisions, they sought clarification of lender liability under CERCLA.14 Responding to the outcry, in 1992 the United States Environmental Protection Agency (EPA) promulgated a lender liability rule.15 The rule advocates a fact-sensitive approach for determining the liability of lenders. EPA's final rule not only insulates lenders from liability based on their influence on borrowers' activities, it also provides that specified "policing" activities undertaken by lenders are not to be considered participation in the management of the borrower's activities.

In 1989, the United States District Court for the Western District of Michigan adopted a similarly fact-specific approach, the "Prevention Test," for determining the CERCLA liability of shareholders and corporate officers of closely-held corporations in Kelley v. Thomas Solvent Co.16 The Thomas court required more than individual participation in or the mere capacity to control the corporation's management for imposition of strict, section 107 liability.17 Instead, the court focused on two factors: the individual's degree of authority in general and the individual's specific responsibility for health and safety practices, including responsibility performed or neglected with respect to hazardous waste disposal practices. The Prevention Test asks "whether the [individual]
could have prevented or significantly abated the release of hazardous substances . . . ." The test also provides an affirmative defense to CERCLA liability for corporate individuals who, despite their genuine efforts, were unable to prevent contamination. 19

Although the standard set forth in Thomas may undercut the strict liability scheme of section 107 by providing an affirmative defense, the Prevention Test encourages desirable shareholder, corporate officer, and lender involvement in environmental management processes. 20 Interpreting CERCLA to encourage participation at a high management level will ensure that environmental management becomes an essential element in business planning and development.

Section I of this paper discusses the common law and statutory theories of liability that courts employ to fix liability among corporate officers, shareholders, and lenders. It also examines the EPA's clarification of Superfund liability for lenders.

Section II describes the Prevention Test, discusses benefits and criticisms of the Prevention Test, and concludes that courts should uniformly apply the Prevention Test. Section II suggests the types of behavior by corporate officers, shareholders, and lenders that should provide an affirmative defense to personal liability.

Holding individuals, shareholders, and lenders strictly liable does not promote corporate responsibility. Rather, a strict liability standard forces corporate officers, shareholders, and lenders to "close their eyes and stop their ears" 21 to avoid assuming the liability of their corporations or borrowers. The threat of strict liability prevents these parties from making a serious commitment to the environmental operations of their corporations or borrowers. Thus, courts should adopt a more forward-looking, fact-specific approach to CERCLA liability for these parties that weighs their positive and negative involvement and provides an affirmative defense to parties who undertake responsibility for environmental management processes.

I
STATUTORY AND COMMON LAW THEORIES OF CERCLA LIABILITY

Traditional corporate law doctrine limits shareholder and corporate officer liability. 22 Generally, shareholders risk loss of their investments
in the corporation, but are not subject to personal liability.\textsuperscript{23} Similarly, absent wrongdoing, shareholders, officers, directors, and employees of a corporation are not liable for the debts of the corporation.\textsuperscript{24} Recent decisions, however, have cast the net of CERCLA broadly, snaring parties traditionally shielded from liability by the corporate entity.

Courts adopt different approaches for finding personal liability under CERCLA. First, courts sometimes disregard the corporate shield to find parent corporations and individual shareholders derivatively liable under CERCLA. Second, courts frequently impose direct statutory liability on owners, operators, and arrangers for disposal. Third, some courts determine liability by measuring the capacity of the shareholder, corporate individual, or lender to control the operations of the corporation.\textsuperscript{25}

\subsection*{A. Derivative Liability}

Courts employing the common law method for imposing personal liability on shareholders, including parent corporations, disregard the corporate entity and pierce the corporate veil.\textsuperscript{26} Some federal courts have recently disregarded the basic corporate law principles respecting the separateness of the corporate entity from its stockholders and held parent corporations and shareholders liable for corporate hazardous waste disposal activities.\textsuperscript{27} Traditionally, to determine whether the cor-

\begin{thebibliography}{9}
\parskip=0pt
\bibitem{23} See generally \textsc{Henry Ballantine}, \textit{Corporations} § 118 (rev. ed. 1946) ("The immunity of the shareholders from corporate obligations is one of the most important incidents and advantages of the separate legal entity, and serves a useful purpose in business life.").
\bibitem{24} See \textit{id.} § 122 ("If the separate corporate capacity is perverted to dishonest uses, as to evade obligations or statutory restrictions, the courts will interpose to prevent the abuse.").
\bibitem{26} The use of control for an improper purpose requires abrogation of limited liability. 1 \textsc{William M. Fletcher}, \textit{Cyclopedia of the Law of Private Corporations} § 4.20 (perm. ed. 1990) (corporate entity will not be disregarded where there is no fraud or wrong to be avoided).
porate entity should be disregarded in the interests of public convenience, fairness, and equity, state courts look at such factors as inadequate capitalization, extensive or pervasive control, intermingling of properties or accounts, failure to observe corporate formalities and separateness, siphoning of funds, absence of corporate records, and non-functioning officers and directors.28

Whether to pierce the corporate veil in a CERCLA action is a question of federal common law, rather than of state law.29 Courts generally conclude that federal programs such as CERCLA require uniform rules and that employing various state laws would frustrate CERCLA's objectives.30

However, the federal courts have been unsuccessful in fashioning a federal common law rule to govern shareholder liability under CERCLA.31 For example, some courts have developed a federal rule for piercing the corporate veil based on CERCLA's statutory objectives.32 Other courts have concluded that the federal rule of decision, in this instance, follows state common law piercing analyses.33

1988) ("[T]he Court looks closely 'at the purpose of the federal statute to determine whether the statute places importance on the corporate form, an inquiry that usually gives less respect to the corporate form than does the strict common law alter ego doctrine . . . .'" (quoting Alman v. Danin, 801 F.2d 1, 3 (1st Cir. 1986))).
31. See Heidelberg, supra note 25, at 886.
32. See Nicolet, 712 F. Supp. at 1201-02 (emphasizing the need for a uniform federal common law rule to further the purposes of CERCLA); Kayser-Roth, 724 F. Supp. at 23-24 (altering the traditional piercing analysis and noting that failure to pierce the veil of the parent corporation "would provide too much solace to deliberate polluters, who would use this [limited liability doctrine] as an escape").
B. Direct Statutory Liability

Courts have also expanded CERCLA’s reach without piercing the corporate veil by holding corporate officers, shareholders, and lenders directly liable as owners, operators, or generators for their participation in the activities of the corporation.\textsuperscript{34} Courts impose such liability by expansively construing CERCLA’s broad definitions of the categories of potentially responsible parties. For example, CERCLA makes liable any “owner or operator,” defined to include “any person” who owns or operates a facility, or who owned, operated, or otherwise controlled any facility at the time of disposal of any hazardous substances at the facility.\textsuperscript{35} CERCLA defines “person” to include “an 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.”\textsuperscript{36}

CERCLA is silent concerning the extent of shareholder liability and contains no statutory guidance as to whether courts may hold shareholders, corporate officers, and lenders directly and personally liable for corporate activities,\textsuperscript{37} leaving courts to fill the voids left by CERCLA’s ambiguities. Most courts that interpret CERCLA look to the statute’s remedial goals\textsuperscript{38} and impose an expansive direct liability scheme to ensure that those parties benefitting from improper waste disposal practices pay to clean up resulting hazardous waste sites.\textsuperscript{39}

\textsuperscript{34} See Mobay Corp. v. Allied-Signal, Inc., 761 F. Supp. 345, 354 (D.N.J. 1991) (announcing that a parent would be liable as an “operator” if it “exercised control over or actively participated in the subsidiary’s activities”); Rockwell Int’l Corp. v. IU Int’l Corp., 702 F. Supp. 1384, 1390 (N.D. Ill. 1988) (indicating in dicta that management of the facility on a day-to-day basis by officers of the parent corporation and actual control over operations, among other factors, could lead to liability of the parent corporation as an operator).


\textsuperscript{37} See Joslyn, 893 F.2d at 82 (applying traditional notions of limited liability to hold that shareholders were not directly liable under CERCLA); Acushnet River & New Bedford Harbor, 675 F. Supp. at 32 (refusing to relax or dispense with traditional requirements of piercing doctrine); Little, supra note 25, at 1514 (arguing that Congress did not intend to rewrite corporate law).

\textsuperscript{38} CERCLA’s goals include rapid cleanup of contaminated sites and placement of the burden of cleanup on parties who acted to create the hazards or benefited from the disposal of hazardous wastes. S. REP. No. 848, 96th Cong., 2d Sess. 12-15, 31-34 (1980). See Heidelberg, supra note 25, at 909-19.

\textsuperscript{39} See New York v. Shore Realty Corp., 759 F.2d 1032, 1045 (2d Cir. 1985) (refusing to interpret CERCLA in a manner that “frustrates the statute’s goals”); Kayser-Roth, 910 F.2d at 26 (following Shore Realty); United States v. Northeastern Pharmaceutical & Chemical Co. (NEPACCO II), 810 F.2d 726, 743 (8th Cir. 1986) (failure to hold corporate individuals liable would create an “enormous, and clearly unintended, loophole”), cert. denied, 484 U.S. 848 (1987). Critics of this liberal construction of CERCLA claim that corporate separateness should be staunchly defended. In their view, only traditional common law principles should determine the extent to which CERCLA liability extends beyond the language of the statute. See Little, supra note 25, at 1514-15.
1. Individual Liability

Some courts hold shareholders and corporate officers who personally participated in a corporation's waste disposal activities liable under CERCLA for the corporation's hazardous releases. For example, in *United States v. Northeastern Pharmaceutical & Chemical Co. (NEPACCO II)*, the Eighth Circuit Court of Appeals held the corporation's vice president, who acted as day-to-day operational plant manager, individually liable as a generator under CERCLA section 107(a)(3) because he "personally participated in conduct that violated CERCLA." The court emphasized that the defendant's liability was not based solely on his status as a corporate officer, but rather on his actual participation in the corporation's CERCLA violations.

The district court in *United States v. Northeastern Pharmaceutical & Chemical Co. (NEPACCO I)* had indicated that it might take direct liability a step further than the personal participation analysis by deeming the "capacity to control" hazardous waste activities, even if not exercised, sufficient to impose CERCLA liability on shareholders and corporate officers. Other courts have explicitly adopted this approach for


42. 810 F.2d 726 (8th Cir. 1986), cert. denied, 484 U.S. 848 (1987).

43. *Id.* at 744.

44. 579 F. Supp. 823 (W.D. Mo. 1984), *aff'd in part, rev'd in part.* NEPACCO II, 810 F.2d 726 (8th Cir. 1986), *cert. denied,* 484 U.S. 848 (1987). The district court held the president and major stockholder of the corporation liable as an "operator" under CERCLA section 107(a)(1) based on his status in the corporation, his general responsibility to control the disposal of hazardous wastes, his power to direct negotiations concerning the disposal of hazardous wastes, and his capacity to prevent and abate the damage caused by the disposal. *Id.* at 848-49. Although the Court of Appeals reversed the district court's holding with respect to this defendant's liability as an "operator," it based its reversal on a finding that NEPACCO was not a "facility" under CERCLA. NEPACCO II, 810 F.2d at 743. In addition, the Court of Appeals held this defendant liable as a "contributor" under the Resource Conservation and Recovery Act of 1976 (RCRA), 42 U.S.C. § 9673(a) (1988), stating that its analysis of the scope of individual liability under RCRA is similar to the analysis under CERCLA.
determining corporate officer and shareholder liability under CERCLA.\textsuperscript{45}

2. Parent Corporation Liability

Parent corporations, as shareholders, may also incur direct liability under the statutory language of CERCLA. For example, the Federal District Court for the District of Rhode Island held a parent corporation liable for its subsidiary's environmental contamination in United States \textit{v. Kayser-Roth Corp.}\textsuperscript{46} In \textit{Kayser-Roth}, the parent corporation participated in the subsidiary's day-to-day management activities, including environmental matters.\textsuperscript{47} The parent corporation incurred "operator" liability for the acts of its subsidiary because the parent exercised control over the subsidiary's operations.\textsuperscript{48}

Some courts indicate that parent corporations, along with individuals, may incur liability based on the mere "capacity to control" the hazardous waste disposal practices of their subsidiaries.\textsuperscript{49} These courts

\textit{NEPACCO II}, 810 F.2d at 745. The Court of Appeals held the defendant liable under RCRA based on his ultimate authority to control the disposal of hazardous substances through his position as the corporation's president and major stockholder, despite the fact that he was not personally involved in the decision to transport and dispose of hazardous waste. \textit{Id.}


\textsuperscript{46} 724 F. Supp. 15 (D.R.I. 1989), \textit{aff'd}, 910 F.2d 24 (1st Cir.), \textit{cert. denied}, 111 S. Ct. 957 (1991). The earliest decision expressly confronting the issue of direct parent liability, as opposed to piercing the corporate veil, was Idaho \textit{v. Bunker Hill Co.}, 635 F. Supp. 665 (D. Idaho 1986). \textit{In Bunker Hill}, the court bolstered its finding of direct liability by noting that the subsidiary was able to expend only $500 on pollution problems without parental authorization, that the subsidiary's capital was only $1,000, and that the parent had the capacity to overrule a transaction or decision regarding management made by the subsidiary. The parent was held liable as owner/operator of its subsidiary based on its extensive involvement, capacity to control, and gained profits. \textit{See also} Rockwell Int'l Corp. \textit{v. IU Int'l Corp.}, 702 F. Supp. 1384 (N.D. Ill. 1988) (finding sufficient evidence of parent's control over its subsidiary to deny a motion to dismiss parent corporation).

\textsuperscript{47} \textit{Kayser-Roth}, 724 F. Supp. at 22-23. The court found that Kayser-Roth had exercised pervasive control over its subsidiary, affecting the subsidiary's finances, capital expenditures, real estate transactions, and contacts with governmental agencies regarding environmental matters. \textit{Id.}

\textsuperscript{48} \textit{Id.} at 23.

\textsuperscript{49} See Idaho \textit{v. Bunker Hill Co.}, 635 F. Supp. 665, 672 (D. Idaho 1986) (stating that while normal activities of a parent corporation "do not automatically warrant finding the parent an owner or operator," a corporate parent may be held liable if it had the capacity to discover subsidiary's release, power to control the release, and the capacity to prevent and abate damage); Colorado \textit{v. Idaho Mining Co.}, 707 F. Supp. 1227, 1241 (D. Colo. 1989) (holding parent corporation liable without discussion), \textit{rev'd in part}, 916 F.2d 1486 (10th Cir.
reason that because an individual stockholder can incur liability for a corporation's hazardous waste disposal based on a capacity to control theory, it follows that a corporation that holds another corporation's stock and can control its management should also incur liability for the cleanup costs the subsidiary incurs as a result of waste disposal practices.  

Courts imposing direct CERCLA liability on individuals and parent corporations agree that operator liability should be interpreted broadly in order to effectuate the purposes of CERCLA. These purposes include the imposition of cleanup responsibility on private parties that directly or indirectly benefited from the disposal of hazardous materials and the preservation of Superfund monies by expending private funds to clean up contaminated sites.

While most courts adopt this expansive view of "operator" liability, some courts hold that the "operator" language of CERCLA does


51. NEPACCO I, 579 F. Supp. at 848-49 (arguing that "the persons who bore the fruits of hazardous waste disposal also bear the costs of cleaning it up"); Ohio ex rel. Brown v. Georgeoff, 562 F. Supp. 1300, 1312 (N.D. Ohio 1983) (explaining that Congress intended that those individuals responsible for creating the hazardous wastes clean them up, and that Congress intended to clean up as many dumps as possible with the Superfund); United States v. Reilly Tar & Chem. Corp., 546 F. Supp. 1100, 1112 (D. Minn. 1982) (explaining that "Congress intended that those responsible for problems caused by the disposal of chemical poisons bear the costs and responsibility for remedying the harmful conditions they created" and suggesting that the need for an effective response to a problem of national magnitude justifies absolute liability with limited defenses).

52. See, e.g., City of New York v. Exxon, 112 B.R. 540, 546-53 (S.D.N.Y. 1990), aff'd on other grounds, 932 F.2d 1021 (2d Cir. 1991) (imposing direct liability on parent corporation); Kayser-Roth, 901 F.2d at 27-28 (holding parent corporation which participated in day-to-day management, including environmental management of subsidiary, directly liable as operator), cert. denied, 111 S. Ct. 957 (1991); Gopher Oil Co., Inc. v. Union Oil Co., 757 F. Supp. 988, 944 (D. Minn. 1990) (holding parent liable for acts of subsidiary); Mobay Corp. v. Allied
not impose liability on parent corporations. For example, in *Joslyn Manufacturing Co. v. T.L. James & Co.*, the Fifth Circuit refused to hold a parent corporation liable based on its finding that CERCLA does not define owners or operators to include the "parent company of the offending wholly-owned subsidiary." The court further reasoned that CERCLA's legislative history does not indicate that Congress intended to "so substantially alter a basic tenet of corporation law."

Adherents to the *Joslyn* viewpoint reason that traditional limitations on corporate liability should be maintained under CERCLA in order to encourage private investment and management of hazardous waste sites. According to this view, corporate officers and shareholders are not acting in their individual capacities, but as officers, directors, or shareholders of the corporation. If shareholders, including parent corporations, and corporate officers are held strictly liable as CERCLA operators, those parties will be less willing to fulfill the necessary corporate environmental roles involving hazardous waste disposal. For example, a corporate officer facing the prospect of personal, strict liability for hazardous waste releases may choose a career unrelated to hazardous waste disposal.


53. See *Joslyn Co. v. T.L. James & Co.*, 893 F.2d 80, 83 (5th Cir. 1990) (stating that CERCLA does not define owners/operators to include the "parent company of the offending wholly-owned subsidiary"), cert. denied, 111 S. Ct. 1017 (1991); FMC Corp. v. Northern Pump Co., 668 F. Supp. 1285, 1292-93 (D. Minn. 1987) (finding no operator liability absent specific authorization of parent for disposal of hazardous waste by subsidiary).

54. 893 F.2d 80 (5th Cir. 1990), cert. denied, 111 S. Ct. 1017 (1991).
55. Id. at 83.
56. Id.
57. See Todd W. Rallison, Comment, The Threat to Investment in the Hazardous Waste Industry: An Analysis of Individual and Corporate Shareholder Liability Under CERCLA, 1987 UTAH L. REV. 585, 619-20 (broad liability under CERCLA discourages industry investment and may encourage divestment); Wallace, supra note 25, at 842 (CERCLA's broad liability scheme creates "uncertainties and fears" which diminish the affected industries' contributions to certain basic economic and business functions); Cynthia S. Korhonen & Mark W. Smith, CERCLA Defendants: The Problem of Expanding Liability and Diminishing Defenses, 31 WASH. U. J. URB. & CONTEMP. L. 289, 315-16 (1987) (interpreting CERCLA liability broadly produces a chilling effect on transactions within waste industries); Little, supra note 25, at 1513-14 (defending *Joslyn*).
58. Harold J. Cronk & Pat Huddleston, II, Comment, Corporate Officer Liability for Hazardous Waste Disposal: What Are the Consequences?, 38 MERCER L. REV. 677, 690 (1987); Allen, supra note 50, at 44 (finding CERCLA's veil-piercing remedy overly broad in that the statute "imposes a form of punitive liability on individual defendants when it is not necessary
Similar concerns apply to lender liability: lenders aware of the possibility of incurring cleanup costs may be discouraged from providing financial assistance to businesses involved with hazardous waste activities.  

3. Lender Liability

The CERCLA liability of lenders differs from that of individuals and parent corporations because CERCLA’s definition of "owner or operator" expressly excludes any individual “who without participating in the management of a . . . facility, holds indicia of ownership primarily to protect his security interest . . . .” The clearest example of holding indicia of ownership “primarily to protect a security interest” is a lender who holds a mortgage but neither participates in the management of the borrower’s business nor forecloses on the borrower’s property. A lender that participates in the daily operations of a hazardous waste facility is likely to lose the benefit of the secured creditor exemption and face liability as an operator.

Until 1990, courts uniformly held that lenders would not incur CERCLA liability if they did not actively participate in the day-to-day operations of the contaminated facility or foreclose on the borrower’s property. However, the Eleventh Circuit deviated from previous rules in the statutory scheme.

59. See Guidice v. BFG Electroplating & Mfg. Co., 732 F. Supp. 556, 562 (W.D. Pa. 1989) (observing that if lenders themselves are subject to CERCLA liability, they have incentives to expedite loan payments or terminate existing relationships with borrowers facing substantial CERCLA liability). See also Roslyn Tom, Note, Interpreting the Meaning of Lender Management Under Section 101(20)(A) of CERCLA, 98 YALE L.J. 925, 928 (1989) (Broad construction of management participation “discourages banks from monitoring and deprives society of further benefits that banks could provide.”).


61. See In re Bergsoe Metal Corp., 910 F.2d 668 (9th Cir. 1990). Mortgage-holding lenders have been held liable as owners after foreclosing on hazardous waste facilities, despite their lack of participation in the management of the borrowing corporation. See United States v. Maryland Bank & Trust Co., 632 F. Supp. 573, 578-80 (D. Md. 1986) (without discussing bank’s pre-foreclosure activities, court ruled that preexisting security interest did not protect bank from liability for cleanup when it held actual title to the property at time of cleanup).


62. Mirabile, 15 Envtl. L. Rep. at 20,997 (denying summary judgement motion of a lender who engaged in the management of the actual operations of the facility which involved more than mere participation in the financial management or financial decision-making of the borrower).

63. See, e.g., Guidice, 732 F. Supp at 562 (finding that pre-foreclosure activities did not give rise to CERCLA liability); Mirabile, 15 Envtl. L. Rep. at 20,997 (holding that “participation in management” is measured by the extent of participation in overall operations, not merely by the extent of financial involvement).
ings and broadened the basis for lender liability under CERCLA in *United States v. Fleet Factors*.

a. **Lender Liability Under Fleet Factors**

In *United States v. Fleet Factors*, the United States brought suit against a secured lender to recover response costs the government had incurred in removing toxic substances from a former cloth printing facility. Fleet Factors had provided financing to the owner/operator of the facility, SPW. As collateral for the loans made to SPW, Fleet had obtained a security interest in the facility's equipment, inventory, and fixtures and a mortgage on the realty. The government claimed Fleet was an owner/operator of the site and responsible for cleanup costs by virtue of its activities there. Fleet never foreclosed on the real property. Nevertheless, the government alleged that after 1981, as SPW began to wind down its affairs, Fleet became an owner/operator by requiring SPW to seek its approval before shipping its goods to customers, establishing the price for excess inventory, dictating when and to whom SPW's finished goods should be shipped, determining when employees should be laid off, supervising the activity of the office administrator at the site, receiving and processing the owner/operator's employment and tax forms, controlling access to the facility, and contracting with the auctioneer to dispose of the owner/operator's fixtures and equipment.

The Eleventh Circuit held that the preceding facts, if proven, would constitute participation in the management of the facility sufficient to deny Fleet the protection of the secured creditor exemption. The court declared that a secured creditor is liable under CERCLA for the environmental harms of its borrower if the secured creditor's "involvement with the management of the facility is sufficiently broad to support the inference that it could affect hazardous waste disposal decisions if it so chose." The court stated that the lender's capacity to influence a corporation's hazardous waste treatment may be inferred from the degree of its financial management of the facility.

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65. 901 F.2d at 1559.
66. *Id*.
67. *Id* at 1557-58. The *Fleet* court stated:
[W]e find [the district court's] construction of the statutory exemption too permissive towards secured creditors who are involved with toxic waste facilities. In order to achieve the "overwhelmingly remedial" goal of the CERCLA statutory scheme, ambiguous statutory terms should be construed to favor liability for the costs incurred by the government in responding to the hazards at such facilities.

*Id.* (quoting Florida Power & Light Co. v. Allis Chalmers Corp., 893 F.2d 1313, 1316 (11th Cir. 1990)).
68. *Id* at 1557-58.
Two months after the Eleventh Circuit issued the Fleet decision, the Ninth Circuit Court of Appeals rejected the strict capacity-to-influence standard in In re Bergsoe Metal Corp. The Ninth Circuit held that lenders must exercise actual management authority in order to incur CERCLA liability for action or inaction that results in the discharge of hazardous waste.

The Fleet Factors decision was not well thought out. The court pointed to two principal policy considerations to support its capacity-to-influence standard, but the standard adopted fails to further these policies. The court believed this liability rule would encourage lenders to "investigate thoroughly" the waste treatment systems and policies of potential debtors. Prior to Fleet, however, lenders already conducted investigations of borrower's sites before lending.

The Eleventh Circuit's second goal was to encourage borrowers to properly handle hazardous wastes. The court believed that lenders could investigate the potential risks of Superfund liability and simply factor those risks into the price of their loans by charging higher premiums. Such investigations would provide borrowers hoping to avoid unfavorable credit terms an incentive to properly handle hazardous wastes.

In fact, Fleet may cause a decline in loans to these parties. Lenders facing the threat of CERCLA liability premised on mere capacity to

69. 910 F.2d 668, 672 (9th Cir. 1990) (holding that where there was no actual participation in management of the facility, creditor is not liable but leaving unresolved the question of what the precise parameters of "some participation" should be).

70. Id. at 672. The Ninth Circuit concluded that the defendant municipality, which held a security interest in a lead recycling plant, retained the secured creditor exemption because it had not engaged in any management activities. The court stated that "whatever the precise parameters of participation, there must be some actual management of the facility" for the lender to lose the secured creditor exemption. Id.

71. The Fleet decision may actually undermine these policy considerations. See Final Rule, supra note 15, at 18,355.

72. Fleet, 901 F.2d at 1558.


74. Fleet, 901 F.2d at 1558. Id.

75. See George A. Nation, III, Minimizing Risk of Loss From Environmental Laws, 108 BANKING L.J. 346, 385 (1991) ("Lenders are quickly learning how not to be left holding the 'environmental liability' bag."); Bruce P. Howard & Melissa K. Gerard, Lender Liability Under CERCLA: Sorting Out the Mixed Signals, 64 S. CAL. L. REV. 1187, 1212 (1991) (citing reports indicating that the financial industry is hesitant to extend credit to certain customers after Fleet); George W. Dent, Jr., Limited Liability in Environmental Law, 26 WAKE FOREST L. REV. 151, 177 (1991) ("The fear that lenders cannot interfere with a debtor's business... without risking CERCLA liability will deter them from making loans in industries dealing
control borrowers' hazardous waste practices have become reluctant to extend credit to users of hazardous materials or businesses located in potentially contaminated areas. Such lenders will likely respond to this increased threat of liability by refusing additional credit to remedy contaminated sites rather than by nursing troubled borrowers back to financial health. Businesses attempting to clean up existing environmental contamination, unable to obtain funding, are more likely to abandon their contaminated property, resulting in an increased number of abandoned hazardous waste sites.

Even if a lender agrees to extend credit to a troubled borrower or to a new business who will handle hazardous wastes, the borrowers may not be able to afford the additional premium the lender adds to cover the loan's excess risk. Thus, lenders are not alone in suffering the repercussions of the Fleet decision.

b. EPA's Final Rule on Lender Liability Under CERCLA

EPA addressed the lending community's reaction to the Fleet decision by issuing a rule on Lender Liability Under CERCLA. The final rule applies a fact-sensitive inquiry to determine whether a lender's activities constitute "participation in management" sufficient to void the se-
According to EPA, participation in management does not include the mere capacity, ability, or unexercised right to influence facility operations.

EPA's final rule specifies a range of activities that lenders may undertake before foreclosure to manage and protect their security interests without triggering CERCLA liability. The EPA rule establishes a two-pronged test whereby a lender "participates in management" if the lender either exercises decision-making control over the borrower's environmental compliance or acts like a manager of the facility. The lender acts like a manager of the facility if the lender assumes or manifests responsibility for the overall management of the enterprise encompassing the day-to-day decision making over either (A) the enterprise's environmental compliance or (B) all, or substantially all, of the operational aspects of the enterprise other than environmental compliance.

In other words, if, before foreclosure, the lender has exercised substantial control over the environmental compliance of the borrower, then the lender has "participated in the management" of the facility within the meaning of the security interest exemption.

EPA's final rule further states that a lender's "involvement in financial or administrative matters" does not reach the level of management participation that voids the exemption. Thus, a lender can act to pre-
tect its security interest by policing the loan, by undertaking a financial workout with a borrower who threatens to default, or by foreclosing and preparing the facility for sale or liquidation. EPA's final rule does not equate such actions with participation in management, provided that the actions are reasonably necessary to protect the security interest. Activities that are not specifically enumerated in EPA's final rule are assessed under the participation in management standard, discussed above.

According to EPA's final rule, actions that a secured party takes before, or concurrently with, obtaining a security interest in a facility are not considered to be evidence of participation in management of a facility. The rule allows a secured party to consult and negotiate freely with its borrower regarding the structure and terms of the loan or other obligation. It allows a lender to require an environmental inspection of the facility securing the loan. A lender who requires the borrower to clean up the facility does not forfeit the secured creditor exemption.


88. Workout activities will not deprive the secured party of its exemption so long as such actions are taken in the course of protecting the security interest. Lenders should be careful, not to divest the borrower of its decision-making control over facility operations, particularly with respect to hazardous substances. Final Rule, supra note 15, at 18,377. If the borrower defaults, and foreclosure proceedings have not yet been instituted, the EPA final rule allows the lender to take mitigative action to preserve the property or to prevent exacerbation. Id.

89. Lenders are allowed more latitude following foreclosure, including operational management of the property. While a lender's activities prior to foreclosure are confined by the two-pronged test for participation in management, secured parties may foreclose and continue the operations of the facility to protect their security interest without losing their exemption. The lender must, however, divest itself of the property as soon as economically feasible. Id.

90. Id. at 18,375. But see Hathaway, supra note 81. The author notes there is a risk that guidelines pertaining to what is and what is not participation in management will be interpreted as unprotective of the lender because EPA states that the activities remain within the security interest exemption only if the lender does not participate in management under EPA's two-pronged test. Id. at 1467. However, the Rule's preamble suggests that the protected activities it articulates in the final rule simply will not be considered as evidence of participation in management regardless of whether they would qualify as participation in management under the general two-pronged test. Final Rule, supra note 15, at 18,375.

91. Final Rule, supra note 15, at 18,376.

92. Id.

93. EPA's final rule also states that an environmental inspection is no longer an absolute prerequisite to a lender's assertion of the security interest exemption. Id.

94. Id. at 18,377. A lender that knowingly takes a security interest in a contaminated facility is not subject to CERCLA liability solely on that basis. Id. at 18,376. Yet, EPA's final rule also implies that when an environmental inspection indicates that the property is contaminated to the extent of affecting the value of the facility, it might be wise for a lender to refuse to extend credit or to obtain a security interest in un-contaminated property.
EPA's final rule also allows a lender to police the borrower's activities. Specifically, a lender may require the borrower to clean the property before or during the term of the loan and to comply with all applicable environmental laws. The lender may also regularly audit a facility by way of site inspections and review of the facility's books. This list of permissible activities is not exclusive; lenders may undertake "other actions to adequately police the loan or security agreement," subject to the "participation in management" test.

By identifying a range of specific activities in which lenders may engage without exposing themselves to CERCLA liability, EPA has achieved Congress's apparent intent that lenders be protected when engaged in the normal course of business. To achieve this goal, EPA has undercut CERCLA's strict liability scheme by allowing some direct participation by lenders in the activities of their borrowers.

This higher threshold of liability, however, is consistent with CERCLA's goals: it encourages lenders to provide funds for expeditious cleanup of hazardous waste sites and to carefully monitor the use of secured property. Lenders should not fear liability for making loans to borrowers who need to remediate contaminated property. With the guidance of legal counsel, lenders can identify and avoid activities which would cause them to incur CERCLA liability. EPA's final rule will help alleviate concerns that the country's inventory of abandoned and inactive hazardous waste disposal sites will increase because borrowers are unable to obtain financing for cleanup projects.

EPA's final rule is consistent with the interpretation accorded the Act's language by many courts who have addressed the question of lender liability under CERCLA. EPA conceded that it could not ad-

95. Covenants or warranties included in loan documents will not be considered evidence of participation in management, nor will a "holder's actions that ensure that the facility is managed in an environmentally sound manner." Id. at 18,377.
96. Id. at 18,376-77.
97. See id. In the preamble to the final rule, however, EPA appears to limit the scope of allowable policing activities by subjecting steps beyond the imposition of covenants to the overall "participation in management" test. Id. at 18357.
98. Id. at 18,377.
99. EPA officials and other analysts have put the total number of sites likely to require remediation in the range of 27,000 to over 400,000. GAO Finds 425,380 Potential Superfund Sites; Florio Hits EPA for Delays in Site Assessments, 18 [Current Developments] Env't. Rep. (BNA) 2043 (January 22, 1988).
100. Guidice v. BFG Electroplating and Mfg. Co., Inc., 732 F. Supp. 556, 562 (W.D. Pa. 1989); see also Lowry, supra note 73, at 325 (arguing that lenders could play a positive role in effectuating hazardous waste cleanup).
101. See, e.g., Bergsoe Metal, 910 F.2d at 672 ("[T]here must be some actual management of the facility before a secured creditor will fall outside the exception."); United States v. Mirabile, [1985] No. 84-2280, 15 Envtl. L. Rep. (Envtl. L. Inst.) 20,992, 20,995 (E.D. Pa. Sept. 4, 1985) ("[T]he participation which is critical is participation in operational, production, or waste disposal activities.").
dress each and every situation it would eventually face when it enumerated certain activities to be excluded from "participation in management." However, the final rule evaluates lender activities which are not specifically enumerated in the rule by applying the fact-specific participation-in-management test.

Three courts ruling on lender liability under CERCLA after the promulgation of EPA's final rule have regarded the rule as valid and binding on their decisions. This interpretation conforms to EPA's position that the rule "is not merely an Agency interpretation... but is a 'legislative' or 'substantive' rule that has undergone notice-and-comment pursuant to the Administrative Procedure Act." EPA contends that the rule has the force and effect of law even in actions between private parties or between a state and a private party. The degree to which EPA's final rule will be effective in controlling judicial decisions, however, is in dispute. The Court of Appeals for the D.C. Circuit will


104. Final Rule, supra note 15, at 18,368.

105. Id. at 18,368-69. The rule governs third party cost recovery or contribution actions because the rule is part of the National Contingency Plan (NCP). Id. All cost recovery actions by third parties must be consistent with the NCP. 42 U.S.C. § 9607(a)(B) (1988). See Howard & Gerard, supra note 76, at 1201 n.105. But see Philip R. Sellinger & Avery Chapman, EPA's Proposed Rule on Lender Liability Under CERCLA: No Panacea for the Financial Services Industry, 21 Envtl. L. Rep. (Envtl. L. Inst.) 10,618, 10,622 (October 1991) (noting that the rule may not apply to private parties or to actions under other statutes); David E. Pierce, The Emerging Role of "Liability-Forcing" in Environmental Protection, 30 Washburn L.J. 381, 402-03 (1991) (arguing that regardless of EPA's final rule, private parties seeking recovery or contribution from lenders will try to push the limits of CERCLA lender liability).

106. EPA claims that courts must defer to its interpretation of lender liability under CERCLA. Final Rule, supra note 15, at 18,368. For support, EPA cites Wilshire Westwood Assoc. v. Atlantic Richfield, 881 F.2d 801 (9th Cir. 1989) (giving deference to internal EPA memoranda interpreting statute) and Wickland Oil Terminals v. Asareco, Inc., 792 F.2d 887 (9th Cir. 1986) (granting deference to preamble statements in EPA rulemaking). See also Chevron v. Natural Resources Defense Council, 467 U.S. 837 (1984) (deferring to agency's interpretation where statute is silent or ambiguous with respect to the specific issue); Aluminum Co. of America v. Central Lincoln Peoples' Util. Dist., 467 U.S. 380, 389-90 (1984) (deference particularly appropriate when administrative rule at issue is complex, necessitating agency's expertise); Wagner Seed Co. v. Bush, 946 F.2d 918, 920 (D.C. Cir. 1991) (EPA's rules entitled to deference because President assigned primary responsibility for CERCLA administration to EPA), cert. denied, 112 S. Ct. 1584 (1992).

likely resolve this dispute when it rules on a pending challenge to EPA's final rule.¹⁰⁷

The District Court for the Western District of Michigan adopted an approach, discussed below, that is similar to EPA's analysis of lender liability for determining corporate officer and shareholder liability under CERCLA. Even if the D.C. Circuit holds that EPA's final rule is not binding, courts could use EPA's rule as persuasive authority in conjunction with the Michigan court's approach to determine lender liability under CERCLA.

II
THE PREVENTION TEST

A. Development of the Prevention Test

The Western District of Michigan established a fact-specific standard called the "Prevention Test" for imposing liability on shareholders and corporate officers of a closely-held corporation. This test, announced in three cases decided by Judge Enslen,¹⁰⁸ focuses on whether an individual could have prevented or significantly abated the release of hazardous substances.

*Kelley v. Arco Industries Corp.*¹⁰⁹ involved a motion by two defendant shareholders to clarify an earlier order denying their dismissal from the action.¹¹⁰ Defendant Matthaei was the majority stockholder of Arco Industries and had limited contact with the day-to-day operations of the facility.¹¹¹ Defendant Ferguson, on the other hand, owned less than five percent of the outstanding shares of Arco, but at various times had acted as the president, the chief operating officer, and a director of the company.¹¹² Ferguson reported directly to the chief executive officer, and other managers of the plant reported to him. He regularly toured the manufacturing areas of the plant and was involved in setting policy for the company's hazardous waste activities.

In the other *Thomas* cases, the government sued individuals who were shareholders and occupants of various positions in two related companies, Thomas Solvent Company and Thomas Development Com-

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¹¹⁰. *Id.* at 1216-17.

¹¹¹. As majority stockholder, defendant Matthaei had authority to elect the board of directors. *Id.* at 1217.

¹¹². *Id.* at 1216.
pany. These related companies were responsible for several toxic waste sites. Thomas Solvent I examined the liability of Richard Thomas, who was president of both companies; a shareholder, director, and secretary of Thomas Development Company; and the sole shareholder and director of Thomas Solvent Company. Thomas Solvent II involved Letha Thomas (Richard's mother), who was a director and secretary of Thomas Solvent Company, a shareholder of Thomas Development Company, and, at times, the president of Thomas Development Company. In each case, the court examined prior courts' standards for determining corporate officer and shareholder liability and distilled from them the standard to apply in the current cases.

Judge Enslen noted that prior case law—piercing the corporate veil or assigning liability to corporate officers based on their personal participation or capacity to control—created disincentives for corporate officers to involve themselves in the environmental processes and decision making of the corporation. He responded to this shortcoming by articulating the Prevention Test, which focuses on whether the individual could have prevented or significantly abated the release of hazardous substances: the court assesses the officer's degree of authority in general and her specific responsibility for health and safety practices, including responsibility performed or neglected with respect to hazardous waste disposal practices. It is a fact-specific test, requiring an examination of the totality of the circumstances.

According to Thomas, a court should consider two factors in analyzing evidence of the individual's authority to control the waste-handling practices of the corporation. First, the court should ascertain whether the shareholder holds a management position within the corporation, such as officer or director. Second, the court must look to the

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115. Heidt, supra note 40, at 170.
119. Id.
120. Id. at 1543-44.
distribution of power within the corporation, including the shareholder's position in the corporate hierarchy and the percentage share of the corporation she owns. The greater the authority of the shareholder to control the conduct of the corporation, the more likely it is that a shareholder has the capacity to control the hazardous waste activities of the corporation and the power to prevent the harm. An individual with the authority to control all corporate operations, such as day-to-day operational affairs, would certainly have the type of power described by the Thomas court.

However, the analysis does not end here; the Thomas court stated that capacity to control is not itself enough to impose liability. The court next examines evidence of responsibility undertaken and neglected. A corporate officer may lack power over the corporation's operations, yet still be responsible for the proper handling of the hazardous waste activities of the corporation. A job description may provide evidence of explicit responsibility. A court may also find implicit responsibility where an individual informally accepts responsibility to manage hazardous wastes. Both implicit and explicit responsibility for waste management activities increase the probability that an officer or shareholder could have had a positive effect on disposal practices.

A corporate individual may be insulated from CERCLA liability if she undertakes responsibility for hazardous waste disposal practices, and, although failing to prevent improper handling, acts in good faith. The court stated that "active, direct, knowing efforts to prevent or abate the contamination may work for—not against—a corporate defendant where the acts suggest the individual tried but was unable to prevent or abate the unlawful waste disposal." Thus, direct participation, including an attempt, albeit unsuccessful, to avoid or prevent harm will not itself render the party personally liable and might constitute an affirmative defense.

Another district court adopted the Thomas Prevention Test in a decision assessing the CERCLA liability of a trustee. In Quadion v. Mache, the current owner of PCB-contaminated property sought clean-up costs and future liability costs from a trust owning seventy percent of

121. Id.
122. See id.
123. See Heidt, supra note 40, at 172.
125. Id.
126. See Heidt, supra note 40, at 172.
128. Id.
129. Id.
the stock of a previous site owner. The trustee moved to dismiss on the grounds that it was merely a shareholder and did not have the necessary control over the facility's operations to incur liability. The *Quadion* court denied the trustee's motion, noting that CERCLA cases are heavily fact-specific and require judicial evaluation of all circumstances of a particular situation. The court adopted the Prevention Test, holding that a court must consider the trustee's position with respect to the company, authority to control waste-handling, and responsibility undertaken and neglected, as well as efforts to avoid damage.

**B. Analysis of the Prevention Test**

The Prevention Test provides individuals, lenders, and shareholders an affirmative defense if they positively involve themselves in the hazardous waste practices of a liable corporation. This defense should encourage high-level corporate officials and lenders to undertake proactive steps to prevent contamination. The Prevention Test thus discourages parties from distancing themselves from important environmental decisions because responsibility undertaken in a beneficial manner is viewed in the defendant's favor.

Although capacity to control alone is insufficient to impose liability under the Prevention Test, where the corporation is closely held, a court applying the test may find that a corporate officer dealing with hazardous waste disposal has *implicitly* undertaken responsibility for hazardous waste decisions. The corporate officer may, however, plead the affirmative defense if she has made significant attempts to avoid or abate hazardous waste damage.

A court could use a similar analysis in applying the Prevention Test to a corporate officer or shareholder in a corporation that is not closely-held. In such a case, a fact-specific analysis may demonstrate that the

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131. *Id.* at 272-73.
132. *Id.* at 274-75.
134. *Thomas Solvent I*, 727 F. Supp. at 1544. Indeed, this reasoning is the basis for the *Thomas* court's adoption of the Prevention Test. The court stated:

> [C]onsistent with CERCLA’s goals, this standard will encourage increased responsibility with increased authority within a corporation. I take this to be a positive result, and thus a better standard than one which measures only the most direct knowledge or involvement in waste disposal activity, because it encourages responsible conduct instead of causing high level corporate individuals “not to see” and “to avoid getting involved with waste disposal at their facilities.”

*Id.*

135. The court's analysis will vary depending on the nature of the corporation's business. For example, a corporate officer of a corporation that produces hazardous waste merely as a by-product is less likely to implicitly have assumed responsibility for hazardous waste disposal than an officer of a business that operates a hazardous waste disposal site.
defendant did not implicitly assume responsibility for hazardous waste decision making or monitoring and, therefore, is not liable. If the defendant explicitly assumed responsibility for hazardous waste decisions by instituting environmentally responsible policies for the corporation, she may benefit from the affirmative defense to liability provided by the Prevention Test.

Most case law continues to discourage beneficial involvement by those with the opportunity to participate in hazardous waste decisions. Current standards for CERCLA liability promote the ignorance of shareholders, corporate officers, and lenders concerning environmental operations and discourage involvement in corporate environmental decision making. These decisions threaten personal liability based on direct participation but do not provide an affirmative defense for preventive actions. Allowing the defendants the latitude set forth in Thomas would encourage them to ensure that wastes are properly handled.

Although EPA's final rule significantly limits lender liability, it provides a defense only for certain EPA-specified activities, and does not balance the fact that contamination occurred against any positive steps taken by lenders to prevent or abate contamination on borrowers' property. If the D.C. Circuit finds that EPA's final rule is not binding, or is only persuasive authority, courts should judge lender liability under CERCLA by applying the Prevention Test in conjunction with EPA's final rule. The Prevention Test would complement EPA's final rule by providing lenders with an affirmative defense to government assertions that they participated in the management of borrowers. Courts would focus less on the amount of control exercised by the lender, and assess liability by balancing the positive and negative behavior of the lender. Lenders rewarded for positive behavior would likely respond by encouraging and participating in proactive, environmentally beneficial behavior of borrowers.

One commentator criticizes Thomas and aligns it with Fleet as establishing an overly broad liability principle premised on capacity to control. However, Thomas requires more than mere status as a corporate officer or director to impose CERCLA liability. Under the Prevention Test, liability can be imposed only after an evaluation of a defendant's responsibility. If responsibility has been undertaken, the party is afforded an affirmative defense if its behavior has been more positive than negative.

Other commentators criticize Thomas for the opposite reason, arguing that Thomas undercuts CERCLA's strict liability scheme by provid-

136. See Final Rule, supra note 15, at 18,344.
137. See supra notes 105-07 and accompanying text.
138. Wolf, supra note 133, at 542 (calling the Thomas test an "authority to control" test).
ing a defense to liability. It appears that Congress intended that responsible parties be held strictly liable under CERCLA, even though an explicit provision for strict liability was not included in the statute.\(^\text{140}\) Arguably, the Thomas Prevention Test does not contradict the strict liability scheme imposed by CERCLA because Congress intended strict liability only for the offending corporation and not for individuals within the corporation.\(^\text{141}\) The Prevention Test may be construed as clarifying which parties should incur CERCLA’s strict liability, but not as undermining the strict liability scheme itself.

The Thomas court admitted that the Prevention Test may depart from the strict liability scheme of CERCLA section 107. However, the court suggested that strict liability may be “too harsh and broad-sweeping” a standard to apply to all corporate shareholders in all cases.\(^\text{142}\) Holding corporate officers individually liable under CERCLA is particularly harsh in light of CERCLA’s retroactive, joint and several liability scheme.\(^\text{143}\) The court proposed the Prevention Test as a compromise between strict liability for corporate officers and the traditional, corporate tort liability standard.\(^\text{144}\) The court maintained that, on the whole, the Prevention Test is more stringent than traditional corporate tort liability, which holds corporate individuals liable for corporate acts only in circumstances that warrant piercing the corporate veil.\(^\text{145}\)

Critics who claim that the Prevention Test undermines the liability scheme set up by Congress should recognize that both EPA and the courts have substituted other approaches for strict liability under CERCLA. EPA’s final rule, for example, defines the term “participation in management” to exclude certain EPA-specified policing activities.\(^\text{146}\)


\(^{141}\) This is a weaker assertion than the position that courts should find liability under CERCLA only through a traditional veil-piercing analysis. In other words, the Prevention Test standard snare more parties than traditional veil piercing or lender liability tests. See supra notes 33, 53-59 and accompanying text.

\(^{142}\) Thomas Solvent I, 727 F. Supp. at 1543.

\(^{143}\) See Allen, supra note 50, at 69-75 (arguing that CERCLA’s strict liability scheme is inappropriately punitive); Heidelberg, supra note 25, at 923 (arguing that strict liability scheme imposes liability arbitrarily).

\(^{144}\) Thomas Solvent I, 727 F.Supp. at 1543-44.

\(^{145}\) Id.

\(^{146}\) Final Rule, supra note 15, at 18,383; see also Guidice v. BFG Electroplating and Mfg. Co., 732 F. Supp. 556, 562 (W.D. Pa. 1989) (“[A] high liability threshold will enhance the dual purposes of protection of the banks’ investments and promoting CERCLA’s policy goals.”).
deed, there may be other escape devices grounded in the statutory language itself.\textsuperscript{147}

A minority of courts reject outright the model of direct strict liability for corporate individuals and parent corporations, applying instead a traditional piercing analysis. These courts read the CERCLA terms “owner and operator” narrowly, based on the fact that the CERCLA definitions do not specifically refer to parent corporations, shareholders, or corporate officials.\textsuperscript{148} Rather, the offending corporation, and only the offending corporation, is the owner or operator for CERCLA liability purposes. These courts have not only narrowed the strict liability scheme of CERCLA, but have also paved the way for corporate officers and shareholders to avoid liability with much less scrutiny than would be required by the \textit{Thomas} court.

Furthermore, applying the strict liability scheme of CERCLA to shareholders, corporate officers, and lenders without further analysis may undermine an important goal of the Act. CERCLA’s objectives include creating incentives for safe behavior by those parties who possess the greatest knowledge about the risks associated with their wastes and who are in the best position to control disposal decisions.\textsuperscript{149} Because strict liability encourages high level corporate officials and lenders to distance themselves from the hazardous waste activities of related corporations, many plant managers continue to have the autonomy to ignore environmental problems for the sake of increased productivity. Moreover, corporate actors who possess the greatest ability to address hazardous waste concerns may seek less risky employment because they fear the strict personal liability imposed by previous case law.

Incorporation of the Prevention Test into CERCLA’s strict liability scheme would encourage progressive environmental corporate policies and practices. By providing an affirmative defense for shareholders, corporate officers, and lenders who implement sound corporate environmental policies and practices, the Prevention Test creates incentives for safer behavior by those parties who are in the best position to control waste disposal decisions and expeditious cleanup.

\begin{itemize}
  \item \textsuperscript{147} Clifton J. McFarland, \textit{Recent Decisions Lay the Ground for “Escape Devices” to Ameliorate Joint and Several Liability Under CERCLA}, NAT. RES. \& ENV'T, Winter 1993, at 59.
  \item \textsuperscript{148} 42 U.S.C. § 9601 (20)-(21). See, e.g., Joslyn Manufacturing Co. v. T.L. James & Co., 893 F.2d 80 (5th Cir. 1990) (refusing to apply operator or owner status to parent shareholder because CERCLA does not define owners or operators to include parent corporations); Riverside Mkt. Dev. Corp. v. Int'l Bldg. Prod., 931 F.2d 327 (5th Cir. 1991) (deciding that an eighty-five percent shareholder was not an “owner” because corporate entity, not its shareholders, was the owner); United States v. Consolidated Rail Corp., 729 F. Supp. 1461 (D. Del. 1990) (holding defendant not liable as “operator” of site even though defendant was involved in setting up operations at site, purchased all output from site, and preapproved the shipments of hazardous materials coming to site); Edward Hines Lumber Co. v. Vulcan Materials Co., 861 F.2d 155 (7th Cir. 1988).
  \item \textsuperscript{149} S. REP. NO. 848, 96th Cong., 2d Sess. 14-15, 31-34 (1980).
\end{itemize}
Corporations are becoming increasingly aware of the need to focus their environmental concerns at higher management levels: hazardous waste management is no longer a low priority "operations" assignment.  

Senior management's increasing appreciation and sophistication regarding the importance of meeting and exceeding minimal environmental requirements will lead to corporate anticipation and prevention of future problems. In turn, upper management's growing commitment to the development of sound environmental procedures encourages employees, officers, and managers to perform their overall duties with an awareness of environmental obligations.

The differing approaches that courts have employed to determine derivative, direct statutory, and lender liability under CERCLA discourage lending activity, as well as progressive environmental practices and rapid cleanup of contaminated facilities. Uniform application of the Prevention Test by the courts would best serve CERCLA's goals by fostering direct involvement of corporate officers, shareholders, and lenders in important hazardous waste handling decisions. At the same time, the Prevention Test would promote cost efficiency because, as history has verified repeatedly, "prevention is much cheaper than cleanup.”

It may be argued that adoption of the Prevention Test should be left to Congress. But Congress, by failing to adequately define the liability of shareholders, lenders, and corporate officials, has left the judiciary with the task of reconciling the Act and its goals with the long-standing body of corporate law. CERCLA’s legislative history indicates that Congress intended courts to develop federal common law to fill gaps in the

150. Lorelei J. Borland, CORPORATE POLICIES IN THE 90’S: LOOKING INTO THE TWENTY SECOND CENTURY (1992). “Some companies, such as IBM, have centralized responsibility, appointing a vice president for environmental health and safety, with appropriate staff. Other companies are developing environmental management committees, with senior directors being given responsibility for overseeing environmental affairs.” Id.

151. Id.


153. See Heidelberg, supra note 25, at 907; Little, supra note 25, at 1513.

154. See, e.g., Lowry, supra note 73, at 325 (“There is little question that lenders could play a positive role in effectuating hazardous waste cleanup, but that role can only be carried out effectively if the lender is free to assist the debtor in solving its hazardous waste problems.”).


156. One leading scholar of the common law has proposed that judges treat statutes as they do common law precedents in order to update earlier legislation to meet new realities. Guido Calabresi, A COMMON LAW FOR THE AGE OF STATUTES 82 (1982); see also Robert Abrams & Val Washington, The Misunderstood Law of Public Nuisance: A Comparison with Private Nuisance Twenty Years After Boomer v. Atlantic Cement Co., 54 ALB. L. REV. 359 (1990) (“After all, the great pride of the common law is its ability to adapt.”).
statute. Courts have both the authority and the ability to develop a federal common law balancing test under CERCLA as they have done in other contexts.

C. Practical Application of the Prevention Test

Courts applying the Prevention Test must cautiously develop this fact-sensitive balancing approach. To discern truly beneficial behavior, courts must develop criteria to indicate whether the corporate official, shareholder, or lender is acting consistently with its asserted defense. Corporate officers, shareholders, and lenders must pay more than lip service to positive involvement in hazardous waste operations. In order to benefit from the protection of the Prevention Test’s affirmative defense, such parties must demonstrate that their actions evidence a serious commitment to positive environmental practices.

For example, writing a memorandum stressing environmentally responsible action would not be sufficient. Merely subscribing to a broad environmental policy statement would not be enough. Conversely, taking extensive measures to implement pollution control practices, while rejecting other steps that might improve environmental policies, might be enough to successfully assert the affirmative defense. If a high-level corporate actor institutes environmental practices that exceed what is required by law, such actions would likely provide a sufficient basis for the actor to successfully assert the affirmative defense. Substantial efforts to avoid hazardous waste contamination would outweigh the fact that the contamination occurs.

Likewise, instituting policies that meaningfully promote specific, positive environmental behavior might constitute an affirmative defense. Examples of such positive corporate behavior might include the following:


159. See CRAIG N. JOHNSTON & JEFF MILLER, HAZARDOUS WASTE LAW AND MATERIALS (forthcoming 1994).

1. Securing top-level commitment to and long-term funding for environmental programs;\textsuperscript{161}

2. Developing a corporate environmental policy statement which, at a minimum: implements regulatory requirements and provides management guidance for environmental hazards not specifically addressed in regulations;\textsuperscript{162}

3. Assigning a senior executive to head the program, appointing a manager with superior managerial skills, and identifying key individuals in other divisions to serve as liaison with the environmental department;\textsuperscript{163}

4. Assessing paths of environmental exposure from the corporation’s activities;\textsuperscript{164}

\textsuperscript{161} Hunt & Auster, supra note 155, at 12; see also Claudia H. Deutsch, \textit{Managing: Giving the Environment Teeth}, N.Y. TIMES, Mar. 3, 1991, sect. 3, pt. 2, at 29 (describing IBM’s goal of setting environmental goals at the top-level of management and attempting to prevent plant managers from pressing for profits instead of complying with environmental goals).

\textsuperscript{162} A corporate environmental policy statement is a written commitment to comply responsibly with all applicable environmental health and safety laws and to implement the necessary compliance measures. Wheeler & Fox, supra note 152, at 497. The statement should emphasize “prevention, protection, premeditation, and immediate response to unexpected developments.” Hunt & Auster, supra note 155, at 12. The corporate policy statement serves as a catalyst for all compliance activities and should be incorporated into a longer document of environmental procedures regarding all aspects of the company’s operations, including hazardous waste handling and regulatory inspections. A well-drafted policy statement, if adhered to, should be evidence of a good faith commitment to sound environmental practices. Wheeler & Fox, supra note 152, at 497. An effective policy statement will include the following provisions:

1. The corporation will design, manufacture, and distribute all products and handle and dispose of all materials safely and will not create unacceptable risks to health, safety, or the environment.

2. The corporation will establish and maintain programs to assure that laws and regulations are known and obeyed.

3. The corporation will adopt its own standards where laws or regulations may not be adequately protective.

4. Every employee is expected to adhere to the spirit, as well as the letter, of this policy. Managers have a special obligation to inform and advise higher management of any adverse situation.


\textsuperscript{163} See Hunt & Auster, supra note 155, at 16 (arguing that a good manager is essential to the success of any environmental program because of the diversity of issues and the difficulties of promoting sound practices).

\textsuperscript{164} One article, written for an audience of managers, set forth the objectives of the assessment as follows:

Knowing both the degree and scope of potential exposure can help firms design efficient, effective programs and determine appropriate levels of investment. . . . The most common way of determining risk is to conduct an environmental assessment or audit at all facilities. These audits should do the following: describe the nature of the operations, including production processes and chemicals used; identify the full scope of regulatory requirements that apply to the facility; identify the persons/positions responsible for ensuring compliance and the organizational structures in place for executing environmental programs; assess the current level of compliance with regulatory programs; identify other potential sources of risk beyond regulatory considerations; and rank each facility according to the relative degrees of risk and compliance.
5. Defining and prioritizing environmental program goals and objectives;

6. Training, educating, and motivating facility personnel to understand and comply with government regulations and the corporation's environmental policy.¹⁶⁵

This list is not meant to be exhaustive;¹⁶⁶ rather, it is intended to show corporate officers, shareholders, and lenders what type of corporate behavior is necessary to entitle the individual to an affirmative defense under the Prevention Test. Because the Prevention Test is not a bright-line test and each case is assessed by the totality of the circumstances, these examples should be tailored to the individual environmental needs of each corporation. Lenders generally play a less substantial role in encouraging their borrowers to adopt these policies or procedures. Nonetheless, a lender may demonstrate its beneficial behavior by showing that it negotiated positive environmental provisions into the loan agreement, conducted environmental inspections of facilities securing a loan, and policed and audited the borrower's environmental activities.

¹⁶⁵ The goal of any training program should be to convey an unswerving corporate commitment to sound environmental practices. A training program should generate discussion regarding the most common environmental problems, how to detect and address those problems, and appropriate response actions to emergency situations. Id. at 14-15.

¹⁶⁶ Other examples of environmentally proactive management might include:

1. Communicating relevant environmental developments and incidents expeditiously to personnel throughout the corporation;
2. Communicating effectively with government and the public regarding serious environmental incidents;
3. Requiring third parties working for, with, or on behalf of the organization to follow its environmental procedures;
4. Ensuring that competent personnel are available at all times to carry out environmental procedures and emergency response procedures;
5. Incorporating environmental protection into written operating procedures;
6. Revising the corporate organizational structure to maximize the program's effectiveness;
7. Applying best management practices and operating procedures, including "good housekeeping" techniques;
8. Instituting preventive and corrective maintenance systems to minimize actual and potential environmental harm;
9. Utilizing the best available process and control technologies;
10. Using the most effective sampling and monitoring techniques, test methods, record-keeping systems and reporting protocols (beyond minimum legal requirements);
11. Developing formalized inspection programs;
12. Evaluating causes behind any serious environmental incidents and establishing procedures to avoid recurrence;
13. Exploiting source reduction, and recycling potential wherever practical;
14. Using the least hazardous substances feasible;
15. Continually re evaluating the program needs and design;
16. Evaluating environmental management programs of alternative materials and energy suppliers and considering such programs in selecting suppliers;
17. In environmental management programs, considering not only the operations at each plant but also all stages of products concerned;
18. Implementing a program of periodic outside audits.

See generally Hunt & Auster, supra note 155; Wheeler & Fox, supra note 152.
Truly enlightened management should also begin "anticipating" as a part of the prevention process. As management anticipates imminent regulations by recognizing the trends in environmental standards, prevention becomes easier and less costly.

Conducting an environmental compliance audit is a particularly thorough way to anticipate future environmental needs. A good audit should include in "crystal ball gazing" to envision new regulations and to ascertain what changes the corporation should make in environmental processes and policy. The auditing process should be much more thorough than the type of assessment conducted in response to government inspections. Courts should view a well-conceived and well-implemented audit as evidence that a corporation is committed to environmentally beneficial behavior and should value corporate self-reporting of environmental violations.

Courts, when evaluating a defendant's behavior with regard to personal liability, should look also to the degree to which the defendant's environmental management program reduces environmental risk, the level of commitment within the organization, and the overall program

168. Id. Corporations anticipating new environmental requirements realize that a commitment to prevention may save substantial funds, not only by avoiding fines for noncompliance with environmental laws, but also by "saving" costs through "clean" manufacturing. Id. See also Hunt & Auster, supra note 155, at 7 (companies that do not have an environmental program may incur several negative consequences including governmental fines, negative publicity, and potentially huge liability costs, as well as causing serious damage to the environment); Amal Kumar Naj, Industrial Switch: Some Companies Cut Pollution by Altering Production Methods, WALL ST. J., Dec. 24, 1990, at 1 (one company cut its annual production costs by $1.2 million by spending $500,000 to eliminate toxic lubricants from its air conditioner manufacturing process; another saved about $3 million annually by changing its production process to eliminate an ozone-depleting compound).
169. RALF BUCKLEY, PERSPECTIVES IN ENVIRONMENTAL MANAGEMENT 150 (1991). An environmental audit means a check, assessment, test, or verification of environmental management. Environmental audits may examine compliance, monitoring programs, impact predictions, equipment performance, physical hazards, financial risks, products and markets, baselines and benchmarks, management programs and structures, and planning procedures and legislation." Id. at 121. "[A]uditing typically takes three forms: 'top-down audits,' in which corporate environmental staff police the operations of individual business units and facilities; 'self-assessment audits,' in which each business unit or facility audits itself and works with the corporate staff to remedy problems; and 'third-party audits,' in which outside professionals perform audits and report their results to corporate environmental staff." Hunt & Auster, supra note 155, at 15.
170. Borland, supra note 150; see also Hunt & Auster, supra note 155, at 8-9, ("Although anticipating every possible event that might occur is difficult, fostering an organizational culture that supports questioning and whistle blowing can help companies manage the unexpected.").
171. See Moore & Dabroski, supra note 160; Borland, supra note 150; Hunt & Auster, supra note 155, at 15.
172. The commitment of the organization might be judged by the general mind set of corporate managers, the resource commitments of the corporation, and the support and involvement of top management. Hunt & Auster, supra note 155, at 12.
design\textsuperscript{173} to determine whether the defendant may reap the benefits of the Prevention Test’s affirmative defense.

**CONCLUSION**

Since the enactment of CERCLA, courts have struggled to reconcile the Act and its goals with the long-standing body of corporate law that recognizes corporate separateness and, in most cases, limits liability. Courts that face the issue of shareholder, corporate officer, and lender liability under CERCLA disagree whether these parties may incur liability for the contamination of their corporations.

One line of authority, including *NEPACCO* and *Kayser-Roth*, expansively construes CERCLA’s definition of “owner or operator” to find shareholders, including parent corporations and corporate officers, that participate in the day-to-day management of the operations of a related corporation directly liable. Other courts extend the standard of liability even further and find the mere capacity to control the operations of the corporation sufficient to impose CERCLA liability on shareholders, corporate officers, and lenders.\textsuperscript{174}

These approaches have led shareholders, corporate officers, and lenders to develop a hands-off approach to management and lending so that they may distance themselves from personal responsibility in the event of a release. This result is inconsistent with CERCLA’s goal of encouraging corporate responsibility. This inconsistency can best be rectified by the adoption of a fact-sensitive approach which rewards positive environmental management practices by providing an affirmative defense to CERCLA liability based on such positive behavior.

The Prevention Test embodies this approach. It allows shareholders, corporate officers, and lenders to develop proactive environmental policies and practices. Encouraging participation by these parties in environmental decision making is essential, because they often have the greatest knowledge of the risks associated with their wastes and are in the best position to control disposal decisions.

Commitment and participation from high-level management are instrumental to the successful implementation of corporate environmental policy.\textsuperscript{175} When a chairman demands “corporate environmentalism,”

\textsuperscript{173} The program design includes performance objectives, integration within the company, reporting structures, and involvement with departments such as legal counsel, public relations, manufacturing, and product design. *Id.*

\textsuperscript{174} At the opposite end of the spectrum, some courts refuse to adopt such a broad interpretation of “owner or operator,” and instead restrict their analysis to whether the shareholder or corporate officer should be derivatively liable as a result of piercing the corporation’s corporate veil. *See, e.g., Joslyn Co. v. T.L. James & Co.*, 893 F.2d 80, 83 (5th Cir. 1990), cert. denied, 111 S. Ct. 1017 (1991).

\textsuperscript{175} “Sometimes, one word from the chairman can be worth a thousand words from the next level down.” Deutsch, *supra* note 161, at 29.
plant managers understand that special attention must be given to environmental projects. High-level management can focus environmental efforts and ensure common understanding of expectations throughout the company. Similarly, lenders may play a positive role by encouraging hazardous waste cleanup, but must be free to assist borrowers in resolving their hazardous waste matters.

By failing to adequately define the liability of shareholders, corporate officers, and lenders, Congress has left to the courts the task of reconciling CERCLA and its goals with corporate law. Of the existing efforts to reconcile corporate law with the aims of CERCLA, the Prevention Test best balances the goals of each body of law.

176. Id.
177. Id.
178. Lowry, supra note 73, at 325.