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THE CHOICE OF LAW ISSUE FOR CORPORATE SUCCESSOR LIABILITY UNDER CERCLA IN *NORTH SHORE GAS COMPANY V. SALOMON, INC.*: ANOTHER OPINION SIDESTEPS THE ISSUE

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I. INTRODUCTION

In an effort to curb environmental pollution by holding responsible parties financially liable for cleanup costs, the federal government enacted the Comprehensive Environmental Response, Compensation and Liability Act (hereinafter "CERCLA") in 1980.[1] Numerous issues in the Act have spawned litigation since its passage, but none, perhaps, as crucial as the determination of exactly who should be held liable for CERCLA violations. Despite its comprehensive nature, CERCLA fails to expressly address the liability of successor parent corporations for violations of subsidiaries.[2] It is this issue, which arose in *North Shore Gas Co. v. Salomon, Inc.* (hereinafter "*North Shore*").[3] In *North Shore*, the Seventh Circuit had the opportunity to further define just how the successor liability doctrine fits under the framework of CERCLA.[4] In accordance with the decisions passed down in other jurisdictions, the court held that the doctrine of successor liability is applicable under CERCLA.[5] However, the court failed to resolve the issue of whether a federal common law test of liability or individual state corporate law should supply the basis for determining when successor corporations will be held responsible for cleanup costs.[6] This omission follows a split among the other circuits and poses a significant threat to the effectiveness of CERCLA regulations.[7]

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[1] Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), 42 U.S.C. §§ 9601-9675 (1996).

[2] *See id.*

[3] 152 F.3d 642 (7th Cir. 1998).

[4] *See id.* at 648.

[5] *Id.* at 649 (citing B.F. Goodrich v. Betkoski, 99 F.3d 505 (2d Cir. 1996); United States v. Carolina Transformer Co., 978 F.2d 832 (4th Cir. 1992); United States v. Mexico Feed & Seed Co., 980 F. 2d 478 (8th Cir. 1992); Anspec Co. v. Johnson Controls, Inc., 922 F. 2d 1240 (6th Cir. 1990); Louisiana-Pacific Corp. v. Asarco, Inc., 909 F.2d 1260 (9th Cir. 1990)).

[6] *See North Shore*, 152 F.3d at 650-51.

[7] *See id.* at 650 (noting that the Sixth Circuit in Anspec Co. v. Johnson Controls, Inc., 922 F. 2d 1240 (6th Cir. 1990) and the Ninth Circuit in Atchison, Topeka and Santa Fe Ry. Co.

This Comment will examine the court's opinion in *North Shore*, consider the effect of the decision within the context of successor liability under CERCLA, and finally, contemplate what course of action future courts may take as they determine the law in this area. The Comment's objective is to illustrate how *North Shore's* failure to decide the choice of law issue under CERCLA continues a tradition of ambiguity in this area of the law.

II. BACKGROUND

North Shore Gas Company initiated this action by seeking a declaratory judgment in the United States District Court for the Northern District of Illinois. The company wanted the court to find it free from liability for the environmental cleanup costs associated with a Colorado waste site.[8] The defendant, Salomon Incorporated (hereinafter "Salomon"), lost a motion to dismiss or transfer the case, and the district court granted North Shore Gas Company's motion for a declaratory judgment.[9] Salomon appealed the district court's decision to the Seventh Circuit Court of Appeals and the opinion, the subject of this Comment, was handed down.[10]

The factual background of the case is not nearly as simple as the procedural background. In a fact pattern typical of cases of this nature, a tangled web of closely related corporate entities must be unraveled. Salomon's predecessor-in-interest purchased the S.W. Shattuck Chemical Company (hereinafter "Shattuck") in 1969.[11] Both prior to and after the transaction, Shattuck operated a mineral processing facility in Denver, Colorado.[12] This is the facility at which the Environmental Protection Agency (EPA) found the CERCLA violations that became the basis for the current action. Salomon guaranteed the financial performance of S.W. Shattuck, its wholly owned subsidiary, and at the time of the appeal to the circuit court, cleanup costs had exceeded $20 million

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v. Brown & Bryant, Inc. 132 F.3d 1295 (9th Cir. 1997) were the only circuit courts that relied on state law to determine issues of successor liability.).

[8] *North Shore*, 152 F.3d at 645.

[9] *Id.*

[10] *Id.*

[11] *Id.* at 642.

[12] *North Shore*, 152 F.3d at 642.

dollars.[13]

According to common practice in such situations, Shattuck sought out other potentially responsible parties in an effort to reduce its costs.[14] It found that from 1934 to 1942, North Shore Coke & Chemical Company (hereinafter "North Shore Chemical") owned 60% of Shattuck and had utilized the Denver site extensively for the processing and disposal of hazardous waste products created in mining operations.[15]

The trail of control over North Shore Chemical presents another series of complications. In 1927, William Baehr (hereinafter "Baehr") incorporated North Shore Chemical. He was also the manager, and later the president, of the North Shore Gas Company (hereinafter "North Shore Gas").[16] From 1927 to 1942, the two corporate entities were very closely related, with North Continent Utilities Corporation, a holding company that Baehr formed in 1922, holding a large portion of the stock in both companies.[17] In describing the relationship between North Shore Chemical and North Shore Gas Company in 1940, a consultant stated: "the actual operations of the properties are interdependent....Broadly speaking, the two companies represent a single business enterprise."[18] This relationship is a key factor in determining the legal responsibilities of the surviving corporate entity of the North Shore conglomerate.

Ultimately, government regulation and disagreements among the companies led to re-organization in 1941. North Shore Chemical sold all of its assets to North Shore Gas Company, except for stock in North Continent mine operations and in Shattuck, both of which were transferred to North Continent Utilities.[19] North Shore Chemical was subsequently liquidated in 1942, and North Continent Utilities dissolved in 1954, leaving only North Shore Gas Company for Shattuck to pursue as a potentially responsible party.[20]

Shattuck's demands upon North Shore Gas led to this suit, filed in the federal district court, seeking a declaration that

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[13] *Id.*
[14] *Id.* at 647.
[15] *Id.* at 645.
[16] *Id.* at 645-46.
[17] *Id.* at 646.
[18] *North Shore*, 152 F.3d at 646.
[19] *Id.*
[20] *Id.* at 647.

North Shore Gas was not liable for cleanup costs associated with the Denver site. In reviewing the district court's grant of North Shore Gas's declaratory judgment motion, the Seventh Circuit upheld the district court's denial of Salomon's motion to dismiss or transfer the case on jurisdictional grounds.[21] The court then addressed whether a successor corporation incurs the liability of its subsidiary for the cost of cleanup under CERCLA.[22] The issue was one of first impression for the Seventh Circuit. To properly comprehend the issue of successor liability in *North Shore*, it is first necessary to understand the development of successor liability under CERCLA.

III. LEGAL BACKGROUND OF SUCCESSOR LIABILITY UNDER CERCLA

The opinion in *North Shore* notes that the plain language of CERCLA imposes liability on "covered persons," with the statute defining a "person" as an "individual, firm, corporation, association, partnership, consortium, joint venture, [or] commercial entity."[23] Furthermore, Congress intended that certain rules of construction apply to the United States Code. These rules include references to a corporation, wherein the terms "company" or "association" "shall be deemed to embrace the words 'successors and assigns of such company or association.'"[24] This broad interpretation of terms allowed for the development of the concept of successor liability under CERCLA.

The court's opinion notes a rich history of case law dealing extensively with successor liability, and despite CERCLA's failure to expressly address the issue, circuit courts faced with the question have unanimously found that Congress intended for successor liability to apply under CERCLA.[25] The court in *North Shore* followed this precedent and recognized the application of successor liability under CERCLA.[26]

The purpose of CERCLA similarly supports such an inter-

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[21] *Id.* at 648.

[22] *Id.* at 649.

[23] *Id.* (citing 42 U.S.C. §§ 9601(21), 9607(a)).

[24] *North Shore*, 152 F.3d at 649 (citing 1 U.S.C. § 5).

[25] *See* B.F. Goodrich v. Betkoski, 99 F.3d 505 (2d Cir. 1996); United States v. Carolina Transformer Co., 978 F.2d 832 (4th Cir. 1992); United States v. Mexico Feed & Seed Co., 980 F. 2d 478 (8th Cir. 1992); Anspec Co. v. Johnson Controls, Inc., 922 F. 2d 1240 (6th Cir. 1991); Louisiana-Pacific Corp. v. Asarco, Inc., 909 F.2d 1260 (9th Cir. 1990).

[26] *North Shore*, 152 F.3d at 650.

pretation of the statute. Congress implemented CERCLA to effectively assign liability to the parties responsible for the production of hazardous waste.[27] The Eighth Circuit, in *United States v. Mexico Feed and Seed Co.*, put it best when it noted that Congress was unlikely to intend for a loophole to allow corporations to die "paper deaths, only to rise phoenix-like from the ashes, transformed, but free of their former liabilities."[28] Extending this logic into the realm of successor liability, the court in *North Shore* points out that successor corporations derive many benefits from their acquired subsidiaries' previous environmental violations.[29] The most obvious benefit is the monetary savings that result from more cost-efficient methods of hazardous disposal.[30]

The most intriguing part of the opinion, and ultimately the issue driving the analysis of this Comment, is the discussion of the application of successor liability. As previously noted, the circuit courts are unanimous in holding that the doctrine of successor liability is applicable under CERCLA.[31] The only unsettled issue among these courts, and the issue on which this Comment focuses, is whether federal common law or state corporate law should govern such an application.[32] In *North Shore*, the court gives a lengthy discussion of this issue, only to sidestep it by claiming neither party contested the district court's application of federal common law.[33]

The application of the federal statute (CERCLA) does not necessitate the promulgation of a federal rule.[34] When a federal statute fails to expressly address an issue, it is typically left to the states to fashion a standard for determining the parameters of regulation.[35] Indeed, in a large portion of corporate law, the United States Code provides only general statutory guidance, leaving the states to regulate through state statutes and state case law. However, there are two distinct policy arguments that address the creation of a federal common law.

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[27] *Id.* at 649.

[28] 980 F 2d. 478, 487 (8th Cir. 1998).

[29] *North Shore*, 152 F.3d at 650.

[30] *Id.*

[31] *Id.* at 649.

[32] *Id.* at 650.

[33] *Id.*

[34] Jessica Demonte, *The Impact Of* United States v. Bestfoods *On Parent Liability Under CERCLA: When A Door Is Closed, Look For An Open Window*, 61 OHIO ST. L.J. 443, 446 n.20 (2000).

[35] *See North Shore*, 152 F.3d at 650.

Proponents of a federal common law rule point out that a federal statute, like CERCLA, should be uniformly applied.[36] They argue that without uniform application of the statute, the goals of CERCLA will be frustrated. Allowing individual states to fashion individual law governing the application of successor liability could invite states to create law in a manner that allows corporations to avoid successor liability under CERCLA, which would hinder the purpose of the federal statute.[37] Furthermore, in applying state law standards, questions arise as to which state law would be applicable.[38] As *North Shore* illustrates, there are often a number of complex corporate entities involved in these proceedings. In a case such as *North Shore*, the law of the state of incorporation or the law of the pollution site could possibly offer different rules and very different results.

However, other circuit courts have concluded that state law should provide the rule of decision for successor liability.[39] This argument, at its most basic level, is founded in federalism.[40] Proponents point out that since CERCLA is silent as to successor liability, it is an issue properly left for the states to decide.[41] State law could be fashioned to favor corporations by allowing them to escape liability as successors under CERCLA, or it could give preference to environmental concerns and promulgate successor liability standards that are tough on corporations.[42] Regardless, many people argue that CERCLA's silence on the issue necessitates deference to state law.[43]

Furthermore, state corporate law on the issue of successor liability is nearly uniform throughout the country.[44] The argument is that this uniformity negates the need for the promulgation of a federal common law standard. As Justice Kennedy's concurring opinion in *Anspec Co., Inc. v. Johnson Controls, Inc.* noted, "without a showing that state law is inadequate to achieve the federal interest, 'we discern no imperative need to develop a general

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[36]Demonte, *supra* note 34, at 476.

[37]*Id.*

[38]*Id.*

[39]*North Shore*, 152 F.3d at 650. (citing Anspec Co. v. Johnson Controls, Inc., 922 F. 2d 1240 (6th Cir. 1990); Atchison, Topeka & Santa Fe Ry. Co. v. Brown & Bryant, 132 F. 3d 1295 (9th Cir. 1997)).

[40]Demonte, *supra* note 34, at 476.

[41]*Id.*

[42]*Id.*

[43]*Id.*

[44]*Atchison*, 132 F.3d at 1300-01; *See also Anspec*, 922 F.2d at 1249.

body of federal common law to decide cases such as this.'"[45] Thus, proponents of state law argue that judicial restraint dictates reliance upon state law to determine the applicability of successor liability under CERCLA.

IV. THE SEVENTH CIRCUIT'S TREATMENT OF THE CHOICE OF LAW ISSUE IN NORTH SHORE GAS

In *North Shore*, the Seventh Circuit chose to sidestep the choice of law issue. The relevant portion of the opinion notes that:

> Here the district court decided that federal common law applied to the dispute between Salomon and North Shore Gas. On appeal, both parties have neglected to brief the issue and seemingly assume that federal common law applies. Although we recognize that we have "the independent power to identify and apply the proper construction of governing law," [citing] Kamen v. Kemper Fin. Servs., Inc., 500 U.S. 90, 99 (1991), we think it prudent to reserve the choice-of-law question until we are confronted with a case in which the parties have argued the issue. [citing] United States v. Bestfoods, 524 U.S. -- - -- n. 9.[46]

The court recognizes the importance of the issue but relies on the parties' failure to raise the issue to avoid making a decision.[47] While it is possible that the question was not ripe, the court's failure to rule on the issue serves to further cloud an already hazy area of the law.

Yet, the court did utilize language in the opinion that indicates how they might decide the issue should it be properly presented.[48] The court noted that the Supreme Court established the proper test for determining whether Congress intended the judiciary to fashion federal common law in *United States v. Kimbell*

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[45] *Anspec*, 922 F.2d at 1249.
[46] *North Shore*, 152 F.3d at 650.
[47] *See id.* at 650-51.
[48] *See id.* at 650.

Foods.[49] In *Kimbell Foods*, the Court set forth three factors that should be considered when deciding whether federal common law would be appropriate. The three factors include: "(1) whether the issue requires a "nationally uniform body of law"; (2) "whether application of state law would frustrate the specific objectives of the federal programs"; and (3) whether "application of a federal rule would disrupt commercial relationships predicated on state law."[50]

While noting these standards, the Seventh Circuit did not apply them to the concept of successor liability under CERCLA, instead choosing to reserve the question for when it is properly before the court.[51] Since the district court decided to follow federal common law and no issue was made of it on appeal, the Seventh Circuit reasoned that it should also use federal common law.[52] This reluctance to follow state corporate law would seem to indicate that the Seventh Circuit favors a uniform federal common law approach to successor liability under CERCLA.

After determining that it was appropriate to apply a federal common law standard in *North Shore*, the court focused on the issue of whether North Shore Gas inherited the liabilities of the North Shore Chemical Company.[53] To make this determination, the Seventh Circuit had to fit North Shore Gas into one of the four established exceptions to the general rule that an asset purchaser does not acquire the liabilities of the seller.[54] The four exceptions are: (1) the purchaser expressly or impliedly agrees to assume the liabilities; (2) the transaction is a de facto merger or consolidation; (3) the purchaser is a "mere continuation" of the seller; and (4) the transaction is an effort to fraudulently escape liability.[55]

The first thing the court noted in its analysis was that an asset purchase can be described more accurately as a reorganization.[56] A theme within the exceptions allowing successor liability is that the seller "survives the sale."[57] This factor cuts in favor of holding North Shore Gas liable for the cleanup of the Shattuck site

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[49]440 U.S. 715 (1979).

[50]*North Shore*, 152 F.3d at 650 (citing *Kimbell Foods*, 440 U.S. at 728-29).

[51]*Id.* at 651.

[52]*Id.*

[53]*Id.*

[54]*See id.*

[55]*Id.*; *see also e.g.*, *Betkoski*, 99 F.3d at 519; *Carolina Transformer*, 978 F.2d at 838; Vernon v. Schuster, 688 N.E. 2d 1172, 1175-76 (1997).

[56]*North Shore*, 152 F.3d at 651.

[57]*See id.*

because a reorganization suggests, in some respects, that the seller survives the sale.[58] Furthermore, the court found that the reorganization did not essentially alter the identity of the company.[59] The close relationship between the corporate entities bolsters this finding. Despite complicated corporate maneuverings, North Shore Gas must be considered the surviving entity of the North Shore conglomerate.

The court then took each exception in turn and attempted to apply it to the facts of *North Shore*. First, North Shore Gas Company cannot be said to have explicitly assumed the liabilities of the Chemical Company.[60] Illinois contract law required the court to give effect to the parties' intent at the time the agreement was made.[61] Noting that the language of the reorganization allows for the assumption of all "existing" liabilities, the court concluded that the CERCLA violations could not be said to be in existence at the time of the transaction.[62]

The second determination involves analyzing the transaction as a de facto merger or consolidation. The court recognized two factors that drive this analysis.[63] The first was a continuation of enterprise with regards to such characteristics as management, personnel, and physical location.[64] The second involved the corporation assuming the obligations of the seller necessary for the uninterrupted continuation of the business.[65] While noting that the de facto merger exception involved a complicated analysis, the court chose to focus on the continuation of the enterprise factor and found it applicable to the facts of *North Shore*.[66] The court relied on a hybrid analysis that combines aspects of the merger doctrine with the basis for the third, "mere continuation" exception to find successor liability exists for the North Shore Gas Company.[67]

The application of this hybrid test to the facts is not so clear. The court seems to rely upon principles of equity to establish that the North Shore Gas Company "continued" the enterprise

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[58] *See id.* at 652.
[59] *Id.*
[60] *Id.*
[61] *Id.*
[62] *See North Shore*, 152 F.3d at 652.
[63] *Id.*
[64] *Id.* at 652-53 (citing *Louisiana Pacific*, 909 F.2d 1264).
[65] *North Shore*, 152 F.3d at 652-53 (citing *Louisiana Pacific*, 909 F.2d 1264).
[66] *North Shore*, 152 F.3d at 653.
[67] *See id.* at 654.

carried on by the North Shore Chemical Company at the Shattuck site.[68] In a footnote, the court recognized that this comes close to a fifth, "substantial continuity" exception to the doctrine of successor liability that is not widely accepted.[69] The court noted that "the mere continuation exception allows recovery when the purchasing corporation is substantially the same as the selling corporation."[70] However, relying upon the close relationship among the operation of the companies previously noted, the court found the exception applicable in this case. In finding the exception applicable, the court neglected to continue with an analysis of the other exceptions.

V. ANALYSIS OF THE CHOICE OF LAW ISSUE

By utilizing a federal common law standard to find North Shore Gas liable for CERCLA cleanup costs, the Seventh Circuit creates an incomplete precedent for future successor liability cases. The court failed to articulate a complete position on the issue by refusing to decide if state corporation law or federal common law should provide the parameters for the application of the successor liability doctrine. The court's ruling does not take a stance on an issue that has divided the federal circuits. The United States Supreme Court, in *United States v. Bestfoods* (hereinafter "*Bestfoods*") provides a telling reason why the court chose this route.[71]

In *Bestfoods*, the parties presented the Supreme Court with the opportunity to decide the choice of law question.[72] At issue in the case was the applicability of a state or federal corporate veil-piercing standard to determine parent corporation liability under CERCLA.[73] In establishing the logic the Seventh Circuit followed in *North Shore*, the Supreme Court stated that the issue was not adequately contemplated by the litigants, and thus, not ripe for adjudication.[74] However, there are indications in *Bestfoods* that suggest the Supreme Court might favor reserving the successor

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[68] *See id.*

[69] *Id.* at n.8.

[70] *Id.* at 654 (citing FLETCHER, CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS §7124.10 (perm. ed. 1990)).

[71] 524 U.S. 51 (1998).

[72] *Id.*

[73] *Id.*

[74] *Id.* at n.9.

liability question for state common law.[75]

One indicator is the Supreme Court's deferral to the Sixth Circuit's application of state veil-piercing standards, since the issue was not challenged on appeal.[76] It is interesting to note that the *North Shore* court cited this deferral in also choosing to defer to a lower court's decision. However, in deferring, the Seventh Circuit was applying a federal rather than state law standard.[77] Perhaps the more persuasive indicator of the Supreme Court's position on the issue is Justice Souter's language in the majority opinion noting that, "the entire corpus of state corporation law is [not] to be replaced simply because a plaintiff's cause of action is based upon a federal statute."[78] This language indicates the Court's preference for leaving the issue to state common law.

VI. CONCLUSION

The Seventh Circuit's opinion in *North Shore* was this jurisdiction's first treatment of an issue that has split the circuits. In finding that the doctrine of successor liability is applicable under the federal CERCLA statute, the court followed the unanimous lead of other circuits. However, the court failed to articulate a complete position on the issue by refusing to decide if state corporate law or federal common law should provide the parameters for the application of the successor liability doctrine. Ultimately, this failure diminishes the effectiveness of the case as an established precedent that corporate entities can rely upon in fashioning their conduct with respect to the CERCLA guidelines. The case also creates uncertainty for the Environmental Protection Agency as it attempts to enforce CERCLA while unsure of which body of law is proper. Furthermore, the case seems to contradict the intent of the Supreme Court as expressed in dicta in the *Bestfoods* opinion. The sidestepping of the choice of law issue was probably a sound decision based on judicial restraint. In the future, however, the court should follow the lead of the Supreme Court by showing similar restraint in fashioning federal common law for an issue properly left to the individual states.

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[75] *See* Demonte, *supra* note 34, at 480.

[76] *See Bestfoods*, 524 U.S. at 63.

[77] *See North Shore*, 152 F.3d at n.8.

[78] *Bestfoods*, 524 U.S. at 63 (citing Burks v. Lasker, 441 U.S. 471, 478 (1979)).