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International Environmental Bankruptcy: An Overview of Environmental Bankruptcy Law, Including a State's Claims against the Multinational Polluter

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NOTES

International Environmental Bankruptcy: An Overview of Environmental Bankruptcy Law, Including a State's Claims against the Multinational Polluter

ABSTRACT

This Note focuses on current environmental bankruptcy law in the United States. It analyzes the claims of a state against a corporate polluter when the corporation discharges a toxic substance in violation of the state's environmental laws, refuses to clean up the waste, and then files bankruptcy in lieu of paying for the cleanup.

This Note analyzes the court decisions subsequent to the United States Supreme Court opinions in Ohio v. Kovacs *and* Midlantic National Bank v. New Jersey Department of Environmental Protection *to evaluate the current status of United States bankruptcy law on the issues of the automatic stay; abandonment of the contaminated property by the bankruptcy trustee; the potential for the state to get an administrative expense priority in the bankruptcy distribution if it has to fund the clean up of the property; and the potential for the corporate debtor to obtain a discharge.*

The Note then examines the possibility that a foreign state parent corporation will be held liable for its subsidiary corporation's environmental debts and obligations in the state where the subsidiary is located. The Note reviews several cases to determine whether it is appropriate to use traditional corporate veil piercing doctrines in the environmental bankruptcy context.

The Note concludes that a unified multinational effort is the necessary response to the pervasive international environmental problems. When a parent corporation's foreign subsidiary violates the foreign state's environmental laws, that jurisdiction should be able to pierce the corporate veil and reach the assets of the culpable parent corporation. State laws

should explicitly allow this and courts should enforce piercing by recognizing foreign court judgments that order the parent to take responsibility for its subsidiary's debts.

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I. INTRODUCTION

In the wake of the rapid increase of foreign investment in the United States in the 1980s, environmental issues became a major concern, causing the United States Congress to enact strict laws for the disposal[1] and cleanup[2] of toxic waste. Many states in the United States also have

1. *See* Resource Conservation and Recovery Act of 1976 (RCRA), Pub. L. No. 94-580, 90 Stat. 2795 (codified as amended at 42 U.S.C. §§ 6901-6964 (1982 & Supp. V 1987)).

2. *See* Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), Pub. L. No. 96-510, 94 Stat. 2767 (codified as amended at 42 U.S.C.

adopted environmental protection laws.[3]

When a corporation violates a United States state environmental protection law, the state usually has two alternatives: first, the state can seek an injunction to force the corporation to clean up its mess; or second, the state can clean up the waste and seek reimbursement from the corporation for its expenditures. Difficulties arise when the corporation files for bankruptcy. An important issue is whether a United States state can seek redemption from the parent of a bankrupt, polluting subsidiary, especially when the parent is a foreign-based, multinational corporation with billions of dollars worth of assets. This Note focuses on this issue and determines what types of claims, if any, the state would have in a bankruptcy proceeding.

For the purpose of clarity, this Note focuses on a hypothetical, although not necessarily unimaginable, situation. The parent company is a foreign-based, multinational corporation, with a wholly owned subsidiary located in the United States. The subsidiary violates a United States state environmental protection law designed to protect the health and welfare of the state's citizens. The cost of cleanup greatly exceeds the assets of the subsidiary corporation. Because the subsidiary cannot afford to comply with the state law, it files a voluntary Chapter 7[4] or Chapter 11[5] bankruptcy petition in a United States federal bankruptcy court and refuses to clean up its toxic waste. The state now seeks a way to fund the cleanup.

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§§ 9601-9657 (1982 & Supp. V 1987)). For discussions of liability under CERCLA, see Note, *Misery Loves Company: Spreading the Costs of CERCLA Cleanup*, 42 VAND. L. REV. 1469 (1989); Barr, *CERCLA Made Simple: An Analysis of the Cases Under the Comprehensive Environmental Response, Compensation and Liability Act of 1980*, 45 BUS. LAW. 923 (1990).

3. *See, e.g.*, ARK. STAT. ANN. § 8-7-501-519 (1987 & Supp. 1989); CONN. GEN. STAT. ANN. § 22a-133a (West Supp. 1989); IOWA CODE ANN. § 455B.448 (West Supp. 1989); N.Y. ENVTL. CONSERV. LAW § 27-0917 (McKinney Supp. 1990); VA. CODE ANN. § 62.1-44.34:8 (1987).

4. In a Chapter 7 case, all the corporation's assets are sold to pay its creditors and the corporate entity ceases to exist. *See infra* notes 6-15 and accompanying text; *see also* 11 U.S.C. § 704(1) (1988) (requiring the trustee to liquidate the property of the estate and expeditiously to close the estate).

5. In a Chapter 11 case, the corporation usually continues its operations and pays a percentage of its debts from its postbankruptcy revenues. 11 U.S.C. §§ 1107-1108, 1141; *see infra* notes 16-21 and accompanying text.

II. Overview of United States Bankruptcy Law

A debtor corporation has two bankruptcy options available to it under the United States Bankruptcy Code: a Chapter 7 liquidation or a Chapter 11 reorganization. In a Chapter 7 case, all property in which the corporation has an interest becomes property of the bankruptcy estate.[6] An appointed trustee[7] then distributes the property of the estate to the corporation's creditors, first to the secured creditors[8] and then to the unsecured creditors in order of priority.[9] In a typical Chapter 7 case, the bankrupt's debts exceed the value of its assets. Hence, the higher the creditor's priority, the more likely the creditor will get paid. The bankruptcy court subsequently discharges debts that do not get paid.[10] The discharge bars further enforcement of, or any attempts to collect from the bankrupt, prebankruptcy debts;[11] the bankrupt corporation never has to repay discharged debts. The Bankruptcy Code, however, excepts certain debtors from discharge, usually for their attempt to defraud a creditor.[12]

The Bankruptcy Code authorizes the bankruptcy court to appoint a trustee to administer the estate in a Chapter 7 case.[13] The trustee collects all the property of the estate, reduces it to money, and distributes the proceeds to the creditors.[14] The trustee can abandon certain property that is burdensome or of inconsequential value to the estate.[15]

In a Chapter 11 reorganization, the debtor corporation usually retains control of its assets[16] and prepares a plan to pay a percentage of its debts from post-bankruptcy income.[17] A reorganization plan must meet certain

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6. 11 U.S.C. § 541(a); *see infra* notes 247-50 and accompanying text (discussing property encompassed by the estate). The commencement of a bankruptcy case creates a bankruptcy estate. The estate is comprised of all of the corporation's legal and equitable interests, wherever located, at the time of the commencement of the case. S. Rep. No. 989, 95th Cong., 2d Sess. 80, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5787, 5868.

7. *See infra* notes 13-15 and accompanying text.

8. 11 U.S.C. § 725. A secured creditor is one who has a claim secured by a lien on property in which the estate has an interest. *Id.* § 506(a).

9. *Id.* § 726.

10. *Id.* § 727; *see infra* part III, section C.4 (discussing discharge).

11. 11 U.S.C. § 524.

12. *See id.* § 727. The other exceptions to discharge found at section 523(a) do not apply to corporations. *Id.* § 523(a).

13. *See id.* §§ 303(g), 701.

14. *Id.* § 704(1).

15. *Id.* § 554; *see infra* note 40 (text of section 554(a)); part III, section C.2 (discussing abandonment).

16. 11 U.S.C. § 1107(a).

17. *Id.* §§ 1121-1129.

requirements.[18] For example, the plan must pay all creditors at least as much as they would have received under a Chapter 7 liquidation,[19] and the plan must be confirmed by the creditors.[20] The bankruptcy court discharges the debts of the corporate debtor when the plan is confirmed.[21] The corporation is liable only for the obligations listed in the plan; all other prebankruptcy debts are discharged. If a debtor corporation meets the requirements of a Chapter 11 bankruptcy, it can stay in business and repay only a percentage of its obligations.

III. THE STATE'S CLAIM AGAINST THE SUBSIDIARY

The United States Supreme Court addressed the issue of a corporation's liability for its environmental torts in *Ohio v. Kovacs*[22] and *Midlantic National Bank v. New Jersey Department of Environmental Protection*.[23] Because a great deal of information is already published on the holdings in both *Kovacs*[24] and *Midlantic*,[25] this Note, after briefly reviewing these two decisions, focuses primarily on United States lower federal courts' interpretations of these cases.

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18. *See id.* § 1129(a).

19. *Id.* § 1129 (a)(7)(A)(ii).

20. A debtor can divide its creditors into classes, provided all claims within each class are "substantially similar." *Id.* § 1122(a). The debtor must treat all claims within a class in the same manner. *Id.* § 1123(a)(4). A class of creditors can reject the debtor's plan, forcing the debtor to submit a new plan or try to get the rejected plan confirmed by the bankruptcy court through the Bankruptcy Code's cramdown provision. The cramdown provision requires the plan to contain several additional features before the court may confirm it. *See id.* § 1129(b).

21. *Id.* § 1141(d)(1)(A).

22. 469 U.S. 274 (1985).

23. 474 U.S. 494 (1986).

24. *See, e.g.*, Comment, *The Future of the Environmental Enforcement Injunction after* Ohio v. Kovacs, 13 B.C. ENVTL. AFF. L. REV. 397 (1986); Note, *Cleaning Up in Bankruptcy: Curbing Abuse of the Federal Bankruptcy Code by Industrial Polluters*, 85 COLUM. L. REV. 870 (1985); Note, *Dumping Waste, Discharging Debts:* Ohio v. Kovacs (Kovacs II), 13 ECOLOGY L.Q. 661 (1986).

25. *See, e.g.*, Note, *Abandoning Hazardous Waste Sites in Bankruptcy:* Midlantic National Bank v. New Jersey Department of Environmental Protection, 13 ECOLOGY L.Q. 555 (1986); Colton, Uehling & Sheehan, *Seven-Cum-Elevens: Rolling the Toxic Dice in the U.S. Supreme Court*, 14 B.C. ENVTL. AFF. L. REV. 345 (1987); Shanker, *A Bankruptcy Superfund for Some Super Creditors: From* Ohio *to* Midlantic *and Beyond*, 61 AM. BANKR. L.J. 185 (1987).

A. Ohio v. Kovacs

The state of Ohio obtained an injunction requiring debtor Kovacs to clean up a hazardous waste site,[26] but Kovacs failed to comply.[27] The state then obtained from a bankruptcy court the appointment of a receiver who took possession of all Kovacs' property and assets and began cleaning up the property to bring it into compliance with Ohio law.[28] Before the receiver completed the cleanup, Kovacs filed a personal bankruptcy petition.[29] In the bankruptcy proceeding, the state sought a declaration that Kovacs could not discharge his obligation to clean up the waste site because this obligation was not a dischargeable debt within the meaning of the Bankruptcy Code.[30]

The United States Supreme Court began its analysis by noting that the Bankruptcy Code defines debt as a liability on a claim[31] and that the Code defines a claim as a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment."[32] The Court determined that once the state secured the appointment of a receiver who took possession of all Kovacs' assets, Kovacs was dispossessed of any assets that were potentially available to clean up the site and was therefore "disabled . . . from personally taking charge of and carrying out the removal of wastes from the property."[33] Hence, the state essentially sought solely the payment of money from Kovacs to cover the cleanup costs.[34] The Court concluded that the state converted the cleanup order into an obligation to pay money, which is a dischargeable debt in bankruptcy.[35] One could read *Kovacs* as a determination that a monetary obligation imposed by the state on the debtor to pay costs which the state incurs in cleaning up the debtor's hazardous waste is a dischargeable debt in bankruptcy; the Court, however, explicitly stated that it did not decide the legal consequences if Kovacs had filed bank-

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26. *Kovacs*, 469 U.S. at 275. Although *Kovacs* deals with a personal bankruptcy under Chapter 7, the issues and holdings are also relevant to a corporation's bankruptcy petition, especially if the corporation is seeking a Chapter 11 reorganization. *But see infra* part III, section C.4.

27. *Kovacs*, 469 U.S. at 276.

28. *Id.*

29. *Id.*

30. *Id.* at 276-77. The Bankruptcy Code discharges all debts of the debtor that are not paid out of the bankruptcy estate. *See* 11 U.S.C. § 727(b) (1988).

31. *Kovacs*, 469 U.S. at 278 (citing 11 U.S.C. § 101(11)).

32. *Id.* (citing 11 U.S.C. § 101(4)(B)).

33. *Id.* at 283.

34. *Id.*

35. *Id.*

ruptcy before a receiver was appointed.[36]

B. Midlantic National Bank v. New Jersey Department of Environmental Protection

Debtor corporation, Quanta, processed waste oil at facilities in New Jersey and New York.[37] After Quanta filed a bankruptcy petition, an investigation at the New York site revealed over 70,000 gallons of toxic, PCB-contaminated oil stored in deteriorating and leaking containers in violation of United States and New York environmental laws.[38] The mortgages on the real property exceeded the property's value; accordingly, the estimated cost of disposing of the waste oil rendered the property a net burden on the bankruptcy estate.[39] The bankruptcy trustee notified the creditors of his intention to abandon the property pursuant to section 554(a) of the United States Bankruptcy Code.[40] The city and state of New York objected to the abandonment on policy grounds, contending that the abandonment would threaten the public's health, safety, and welfare.[41]

The Supreme Court of the United States held that a trustee does not have absolute power to abandon property;[42] a trustee's abandonment power is limited by a judicially developed doctrine intended to protect legitimate United States federal and state interests.[43] Thus, a trustee "[can] not exercise his abandonment power in violation of certain state and federal laws."[44] After discussing its reasons for enunciating this rule,[45] the Court concluded that a trustee cannot abandon property in

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36. *Id.* at 284.

37. Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494, 496-97 (1986).

38. *Id.* at 497.

39. *Id.*

40. *Id.* Section 554(a) of the Bankruptcy Code provides, "[A]fter notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value to the estate." 11 U.S.C. § 554(a).

41. *Midlantic,* 474 U.S. at 498.

42. This holding seems to contradict the United States Supreme Court's earlier statement in dicta in *Kovacs* that if the property were worth less than the cost of cleanup, the trustee could abandon it to the prior owner. 469 U.S. at 284 n.12; *see supra* notes 35-36 and accompanying text. In *Midlantic,* the Court perhaps realized that if the trustee abandons the property, the property reverts back to the debtor, who has no resources to clean up the site. This would put the costs of the cleanup on the Government. *See* Note, *supra* note 25, at 556.

43. *Midlantic,* 474 U.S. at 500-01.

44. *Id.* at 501.

45. While many commentators applaud Justice Rehnquist's dissent, which attempts

contravention of a United States "state statute or regulation that is reasonably designed to protect the public health or safety from identified hazards."[46] Because the environmental laws that Quanta violated were designed to protect the public's health and safety, the Court denied the trustee's abandonment of the contaminated property.[47]

C. *Post* Kovacs *and* Midlantic

The United States Supreme Court established general guidelines for environmental bankruptcy proceedings in *Kovacs* and *Midlantic.* The Court, however, left the following important questions unanswered: (1) Does the automatic stay provision of section 362 apply to a state seeking a money judgment? (2) What can the trustee do with hazardous property if the trustee cannot abandon it? (3) When can a bankrupt corporation obtain a discharge of environmental claims against it? (4) What type of lien or claim can the state obtain in a bankruptcy proceeding? Lower courts have struggled to answer these questions in recent bankruptcy cases.

1. The Automatic Stay

The filing of a bankruptcy petition generally invokes the automatic stay provision of the United States Bankruptcy Code,[48] which prevents the commencement, continuation, or enforcement of judicial proceedings against the debtor or property of the estate until the bankruptcy case is closed or dismissed.[49] The automatic stay seems to prevent a state from pressing its claims for environmental clean up costs against a corporation in bankruptcy. Section 362(b) of the Bankruptcy Code,[50] however, lists exceptions to the automatic stay. Of these, the most important to an environmental bankruptcy is found in section 362(b)(4), which provides that "an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power" is excepted from the reach of the automatic stay.[51] In contrast, section 362(b)(5) provides that the automatic stay applies to actions to enforce money judgments, even if the

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to undermine the majority's reliance on pre-Bankruptcy Code judicial doctrine, *see id.* at 507-17 (Rehnquist, J., dissenting), courts follow and apply the majority opinion.

46. *Id.* at 507.
47. *Id.*
48. 11 U.S.C. § 362(a) (1988).
49. *Id.* § 362(a)(1)-(8).
50. *Id.* § 362(b).
51. *Id.* § 362(b)(4).

action is in furtherance of the state's police powers.[52] Thus, while the United States Bankruptcy Code gives a United States state the power to enforce its environmental laws in section 362(b)(4),[53] it ostensibly takes away any enforcement through monetary means in section 362(b)(5).[54]

Prior to either of the United States Supreme Court decisions in *Kovacs* and *Midlantic*, the United States Court of Appeals for the Third Circuit, in *Penn Terra Ltd. v. Department of Environmental Resources*,[55] tackled the issue of whether a state's enforcement of an environmental liability judgment against a debtor violates the automatic stay. Penn Terra operated coal mines in violation of several Pennsylvania environmental statutes.[56] Penn Terra and the Pennsylvania Department of Environmental Resources (DER) entered into a consent order to bring the company into compliance with the Pennsylvania laws.[57] Penn Terra, however, failed to comply with the order and filed a Chapter 7 bankruptcy petition.[58] The DER then brought an action in Pennsylvania seeking a preliminary injunction against Penn Terra to correct the statutory violations and to enforce the cleanup consent orders.[59] Penn Terra contended that the proceeding violated the automatic stay provision of section 362(a) of the United States Bankruptcy Code.[60] The bankruptcy court agreed and enjoined the state court proceedings.[61]

The United States Court of Appeals for the Third Circuit first examined the legislative history of section 362(b)(4),[62] which explains that "*where a government unit is suing a debtor to prevent or stop violation of fraud, environmental protection*, consumer protection, safety, or similar police or regulatory laws, . . . the action or proceeding is not stayed under the automatic stay."[63] The Third Circuit interpreted this language in light of the legislative history of section 362(b)(5), which indicates

52. *Id.* § 362(b)(5).
53. *Id.* § 362(b)(4).
54. *Id.* § 362(b)(5).
55. 733 F.2d 267 (3d Cir. 1984).
56. *Id.* at 269.
57. *Id.*
58. *Id.* at 269-70.
59. *Id.* at 270.
60. *Id.*
61. *In re* Penn Terra Ltd., 24 Bankr. 427, 435 (Bankr. W.D. Pa. 1982).
62. Penn Terra Ltd. v. Department of Envtl. Resources, 733 F.2d 267, 272 (3d Cir. 1984).
63. *Id.* (citing S. REP. No. 989, *supra* note 6, at 52, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS at 5838; H.R. REP. No. 595, 95th Cong., 2d Sess. 343, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 6299) (emphasis added by the court).

that the (b)(5) exception permits injunctions and the entry of money judgments, but allows the automatic stay to reach the enforcement of such money judgments.[64] The *Penn Terra* court held that courts should construe section 362(b)(5) narrowly to leave the United States states most of their police power.[65] By synthesizing section 362(b)(4) and its legislative history with section 362(b)(5) and its legislative history, the court concluded that the entry of a money judgment and enforcement of an injunction are not subject to the automatic stay and that the state could proceed with its action against Penn Terra.[66] The court distinguished, however, the enforcement of a money judgment, which section 362(b)(5) bars.[67] The automatic stay therefore does not bar a United States state from suing a corporation for the corporation's violation of state environmental law and obtaining a money judgment, but it does prevent the state from seizing the debtor's property to satisfy the judgment.[68]

In *Kovacs*,[69] the Supreme Court carefully distinguished *Penn Terra* on the basis that the court in *Penn Terra* had not appointed a receiver who was seeking money from the debtor.[70] The presence of a receiver in *Kovacs*, absent in *Penn Terra*, is the only substantive difference between the two cases. Focusing on the United States Supreme Court's language that "the only performance sought from Kovacs was the payment of money,"[71] three commentators argue that the *Kovacs* holding could be used in a hypothetical *Penn Terra* appeal.[72] These commentators note that in *Penn Terra* the cost of cleanup substantially exceeded the debtor corporation's $14,000 in assets.[73] Because the corporation did not have the assets to perform the cleanup, the debtor could be viewed as "disabled . . . from personally taking charge of and carrying out the removal of wastes from the property."[74] Even the bankruptcy court in *Penn*

64. *Id.* (citing S. REP. No. 989, *supra* note 6, at 52, *reprinted in* 1978 U.S. CODE CONG. & ADMIN. NEWS at 5838).
65. *Id.* at 273.
66. *Id.* at 274-75.
67. *Id.* at 275.
68. *Id.*
69. Ohio v. Kovacs, 469 U.S. 274 (1985).
70. *Id.* at 283-84 n.11.
71. *Id.* at 283.
72. Colton, Uehling & Sheehan, *supra* note 25, at 361.
73. *Id.* (citing Penn Terra Ltd. v. Department of Envtl. Resources, 733 F.2d 267, 270 (3d Cir. 1984)).
74. *Id.* (quoting *Kovacs*, 469 U.S. at 283); *see supra* note 33 and accompanying text.

Terra labeled the equitable relief sought by the state as "meaningless."[75] Under the *Kovacs* reasoning, the commentators argue that the only performance actually sought from Penn Terra was the payment of money,[76] which is equivalent to the enforcement of a money judgment and thus should have been barred by section 362(b)(5).

Despite the analogy that one may draw between *Penn Terra* and *Kovacs*, decisions subsequent to *Penn Terra* and *Kovacs* reinforce the holding and rationale of the United States Court of Appeals for the Third Circuit. In *In re Lenz Oil Service*,[77] the debtor allegedly violated the Illinois Environmental Protection Act. An Illinois state court entered an order that obligated the debtor to clean up existing contamination.[78] Instead of complying with the order, the debtor filed a Chapter 7 bankruptcy petition.[79] Illinois sought relief from the stay to enforce the cleanup order.[80] The bankruptcy court, stating that the policy behind the police or regulatory exception to the automatic stay of section 362(b)(4) is "to prevent the bankruptcy court from becoming a haven for wrongdoers,"[81] followed *Penn Terra*'s reasoning to distinguish the entry of a money judgment from the enforcement of a money judgment.[82] In the court's view, the mere fact that the requested injunction may require an expenditure of money does not necessarily make the injunction an enforcement of a money judgment.[83] The state sought an injunction and the entry of a money judgment in response to environmental violations, both of which the court determined are exceptions to the automatic stay.[84]

Subsequent cases uphold *Penn Terra*.[85] Today, a United States state may seek either an injunction or the entry of a money judgment in response to a bankrupt corporation's violation of the state's environmental laws. Although a state cannot enforce a money judgment, entry of a money judgment assures the state that it can share in the proceeds from

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75. Colton, Uehling & Sheehan, *supra* note 25, at 361 (quoting *Penn Terra*, 733 F.2d at 270).

76. *Id.*

77. 65 Bankr. 292 (Bankr. N.D. Ill. 1986).

78. *Id.* at 293.

79. *Id.*

80. *Id.*

81. *Id.* at 294 (quoting CFTC v. Co Petro Mktg., 700 F.2d 1279, 1283 (9th Cir. 1983)).

82. *Id.* at 294-95.

83. *Id.* at 294.

84. *Id.* at 294-95.

85. *See, e.g.*, United States v. Nicolet, 81 Bankr. 310 (Bankr. E.D. Pa.), *aff'd*, 857 F.2d 202 (3d Cir. 1988).

the estate of the bankrupt debtor along with the debtor's other creditors. While the state seldom gets total reimbursement for the cleanup costs because the bankrupt estate's assets seldom cover the claims against it, this line of decisions at least allows a state a chance to recover a portion of its costs.

2. Abandonment

In *Midlantic National Bank v. New Jersey Department of Environmental Protection*,[86] the United States Supreme Court held that a trustee cannot abandon property in contravention of a law "reasonably designed to protect the public health or safety from identified hazards."[87] Read literally, this decision bars a trustee from abandoning any property if the abandonment violates a state law designed to protect the public health and safety. The Supreme Court, however, said in a footnote that this restriction on the trustee's abandonment power is limited and that "[t]he abandonment power is not to be fettered by laws or regulations not reasonably calculated to protect the public health from imminent and identifiable harm."[88] Some subsequent United States lower federal court decisions seize upon the language in this footnote in an effort to limit and refine the *Midlantic* decision.

The United States Bankruptcy Court for the District of Minnesota failed to follow a strict reading of *Midlantic* in *In re Franklin Signal Corporation*.[89] In *Franklin Signal*, Bankruptcy Judge Robert J. Kressel wrote that in the *Midlantic* decision the United States Supreme Court intended to hold only that a "bankruptcy court cannot authorize the abandonment of property in contravention of state law *unless* conditions are formulated that will adequately protect the public health and safety."[90] Judge Kressel established five factors for courts to consider in determining when a trustee appropriately may abandon property: "(1) the imminence and danger to the public health and safety, (2) the extent of the probable harm, (3) the amount and type of hazardous waste, (4) the cost to bring the property into compliance with environmental laws, and (5) the amount and type of funds available for cleanup."[91] Although Judge Kressel did not indicate exactly how much danger the hazardous site must pose in comparison to the cost of cleanup, he did set a mini-

86. 474 U.S. 494 (1986).
87. *Id.* at 507.
88. *Id.* at 507 n.9.
89. 65 Bankr. 268 (Bankr. D. Minn. 1986).
90. *Id.* at 271.
91. *Id.* at 272.

mum standard that a trustee must meet before he abandons property in contravention of state law: a trustee must conduct an investigation to determine what hazardous substances burden the property and the trustee must inform the appropriate United States federal and state agencies of the investigation results along with his intent to abandon.[92] Under this standard, the court in *Franklin Signal* allowed the trustee to abandon property which contained fourteen drums of hazardous chemicals that were of no value to the bankrupt estate, that would cost $20,000 to remove, and that posed no imminent threat to the public.[93]

The bankruptcy court in *Franklin Signal* departed from the strict environmental compliance teachings of the Supreme Court in *Midlantic.* The departure in *Franklin Signal,* however, pales in comparison to that of another bankruptcy court in In re *Oklahoma Refining Co.*[94] In *Oklahoma Refining,* the results of well samples revealed that unacceptable levels of arsenic, lead, cadmium, chromium, and other toxic substances were leaking into tributaries of public consumption streams.[95] Cleanup would cost an estimated $2.5 million, yielding usable land worth $100,000.[96] The court stated that a strict reading of *Midlantic* requires the trustee to comply with state laws and regulations but that the trustee had no funds with which to authorize the cleanup.[97] Noting that the *Midlantic* decision does not address whether a trustee must pay for the environmental cleanup, the court decided that it was unfair to put the trustee in the nearly impossible position of trying to eliminate the toxic effects without any funds to pay for the cleanup.[98] In determining whether to permit abandonment, the court held that a bankruptcy court must "take state environmental laws and regulations into consideration."[99] In the facts before the *Oklahoma Refining* court, the estate posed no "immediate" danger and the trustee did what was "reasonable" under the circumstances; therefore, the court granted the trustee's motion for abandonment.[100]

Although the United States Supreme Court in *Midlantic* established a rigid rule against abandonment of a debtor's property by a trustee until environmental laws are satisfied, these subsequent decisions by the lower

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92. *Id.* at 273.
93. *Id.* at 273-74.
94. 63 Bankr. 562 (Bankr. W.D. Okla. 1986).
95. *Id.* at 563-64.
96. *Id.* at 564.
97. *Id.* at 565.
98. *Id.*
99. *Id.*
100. *Id.* at 565-66.

courts sympathize with the trustee and allow abandonment upon the trustee's showing that the cost of compliance far exceeds the bankruptcy estate's assets. Hence, these courts create a cost argument for allowing abandonment.

The United States Court of Appeals for the Fourth Circuit adopted this cost-conscious line of reasoning in *In re Smith-Douglass, Inc.*[101] Smith-Douglass filed a Chapter 11 reorganization petition and sought to abandon a fertilizer plant.[102] The fertilizer plant violated several provisions of the state environmental act by creating water pollution hazards, violating water quality standards in creek beds, and maintaining numerous drums and tanks containing various types of hazardous waste.[103] The court held that this did not pose an immediate threat to the public health and safety within the meaning of *Midlantic.*[104] While the court stated that it would require the debtor to comply with state environmental requirements if the debtor had unencumbered assets, this debtor had no such assets; accordingly, the court permitted abandonment.[105]

Other courts, conversely, rigidly apply the nonabandonment language of *Midlantic* and hold that a trustee cannot abandon property without first bringing the property into compliance with the applicable environmental laws. In *In re Peerless Plating Co.*,[106] the Environmental Protection Agency (EPA) detected cyanide gas inside the Peerless plant ten days after the company filed a Chapter 7 bankruptcy petition.[107] EPA officials demanded immediate removal of the hazardous material.[108] The Peerless estate responded that it had no funds to comply with the EPA order.[109] The EPA then performed the cleanup at a cost of $130,534.14, which exceeded the total value of the bankruptcy estate's assets.[110] The bankruptcy court rejected the *Franklin Signal*[111] court's interpretation of *Midlantic*[112] and held that a trustee cannot abandon a hazardous waste site unless

1. the environmental law in question is so onerous as to interfere with the

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101. 856 F.2d 12 (4th Cir. 1988).
102. *Id.* at 13.
103. *Id.* at 14.
104. *Id.* at 17.
105. *Id.*
106. 70 Bankr. 943 (Bankr. W.D. Mich. 1987).
107. *Id.* at 945.
108. *Id.*
109. *Id.*
110. *Id.*
111. *In re* Franklin Signal, 65 Bankr. 268 (D. Minn. 1986).
112. *In re* Peerless Plating Co., 70 Bankr. 943, 946-47 (Bankr. W.D. Mich. 1987).

bankruptcy adjudication itself; or
2. the environmental law in question is not reasonably designed to protect the public health or safety from identified hazards; or
3. the violation caused by abandonment would merely be speculative or indeterminate.[113]

The court held that the mere fact that one creditor—here, the EPA—will get most, if not all, of the proceeds from the bankruptcy estate does not render the claim onerous.[114] The court found the harm presented by the property immediate[115] and not speculative,[116] satisfying the last two prongs of the test. Hence, the court held that the trustee could not abandon the property.[117]

Other courts follow a more literal interpretation of the *Midlantic* language, which provides that a trustee cannot abandon property in contravention of a state law designed to protect the public health and safety.[118] In *In re Wall Tube & Metal Products Co.*,[119] the United States Court of Appeals for the Sixth Circuit refused to allow a trustee to abandon property of drums and tanks of hazardous substances.[120] The court found that the presence of the hazardous substances constituted a "continuing, potentially disastrous environmental health hazard"[121] in the event of a leak, spill, or overflow of a tank due to rainwater accumulation. Several bankruptcy courts refuse abandonment along similar lines.[122]

While some courts strain to allow a trustee to abandon property in violation of state environmental laws, other courts resoundingly deny abandonment absent full compliance with the applicable environmental law. Until the United States Supreme Court clarifies its holding in *Midlantic*, this split of authority likely will continue. The unfortunate

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113. *Id.* at 947.
114. *Id.*
115. *Id.*
116. *Id.*
117. *Id.* at 947-48.
118. Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494, 507 (1986).
119. 831 F.2d 118 (6th Cir. 1987).
120. *Id.* at 120-22.
121. *Id.* at 122.
122. *See In re* FCX, Inc., 96 Bankr. 49 (Bankr. E.D.N.C. 1989); *In re* 82 Milbar Blvd., Inc., 91 Bankr. 213 (Bankr. E.D.N.Y. 1988); *see also In re* Stevens, 68 Bankr. 774, 781 (Bankr. D. Me. 1987) (*Midlantic* does not allow abandonment "except upon the acquiescence of the public authorities whose ultimate legal obligation it is to protect the public health and safety from hazardous waste abandoned by those responsible for its existence.").

consequence is that a trustee in one jurisdiction must comply with United States state environmental laws, while a trustee facing a similar situation in another jurisdiction can simply walk away.

3. The State's Claim—Administrative Expense Priority

A state must eliminate the effects of toxic materials in order to protect the public health, regardless of whether a trustee abandons property or whether there are insufficient funds in the estate to pay for the cost of cleanup. In either situation, the issue of who ultimately must pay for the cost of cleanup remains. Two possible solutions emerge: (1) the state can receive an administrative expense claim in the bankruptcy proceeding[123] which would allow it to reach the estate's assets before the creditors of the debtor and thereby effectively force the creditors to pay for the cost of cleanup; or (2) the state can receive a general unsecured claim, so that it probably receives little or no assets from the estate, and thereby forces the state's taxpayers to fund the necessary cleanup. The United States Supreme Court has never addressed the issue and explicitly refused to consider the matter in *Midlantic*.[124] Lower United States federal court decisions, both before and after *Midlantic*, reach varying conclusions.

Courts that do not allow the trustee to abandon contaminated property[125] hold that the state can receive an administrative expense priority in the distribution of the assets of the estate. In *In re Peerless Plating Co.*,[126] the court held that because the trustee could not abandon the property without complying with federal law,[127] the trustee was under an implicit duty to expend the estate's resources to clean up the site.[128] Because the EPA performed the trustee's obligation, the EPA incurred an actual and necessary cost of preserving the estate and thus was entitled to an administrative expense priority.[129]

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123. Payment of administrative expenses receive the first priority in the distribution of the estate's assets to the unsecured creditors. 11 U.S.C. § 507 (1988). Administrative expenses are defined as "the actual, necessary costs and expenses of preserving the estate." *Id.* § 503(b)(1)(A); *see also infra* note 137 and accompanying text.

124. *Midlantic*, 474 U.S. at 498 n.2.

125. See *supra* part III, section C.2.

126. 70 Bankr. 943 (Bankr. W.D. Mich. 1987).

127. The company violated federal CERCLA legislation. *Id.* at 947; *see* 42 U.S.C. §§ 9601-9675 (1982 & Supp. V 1987). This case involved an EPA claim because the EPA performed the hazardous waste removal. The same analysis and reasoning apply when a state cleans up the property. *See Peerless Plating*, 70 Bankr. at 948 n.4.

128. *Peerless Plating*, 70 Bankr. at 947-48.

129. *Id.* at 948-49; *see supra* note 123, *infra* note 137 and accompanying text (describing the Bankruptcy Code allowance for expenses to preserve the estate). The

The United States District Court for the District of Maine followed similar reasoning in *In re Stevens*.[130] Maine was forced to remove drums containing PCB-contaminated waste oil after the trustee refused to comply with state and federal cleanup orders.[131] The state received an administrative expense priority for the removal costs because removing the drums protected the public from danger.[132] Likewise, an Ohio bankruptcy court stated that because CERCLA imposed liability on the estate for removal of the hazardous waste, "the cost incurred by the E.P.A. in discharging this liability [was] an actual necessary cost of preserving the estate."[133] These courts all agree that because the *Midlantic* decision does not permit trustees to abandon property, the state or federal agency that brings property into compliance with the environmental law helps preserve the estate and is, therefore, entitled to an administrative expense priority.[134]

Under particular circumstances, however, some courts do not grant the state an administrative expense priority. For example, the bankruptcy court in *In re Pierce Coal & Construction Inc.*,[135] addressed whether West Virginia had a claim against the debtor's assets to pay for environmental damages.[136] The court noted that the Bankruptcy Code allows administrative expenses for the necessary costs of preserving the estate, "including wages, salaries or commissions for services rendered *after the commencement of the case*."[137] The court further stated that the Bankruptcy Code specifically categorizes prepetition expenses into priorities in section 507, but that no category exists for environmental damages.[138]

Bankruptcy Code grants an administrative expense priority for costs necessary to preserve the estate to help the Code function properly and to keep the estate in as healthy a form as possible for the benefit of creditors. *See generally In re* Dant & Russell, Inc., 853 F.2d 700, 706-07 (9th Cir. 1988).

130. 68 Bankr. 774 (D. Me. 1987).

131. *Id.* at 776.

132. *Id.* at 783-84. This decision reversed the bankruptcy court's prior decision. *See In re* Stevens, 53 Bankr. 783 (Bankr. D. Me. 1985). The bankruptcy court determined that the trustee could abandon the property and that the state was not entitled to an administrative expense priority because, among other reasons, it rejected the idea that the trustee could not abandon the waste. Hence, the court refused to follow the United States Court of Appeals for the Third Circuit opinion affirmed by the United States Supreme Court in *Midlantic*. *Stevens*, 68 Bankr. at 776-77.

133. *In re* T.P. Long Chem., 45 Bankr. 278 (Bankr. N.D. Ohio 1985).

134. *See also In re* Wall Tube & Metal Prod., 831 F.2d 118 (6th Cir. 1987).

135. 65 Bankr. 521 (Bankr. N.D.W. Va. 1986).

136. *Id.* at 525.

137. *Id.* (quoting 11 U.S.C. § 503) (emphasis added by the court).

138. *Id.* at 530.

The court concluded that prepetition expenses incurred because of the actions of a prebankruptcy debtor are not entitled to an administrative expense priority.[139] The court indicated that it could not elevate a prepetition unsecured claim to an administrative expense priority unless, as required in *Midlantic*, the costs are necessary to prevent imminent and identifiable harm to the public.[140]

These cases illustrate the views prevalent in the United States bankruptcy courts. If a trustee cannot abandon property because of imminent danger to the public health and safety and the estate lacks sufficient assests, requiring the state to pay for the cleanup, then a court likely finds that the state incurred a cost necessary to the preservation of the estate and allows the state an administrative expense priority claim. Conversely, if the hazardous material does not cause an immediate threat to the public health and safety, a court allows the trustee to abandon the property, and the payment by the state for toxic waste removal is not a necessary cost of preserving the estate. The state is not entitled to an administrative expense priority for cleanup costs incurred on property that the estate no longer owns. The outcome turns on whether the court characterizes the threat as an imminent or immediate threat to the public health and safety—a characterization that depends entirely on the views of the courts in the particular jurisdiction. Although courts support their decisions by citing the holding and rationale of *Midlantic*, the underlying reason for the ruling may be dictated more by the particular judge's view of whether the taxpayers or the unsecured creditors of the debtor should pay for the cleanup.

4. Discharge

The United States Supreme Court granted the bankrupt debtor a discharge in *Kovacs*.[141] *Kovacs*, however, dealt with an individual debtor, not a corporation.[142] The Bankruptcy Code denies discharge to corporations under Chapter 7.[143] This denial of discharge, however, normally makes no real difference. After a Chapter 7 liquidation and distribution, all the corporation's assets are gone and only the corporate shell remains. Due to the principle of limited liability, the shareholders are not liable

139. *Id.* Costs incurred due to environmental violations by the debtor as a debtor in possession of the property, however, are entitled to administrative priority. *Id.*

140. *Id.* at 530-31.

141. *See supra* part III, section A (discussing *Kovacs*).

142. *But see supra* note 26.

143. 11 U.S.C. § 727(a)(1) (1988).

for the corporation's debts;[144] consequently, no entity exists to pay the corporation's debts if they are not discharged. Hence, even though the corporation's debts are not discharged, the same result occurs as if they were discharged: creditors not paid in the distribution of the estate go unpaid.

A similar scenario exists in a Chapter 11 bankruptcy reorganization, but through the exact opposite treatment of discharge. In a Chapter 11 case, upon confirmation of the plan,[145] the debtor automatically receives a discharge[146] unless the plan otherwise provides.[147] In a Chapter 11 case, therefore, the bankruptcy court discharges all the corporation's debts that the plan does not require the corporation to repay, and the debtors have no further recourse against the corporation or its owners. The effect of the confirmation of a Chapter 11 plan is that a majority of a state's claim is not paid. This is the same result as that reached in a Chapter 7 case in which the state does not get an administrative expense priority.

The owners of a bankrupt corporation normally do not have an interest in what happens to the corporation after the corporation files for a Chapter 7 bankruptcy because their stock has little or no value. If, however, they lose their limited liability, the lack of discharge in a Chapter 7 case is extremely important.[148] If a court holds the shareholders personally liable for the corporation's debts, then the state and the other creditors of the corporation can look to the owners for payment.

IV. Parent Corporation Liability for the Debts of a Bankrupt Subsidiary

Before a state can make a claim against a corporation, the United States court in which the state brings suit must have personal jurisdiction over the corporation.[149] To hold a parent corporation of a resident subsidiary liable, the court must obtain jurisdiction over the parent corpora-

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144. An exception exists to make the shareholders liable if the corporate veil can be pierced. *See infra* part IV, section B (discussing piercing the corporate veil).

145. A Chapter 11 plan provides for a schedule of repayment to the creditors over a period of time. The plan usually pays each class of creditors a percentage of their claims. 11 U.S.C. § 1123(a) outlines provisions that the plan must contain, and 11 U.S.C. § 1123(b) discusses provisions that may be contained in the plan. *See* 11 U.S.C. § 1123(a)-(b); *see also* 11 U.S.C. § 1122; *supra* note 20 (discussing segregating claims into classes).

146. 11 U.S.C. § 1141(d).

147. 11 U.S.C. § 1141(c)-(d).

148. *See supra* note 144; *infra* part IV, section B (discussing personal liability of shareholders of a bankrupt corporation).

149. International Shoe Co. v. Washington, 326 U.S. 310, 316 (1945).

tion; the mere fact that a subsidiary of a foreign corporation carries on business in the forum state does not satisfy the *International Shoe* requirements to give the court personal jurisdiction over the parent corporation.[150] Under *International Shoe*, a United States court can establish jurisdiction over a corporation if the corporation has sufficient contacts with the forum state such that traditional notions of fair play and substantial justice are not offended by subjecting the nonresident corporation to the in personam jurisdiction of the forum.[151]

If the parent corporation itself does business within the forum state, then the *International Shoe* test likely will be satisfied. If the parent does no business in the state and its only contact with the state is through its subsidiary, the court attains jurisdiction over the parent only in two situations: (1) if the parent's affairs are intended to have or do have substantial effect within the state's territory[152]—the effects principle[153]—and the exercise of jurisdiction is reasonable under the circumstances;[154] and (2) if the court can pierce the corporate veil of the parent corporation.[155]

A. *The Effects Principle*

The United States District Court for the District of Massachusetts applied the *Restatement Third of Foreign Relations* effects principle to find jurisdiction over an East German citizen who allegedly committed acts of espionage against the United States in Mexico and in East Germany.[156] Although the defendant was not a United States citizen and committed the alleged espionage outside the United States, the defendant intended the acts to have, and they did have, substantial effect within the United States; the court, therefore, held that jurisdiction was proper.[157]

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150. Cannon Mfg. v. Cudahy Packing Co., 267 U.S. 333, 336 (1925); *cf. International Shoe*, 326 U.S. at 316-19. A corporation also must be served with notice of the action before a United States court may assert jurisdiction over the corporation. *See* Note, The "Mandatory" Nature of the Hague Service Convention in the United States is the Forum's Victory, 23 VAND. J. TRANSNAT'L L. 179 (1990) (discussing service of process on a foreign parent corporation that has United States subsidiaries).

151. *International Shoe*, 326 U.S. at 316.

152. *See* RESTATEMENT (THIRD) OF FOREIGN RELATIONS § 402(1)(c) (1987).

153. *Id.* § 402 comment d.

154. *Id.* § 403(1).

155. *See* Idaho v. Bunker Hill Co., 635 F. Supp. 665, 670 (D. Idaho 1986).

156. United States v. Zehe, 601 F. Supp. 196, 198 (D. Mass. 1985).

157. *Id.* The court implicitly held that jurisdiction is proper only if the United States Congress grants jurisdiction under the Espionage Act. *Id.* at 197. Throughout the decision, however, the court operated on the premise that Congress has the power to grant

The United States District Court for the Southern District of Florida explicitly applied the effects principle in *National Transportation Safety Board v. Carnival Cruise Lines.*[158] In that case, two ships collided in international waters off the coast of Cuba.[159] One ship was registered in Cuba; the other, registered in Liberia, was owned by Carnival Cruise Lines, a Panamanian corporation.[160] Carnival Cruise Lines routinely engaged in business in the United States.[161] At the time of the accident, most of the ship's more than 1500 passengers were United States citizens.[162] Because the conduct of Carnival Cruise Lines had a "substantial, direct, and foreseeable effect in the territory of the United States," the court held that Congress had the power to prescribe law authorizing the investigation of this accident.[163]

The above cases are easily distinguishable from the situation in which a foreign corporation establishes a subsidiary that does business in the United States. Although United States case law currently does not address this issue, the effects principle seems to apply to a situation in which a parent establishes a subsidiary in the United States solely for the purpose of producing a hazardous substance. If the parent fails to provide the subsidiary with any funds or other means to dispose of the hazardous waste, then the parent definitely intends its affairs to have substantial effect within the United States. If the subsidiary fails to dispose of its waste properly, then it violates local environmental laws. Theoretically, a court could use the effects principle to obtain jurisdiction over the parent corporation. Once the court obtains jurisdiction over a foreign parent corporation, it can impose liability upon the corporation if the acts giving rise to liability are attributable to the parent corporation. A court could attribute liability to a foreign parent if the foreign parent thinly capitalizes a toxic waste producing plant in the United States without giving that subsidiary sufficient funds to pay for proper disposal. Although the *Restatement of Foreign Relations* effects principle provides a United States court with one means to subject the parent corporation to

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jurisdiction in this type of case because of the effect of the act in the United States. The court thereby implicitly applied the effects test of the *Restatement* to allow jurisdiction over a nonresident defendant.

158. 723 F. Supp 1488 (S.D. Fla. 1989).

159. *Id.* at 1489.

160. *Id.* at 1489-90.

161. *Id.* at 1491.

162. *Id.* at 1489.

163. *Id.* at 1491. The court denied jurisdiction in *Carnival Cruise Lines* because it found that Congress did not extend jurisdiction to the National Transportation Safety Board to investigate this accident. *Id.* at 1494.

liability, the most common method is for the court to pierce the corporate veil.

B. *Piercing the Corporate Veil*

A major feature of corporate formation is limited liability: creditors cannot hold personally liable the owners of a corporation for that corporation's debts. This holds true whether the investor is a person or another corporation.[164] A corporation is an independent legal entity and is responsible for its own debts and liabilities.[165] Under normal circumstances, a parent corporation is not liable for the environmental debts and obligations of its bankrupt subsidiary corporation.

United States courts, in certain circumstances, will pierce the corporate veil so that a creditor may reach the assets of a corporation's shareholders.[166] Courts generally do not set rigid guidelines to determine when they will pierce the corporate veil.[167] Commentators generally

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164. L. SOLOMON, D. SCHWARTZ & J. BAUMAN, CORPORATIONS LAW AND POLICY: MATERIALS AND PROBLEMS 240 (2d ed. 1988).

165. *Id.*

166. *Id.*

167. The Supreme Court of Appeals of West Virginia enumerated nineteen different factors to be considered in Laya v. Erin Homes, Inc., 352 S.E.2d 93, 98 (W. Va. 1986). These factors are:

(1) commingling of funds and other assets of the corporation with those of the individual shareholders;

(2) diversion of the corporation's funds or assets to noncorporate uses (to the personal uses of the corporation's shareholders);

(3) failure to maintain the corporate formalities necessary for the issuance of or subscription to the corporation's stock, such as formal approval of the stock issue by the board of directors;

(4) an individual shareholder representing to persons outside the corporation that he or she is personally liable for the debts or other obligations of the corporation;

(5) failure to maintain corporate minutes or adequate corporate records;

(6) identical equitable ownership in two entities;

(7) identity of the directors and officers of two entities who are responsible for supervision and management (a partnership or sole proprietorship and a corporation owned and managed by the same parties);

(8) failure to adequately capitalize a corporation for the reasonable risks of the corporate undertaking;

(9) absence of separately held corporate assets;

(10) use of a corporation as a mere shell or conduit to operate a single venture or some particular aspect of the business of an individual or another corporation;

(11) sole ownership of all the stock by one individual or members of a single family;

(12) use of the same office or business location by the corporation and its individual shareholder(s);

agree that the three most important factors in a court's decision to hold a parent liable for a subsidiary's debts are: (1) undercapitalization of the subsidiary; (2) failure to follow legal corporate formalities; and (3) use of the subsidiary's funds for the sole benefit of the parent.[168] If all three above factors are present, then a court usually will pierce the corporate veil and hold the parent liable for the subsidiary's debts.[169] When these three factors are not all present, the court has more discretion to determine the parent's liability; the less significant these three factors are in a situation, the less likely the court is to impose liability on the parent.[170]

Foremost in a judge's mind lies the result of piercing the veil: the extinction of limited liability for the shareholders,[171] which destroys a major incentive to the corporate form of investment. This consideration could explain why a Georgia bankruptcy court held that liquidation of a subsidiary's assets compelled by a parent does not evince control sufficient to warrant piercing the corporate veil.[172] The court stated that to pierce the corporate veil

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(13) employment of the same employees or attorney by the corporation and its shareholder(s);

(14) concealment or misrepresentation of the identity of the ownership, management or financial interests in the corporation, and concealment of personal business activities of the shareholders (sole shareholders do not reveal the association with a corporation, which makes loans to them without adequate security);

(15) disregard of legal formalities and failure to maintain proper arm's length relationships among related entities;

(16) use of a corporate entity as a conduit to procure labor, services or merchandise for another person or entity;

(17) diversion of corporate assets from the corporation by or to a stockholder or other person or entity to the detriment of creditors, or the manipulation of assets and liabilities between entities to concentrate the assets in one and the liabilities in another;

(18) contracting by the corporation with another person with the intent to avoid the risk of nonperformance by use of the corporate entity; or the use of a corporation as a subterfuge for illegal transactions;

(19) the formation and use of the corporation to assume the existing liabilities of another person or entity.

Id.

168. Lecture by Professor Donald Langevoort, Vanderbilt University School of Law (Jan. 17, 1989).

169. *Id.*

170. *Id.*

171. Landers, *A Unified Approach to Parent Subsidiary, and Affiliate Questions in Bankruptcy*, 42 U. CHI. L. REV. 589, 620 (1975); *see supra* note 164 and accompanying text.

172. *In re* International Horizons, Inc., 51 Bankr. 747 (Bankr. N.D. Ga. 1985).

> it must be shown that the stockholders' disregard of the corporate entity made it a mere instrumentality for the transaction of their own affairs; that there is such unity of interest and ownership that the separate personalities of the corporation and the owner no longer exist; and to adhere to the doctrine of corporate entity would promote injustice or protect fraud.[173]

The court held that the mere selling of all of the subsidiary's assets does not rise to the requisite level of a "mere instrumentality" or "fraud" to require piercing the corporate veil.[174]

It is questionable whether the traditional veil piercing doctrine properly is applicable in the environmental bankruptcy field. Professor Jonathan M. Landers developed a novel approach that would often call for piercing the veil in an environmental bankruptcy situation.[175] Landers claims that the intent of limited liability is not to protect a parent corporation against liability for the debts of its subsidiary.[176] Because the parent manages the subsidiary, it should be liable for the subsidiary's corresponding debts.[177] Professor Landers argues that when a corporation departs from the traditional corporate model inherent in the legislative grant of corporate authority, the entity should lose the benefits of corporate status, including limited liability.[178]

Landers argues that the corporate model requires both economic viability and the observance of certain procedural formalities.[179] To meet the requirements of economic viability and corporate formalities, the subsidiary must display several characteristics. First, the subsidiary must be sufficiently capitalized to perform its intended business.[180] Second, the parent must provide effective management to insure that the subsidiary has a realistic potential for profitability.[181] This second characteristic prevents a parent from draining the profits out of a subsidiary through excessively high dividends.[182] Third, the subsidiary must exist somewhat autonomously.[183] Finally, the parent must recognize and treat the sub-

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173. *Id.* at 751 (quoting Farmers Warehouse v. Collins, 220 Ga. 141, 150, 137 S.E.2d 619, 625 (1964)).
174. *Id.*
175. Landers, *supra* note 171.
176. *Id.* at 619.
177. *Id.*
178. *Id.* at 621.
179. *Id.*
180. *Id.*
181. *Id.*
182. *Id.*
183. *Id.*

sidiary as a separate entity.[184] Landers contends that courts must pierce the corporate veil when assets are freely commingled between subsidiary and parent, when corporate formalities are not observed, or when the subsidiary does not have a separate corporate image.[185]

Applying this economic viability-procedural observance test, Landers would hold a parent liable for its subsidiary's debts when the parent "impairs the viability of the subsidiary as a separate business entity either at its inception or in its administration or fails to observe the procedural formalities that would identify the subsidiary as a separate corporation."[186] Landers creates an exception to parent liability only when a creditor is in a position to inquire as to the financial status of the subsidiary and the investigation would reveal the subsidiary's relation to the parent and the shallowness of the subsidiary's resources.[187]

The main rationale for imposing liability on a parent in Landers' analysis rests on the assumption that the owners in a parent-subsidiary structure have little or no concern for the independent profitability of the constituent corporations.[188] The owners only care about overall profitability of the combined enterprise. A group of affiliated corporations form a single economic enterprise and the law should treat them as such.[189] Parent corporations do not care that the subsidiary takes heavy losses so long as the enterprise as a whole benefits.[190] To counter this reality, Landers presumes parental liability unless the parent adequately can show that it passes the economic viability-procedural observance test. Landers concludes that "the parent should not be permitted to hold the subsidiary out to the world as an integral part of its operation and then call foul when a creditor attempts to hold it liable for the subsidiary's debts."[191]

Environmental polluters fit neatly into Landers' theory. For example, a parent corporation can create a subsidiary corporation to dispose of the parent's toxic wastes. The subsidiary then incurs huge environmental cleanup costs and files for bankruptcy. If the parent consistently takes capital from the subsidiary, leaving it underfunded, then the losses incurred by the bankrupt subsidiary are infinitely small in comparison to the benefits the parent reaps by not involving itself with the costs of

184. *Id.*
185. *Id.*
186. *Id.* at 625.
187. *Id.* at 625-26.
188. *Id.* at 591-92.
189. *Id.*
190. *Id.*
191. *Id.* at 622.

cleaning up the hazardous waste. Traditional corporate law invokes limited liability, especially if corporate formalities are followed and the subsidiary's funds are not used solely to benefit the parent; thus the state cannot reach the parent's funds to pay for the cleanup. Under Landers' approach, however, the parent probably faces direct liability, because a presumption of liability exists until the parent can show that it passes the economic viability-procedural observance test.

Judge Richard A. Posner of the United States Court of Appeals for the Seventh Circuit and former Professor at the University of Chicago Law School, rebuts Landers' approach[192] by declaring that certain economic principles are "vital to an understanding of credit transactions, limited liability, and corporate affiliation."[193] Judge Posner's premise is that limited liability benefits both the creditor and the borrower. Incorporation allows a borrower to shift part of the risk of the business' failure to the creditor; the lender charges higher interest to compensate itself for the risk of loss if the corporation fails.[194] Without limited liability, investment in business ventures would decrease because most investors are risk adverse.[195] Therefore, the supply of investment and demand for credit would consist of a smaller amount than at the present.[196]

Posner also rejects the theory behind Landers' "single enterprise" approach.[197] Posner contends that when a parent corporation owns a subsidiary, the subsidiary is managed and run the same as if it were owned by individual shareholders.[198] Posner states that maximizing the profits of the subsidiary maximizes the profits of the whole enterprise, and he sees little chance for abuse.[199] Posner suggests that creditors contract around the limited liability rule by asking for personal guarantees on any loans.[200]

Posner would hold a parent liable for its subsidiary's debts only when

192. Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499 (1976).

193. *Id.* at 500.

194. *Id.* at 502-03.

195. *Id.* at 502.

196. *Id.* at 503.

197. *See supra* notes 188-91 and accompanying text (discussing Landers' single enterprise approach).

198. Posner, *supra* note 192, at 515.

199. *Id.* at 513-15.

200. *Id.* at 515. Since the time that Posner wrote this, the use of personal guarantees has become a significantly less attractive option. *See* Levit v. Ingersoll Rand Financial Corp., 874 F.2d 1186 (7th Cir. 1989); Katzen, Deprizio *and Bankruptcy Code Section 550: Extended Preference Exposure via Insider Guarantees, and Other Perils of Initial Transfer Liability*, 45 BUS. LAW. 511 (1990).

separate incorporation is "misleading" to creditors.[201] This approach allows a creditor to recover from the parent when the subsidiary represents that it possesses greater assets than it actually owns.[202] Posner claims this approach automatically answers Landers' concern with corporations that divide their business into a number of separate corporations to avoid their creditors; if the creditor was misled, it can pierce the corporate veil and reach the parent's assets.[203] Posner briefly admits that this approach does not help the involuntary tort creditor.[204] He finds, however, that this type of creditor is less important than voluntary tort creditors.[205]

Posner seems uncertain how to treat involuntary creditors because his approach fails adequately to incorporate their needs.[206] He does favor, however, a judicial presumption against piercing the corporate veil for the financial creditor and a presumption in favor of piercing the corporate veil in the case of the nonbusiness creditor.[207] In an environmental bankruptcy, Posner's approach varies little from that suggested by Landers. Both apparently favor a presumption in favor of piercing the corporate veil for the involuntary state environmental creditor, a nonbusiness creditor.

While most courts follow traditional corporate limited liability law and disregard Landers' presumption of parent liability for subsidiary debts to involuntary creditors, one court adopts an approach similar to Landers' economic viability-procedural observance test. In *Henderson v. Rounds & Porter Lumber Co.*,[208] the parent corporation, Rounds & Porter, created a subsidiary corporation to manufacture oak flooring. The United States District Court for the Western District of Arkansas found the determinative factor in piercing the corporate veil to be the subsidiary's continual sale of lumber to the parent at a loss.[209] While the subsidiary sold at a loss to the parent, a critical shortage of hardwood flooring existed in the market.[210] Rounds & Porter, however, did not permit its subsidiary to take advantage of the prevailing high prices due to the market shortage; it used the subsidiary solely for the purpose of

201. Posner, *supra* note 192, at 520.
202. *Id.* at 520-21.
203. *Id.* at 524.
204. *Id.* at 506.
205. *Id.* at 506-07.
206. *Id.* at 519-20, 523.
207. *Id.* at 523.
208. 99 F. Supp. 376 (W.D. Ark. 1951).
209. *Id.* at 378.
210. *Id.*

obtaining a supply of hardwood lumber at low prices.[211] The court found that, through this practice, the parent "dominated and manipulated the affairs of [the subsidiary] for its own interest, rather than the best interest of [the subsidiary] as a separate corporate entity."[212] Based on these findings, the court held the parent liable for the subsidiary's obligations as if the parent directly had incurred the obligations.[213]

A decade before the United States Supreme Court tackled environmental bankruptcies in *Ohio v. Kovacs* and *Midlantic National Bank v. New Jersey Department of Environmental Protection*, the United States District Court for the District of Vermont disregarded the corporate veil in *United States v. Ira S. Bushey & Sons.*[214] Bushey wholly owned forty corporations, each of which owned vessels that transported liquid cargoes.[215] Bushey received the subsidiaries' net profits through receipt of corporate dividends.[216] Bushey subsidiaries were involved in nine oil spills in the Lake Champlain area between 1967 and 1972.[217] Because these spills presented severe environmental problems,[218] the United States sought injunctive relief from Bushey to prevent future hazards. The court found that the subsidiaries consisted of "mere corporate shells" that Bushey established to avoid personal tort liability for acts of the subsidiaries.[219] The court found that the public interest in preserving the environmental integrity of Lake Champlain was sufficiently paramount to the interests of Bushey in maintaining the separate corporate identities of its "alter-ego subsidiaries" to pierce the corporate veil.[220] The court held Bushey responsible to ensure that the subsidiaries complied with the injunctions and policies of the United States Government in preventing future oil spills.[221] The *Bushey* opinion stands for the principle that forming a subsidiary simply to avoid liability under environmental laws will not work; courts will pierce the corporate veil and hold the parent liable.

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211. *Id.*
212. *Id.* at 381.
213. *Id.* at 384.
214. 363 F. Supp. 110 (D. Vt.), *aff'd*, 487 F.2d 1393 (2d Cir. 1973), *cert. denied*, 417 U.S. 976 (1974).
215. *Id.* at 112.
216. *Id.*
217. *Id.* at 113.
218. *Id.* at 116-17.
219. *Id.* at 119.
220. *Id.*
221. *Id.* at 122-23.

Despite the logic of Landers' analysis and the promising beginning to parent liability in environmental bankruptcies in *Bushey*, the courts in the United States today usually use traditional veil piercing factors in determining whether to disregard the corporate entity in environmental bankruptcy matters. The United States Court of Appeals for the Fifth Circuit, in *Joslyn Manufacturing Co. v. T.L. James & Co.*,[222] recently rejected a contention that courts should hold parent corporations directly liable for their subsidiary's activities in CERCLA matters. The court held that to find parent liability "would dramatically alter traditional concepts of corporation law."[223] The court added, "Any bold rewriting of corporation law in this area is best left to Congress."[224] The court ruled that it would not pierce the corporate veil unless the subsidiary was formed merely as a sham organization "to perpetrate a fraud or avoid personal liability."[225]

In *United States v. Nicolet*,[226] the United States District Court for the Eastern District of Pennsylvania established a rule to determine when the court would pierce the corporate veil in a CERCLA case. The court outlined two factors necessary to lead it to disregard the parent's separate corporate existence: (1) the parent has an ownership or financial interest in the subsidiary; and (2) the parent controls the management and operations of the subsidiary.[227] This holding parallels traditional veil piercing factors. The United States District Court for the District of Idaho cited similar factors in another CERCLA case.[228] In *Idaho v. Bunker Hill Co.*, the court pierced the corporate veil because the parent controlled the majority of the subsidiary's board of directors, would not allow the subsidiary to spend over $500 on pollution matters without the parent's approval, combined the subsidiary's federal tax return with the parent's return, approved all the subsidiary's capital expenditures, could overrule decisions regarding management and operations made by the subsidiary, and thinly capitalized the subsidiary.[229] These cases exemplify that courts today are unwilling to relax the standards to disregard the corporate entity in an environmental bankruptcy situation.

In re Acushnet River & New Bedford Harbor Proceedings re Alleged

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222. 893 F.2d 80 (5th Cir. 1990).
223. *Id.* at 82.
224. *Id.* at 83.
225. *Id.*
226. 712 F. Supp. 1193 (E.D. Pa. 1989).
227. *Id.* at 1202.
228. Idaho v. Bunker Hill Co., 635 F. Supp. 665 (D. Idaho 1986).
229. *Id.* at 670.

PLB Pollution[230] illustrates one state's inability to pierce the corporate veil of an environmental polluter and hold its foreign parent liable for the damage.[231] In *Acushnet*, the United States and Massachusetts brought an action under CERCLA to recover the costs of removing PCB contaminants that Aerovox corporation dumped into New Bedford Harbor and the Acushnet River. The plaintiffs sought to pierce the corporate veil of Aerovox and hold liable RTE, its foreign parent.[232] The plaintiffs, following Landers' approach, argued that RTE must answer for all of Aerovox's liability under the statute because the purposes of the CERCLA legislation are so important.[233] The court rejected the plaintiff's approach, adopted a view along the lines of Posner's economic reasoning,[234] and applied traditional corporate veil piercing theory.[235] The court did not find dispositive the fact that RTE specifically formed Aerovox to limit its own liability for environmental contamination.[236] It held, "Avoiding liability through the corporate form, without more, is not a wrong that equity's hand must right."[237] Although RTE did show some signs of parent control,[238] the court found that Aerovox was adequately

230. 675 F. Supp. 22 (D. Mass. 1987).

231. Several cases hold that mere ownership of a subsidiary by a foreign parent does not warrant piercing the corporate veil. Accordingly, the foreign parent is not doing sufficient business in the state to allow long arm jurisdictional statutes to reach the foreign parent corporation, and the foreign parent can successfully ask for dismissal for lack of personal jurisdiction. *E.g.*, Andros Compania Maritima S.A. v. Intertanker Ltd., 714 F. Supp. 669 (S.D.N.Y. 1989); McPheron v. Pennsylvania Central Transp. Co., 390 F. Supp. 943 (D. Conn. 1975); Johnson v. Warnaco, Inc., 426 F. Supp. 44 (S.D. Miss. 1976); *see also* American Protein Corp. v. AB Volvo, 844 F.2d 56 (2d Cir. 1988).

232. *Acushnet*, 675 F. Supp. at 28.

233. *Id.* at 31-32.

234. The court believed that the plaintiff's rule would discourage investment in the corporate form. *Id.* at 32; *see supra* notes 192-205 and accompanying text (discussing Posner's approach).

235. *Acushnet*, 675 F. Supp. at 32. The court stated that Congress must explicitly state in legislation its intention to alter the structure of such an important traditional rule as limited liability. *Id.* At least one other court applies traditional principles in rejecting claims to pierce the corporate veil. *See* United States v. Bliss, 108 F.R.D. 127, 23 Env't Rep. Cas. (BNA) 1638 (E.D. Mo. 1985); Wehner v. Syntex Agribusiness, 616 F. Supp. 27, 22 Env't Rep. Cas. (BNA) 1732 (E.D. Mo. 1985).

236. *Acushnet*, 675 F. Supp. at 34.

237. *Id.*

238. For example, RTE consolidated the cash accounts of all its subsidiaries; Aerovox was required to obtain RTE approval for large capital expenditures; RTE loaned Aerovox money which was repaid through intercompany billing rather than through formal loan agreements; and RTE required Aerovox to change some accounting procedures. *Id.*

capitalized and profitable.[239] The court mainly relied on the lack of evidence "that RTE exploited Aerovox's existence to shield itself from potential CERCLA liability other than that relating to Aerovox's operations"[240] to reject the plaintiff's corporate veil piercing claim. Because the court refused to pierce the corporate veil, it had no personal jurisdiction over RTE and thus granted RTE's motion to dismiss.[241] Although the *Acushnet* court failed to pierce the corporate veil on the facts before it, the court did suggest that if a parent establishes a subsidiary merely to manufacture a product that involves producing hazardous waste, or to dispose of the parent's hazardous waste, then the parent may be held liable.

United States courts typically apply traditional veil piercing factors to environmental bankruptcies to determine if the parent corporation is liable for the subsidiary's debts, namely the costs associated with the cleanup of the hazardous waste. Courts seldom rely solely on public policy or thin capitalization of the subsidiary to pierce the corporate veil. The courts seem to value the limited liability characteristic of the corporate form over a clean environment. Although several courts disregard the corporate entity of a polluting subsidiary and hold the parent liable, these courts rest their reasoning on traditional veil piercing factors; no court has taken the initiative and held that a clean environment and the public health, safety, and welfare matter more than encouraging investment in the corporate form. Until this occurs, courts will continue to encourage the incorporation of toxic-producing entities as thinly capitalized subsidiaries of larger corporations.

V. Power of the State to Reach a Foreign Parent's Assets

Assuming a state does receive a judgment against a foreign parent corporation, the state still faces one major obstacle: enforcing the judgment of the United States court in the parent's home state and satisfying its claim through the parent's assets located therein.

Two scenarios occur frequently in an environmental bankruptcy. First, the parent is insolvent, creating an international bankruptcy situation in which the parent corporation is in, or is about to be in, bankruptcy proceeding judgments in more than one state. This involves a conflict of laws problem in enforcing one state's bankruptcy proceedings in

239. *Id.* at 35.

240. *Id.* The court continued, "For example, there is no evidence that Aerovox is making some component vital to a RTE product line, the manufacture of which necessarily involves generating hazardous substances." *Id.*

241. *Id.*

another state.[242] The second situation occurs when the parent is solvent in the foreign state. The United States state then faces the problem of enforcing the United States judgment against the parent.

A. *International Bankruptcy*

Courts and commentators have developed two major theories of international bankruptcy: universality and territoriality.[243] Under the universality theory, a bankruptcy judgment obtained by a court of proper jurisdiction must be recognized everywhere.[244] The problem with the universality doctrine is that it depends upon universal acceptance;[245] all states must agree to abide by the holding made in the original bankruptcy court. The doctrine of territoriality, on the other hand, gives no extraterritorial effect to the laws of a foreign state.[246] Under this theory, a United States bankruptcy proceeding is ineffective in other states.

The United States Bankruptcy Code includes all property of the debtor, wherever located, in the property of the estate;[247] a bankruptcy trustee therefore is responsible for bringing all of the debtor's property within his control.[248] The Code's definition of the property of the estate—all property of the debtor "wherever located"[249]—includes those assets located on foreign soil. Trustees face difficult problems in attaining control over the debtor's property located abroad because there is no general rule among states whereby the bankruptcy courts of one state assist the courts of another by allowing a foreign bankruptcy trustee to gain possession of local assets.[250]

International bankruptcy occurs when an insolvent debtor owns prop-

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242. Several commentators have written on this subject. *See, e.g.*, Honsberger, *Conflict of Laws and the Bankruptcy Reform Act of 1978*, 30 CASE W. RES. L. REV. 631 (1980); Note, *The Lure in "International Bankruptcies" of Assets Located Abroad*, 33 I.C.L.Q. 431 (1984); Klöcker, *Foreign Debtors and Creditors under United States and West German Bankruptcy Laws: An Analysis and Comparison*, 20 TEX. INT'L L.J. 55 (1985); Huber, *Creditor Equality in Transnational Bankruptcies: The United States Position*, 19 VAND. J. TRANSNAT'L L. 741 (1986); James, *International Bankruptcy: Limited Recognition in the New U.S. Bankruptcy Code*, 3 HOUS. J. INT'L L. 241 (1981).

243. Honsberger, *supra* note 242, at 633.

244. *Id.*

245. *Id.* at 634.

246. *Id.*

247. 11 U.S.C. § 541(a) (1988).

248. *Id.* § 704(1).

249. *Id.* § 541(a).

250. Honsberger, *supra* note 242, at 660 (quoting Nadelmann, *International Bankruptcy Law: Its Present Status*, 5 U. TORONTO L.J. 324, 339 (1944)).

erty situated in more than one state.[251] Most states apply the doctrine of territoriality. In *Harrison v. Sterry*,[252] for example, the United States Supreme Court held that bankruptcy laws of foreign states are "incapable of operating a legal transfer of property in the United States."[253] Some commentators conclude,[254] based on the more universal nature of the United States Bankruptcy Code[255] and some recent decisions,[256] that the United States is moving toward a distinct policy of universality. In *In re Toga Manufacturing*,[257] however, the Bankruptcy Court for the Eastern District of Michigan subordinated universality principles for those of the territorial theory. In *Toga*, a creditor of the corporation filed an involuntary bankruptcy petition in Canada before any action was taken in the United States.[258] The court, relying on section 304(c) of the United States Bankruptcy Code,[259] found that one of the largest secured creditors under United States bankruptcy law would be treated as an ordinary creditor under Canadian law.[260] Thus, the proceeds of the estate would not be awarded to creditors in the same proportions under Canadian law as they would be awarded under United States law.[261] The court held that this violated section 304(c)(4) of the Bankruptcy Code[262] and ruled that the Canadian bankruptcy proceeding was not effective in the United States.[263]

Toga shows that, even with the trend toward the universality doctrine, no bankruptcy proceeding—not even in the United States—is safe from the limitation of the territoriality doctrine. If the United States does not

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251. Honsberger, *supra* note 242, at 631.

252. 9 U.S. (5 Cranch) 289 (1809).

253. *Id.* at 302.

254. *See, e.g.*, Note, *In the Matter of Toga Mfg. Ltd.: A Step in the Wrong Direction for International Bankruptcy*, 2 INT'L PROP. INVESTMENT J. 633, 638 (1986).

255. 11 U.S.C. § 304.

256. Clarkson Co. v. Shaheen, 544 F.2d 624 (2d Cir. 1976); Israel-British Bank (London) Ltd. v. FDIC, 536 F.2d 509 (2d Cir.), *cert. denied*, 429 U.S. 978 (1976).

257. 28 Bankr. 165 (Bankr. E.D. Mich. 1983).

258. *Id.* at 166.

259. 11 U.S.C. § 304(c). This section provides six factors for a court to consider in determining whether to give effect to a foreign bankruptcy proceeding. The fourth factor provides that the distribution of the proceeds of the bankruptcy estate should be essentially the same as that under United States bankruptcy law. 11 U.S.C. § 304(c)(4).

260. *Toga*, 28 Bankr. at 168. Secured creditors have higher priority for payment than ordinary creditors under the United States Bankruptcy Code. *See supra* notes 8-9 and accompanying text.

261. *Id.* at 169.

262. *Id.* at 170-71.

263. *Id.* at 168-70.

give effect to bankruptcy decisions of another state, then that state likely will not give effect to United States bankruptcy decisions. The only way to ensure the acceptance of foreign bankruptcy proceedings in the United States and, conversely, to guarantee the acceptance of United States bankruptcy proceedings in foreign jurisdictions, is for states to sign treaties to that effect.[264] A significant problem that inhibits entrance into these treaties, and thus true universality, is that each state has its own policies and customs to deal with bankruptcy matters; some states seek rehabilitation of the debtor while others emphasize liquidation of the debtor's property.[265] Most states have no problem with exporting their local laws, yet they severely limit recognition of foreign bankruptcy laws when the proceeding involves local creditors and local assets of a foreign debtor.[266] If a foreign parent corporation is bankrupt, a United States state probably cannot enforce a United States bankruptcy judgment against the foreign parent; it must make its claim in the foreign bankruptcy court. The foreign bankruptcy court likely will provide resistance, given that most states favor local creditors over foreign creditors in bankruptcy proceedings.

B. *Enforcement of a United States Judgment*

Whether a foreign court will respect and uphold a United States judgment often depends on which state is asked to recognize and enforce the judgment.[267] EEC states require, as a prerequisite, that the foreign court entering the judgment have jurisdiction over the matter[268] and that the judgment is final in the state rendering the decision.[269] One defense to recognition that European states generally allow is that the foreign judg-

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264. *See generally* Maier, *Extraterritorial Jurisdiction at a Crossroads: An Intersection between Public and Private International Law,* 76 A.J.I.L. 280 (1982) (exploring the limits of private law in dealing with problems of transnational application of national law).

265. *See* Gitlin & Flaschen, *The International Void in the Law of Multinational Bankruptcies,* 42 BUS. LAW. 307, 308 (1987).

266. *Id.*

267. Two excellent treatises provide state by state analyses of the rules regarding the recognition and enforcement of foreign judgments in the civil law states of the European Economic Community. *See* G. DELAUME, LAW AND PRACTICE OF TRANSNATIONAL CONTRACTS §§ 7.01-.07 (1988) [hereinafter LAW AND PRACTICE]; G. DELAUME, TRANSNATIONAL CONTRACTS—APPLICABLE LAW AND SETTLEMENT OF DISPUTES §§ 10.01-.11 (1986) [hereinafter TRANSNATIONAL CONTRACTS]. For a complete discussion of the recognition and enforcement of foreign judgments in Germany, see U. DROBNIG, AMERICAN-GERMAN PRIVATE INTERNATIONAL LAW 350-63 (2d ed. 1972).

268. LAW AND PRACTICE, *supra* note 267, § 7.02.

269. TRANSNATIONAL CONTRACTS, *supra* note 267, § 10.01.

ment offends the public policy of the forum state.[270] Beyond these similarities, the European states differ in their treatment of foreign judgments. The methods that English, French, and German courts use to handle United States judgments provide good examples.

1. England

English courts recognize and enforce judgments from foreign courts of competent jurisdiction when the judgments are final and conclusive on the merits.[271] Under English law, a foreign court has jurisdiction over the defendant if the defendant submits or agrees to submit to the jurisdiction of the foreign court.[272] A defendant submits to the jurisdiction of the foreign court if (1) the defendant chooses the forum as a plaintiff and becomes a defendant through a crossclaim or counterclaim; (2) the defendant voluntarily appears;[273] or (3) the defendant, if a corporation, carries on business in the state of the court at a "definite and reasonably permanent place" on the date of the commencement of the proceedings.[274] Insufficient bases for a foreign court to claim jurisdiction under English law include the defendant's possession of property in the foreign state,[275] and the defendant's mere presence in the foreign state.[276]

In the hypothetical environmental bankruptcy scenario, if the foreign parent appears in the bankruptcy proceeding to contest its liability, the

270. *Id.* United States courts recognize a similar defense. *See generally* Note, *The Public Policy Exception to the Recognition of Foreign State Judgments*, 22 VAND. J. TRANSNAT'L L. 969 (1989).

271. 8 HALSBURY'S LAWS OF ENGLAND 482 (4th ed. 1974). Three general exceptions to enforcement in the English courts exist: (1) judgments obtained by fraud; (2) judgments contrary to public policy; and (3) judgments rendered in proceedings contrary to natural justice. *Id.* at 480-82. Because no fraud exists in the raised hypothetical, the first exception poses no problem. Also, because United States law is based on the English common law, natural justice should not prevent enforcement in the hypothetical. Finally, judgments contrary to public policy are rare and unlikely in the described situation. *See* Ram, *Reciprocal Recognition of Foreign Country Money Judgments: The Canada-United States Example*, 8 MAN. L.J. 473, 490 n.110 (1977) (stating that no Canadian court had yet invalidated a foreign judgment because it was contrary to public policy).

272. 8 HALSBURY'S LAWS OF ENGLAND, *supra* note 271, at 477.

273. *Id.* A defendant who appears to plead on the merits, but contests the jurisdiction of the court, is deemed to have voluntarily appeared; a defendant who appears to contest the court's jurisdiction only, however, has not voluntarily appeared. *Id.*

274. *Id.* at 476.

275. *Id.* at 479. Under the laws of the United States, a court in the United States does not have jurisdiction over a foreign entity merely because that entity owns property in the United States. *See* Shaffer v. Heitner, 433 U.S. 186 (1977).

276. 8 HALSBURY'S LAWS OF ENGLAND, *supra* note 271, at 479.

United States bankruptcy court's decision will be enforced in England, regardless of whether the parent contests the court's jurisdiction over it. A more difficult situation arises if the parent does not appear at the bankruptcy proceeding. By piercing the corporate veil, the court necessarily decides that the parent is carrying on business in the United States, which satisfies the English court's requirement for jurisdiction. The parent, however, can claim that piercing the corporate veil in this situation is contrary to public policy in England and that the United States judgment, therefore, is unenforceable.[277]

This public policy defense may not be viable under current English law. Under the Companies Act of 1985, a company is a subsidiary if the parent corporation is a member of the subsidiary and controls the composition of its board of directors or holds over half of the nominal value of the subsidiary's share capital.[278] Both the requirements of the Companies Act are satisfied if the parent wholly owns the subsidiary. Further, under the treaty establishing the EEC,[279] the conduct of a subsidiary is imputed to its parent regardless of whether the parent wholly owns the subsidiary or whether the subsidiary has its own separate legal personality.[280] While the United States is not a member of the treaty, the treaty shows that imputing a subsidiary's liability to the parent is not so contrary to the public policy of England that it warrants nonenforcement of a United States judgment.

2. France

The requirements to enforce a foreign judgment in France vary somewhat from those in England. To enforce a foreign judgment in France, the judgment creditor must first apply for and receive *exequatur* by a French court.[281] Before 1964, when a party applied for *exequatur* in a French court, the court could exercise *révision au fond* or review the merits of the foreign judgment.[282] The *Cour de cassation* abolished *révi-*

277. *See supra* note 271 (explaining that if the foreign judgment is contrary to public policy, it will not be enforced in England). While this is an extremely narrow defense, if the English court accepts the defense in this situation, the judgment rendered by the United States court is meaningless.

278. Companies Act, 1985, ch. 6, § 736.

279. The EEC was established by the Treaty of Rome, *done* Mar. 25, 1957, 298 U.N.T.S. 11.

280. 7(1) HALSBURY'S LAWS OF ENGLAND, *supra* note 271, at 588.

281. TRANSNATIONAL CONTRACTS, *supra* note 267, § 10.01. *Exequatur* is the formal means to get a foreign judgment recognized and enforced in France. *Id.*

282. *Id.* § 10.02.

sion au fond in the case of *Munzer v. Munzer*.[283] The *Cour de cassation* broadened the basis for the recognition of foreign judgments in France in the recent decision of *Fairhurst v. Simitch*.[284] The court held:

> Whenever the French rule on conflicts of jurisdictions does not give exclusive jurisdiction to the French courts, the foreign court must be recognized as having jurisdiction if the dispute has a significant connection with the country of the judge to whom the case was submitted and if the selection of the court in question was not made with fraudulent intent.[285]

The significant connection test is satisfied by looking at the jurisdictional basis of the foreign court that rendered the decision even though the basis is unknown to French law.[286] If the foreign court has jurisdiction under its local law, the French courts will recognize the foreign court's judgment unless French law gives French courts exclusive jurisdiction.

A foreign court must enter a judgment that is both enforceable and final in the forum state before a French court will recognize it.[287] The finality requirement does not require exhausting all remedies, including appeals.[288] So long as the foreign judgment is locally enforceable, the French court can grant *exequatur*.[289] Of course, if an appeal is taken on the foreign judgment, the French court likely will stay the *exequatur* proceedings.[290]

3. Germany

Germany adheres to four mandatory grounds for refusing the recognition or enforcement of a foreign judgment.[291] First, foreign judgments are not recognized when the foreign court lacks international jurisdiction according to German law.[292] The German rules generally allow a court to obtain jurisdiction if the court has "a reasonable connection with the persons or the subject matter of the litigation."[293] Second, German courts

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283. Judgment of Jan. 7, 1964, *cited in* TRANSNATIONAL CONTRACTS, *supra* note 267, § 10.02. The *Cour de cassation* is the supreme judicial tribunal in France.

284. Judgment of Feb. 6, 1985, Cass. civ. 1re, 1985 D.S. Jur., Informations Rapides 497, *cited in* LAW AND PRACTICE, *supra* note 267, § 7.02.

285. Judgment of Feb. 6, 1985, *translated in* LAW AND PRACTICE, *supra* note 267, § 7.02.

286. *Id.*

287. TRANSNATIONAL CONTRACTS, *supra* note 267, § 10.04.

288. *Id.*

289. *Id.*

290. *Id.*

291. U. DROBNIG, *supra* note 267, at 350.

292. *Id.*

293. *Id.*

must deny enforcement of a foreign judgment when recognition of the foreign judgment is contrary to German public policy.[294] These first two grounds parallel those in other states, including England and France. Third, nonrecognition occurs while the foreign judgment is still subject to appeal in the foreign courts.[295]

The final reason for nonenforcement is based on a lack of judicial reciprocity.[296] This is a unique requirement of German law. Although the German courts have relaxed the reciprocity requirement in recent years, it remains the major factor in denying recognition of foreign judgments in Germany.[297] German courts assume the existence of reciprocity if parties seeking recognition and enforcement of German judgments in the foreign state do not meet greater difficulty than the obstacles imposed by German courts in the converse situation.[298] Reciprocity for the particular class of judgment at issue, rather than total reciprocity of all German judgments, suffices.[299]

Reciprocity is probably the greatest stumbling block to enforcement of a foreign environmental bankruptcy decision in Germany. Even if jurisdiction and public policy concerns are overcome, reciprocity may hinder enforcement. An issue might arise as to whether a state court, or even a federal court, in the United States would enforce a German judgment that sought to claim assets of a United States corporation after its subsidiary filed for bankruptcy because it could not pay for the costs of environmental cleanup imposed under German law. A German court, lacking any case precedent, may refuse enforcement of the United States claim on reciprocity grounds.

4. Summary

Judgment creditors encounter difficulties in enforcing judgments against a foreign corporation in an environmental bankruptcy situation. First, the creditor must prove that the United States court had proper jurisdiction over the parent corporation. If the parent does no business in the forum state, then the creditor must hope that the foreign courts recognize the concept of piercing the corporate veil. Even if a court does recognize this doctrine, as the English courts do, then the creditor must hope that the public policy of the foreign state does not sway the foreign

294. *Id.* at 351.
295. *Id.*
296. *Id.*
297. *Id.*
298. *Id.* at 353.
299. *Id.*

court from recognizing the foreign judgment. If the foreign state prefers corporate prosperity over environmental sterility, then it can refuse to enforce the judgment on public policy grounds. Even if the judgment creditor convinces the foreign court of its position on the jurisdictional and public policy grounds, it still must overcome local rules, such as *révision au fond* and reciprocity. The odds are stacked against a judgment creditor seeking to enforce its judgment abroad.

VI. CONCLUSION

Although this Note deals with a hypothetical situation—the problem of a multinational corporation creating a subsidiary which dumps toxic waste—the environmental and policy concerns that it raises are matters that the United States, and the rest of the world, must face in the near future. Unanswered questions coupled with splits of authority, even between United States bankruptcy courts, exhibit the minimal attention paid to environmental bankruptcy issues by the leaders of the United States.

Four years have elapsed since the United States Supreme Court decision in *Midlantic*, yet neither the United States Congress nor the Supreme Court have cleared up the conflicting interpretations of that opinion. One state may obtain an administrative expense priority for cleaning up a corporation's toxic waste, leaving the corporation's other creditors penniless; meanwhile, a court in a neighboring state may not grant such a priority and that state must force its taxpayers to pay the cleanup bill. Perhaps this policy decision is best left to the legislatures rather than to the courts,[300] but no state legislature has acted to resolve this controversy.

Courts continue to apply traditional corporate veil piercing theory to environmental bankruptcy matters despite the fact that some learned commentators advocate expanding the parent corporation's liability, especially to the involuntary creditor. Again, state legislatures may best decide this policy decision, but to date no state has expanded the veil

300. Justice O'Connor's concurring opinion in *Ohio v. Kovacs* left open the possibility that state law can determine the state's interest in the assets of the estate. 469 U.S. 274, 285-86 (1985) (O'Connor, J., concurring). O'Connor asserted that the state could "protect its interest in the enforcement of its environmental laws by giving cleanup judgments the status of statutory liens or secured claims." *Id.* at 286. None of the other eight Justices, however, joined Justice O'Connor's opinion, although Justice Rehnquist did mention O'Connor's concurrence with approval in his dissent in Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 494 U.S. 494, 517 (1986) (Rehnquist, J., dissenting). Hence, another question in an environmental bankruptcy left unanswered is whether a state can fix its own priority status in a bankruptcy proceeding to enforce its environmental laws.

piercing doctrine through legislative efforts. Furthermore, the United States Congress has not taken any steps to resolve this matter in federal CERCLA cases.

In an age when environmental issues gather a great deal of attention, politicians are turning their back on an expanding environmental threat. When a parent corporation creates a subsidiary simply to avoid exposure to environmental laws and fines, courts should pierce the corporate veil. Current United States law, however, lacks this clarity. Legislatures are not the only accountable parties. The courts created the veil piercing doctrine, so they should feel no constraint in expanding the doctrine as necessary to do justice. Nobody likes to live in a polluted environment; it adds an inexcusable insult to injury when taxpayers pay to clean up a toxic mess simply to enrich a major corporation and its shareholders.

Internationally, the United States cannot expound universality in bankruptcy proceedings and then practice territoriality to benefit local creditors. The leaders of the United States need to work with the heads of other states to develop reciprocity agreements, both in and out of bankruptcy proceedings. With the globalization of international trade, it is ridiculous that the enforcement of United States judgments abroad hinges upon the home state of the multinational corporation. Reciprocity agreements are vital to limit the uncertainty faced in dealing with foreign trading partners.

The globalization of trade between companies and states makes it necessary for states to work together to create a worldwide system that balances the interests of both corporations and consumers. Environmental waste is a problem that will not disappear; only a unified multinational effort can place the costs of its disposal on the rightful parties.

Rick Monte Reznicsek