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***Duke Energy Florida* and Pre-CERCLA Indirect Liability**

*By Chase R. Raines**

The U.S. Court of Appeals for the Sixth Circuit's recent decision in Duke Energy Florida LLC v. FirstEnergy Corp. illustrates that indirect liability can be a very challenging legal theory to pursue when the alleged conduct violating CERCLA occurred prior to CERCLA's 1980 enactment. The author of this article discusses the decision and its lessons.

In *United States v. Bestfoods*, the U.S. Supreme Court clarified the law governing when the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA") liability of a subsidiary corporation can be imposed upon a parent company.¹ Under *Bestfoods*, such liability can be imposed *directly* when parent company sufficiently controls the operations of a subsidiary, and *indirectly* when the parent's corporate veil can be pierced. However, as the U.S. Court of Appeals for the Sixth Circuit's recent decision in *Duke Energy Florida LLC v. FirstEnergy Corp.* illustrates, indirect liability can be a very challenging legal theory to pursue when the alleged conduct violating CERCLA occurred prior to CERCLA's 1980 enactment.²

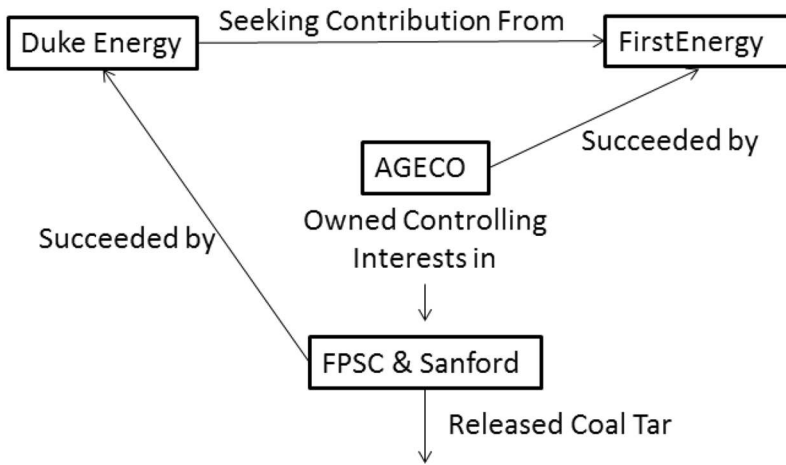
THE DUKE ENERGY CASE

Duke Energy involved the release of coal tar by two Florida manufactured gas plants in violation of CERCLA from 1929–1943. The two entities involved, Florida Public Service Company ("FPSC") and Sanford Gas Company, were at the time owned by Associated Gas & Electric Company ("AGECO"). Subsequently, FPSC and Sanford were succeeded by Duke Energy Florida LLC, while AGECO was succeeded by FirstEnergy Corp. After Duke Energy undertook a cleanup of contamination caused by FPSC and Sanford, it sought contribution under CERCLA from FirstEnergy in its role as AGECO's corporate successor. These relationships are illustrated in the diagram below:

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¹ 524 U.S. 51, 118 S. Ct. 1876, 141 L. Ed. 2d 43 (1998).

² No. 17-3024, 731 Fed. Appx. 385, (6th Cir. Apr. 10, 2018).



In Duke Energy’s appeal before the Sixth Circuit, the issue was whether FirstEnergy was a potentially responsible party under CERCLA as a successor to AGECO. Duke Energy sought to prove FirstEnergy’s liability by arguing that there was indirect liability under *Bestfoods*—that is, that it was permissible to pierce the corporate veil between FPSC and Sanford and their parent AGECO. If such veil-piercing were successful, FirstEnergy could be held liable for the actions of the subsidiaries which were undoubtedly in violation of CERCLA.

The Sixth Circuit evaluated this veil piercing question under Florida law because that was the place where the alleged injury occurred. Florida’s veil piercing test, like the test of many other states, has two main prongs: (1) whether the parent dominated and controlled the subsidiary; and (2) whether that domination and control was for a fraudulent or improper purpose.

As to the first prong, domination and control, the court found that it was clearly satisfied. Applying Florida’s veil-piercing factors, the court found both that AGECO owned controlling stakes in both FPSC and Sanford and that shared officers and board members among the corporate entities was so rampant that “the sheer extent of overlap causes concern.”

However, it was the extent to which FPSC and Sanford could operate independently which raised the “greatest concern” under the first veil-piercing prong. The court described AGECO as a notorious “empire” of public utility companies run by the “iconic felon” Howard Hopson. Everything was run from Hobson’s New York office and the two subsidiaries lacked basic materials in

their Florida locations such as records of the monies they had borrowed. The boards and officers of the entities did not operate independently, such that a board member of both AGECO and FPSC stated that he could not “divide himself up” during transactions between the two entities. The two subsidiaries also did not act distinctly from one another, with their two boards approving management agreements with another AGECO entity on the same day, at the same location, within 30 minutes of each other, and using identical language.

Although there was a clear lack of corporate distinctions and formalities sufficient to satisfy the first prong, the Sixth Circuit found that the second, improper purpose, prong was not satisfied. Primarily, the court did not find sufficient evidence of the “subjective motivation” of AGECO leadership to use the subsidiaries to undertake an improper purpose of violating environmental laws or “cutting costs at the expense of the environment.” The court was influenced by the fact that CERCLA and analogous environmental laws did not exist during the 1929–43 violation period, so AGECO executives could not have been subjectively aware they were violating applicable laws. Further, evidence of the knowledge of AGECO executives in general was so sparse that the court could not determine whether they were even aware of “the environmental costs of their business model.” Therefore, the Sixth Circuit held that AGECO’s corporate veil could not be pierced and thus that it could not be held indirectly liable for the subsidiaries’ CERCLA violations.

LESSONS ON INDIRECT LIABILITY UNDER CERCLA

The Sixth Circuit’s decision illustrates two contrasting points related to the two prongs of the veil piercing test: (1) a clear example of how not to operate a parent corporation under the first prong; and (2) a demonstration of the difficulties in proving the second prong in cases where CERCLA-violating-actions occurred before CERCLA was enacted.

Under the first prong of the veil-piercing test, a clear lesson from *Bestfoods* and its progeny is that corporate formalities matter. There are some concrete steps that corporations can take to avoid indirect liability, such as maintaining separate boards, avoiding dual officers with the appearance of acting on behalf of the parent company, and giving subsidiaries the resources necessary to operate independently. Here, it was clear that AGECO followed none of those important steps, other than providing that the subsidiaries were adequately capitalized. Had AGECO taken even some of these precautionary formalities, the first prong would have been a close question and might even have been decided in AGECO’s favor.

Despite AGECO’s clear blunders related to the first veil-piercing prong and even its status as the “poster child for the abusive practices of certain public utility holding companies,” FirstEnergy was nonetheless saved from indirect

CERCLA liability because of the difficulty in proving subjective bad intent under the second prong. One important factor for the Sixth Circuit was that the “waste was released decades before most major environmental legislation, including CERCLA, was passed.” This factor could be applied to any pre-CERCLA releases, and amounts almost to a presumption against there being an improper purpose behind releases of contaminants before such releases were regulated under environmental laws. For the many CERCLA claims stemming from older releases, then, there must be some other evidence of improper purpose because it will be impossible to prove subjective awareness of violating non-existent environmental laws.

However, *Duke Energy* also illustrates that such other evidence of improper motive is not easy to obtain. Particularly because pre-CERCLA releases necessarily involve conduct that is decades-old, there will almost certainly be a relative lack of evidence compared to most complex litigations. In *Duke Energy*, for example, the available evidence was insufficient even though a special master had conducted an investigation of AGEKO around the same time and a contemporaneous court decision had analyzed a corporate veil piercing question between AGEKO and FPSC. This lack of evidence is compounded by the fact that subjective motivation is difficult to establish in any context, and that an improper purpose is simply less likely to exist when laws proscribing the conduct are not yet in existence.

DUKE ENERGY SHOULD NOT BE READ TOO BROADLY

It is important to recognize the limitations of applying the lessons from *Duke Energy* more broadly. For one thing, litigation decisions by the parties eliminated two lines of argument that are commonly raised in CERCLA contribution disputes. First, the parties stipulated that directly liability under *Bestfoods* was not at issue, so this decision should not be read as informing the contours of direct liability law. Second, *Duke Energy* did not pursue an undercapitalization theory on appeal. Such undercapitalization arguments are commonly used to pierce the corporate veil and could represent a way to avoid the challenges in establishing improper purpose based purely on environmental conduct.

Another limitation on extrapolating from this decision is that the court’s holding was largely based on the specific evidentiary issues of this case. The Sixth Circuit did not hold that proving improper purpose through environmental activities is a fruitless legal theory, but instead that it was not supported by the evidence in this case. Therefore, the takeaway is not that indirect liability is inherently legally difficult pre-CERCLA, but instead that there will often be evidentiary challenges with proving the subjective motivation.

Finally, it is important to remember that there is some variance in veil piercing law between states. While this case was decided under Florida law, it is possible that the decision could have been different in another state. In fact, AGECO's corporate veil was pierced in two New York CERCLA indirect liability cases, although for different subsidiaries.³

CONCLUSION

Duke Energy illustrates some of the challenges in seeking pre-CERCLA indirect liability. These challenges are significant because CERCLA itself applies retroactively and does not discriminate between pre- and post-CERCLA-enactment conduct. Thus, under *Duke Energy*, pre-1980 CERCLA liability may carry additional risks because of the increased difficulty in sharing that CERCLA burden with other potentially liable parties through an indirect liability theory. Organizations should be aware of these challenges, and evaluate CERCLA contribution strategies that can be reasonably supported by what may be limited available evidence.

³ See *N.Y. State Elec. & Gas Corp. v. FirstEnergy Corp. (NYSEG I)*, 808 F.Supp.2d 417, 430 (N.D.N.Y. 2011), *aff'd in part and vacated in part*, *N.Y. State Elec. & Gas Corp. v. FirstEnergy Corp. (NYSEG II)*, 766 F.3d 212, 217 (2d Cir. 2014); *Rochester Gas & Elec. Corp. v. GPU, Inc. (RG&E I)*, No. 00-cv-6369 (W.D.N.Y. Aug. 8, 2008), *aff'd*, *Rochester Gas & Elec. Corp. v. GPU, Inc. (RG&E II)*, 355 F. App'x 547 (2d Cir. 2009). These cases applied New York law, rather than Florida law, and applied to different subsidiaries with different factual circumstances. Additionally, these decisions focused almost exclusively on the first prong, domination and control.