DE FACTO MERGER, FEDERAL COMMON LAW, AND *ERIE*: CONSTITUTIONAL ISSUES IN SUCCESSOR LIABILITY

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For many decades, the Supreme Court has directed that federal courts limit the creation of federal common law, and instead use state common law to fill in the gaps in federal statutes. Contrary to this directive, federal courts have developed rules of corporate successor liability for obligations pursuant to CERCLA and other federal statutes. Although other commentators have explored this inconsistency, none have taken the position that the creation of federal common law preempts state corporate de facto merger analysis. This Article discusses the Erie doctrine and federal common law with a focus on the preemption of the state de facto merger doctrine and the resulting impact on mergers and acquisitions. The creation of a federal common law of successor liability implicates the Constitutional requirements of separation of powers, due process, and the direct mandate of the Supreme Court.

I. INTRODUCTION

A. Prologue

Suppose that John operates a sandwich shop that is losing money. John's unsanitary practices have caused several customers to suffer from food poisoning. Cleaning solvents used by John have polluted the land surrounding the sandwich shop, which John rents. John has also harmed his employees, violating their Employee Retirement Income Security Act ("ERISA") rights and discriminating in hiring and promotion practices. John has stolen a secret recipe for salad dressing from a competing restaurant. John formed a corporation, the Sandwich Chef Corp., in hopes of protecting himself from personal liability, and he is the sole shareholder.

Mary and Sue operate a profitable organic grocery store on the same block as the Sandwich Chef. Mary and Sue own all of the stock of Organic Corp., which owns the store. Mary and Sue want to eliminate the Sandwich Chef, and replace it with a healthier eating establishment. John is more than willing to sell out to avoid the various creditors and suppliers that are hounding him, and decides to retire.

If the two business corporations are merged, Mary and Sue know that Organic Corp. could be liable for the various obligations of the Sandwich Chef. To avoid this liability, they structure their acquisition as an asset purchase. Organic buys the pizza ovens, tables, chairs, and most of the equipment of the Sandwich Chef. Organic negotiates with the landlord to take over the lease, and retains most of the Sandwich Chef's employees, including the night supervisor. After a strenuous retraining program for the employees, and a thorough cleaning of John's facility, Organic opens the Heavenly Haven organic calzone and sandwich shop, to rave reviews.

Within weeks after opening, numerous suits are filed against Organic Corp. by creditors of the Sandwich Chef.

Several of the actions are filed in federal court, including a suit by the landlord seeking contribution for environmental cleanup under the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") and suits by former employees for violations of Title VII, ERISA and Americans with Disabilities Act ("ADA"). State law de facto merger analysis is employed by the state court in the actions by suppliers and the trade secret case. Organic is not liable in these actions, because Organic does not have the same shareholders as the Sandwich Chef. The federal court, however, applies federal common law, not only when a federal statute is involved, but also in diversity actions when the plaintiff is from another state. Organic may be responsible for the liabilities of the Sandwich Chef in federal court, because Organic had notice of the potential claims and operates a restaurant at the same location with the same employees, even though Organic played no role in the actions that harmed the plaintiffs.

This Article discusses the reasons for the different results under federal and state laws, and whether such a difference conforms to the decisions of the Supreme Court. This Article will take the position that this potential forum shopping, where a plaintiff may receive a more favorable result in federal rather than state court, is the sort of injustice sought to be prevented by the court's decision in *Erie v. Tompkins*.[1]

B. Identification of Inconsistent Successor Liability Results

If corporations merge or engage in a stock purchase or exchange, the successor corporation is generally liable for the obligations of the predecessor.[2] To avoid this assumption of liability, many transactions are structured as asset

[1] Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938).

[2] *See* Smith Land & Improvement Corp. v. Celotex Corp., 851 F.2d 86, 91 (3d Cir. 1988); Town of Oyster Bay v. Occidental Chem. Corp., 987 F. Supp. 182, 198-99 (E.D.N.Y. 1997).

purchases, similar to Organic's purchase of Sandwich Chef.[3] When one corporation acquires the assets of another, the liabilities of the selling corporation are generally not assumed by the buyer.[4] The assets are segregated from the liabilities to facilitate commercial transactions; innocent purchasers are protected from unknown and unbargained-for liabilities.[5]

This Article will explore whether state, rather than federal common, law should determine successor liability in order to prevent unfair imposition of liability on innocent asset purchasers.

Some federal courts have created a federal common law rule of corporate successor liability, imposing liability on an innocent purchaser of the assets of a corporation with liabilities.[6] This is contrary to the Supreme Court decision in *Erie* and other cases, which hold that the creation of federal common law should be limited.[7] Although other commentators have explored this inconsistency, none have taken the position that the creation of federal common law

[3] *See, e.g.*, Holland v. Williams Mountain Coal Co., 256 F.3d 819, 824 (D.C. Cir. 2001) ("Under the traditional rule on corporate successorship liability, a corporation that acquired manufacturing assets from another corporation does not thereby assume the liabilities of the seller.").

[4] *See* Upholsterers' Int'l Union Pension Fund v. Artistic Furniture of Pontiac, 920 F.2d 1323, 1325 (7th Cir. 1990); Aluminum Co. of Am. v. Beazer East, Inc., 124 F.3d 551, 565 (3d Cir. 1997); Vernon v. Schuster, 688 N.E.2d 1172, 1175 (Ill. 1997); Brend v. Sames Corp., No. 00-C4677, 2002 WL 1488877 (N.D. Ill. 2002); United States v. Davis, 261 F.3d 1, 54 (1st Cir. 2001); Polius v. Clark Equip. Co., 802 F.2d 75, 77 (3d Cir. 1986).

[5] *See* Storage and Office Sys., LLC v. United States, 490 F. Supp 2d. 955, 960 (S.D. Ind. 2007) ("If the liabilities always went with the assets, it would be difficult to sell assets because the purchaser would not know what he was getting . . . . Without this rule, the purchaser might find that he inherited hidden liabilities, the cost of which exceeded the value of the asset purchased, yet it would be too late for him to back out of the sale or renegotiate the price.") (citing Chaveriat v. Williams Pipeline Co., 11 F.3d 1420, 1424 (7th Cir. 1993)).

[6] *See, e.g.*, Action Mfg. Co., Inc. v. Simon Wrecking Co., 428 F. Supp. 2d 288, 334 (E.D. Pa. 2006) (deciding that successor liability pursuant to CERCLA should be determined by "uniform federal law").

[7] Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938).

inappropriately preempts state corporate de facto merger analysis.

The creation of federal common law may produce unjust results, because the purchaser, like Organic Corp., may not have participated in the wrongdoing. State laws of successor liability in de facto merger situations have been developed to target asset purchasers who are less innocent and may have played a role in the wrongdoing. These state laws are adequate to govern successor liability of asset purchasers, eliminating the need for the creation of federal common law.

State rules of de facto merger should apply to all liabilities of asset purchasers, including liability pursuant to a federal statute that is silent as to successor liability. When liabilities under these federal statutes are subject to a broader federal rule, innocent purchasers may be unjustly forced to pay for wrongs in which they did not participate. In addition, the uncertainty, disruption of economic transactions, and harm to reasonable investment backed expectations are wasteful and costly to the economy. In this time of heightened merger activity, corporate asset purchasers are entitled to more predictability of potential liabilities than the present decisions have afforded them. It is not always clear whether a state will impose liability based on substantial continuity of the business where there is no continuation of stock ownership. It is even more difficult to ascertain whether a court will impose a broader federal rule. The inconsistency of results hinders business decisions and increases transaction costs. More importantly, lower federal courts should not be permitted to ignore the directions of the Supreme Court and create rules contrary to the Rules of Decision Act. State law is appropriate in both diversity actions in federal court as well as actions brought under federal statutes where the terms of the statutes do not expressly provide for successor liability.

Part C of this section briefly discusses the impact of corporate mergers and acquisitions. Section II addresses the allocation of liability in such transactions. Section III covers the *Erie* Doctrine and the development of federal common law. Section IV discusses the application of federal

common law under federal statutes. Section V includes a comparison of the federal common law of successor liability and the state de facto merger rules. Section VI discusses the courts' interpretation of uniquely federal interests, and Section VII discusses the legal theories supporting or condemning the use of federal common law. Section VIII concludes.

C. Impact of Recent Mergers and Acquisitions

In 2006, the total global value of mergers and acquisitions was reported to be between $3.79 trillion[8] and $4 trillion,[9] an increase of nearly forty percent over the prior year. At the end of the first quarter of 2007, the value of U.S. acquisitions was up twenty-one percent from 2006.[10] According to research firm Dealogic, there were $428.9 billion worth of domestic transactions and $1.13 trillion in global transactions.[11] In the United States alone, the National Venture Capital Association reported that in the first quarter of 2007, there were 832 transactions backed by U.S. venture capital, with a total investment of $7.4 billion.[12]

As a result, cash-rich strategic and financial buyers competed aggressively for acquisitions, buying companies across a wide range of industries including the energy, utilities, retail and financial sectors. Some market analysts anticipate that this trend will continue for at least the next few years, while others expect a downturn based on various economic factors.[13] In one example of the heightened level of merger activity, Oracle Corp., a U.S.-based software company, completed an average of three to four acquisitions per year in the decade leading up to 2006; however, in the

[8] http://www.smallcapinvestor.com/articles/04242007-mergers_acquisitions (last visited Mar. 17, 2008).

[9] Andrew Dolbeck, *M&A Deal Activity in the First Quarter of 2007*, WEEKLY CORPORATE GROWTH REPORT, May 14, 2007, *available at* http://findarticles.com/p/articles/mi_qa3755/is_20070514/ai_n19179544.

[10] *Id.*

[11] *Id.*

[12] *See* http://www.nvca.org/ffax.html, (last visited Mar. 13, 2008).

[13] *See, e.g.*, Dolbeck, *supra* note 9.

two years ending in July 2006, Oracle acquired twenty-two companies.[14] Mergers and acquisitions are an accepted manner of doing business and a common method of expanding a company.

The frequency of mergers and acquisitions is cyclical. The first cycle of merger activity in the United States lasted from 1895 to 1903.[15] During this period, the Standard Oil Company acquired a ninety percent share of the U.S. petroleum refining capacity, achieving economies of scale that may have reduced the cost of production significantly.[16] The second wave of mergers occurred in the 1920s, when electric and gas utility companies were consolidated.[17] The third wave of mergers occurred in the 1960s, when diversification was the goal of corporations intending to avoid the new antitrust laws.[18] The Williams Act, which added to Sections 13 and 14 of the Securities and Exchange Act of 1934, was enacted in 1968 in response to this wave of mergers, which were often the result of tender offers. The 1980s saw bargain hunting for expansion purposes, with many acquirers borrowing funds to pay for the shares of targets in leveraged buyouts.[19] Because the new entities were saddled with significant debt, portions of the businesses were often sold off to raise cash or closed down. The debt load resulted in a wave of bankruptcy filings soon thereafter. The fifth wave of merger activity began in 2003; it involved

[14] *See* China Martens, *Oracle: New Acquisitions Could Focus on Systems Management*, http://www.computerworld.com/action/article.do?command=viewArticleBasic&articleId=9001858 (last visited Feb. 19, 2008).

[15] *See* Bernard S. Black, *The First International Merger Wave (and the Fifth and Last U.S. Wave)*, 51 U. MIAMI L. REV. 799, 800 (2000).

[16] WILLIAM J. CARNEY, MERGERS AND ACQUISITIONS: CASES AND MATERIALS, 3 (Foundation Press 2000).

[17] Black, *supra* note 15, at 800.

[18] THERESE H. MAYNARD, MERGERS AND ACQUISITIONS: CASES, MATERIALS, AND PROBLEMS, 21 (Aspen Publishers 2005).

[19] Black, *supra* note 15, at 800.

larger, more international companies and a greater number of transactions than ever before.[20]

The importance of mergers and acquisitions to the economy cannot be overstated. Although it has been argued that a significant portion of such transactions are not economically beneficial,[21] there is no denying that the transactions have a significant impact on our economy. If acquiring corporations cannot determine with certainty the liabilities and obligations of the target for which they will become responsible, the transaction is less likely to be consummated. The costs of aborting a merger are substantial. For example, in the 2005 sale of Toys "R" Us, Inc., the final bidder estimated out-of-pocket expenses for their due diligence investigation of the seller to be $50 million, and negotiated a termination fee in excess of $247 million, to be paid by Toys "R" Us if it decided to sell to a different bidder.[22] If a transaction is not aborted and is ultimately consummated, the unexpected liability may cause the new entity to fail, with bankruptcy as the result. This waste of assets could be a substantial cost to society. At the very least, the uncertainty caused by the choice of law issues,

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[20] *Id.*; *see also* Richard G. Parker & David A. Balto, *The Merger Wave: Trends in Merger Enforcement and Litigation*, 55 BUS. LAW 351 (1999).

[21] *See, e.g.*, Margaret M. Blair, *Reforming Corporate Governance: What History Can Teach Us*, 1 BERKELEY BUS. L.J. 1 35-36 (2004) ("[T]here is substantial evidence indicating that acquiring companies typically lose money on corporate acquisitions. Meanwhile, there is little or no evidence that takeover targets are poorly performing companies, or that their performance improves after the takeover. Moreover, there is no robust evidence that takeover defenses, such as staggered boards and poison pills, actually impair the performance of companies that have them, nor that they are effective at preventing takeovers. One possible explanation for the absence of clear empirical support for the efficacy of takeovers is that the threat of takeovers actually has a mixed effect on corporate performance. On one hand, takeovers may in some cases discourage wasteful managerial empire-building, but on the other hand, the vulnerability of companies to unwanted takeovers may make it more difficult for corporate managers to foster long-term cooperation and commitment to the corporate enterprise by "team members" other than shareholders.").

[22] *See* In re Toys "R" Us, Inc., 877 A.2d 975 (Del. Ch. 2005).

discussed *infra*, will increase the costs of business transactions by requiring additional warranties by the seller, legal opinions, and escrow provisions to protect the purchaser. These problems would be reduced if courts were consistent in applying familiar state rules of corporate liability, including the de facto merger doctrine, in determinations of successor liability.[23]

II. LIABILITY ALLOCATION IN MERGERS AND ACQUISITIONS

When one corporation purchases the assets of another, the purchaser is generally not liable for the obligations of the seller.[24] There are four exceptions[25] to this general rule, recognized by most states, whereby an asset purchaser may be liable for the obligations of the seller: (1) the purchaser expressly or impliedly agreed to assume the liability;[26] (2) the

[23] Admittedly, eliminating the option of federal common law will not eliminate all choice of law risk for corporate mergers and acquisitions. The Third Circuit decided that de facto merger analysis was outside the scope of the asset purchase agreement, and therefore the parties' choice of law provision was not controlling. *See* Berg Chilling Sys., Inc. v. Hull Corp., 435 F.3d 455 (3d Cir. 2006). The Court applied the law of the state in which the successor corporation was incorporated and the place of performance of the asset purchase agreement. *Id.*

[24] *See* Upholsterers' Int'l Union Pension Fund v. Artistic Furniture of Pontiac, 920 F.2d 1323, 1325 (7th Cir. 1990); Aluminum Co. of Am. v. Beazer East, Inc., 124 F.3d 551, 565 (3d Cir. 1997); Vernon v. Schuster, 688 N.E.2d 1172, 1175 (Ill. 1997); Brend v. Sames Corp., No. 00-C4677, 2002 WL 1488877 (N.D. Ill. 2002); United States v. Davis, 261 F.3d 1, 54 (1st Cir. 2001); Polius v. Clark Equip. Co., 802 F.2d 75, 77 (3d Cir. 1986).

[25] Some states recognize a fifth exception in products liability actions, referred to as the product-line exception, which is not relevant here. *See* Ray v. Alad Corp., 560 P.2d 3 (Cal. 1977).

[26] The first exception, an express or implied assumption of liability, was found satisfied and thus liability imposed on a successor corporation, in *Aluminum Co. of Am. v. Beazer East, Inc.* 124 F.3d at 565. Although the District Court had found a de facto merger, and the transaction was described as a stock swap rather than an asset purchase, the Third Circuit found that the language in the purchase agreement, stating that the asset purchaser "does hereby assume all of the liabilities and obligations of [the seller] of whatsoever nature" was sufficient to impose liability on the asset

purchaser is a mere continuation of the seller;[27] (3) the purchase of assets is deemed to be a fraudulent attempt to avoid such liability;[28] or (4) the transaction is a de facto merger.[29] The second exception—mere continuation, and the fourth—de facto merger, are similar doctrines and most courts use identical analysis in applying these exceptions.[30]

The de facto merger doctrine imposes successor liability on a corporation that acquires the assets of a selling corporation, on the theory that the asset purchase was, in

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purchaser under the first exception. The asset purchaser argued that CERCLA liability was not an obligation of the seller because the seller had dissolved more than three years earlier, and under Delaware law, all liabilities of the seller had ceased to exist. The court found this argument unpersuasive, holding that where "a separate entity has received assets of a dissolved corporation and assumed its corporate liabilities," the successor was liable for the obligations of the dissolved corporation. *Id.*

[27] The second exception – the mere continuation – is determined by five factors: (1) a transfer of corporate assets; (2) for less than adequate consideration; (3) where the buyer continued the business of the seller; (4) both buyer and seller had at least one common officer or director who was instrumental in the transfer; and (5) after the sale, the seller was either legally dissolved or rendered incapable of paying its creditors. *See* Carriero v. Rhodes Gill & Co., 1995 WL 866092, at 3 (D. Mass. 1995); *see also* North Shore Gas Co. v. Salomon, Inc., 152 F.3d 642, 654 (7th Cir. 1998).

[28] The third exception – a fraudulent attempt to avoid liability – is beyond the scope of this Article.

[29] *See* Upholsterers' Int'l, 920 F.2d at 1326; Pfohl Bros. Landfill Site Steering Comm. v. Browning-Ferris of New York, Inc., No. 95-CV-956A(f), 2004 WL 941816, at *8 (W.D.N.Y. 2004); New York v. Nat'l Servs. Indus., Inc., 352 F.3d 682, 685 (2d Cir. 2003); *see also* Ronald G. Aronovsky & Lynn D. Fuller, *Liability of Parent Corporations for Hazardous Substance Releases under CERCLA*, 24 U.S.F.L. REV. 421, 455 (1990) ("CERCLA enforcement should not be hampered by subordination of its goals to varying state law rules of alter ego theory"). Some courts have imposed successor liability in situations beyond the four exceptions, particularly in employee benefit situations. *See, e.g.*, Upholsterers' Int'l., 920 F.2d at 1326 (where the successor had prior notice of the liability, successor liability was imposed).

[30] *See* Berg Chilling Sys., Inc. v. Hull Corp., 435 F.3d 455, 464 (3d Cir. 2006).

essence, a merger.[31] The elements required to find a de facto merger include: (1) a continuity of the selling corporation, evidenced by the same management, personnel, assets, and physical location; (2) a continuity of stockholders, accomplished by paying for the acquired corporation with shares of stock; (3) a dissolution of the selling corporation; and (4) the purchaser's assumption of specified liabilities required to operate the business.[32] There is a split in authority as to whether the second factor – continuity of ownership – is required. Some courts find this to be the most important factor,[33] while other courts have imposed liability even where this factor is lacking.[34]

The creation of a federal common law rule of successor liability in the absence of continuity of ownership is the focus of this Article. States have authority to determine corporate liability as well as corporate formation and other corporate characteristics. States have resolved such issues with some variation. Businesses rely on the state rules to predict successor liability and to avoid the transfer of liability to asset purchasers. The creation and application of a contrary federal rule creates uncertainty, may disrupt the economy, and is also contrary to the *Erie* doctrine, as discussed *infra*.

[31] *See* Schumacher v. Richards Shear Co. Inc., 59 N.Y.2d 239, 245 (N.Y. Ct. App. 1983).

[32] *See* Ladjevardian v. Laidlaw-Coggeshall, Inc., 431 F. Supp. 834, 839 (S.D.N.Y. 1977).

[33] *See* Town of Oyster Bay v. Occidental Chem. Corp., 987 F. Supp. 182, 205 (E.D.N.Y. 1997); Village Builders 96, L.P. v. United States Labs., Inc., 112 P.3d 1082 (Nev. 2005).

[34] *See* Glynwed, Inc. v. Plastimatic, Inc., 869 F. Supp. 265 (D. N.J. 1994) (holding that continuity of ownership is not required, and that the parties' intent to merge rather than merely transfer assets was key); *In re* Asousa Partnership, 2006 WL 1997426, at *8 (stating that "though each of these factors is considered, they do not all have to be present"); *see also* Berg Chilling Systems, 435 F.3d at 469 (rejecting the necessity of stock transfer for de facto merger).

III. THE *ERIE* DOCTRINE AND DEVELOPMENT OF FEDERAL COMMON LAW

This Article is not intended to be an exhaustive history of the *Erie* jurisprudence beginning in 1938. Others have done this admirably.[35] Instead, a brief discussion of only the more recent *Erie* decisions which impact the state corporate law de facto merger doctrine will be included.

Eighty years ago, the Supreme Court in *Erie v. Tompkins* stated, "There is no federal general common law."[36] The Court was concerned with the "injustice and confusion" that could result from forum shopping, where plaintiffs sought out the courts of federal judges more likely to create common law in their favor, and from federal judges "brushing aside the law of a state in conflict with their view."[37] *Erie* has been referred to as both "the very essence of our federalism,"[38] and as an "esoteric procedural technicality."[39] Notwithstanding some differences of opinion, the *Erie* doctrine, whereby the authority of the federal courts to create common law is limited, remains a frequent command of the Supreme Court. This is also consistent with the Rules of Decision Act,[40] which provides that state laws are controlling in controversies decided by federal courts, unless a federal statute applies.

Although the Supreme Court has indicated a preference for the use of state law, there are exceptions where federal

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[35] *See, e.g.*, John Hart Ely, *The Irrepressible Myth of Erie*, 87 HARV. L. REV. 693, 695 (1974) (discussing the substantive/procedural command of *Erie* in light of the Rules of Decision Act and the Rules Enabling Act).

[36] Erie R.R. Co. v. Tompkins, 304 U.S. 64, 78 (1938).

[37] *Id.* at 77-78.

[38] Ely, *supra* note 35, at 695.

[39] Earl C. Dudley, Jr. & George Rutherglen, *Deforming the Federal Rules: An Essay on What's Wrong with the Recent Erie Decisions,* 92 VA. L. REV. 707 (2006) ("*Erie* has apparently been demoted to the role of an esoteric procedural technicality, one whose true meaning is hard to discern and whose application is impossible to predict.").

[40] 28 U.S.C. § 1652 (2006) ("The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.").

law has been created. The Federal Rules of Civil Procedure ("FRCP") were promulgated during the same term as the *Erie* decision, limiting the use of state law in federal courts.[41] The *Erie* doctrine does not prevent application of a federal rule if a question in a diversity suit is covered by a Federal Rule of Civil Procedure, notwithstanding a contrary state rule.[42] In another example of the creation of federal common law, the Court held in the 1943 *Clearfield Trust* case that *Erie* did not apply, and that federal common law governed the rights and duties of the United States pursuant to commercial paper issued by the federal government.[43] Courts and commentators agree that purely procedural issues and controversies where the obligations of the federal government are at issue are appropriate situations for the application of federal law.[44] Substantive determinations regarding the liability of state-chartered corporations are another matter; Rule 17(b) of the FRCP provides that the "capacity of a corporation to sue or be sued shall be determined by the law under which it was organized," indicating Congress' hesitancy to preempt state corporate law.

Although in past decades the Supreme Court has sometimes presumed the creation of federal common law was appropriate, such as in the 1965 *Hanna v. Plumer* decision,[45] Professor Ely explained that this presumption applied only

[41] *See* Dudley & Rutherglen, *supra* note 39, at 728.

[42] *See* Com/Tech Commc'n Tech., Inc. v. Wireless Data Sys., Inc., 163 F.3d 149 (2d Cir. 1998) (holding that counterclaims that would be permitted pursuant to FRCP were allowed even though New York procedure was contrary); *see also* Correia v. Fitzgerald, 354 F.3d 47 (1st Cir. 2003) (applying federal standards for granting a new trial).

[43] Clearfield Trust Co. v. United States, 318 U.S. 363, 366 (1943).

[44] *See, e.g.*, Hanna v. Plumer, 380 U.S. 460, 471 (1965) (stating that "both the Enabling Act and the *Erie* rule say, roughly, that federal courts are to apply state 'substantive' law and federal 'procedural' law . . ."); Gaspirini v. Center for Humanities Inc., 518 U.S. 415, 427 (1996) ("[U]nder the *Erie* doctrine, federal courts sitting in diversity apply state substantive law and federal procedural law.").

[45] Hanna, 380 U.S. at 474.

when the federal rule was at least "arguably procedural."[46] The Court has refined its application of the *Erie* doctrine in more recent decades, generally applying state law to determine substantive issues.[47]

In 1979, the Supreme Court discussed the application of federal common law in *United States v. Kimbell Foods*.[48] In determining the priority of a lien granted to a federal lending agency, the Court decided that federal common law should govern, because the issue involved the rights of the United States arising under a federal program.[49] The Court found "federal interests are sufficiently implicated to warrant the protection of federal law."[50] Once a court determines that federal common law governs, the next step is a determination of whether to adopt the state law as the federal common law, or to fashion a new rule from some other source, with reference to any relevant federal policy or federal statutory mandate.[51] The test imposed by the Court in *Kimbell Foods* to determine whether state law would be adopted as the federal common law included analyzing the following: (1) the need for national uniformity; (2) whether state law would "frustrate specific objectives of the federal program;" and (3) whether federal rules would "disrupt commercial relationships predicated on state law."[52]

The Court found no need for national uniformity because "state commercial codes furnish convenient solutions in no way inconsistent with adequate protection of the federal interests."[53] The Court decided that the issues of federal lien priority "although governed by federal law, do not inevitably

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[46] Ely, *supra* note 35, at 697.

[47] *See id.*; John C. McCoid, *Hanna v. Plumer: The Erie Doctrine Changes Shape*, 51 VA. L. REV. 884 (1965).

[48] United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979).

[49] *Id.* at 726.

[50] *Id.* at 727.

[51] *Id.*; *see also* Thomas W. Merrill, *The Common Law Powers of Federal Courts*, 52 U. CHI. L. REV. 1 (1985).

[52] Kimbell Foods, 400 U.S. at 728.

[53] *Id.*

require resort to uniform federal rules."[54] The Court held that state law would be incorporated as the federal common law to determine priority.

In some cases, the Court has limited federal court rulemaking authority. For example, in the 1980 case *Northwest Airlines v. Transport Workers Union of America*, the Court decided that there is no federal common law right to contribution under Title VII of the Civil Rights Act.[55] The Court did not deny that federal common law existed, admitting "Although it is much too late to deny that there is a significant body of federal law that has been fashioned by the federal judiciary in the common law tradition, it remains true that federal courts, unlike their state counterparts, are courts of limited jurisdiction that have not been vested with open-ended lawmaking powers."[56] The Court refused to create federal common law to alter the rights and obligations expressed in the statute.[57]

That same year, the Court decided in *Texas Industries, Inc. v. Radcliff Materials, Inc.*[58] that federal courts lack the authority to formulate common law rules of contribution for violation of the Sherman and Clayton Acts. The Court recognized two categories of determinations wherein federal common law may be authorized, "those in which a federal rule of decision 'is necessary to protect uniquely federal interests' . . . and those in which Congress has given the courts the power to develop substantive law . . . ."[59] The Court described "uniquely federal interests" as "such narrow areas as those concerned with the rights and obligations of the United States, interstate and international disputes implicating the conflicting rights of States or our relations

[54] *Id.* at 729.

[55] Nw. Airlines, Inc. v. Transp. Workers Union of Am., 451 U.S. 77 (1980).

[56] *Id.* at 95.

[57] *Id.*

[58] Texas Indus., Inc. v. Radcliff Materials, Inc., 451 U.S. 630, 640 (1981).

[59] *Id.*

with foreign nations, and admiralty cases."[60] The Court subsequently limited the application of the "uniquely federal interest" test when a federal statute can be interpreted to control the issue in its 1988 decision in *Stewart Org. Inc. v. Ricoh Corp.*[61] The Court held that because a federal statute determined forum selection, there was no need to create federal common law.[62]

One area where the Supreme Court has allowed the creation of federal common law is where a federal statute can be interpreted to expressly or impliedly grant such power to the federal courts.[63] The policy supporting the legislation and its legislative history may provide such authority.[64] Where no such authority can reasonably be implied, and a federal statute is silent as to the issue in dispute, the Court has consistently ruled that state law governs.[65]

While the Supreme Court has become more restrictive in using federal common law, some lower federal courts have become more willing to do so when determining liability under federal statutes, even when such authority is not expressly granted in the statute, thereby broadening the reach of "uniquely federal interests."[66] Lower federal courts

[60] *Id.* at 640-41.

[61] Stewart Org., Inc. v. Ricoh Corp., 487 U.S. 22 (1988).

[62] *Id.* at 28-29.

[63] Textile Workers Union v. Lincoln Mills, 353 U.S. 448, 457 (1957).

[64] *Id.*

[65] *See, e.g.*, O'Melveny & Myers v. Fed. Deposit Ins. Corp., 512 U.S. 79 (1994) (finding that the federal statutory scheme did not address the issue in detail and that state law governs as to the imputation of corporate officers' knowledge of fraud).

[66] *See, e.g.*, Georgia Power Co. v. 54.20 Acres of Land, 563 F.2d 1178, 1189-91 (5th Cir. 1977) (finding that provisions of the Federal Power Act and its legislative history justified the use of federal common law to determine the appropriate compensation in a condemnation action by a utility company), *overruled in part by* Georgia Power Co. v. Sanders, 617 F. 2d 1112 (5th Cir. 1980); Acushnet River & New Bedford Harbor Proceedings re Alleged PCB Pollution, 716 F. Supp. 676, 681 (D. Mass. 1989); *see also* Dudley & Rutherglen, *supra* note 39 at 707 ("*Erie* has apparently been demoted to the role of an esoteric procedural technicality, one whose true meaning is hard to discern and whose application is

have created and applied federal common law even when the provisions of a federal statute are silent, such as in determinations of corporate successor liability.[67] The need for uniformity is often given as a reason for this action.[68] When the defendant is a purchaser of assets of a corporation with liabilities, the application of federal law to determine successor liability, instead of the application of state law to determine whether the asset purchase was a de facto merger, is troubling. Congress has allocated corporate governance to the states and has not exercised authority in this area. Because corporations are creatures of state law, it could be argued that state law should determine successor liability, as other aspects of corporate governance, creation, and regulation are so determined. Another reason for the use of state law was stated by the Supreme Court in *United States v. Kimbell Foods*: "In structuring financial transactions, businessmen depend on state commercial law to provide the stability essential for reliable evaluation of the risks involved."[69] Further, states differ on the relevant elements required to find a de facto merger, and the fiction of a national standard is in conflict with the *Erie* doctrine.

The Supreme Court has issued a long line of decisions, starting with *Erie*, providing that state common law should govern controversies that are beyond the scope of federal statutes, and that preemption by federal common law should be the exception, and not the rule.[70] The reasons provided

impossible to predict."); Rodney B. Griffith & Thomas M. Goutman, *A Hiccup in Federal Common Law Jurisprudence:* Sosa, Bestfoods, *and the Supreme Court's Restraints on Development of Federal Rules of Corporate Liability*, 14 U. MIAMI BUS. L. REV. 359, 411 (2006) ("During those thirty or more years, lower federal courts have shown a great willingness to use common law analysis.").

[67] *See, e.g.*, United States v. Gen. Battery Corp., 423 F.3d 294 (3d Cir. 2005) (finding that Comprehensive Environmental Response Compensation and Liability Act (CERCLA) requires a uniform federal standard).

[68] *Id.*

[69] United States v. Kimbell Foods, Inc., 440 U.S. 715, 739 (1979).

[70] In a recent departure from this trend, the Court in *Sosa v. Alvarez-Machain* decided that the Alien Tort Statute provides jurisdiction in the

for such decisions include the autonomy and independence of the states,[71] separation of powers,[72] and a lack of conflict between state law and federal policy.[73] Lower federal courts have reached inconsistent conclusions when deciding whether Congress has granted authority to the federal courts to create federal common law to implement certain federal statutes, but the majority of Circuit Courts of Appeal are much more willing than the Supreme Court to create federal common law.[74] These courts are not always clear about whether they are creating and applying federal common law because of a "uniquely federal interest," as identified in *Texas Industries*,[75] or because a congressional grant of power can be implied in a federal statute or its legislative history. The Supreme Court has sanctioned the creation of federal

federal courts for actions brought by aliens for violations of international law, and that federal courts have authority to create federal common law to supplement international law. 542 U.S. 692 (2004). *See generally* Griffith & Goutman, *supra* note 66 at 361 ("For more than fifty years, the Supreme Court has endeavored not only to limit development of federal common law but also lower federal courts' use of common law analysis.").

[71] *See, e.g.,* Erie R.R. Co. v. Tompkins, 304 U.S. 64, 78 (1938) (recognizing that the Constitution protects the autonomy and independence of the states, thereby limiting federal general common law).

[72] *See, e.g.,* Atherton v. Fed. Deposit Ins. Corp., 519 U.S. 213, 218 (1997) (holding that it is up to Congress, not the federal courts, to displace state law).

[73] *See, e.g.*, United States v. Bestfoods, 524 U. S. 51, 63 (1998) ("[I]n order to abrogate a common-law principle, the statute must speak directly to the question addressed by the common law."); O'Melveny & Myers v. Fed. Deposit Ins. Corp., 512 U.S. 79, 87 (1994) (requiring the plaintiff to prove that a "concrete federal policy or interest . . . is compromised" by the application of state common law); *see also* Martha A. Field, *Sources of Law: The Scope of Federal Common Law*, 99 HARV. L. REV. 883, 983 (1986) ("[F]ederal law can apply whenever federal interests require a federal solution.").

[74] *See* Ronald H. Rosenberg, *The Ultimate Independence of the Federal Courts: Defying the Supreme Court in the Exercise of Federal Common Law Powers*, 36 CONN. L. REV. 425 (2004) (discussing the Federal Circuit's recent willingness to apply federal common law and the Supreme Court's propensity to overturn these decisions).

[75] Texas Indus., Inc. v. Radcliff Materials, Inc., 451 U.S. 630, 640 (1980).

common law when so implied. For example, the Court interpreted Section 301(a) of the Labor Management Relations Act[76] as "granting jurisdiction over defined areas of labor law but also as vesting in the courts the power to develop a common law of labor-management relations within that jurisdiction."[77] The Court acknowledged that some issues "will lie in the penumbra of express statutory mandates."[78] Lacking an "express statutory mandate," such issues can be resolved by "looking at the policy of the legislation."[79] In *City of Milwaukee v. Illinois*, the Court noted that "we have not hesitated to find preemption of state law, whether express or implied, when Congress has so indicated . . . ."[80]

The underlying question is whether federal courts have the authority to create federal common law in the absence of clear direction from Congress. As the Supreme Court stated in *City of Milwaukee*, "federal courts, unlike state courts, are not general common-law courts and do not possess a general power to develop and apply their own rules of decision."[81] The authority to displace state law does not reside in the federal judiciary, but in Congress.[82] This is mandated by the Rules of Decision Act.[83] In *City of Milwaukee*, the Court described the federal common law as a "necessary expedient," in those "few and restricted instances" where

[76] 29 U.S.C. § 185(a) (2006).

[77] Texas Indus., Inc., 451 U.S. 630 at 642-43; *see also* Textile Workers Union v. Lincoln Mills, 353 U.S. 448 (1957).

[78] Lincoln Mills, 353 U.S. at 457.

[79] *Id.*

[80] City of Milwaukee v. Illinois, 451 U.S. 304, 316 (1981).

[81] *Id.* at 312. *See* Storage and Office Sys., LLC v. United States, 490 F. Supp. 2d 955 (S.D. Ind. 2007).

[82] City of Milwaukee, 451 U.S. at 313. *See also* Hart, *The Relations Between State and Federal Law*, 54 COLUM. L. R. 489, 497 (1954) (cited by the Court in *City of Milwaukee* and discussing how it is only statutory authority, not judicial authority that can displace state law).

[83] 28 U.S.C. § 1652 (2002) ("The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.").

Congress has not spoken and where "there exists a significant conflict between some federal policy or interest and the use of state law."[84] This begs the question of how federal policy is determined if Congress is silent and federal courts lack the authority to create policy. This ambiguity has opened the door for the lower federal courts to find substantial areas of state common law to be in conflict with federal policy. Because *City of Milwaukee* involved the preemption of federal common law by a federal statute, the Court did not reach the issue of how a federal policy is created.[85]

The Ninth Circuit in *Atchison, Topeka & Santa Fe Railway Co. v. Brown & Bryant, Inc.* accused courts of "creat[ing] conflicts and uncertainties" in the common law of successor liability as an excuse to create federal common law.[86] There is no such indication by Congress that federal law should be created to define the limits of successor liability or the reach of the de facto merger doctrine.

In some cases, the Court has referred to federal common law as the appropriate governing rule, yet adopted state law as the applicable federal common law.[87] This is mandated by the Rules of Decision Act.[88] In other cases, the Court has insisted that state law, and not federal common law, would govern.[89] The result in these situations may have subtle differences, but for the purposes of successor liability pursuant to the de facto merger doctrine, either analysis will reach the same conclusion and have the same impact. The

[84] City of Milwaukee, 451 U.S. at 313 (quoting Wallis v. Pan Am. Petroleum Corp., 384 U.S. 63, 68 (1966)).

[85] *Id.* at 315.

[86] Atchison, Topeka & Santa Fe Ry. Co. v. Brown & Bryant, Inc., 159 F.3d 358, 363 n.5 (9th Cir. 1997).

[87] *See* United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979).

[88] 28 U.S.C. § 1652 (2006) ("The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.").

[89] *See, e.g.*, O'Melveny & Myers v. Fed. Deposit Ins. Corp., 512 U.S. 79 (1994) (finding a uniform federal rule unnecessary because, among other things, it would disrupt commercial relationships predicated on state law).

opposite result, where a federal common law is created that is contrary to state law, and therefore in conflict with the Rules of Decision Act, is the concern here.

In *Kamen v. Kemper Financial Services, Inc.*, decided in 1991, the Supreme Court determined that state law would be adopted as the federal common law.[90] The form of shareholder demand for a derivative action was deemed to be a traditional state law matter, even though the claim was brought under a federal statute, the Investment Company Act of 1940.[91] The Court held:

> [W]here a gap in the federal securities laws must be bridged by a rule that bears on the allocation of governing powers within the corporation, federal courts should incorporate state law into federal common law unless the particular state law in question is inconsistent with the policies underlying the federal statute.[92]

Referring to the third *Kimbell Foods* factor above, the Court noted that, "[T]he presumption that state law should be incorporated into federal common law is particularly strong in areas in which private parties have entered legal relationships with the expectation that their rights and obligations would be governed by state-law standards . . . . [C]orporation law is one such area."[93] Although *Kamen* involved governing powers within the corporation, the argument could be equally applied to corporate successor liability rules.

In 1994, the Supreme Court once again declined to apply federal common law in *O'Melveny & Myers v. Federal Deposit Insurance Corp.*[94] The Court held that the cases where

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[90] Kamen v. Kemper Financial Servs., Inc., 500 U.S. 90 (1991).

[91] *Id.* at 107.

[92] *Id.* at 108.

[93] *Id.* at 98.

[94] O'Melveny, 512 U.S. 79 at 87-88 ("Such cases are, as we have said in the past, 'few and restricted' . . . limited to situations where there is a 'significant conflict between some federal policy or interest and the use of state law . . . .' Our cases uniformly require the existence of such a conflict as a precondition for recognition of a federal rule of decision . . . . Not only

federal common law should be applied are "few and restricted," and that federal common law is appropriate only when there is a conflict between a federal policy and the use of state law.[95] The plaintiff argued that uniformity was a valid reason to apply federal, rather than state law, to avoid duplicative and inefficient state-by-state research, and to reduce the inherent uncertainty caused by states reaching differing conclusions. The Court responded that "if the avoidance of those ordinary consequences qualified as an identifiable federal interest, we would be awash in 'federal common law' rules."[96] The Court cautioned against "the runaway tendencies of 'federal common law' untethered to a genuinely identifiable (as opposed to judicially constructed) federal policy."[97] The Court then applied state law to determine whether the knowledge of corporate officers could be imputed to a savings and loan company.[98]

State law was controlling in the 1996 Supreme Court decision in *Gaspirini v. Center for Humanities, Inc.*[99] The Court reiterated the long-held rule that federal courts sitting in diversity actions apply state substantive law and federal procedural law.[100] The Court acknowledged the challenges inherent in classifying law as substantive or procedural.[101] Although the FRCP would apply regardless of contrary state law, the Court explained that federal courts interpret the

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the permissibility but also the scope of judicial displacement of state rules turns upon such a conflict . . . .") (internal citations omitted).

[95] *Id.* at 87-88.

[96] *Id.* at 87.

[97] *Id.*

[98] *See* Paul Lund, *The Decline of Federal Common Law*, 76 B.U. L. REV. 895, 925 (1996) (criticizing the *O'Melveny* decision and stating that the court should have concluded that federal law governs).

[99] Gaspirini v. Ctr. for Humanities, 518 U.S. 415 (1996).

[100] *Id.* at 427.

[101] *Id.*; *see also* Hanna v. Plumer, 380 U.S. 460, 472 (1965) ("The constitutional provision for a federal court system . . . carries with it congressional power to make rules governing the practice and pleading in those courts, which in turn includes a power to regulate matters which, though falling within the uncertain area between substance and procedure, are rationally capable of classification as either.").

FRCP "with sensitivity to important state interests and regulatory policies."[102] The Court referred to the "twin aims" of *Erie*, which preclude a federal court from extending a state-created claim, but also preclude a federal court award that would be significantly larger than what would have been obtained in state court in a diversity action.[103] As a result, the Court applied a state standard for excessiveness in a jury award, but followed the federal practice for allocation of responsibility for trial court application.[104]

In analyzing corporate successor liability, courts generally do not rely on the substantive/procedural differentiation, and no decisions were located where a court characterized corporate successor liability as a procedural matter as a justification for the imposition of federal common law. The focus of this Article is not the preemption of state procedural rules by the FRCP, but rather the preemption of fundamental state corporate law principals such as the de facto merger doctrine.

In the year following the *Gaspirini* decision, the Supreme Court in *Atherton v. Federal Deposit Insurance Corp.*, held that state law should determine the negligence standard even when implementing a federal statute.[105] Emphasizing that only Congress, and not the federal courts, has the authority to displace state law, the court stated, "Nor does the existence of related federal statutes automatically show that Congress intended courts to create federal common law rules."[106] The issue in *Atherton* was corporate governance standards of negligence for officers and directors of federally chartered banks.[107] Similarly, corporate successor liability should be governed by state law, absent a federal statute with express contrary provisions.

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[102] Gaspirini, 518 U.S. 415 at 428.

[103] *Id.* at 430-31.

[104] *See* Thomas D. Rowe, *Not Bad for Government Work: Does Anyone Else Think the Supreme Court Is Doing a Halfway Decent Job in its* Erie-Hanna *Jurisprudence*? 73 NOTRE DAME L. REV. 963 (1998).

[105] Atherton v. Fed. Deposit Ins. Corp., 519 U.S. 213, 218 (1997).

[106] *Id.*

[107] *Id.*

It is significant that the Supreme Court in *Atherton* refused to create federal common law to determine the degree of negligence required to impose liability on directors of national banks, and yet several Circuit Courts have been willing to create federal law to determine successor liability issues for state chartered corporations.[108] Although successor liability issues differ from the *Atherton* internal corporate governance issues, they are equally state-specific issues. The *Atherton* Court found the FDIC's argument in favor of a uniform standard unpersuasive, because there are an equal number of federally chartered banks compared to state banks, and therefore a federal standard would not be uniformly applied to all the state banks.[109] Similarly, a federal common law of successor liability for violations of certain federal statutes would not be uniformly applied to all potential liabilities of asset purchasers. For example, a corporation such as Organic Corp. described in the Prologue may be liable for the CERCLA obligations of Sandwich Chef

[108] *See, e.g.*, Town of Oyster Bay v. Occidental Chem. Corp., 987 F. Supp. 182, 199 (E.D.N.Y. 1997) ("With all due respect to the opinions of the Seventh and Ninth Circuits, their conclusions that corporate capacity should be determined on a state-by-state basis undermines the logic that exposure to CERCLA liability should be uniform throughout the country and not dependent upon variations of the states' corporate capacity laws."); Idylwoods Assocs. v. Madar Capital, Inc., 915 F. Supp. 1290, 1304 (W.D.N.Y. 1996) ("state statutes governing the capacity of a dissolved corporation to be sued are preempted by the overall purposes of CERCLA"); AM Properties Corp. v. GTE Prods. Corp., 844 F. Supp. 1007 (D.N.J. 1994) ("CERCLA must preempt state laws governing the capacity of dissolved corporations to be sued."); BASF Corp. v. Central Transport, Inc., 830 F. Supp. 1011 (E.D. Mich. 1993) (CERCLA preempts Michigan law); City and County of Denver v. Adolph Coors Co., 813 F. Supp. 1471 (D. Colo 1992); Travers Bay Area Intermediate School Dist. v. Hitco, Inc., 762 F. Supp. 1298 (W.D. Mich. 1991); United States v. Distler, 741 F. Supp. 643 (W.D. Ky. 1990); United States v. Sharon Steel Corp., 681 F. Supp. 1492 (D. Utah 1987); *c.f.* United States v. SCA Services of Indiana, Inc., 837 F. Supp. 946 (N.D. Ind. 1993) (finding that the state corporate capacity laws were less restrictive than CERCLA; therefore, preemption of Rule 17(b) by CERCLA was not considered). *See also* Joel R. Burcat & Craig P. Wilson, *Post-Dissolution Liability of Corporations and Their Shareholders Under CERCLA*, 50 BUS. LAW. 1273 (1995).

[109] Atherton, 519 U.S. at 220.

but not for its tort liabilities. Second, the *Atherton* court stated "[O]ur Nation's banking system has thrived despite disparities in matters of corporate governance."[110] Our nation's state chartered corporations have similarly thrived despite disparities in the de facto merger doctrine, as interpreted by the various states. The argument that the banks were federally chartered was not controlling because the Court held in 1870 that federally chartered banks are subject to state law.[111] Third, the FDIC referred to the "internal affairs doctrine," whereby only one state should regulate a corporation's internal affairs.[112] The Court found that the doctrine required that the laws of a single state control, not that federal common law preempt.[113] Because the Court found no significant conflict with a federal policy, state law would control.[114] These arguments are also applicable to successor liability issues; the state of incorporation should govern the successor liability of corporations chartered by the state because there is no indication that such a rule would conflict with federal policy.

In 1998, the Court further limited federal common law in *United States v. Bestfoods*, stating that state corporation law should not be replaced by federal common law "simply because a plaintiff's cause of action is based upon a federal statute."[115] The federal statute at issue was the CERCLA.[116] Given that the parent's control of its subsidiary caused the contamination, the issue was the derivative liability of a parent corporation for CERCLA response costs.[117] While the *Bestfoods* Court did not decide whether federal or state law would govern, the Court condemned federal courts using statutory gaps as an excuse to reject state corporate law

[110] *Id.*

[111] *Id.* at 222.

[112] *Id.* at 223-24.

[113] *Id.*

[114] *Id.* at 225.

[115] United States v. Bestfoods, 524 U.S. 51, 63 (1998).

[116] 42 U.S.C.A. § 9601 (2000).

[117] Bestfoods, 524 U.S. 51 at 64.

principles.[118] Some courts have interpreted this dicta to prohibit the further development of federal common law,[119] while other courts have limited *Bestfoods* to veil-piercing cases arising under CERCLA.[120] Some commentators have interpreted *Bestfoods* to indicate a preference for state law absent contrary federal legislative language.[121]

In *Semtek International Inc. v. Lockheed Martin Corp.*, the Court found that the preclusive effect of a federal judgment was governed by federal common law, which in turn was controlled by the law of the state in which the federal court was sitting.[122] The Court found no need for a uniform federal rule.[123] While this decision has been criticized,[124] it indicates the Supreme Court's reluctance to enlarge the body of federal common law in derogation of state law.

In the absence of congressional guidance on the issue, federal courts determining whether federal common law should displace state law have continued to apply the three-part *Kimbell Foods* test: (1) whether the federal program, by its very nature, requires uniformity; (2) whether application of state law would frustrate specific objectives of the federal program; and (3) whether application of a uniform federal rule would disrupt existing commercial relationships based

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[118] *Id.*

[119] *See* Mickowski v. Visi-Trak Worldwide, LLC, 415 F.3d 501 (6th Cir. 2005).

[120] *See, e.g.*, K.C. 1986 Ltd. P'ship v. Reade Mfg., 472 F.3d 1009, 1022 (8th Cir. 2007) ("*Bestfoods* does not directly address corporate successor liability, and consequently, there may yet be contexts in which the substantial continuity test could survive.").

[121] *See, e.g.*, Rosenberg, *supra* note 74, at 431 ("The *Bestfoods* decision strongly reinforces the Supreme Court's recently promoted idea that state law should serve as the guide of crucial meaning for federal statutory law in the absence of legislative language to the contrary.").

[122] Semtek Int'l. Inc. v. Lockheed Martin Corp., 531 U.S. 497 (2001).

[123] *Id.* at 508-09.

[124] *See* Dudley & Rutherglen, *supra* note 39, at 748 ("[I]t compromises the entire federal court system when the Court overreacts and distorts the federal Rules to accommodate state law . . . .").

on state law.[125] One scholar has stated these factors as: (1) the interests of the state in having its rule applied; (2) the federal interests in having federal common law applied; and (3) "the negative federal interest in avoiding the forum-shopping and inequality effects of any outcome-determinative difference between state and federal law."[126] Regardless of the list of factors chosen by a court, the result is that the Supreme Court generally defers to state law. Conversely, the lower federal courts are much more likely to find that federal common law preempts state law in areas where Congress has not expressly granted authority to the federal courts.[127] Since the *Erie* decision, a split in authority has developed as to whether federal courts should apply state law or federal common law when determining liability under certain federal statutes, as will be discussed in the following section.[128]

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[125] United States v. Kimbell Foods Inc., 440 U.S. 715, 728-29 (1979). *See also* N. Shore Gas Co. v. Salomon Inc., 152 F.3d 642, 650 (7th Cir. 1998); B.F. Goodrich v. Betkoski, 112 F.3d 88, 90 (2d Cir. 1997).

[126] Kevin M. Clermont, *Reverse*-Erie, 82 NOTRE DAME L. REV. 1, 14 (2006).

[127] *See, e.g.*, Rosenberg, *supra* note 74, at 468 ("Prior to the *O'Melveny and Myers* and *Bestfoods* decisions, federal courts had been willing to apply the substantial continuity test for the sake of 'uniformity.' In the wake of these more recent Supreme Court decisions which emphasize the use of state law norms, the future of the substantial continuity test as a federal common law model would seem to be seriously in doubt.").

[128] *See generally*, Aronovsky & Fuller, *supra* note 29, (stating that "federal courts are charged with developing federal common law rules to pierce the corporate veil where necessary to vindicate the policies underlying federal statutes, even if the statute and its legislative history are silent as to the role of state law rules of limited liability . . . ; the choice of federal common law to govern this area appears likely to become a matter of settled law"); Richard Dennis, *Liability of Officers, Directors, and Stockholders Under CERCLA: The Case for Adopting State Law*, 36 VILL. L. REV. 1367 (1991) (arguing that state law should apply). The choice of law principles as applied to contracts have been developed over time, with the Restatement of Conflict of Laws playing a key role; Katherine J. Florey, *Choosing Tribal Law: Why State Choice-of-Law Principles Should Apply to Disputes with Tribal Contacts*, 55 AM. U. L. REV. 1627, 1696 (2006) ("The Supreme Court's decision to treat the problem of cases with mixed state and tribal contacts as solely a question

Following the reasoning of the Supreme Court in *O'Melveny*, the Third Circuit in *United States v. General Battery*, stated that "[t]o view every ambiguous federal statute as authorizing an expansive body of 'federal common law' would be an invitation to federal courts to eviscerate both the *Erie* doctrine and the concept of dual sovereignty it embodies."[129] Yet not all courts are as hesitant to apply federal common law.[130]

There is no indication by Congress that federal law should be created to define the limits of successor liability or the reach of the de facto merger doctrine. There can be no federal policy regarding the liability of successor corporations, which are themselves creations of state law.

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of jurisdiction and forum choice has obscured the potential a choice-of-law approach offers to advance the interests of tribes and resolve the procedural dilemmas of litigants."); Note, *Piercing the Corporate Law Veil: The Alter Ego Doctrine Under Federal Common Law,* 95 HARV. L. REV. 853 (1982) ("[F]ederal common law should look to federal statutory policy rather than to state corporate law when deciding whether to pierce the corporate veil.").

[129] United States v. General Battery Corp., 423 F.3d 294, 304 (3d. Cir. 2005). *See generally*, Henry J. Friendly, *In Praise of* Erie--*And of the New Federal Common Law,* 39 N.Y.U. L. REV. 383 (1964) (discussing the *Erie* doctrine and the development of federal common law).

[130] *See generally* Bernadette Bollas Genetin, *The Powers That Be: A Reexamination of the Federal Courts' Rulemaking and Adjudicatory Powers in the Context of a Clash of a Congressional Statute and a Supreme Court Rule,* 57 BAYLOR L. REV. 587, 673 (2005) ("The conclusion, based on a narrowed role for federal courts in statutory interpretation and federal common lawmaking, that CERCLA and Rule 17(b) do not conflict goes against two decades of jurisprudence in which federal courts, in large numbers, held to the contrary . . . . The conclusion that CERCLA incorporates state-law amenability to suit standards, rather than enlarges the duration of corporate amenability to suit, also reflects a deference to state law in the course of statutory construction and federal common lawmaking that is not reflected in a sister doctrine in which the federal courts must similarly construe federal statutes to determine whether they displace state law – preemption doctrine. This deference to state law in cases of statutory construction and federal common lawmaking is so strong that it creates a presumption against preemption of state law at a time when preemption scholars are noting (and some are disparaging) the disappearance of the presumption against preemption of state law in federal preemption cases.").

Only if there is a significant and unique federal interest should the federal courts be authorized to preempt state successor liability common law by creating federal common law.[131] Several circuit courts of appeals have found such a unique federal interest in the determination of successor liability under CERCLA and other federal statutes,[132] which may be beyond the authority defined by the Supreme Court in *Erie* and its progeny. Another scholar has asserted, "If a federal statute simply creates a cause of action without addressing successor liability, courts ordinarily should conclude that these theories of successor liability lie beyond the statute's domain. Instead of being governed by a federalized version of general law, the applicability of these theories will typically depend on the local law of a particular state."[133] This statement may be overly optimistic, because it appears that several federal courts will create federal common law to preempt state law, at least in some circumstances.

IV. APPLICATION OF FEDERAL COMMON LAW UNDER FEDERAL STATUTES

As the Court stated in *Texas Industries*, there are areas in which Congress has expressly given courts authority to develop federal common law to implement a federal statute.[134] However, such a grant of authority may be

[131] *See* Kimbell Foods, 440 U.S. 715, at 728-29 ("Whether to adopt state law or to fashion a nationwide federal rule is a matter of judicial policy 'dependent upon a variety of considerations always relevant to the nature of the specific governmental interestas and to the effects upon them of applying state law.'"); *see also* O'Melveny & Myers v. Fed. Deposit Ins. Corp., 512 U.S. 79 (1994).

[132] *See* B. F. Goodrich v. Betkoski, 99 F.3d 505, 519 (2d Cir. 1996); United States v. Mexico Feed & Seed Co., 980 F.2d 478, 487 n.9 (8th Cir. 1992); United States v. Carolina Transformer Co., 978 F.2d 832, 837-38 (4th Cir. 1992); Smith Land & Improvement Corp. v. Celotex Corp., 851 F.2d 86, 91-92 (3d Cir. 1988).

[133] Caleb Nelson, *The Persistence of General Law*, 106 COLUM. L. REV. 503, 557 (2006).

[134] Texas Indus. v. Radcliff Materials, Inc., 451 U.S. 630, 640 (1981).

implied where not clearly expressed. Federal common law may be created to define terms in a federal statute. This practice is less troublesome than the federal successor liability rules, because state law is not thereby contradicted and business expectations are not thwarted. If the state statute at issue has a provision that determines the entities that bear the liability, there is no need to create federal common law of successor liability.[135] The Supreme Court is more likely to find that federal common law supersedes state rules in controversies arising under the following federal statutes, because either (1) the comprehensive nature of the statute's provisions indicate an intent to preempt state laws; (2) the need for a uniform national rule; or (3) federal common law was merely interpreting the federal statute.

A. ERISA

The Supreme Court held in *Firestone Tire & Rubber v. Bruch* that federal common law would be developed to determine the rights and obligations under ERISA.[136] The Court relied on legislative intent, quoting a senator who stated that "federal substantive law will be developed by the courts to deal with issues involving rights and obligations under private welfare and pension plans."[137] Consistent with this holding, the Third Circuit used federal common law to determine the validity of a waiver of rights under ERISA, although ERISA does not contain an express provision for waiver of benefits by a beneficiary.[138] The Seventh Circuit used federal common law to determine successor liability for ERISA obligations, without discussing why state successor liability rules were rejected.[139] The comprehensive nature of

[135] *See* Storage and Office Sys., LLC v. United States, 490 F. Supp. 2d 955 (S.D. Ind. 2007) (applying statutory provisions rather than federal common law).

[136] Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101 (1989).

[137] *Id.* at 110.

[138] *See* McGowan v. NJR Serv. Corp., 423 F.3d 241 (3d Cir. 2005).

[139] *See* Chicago Truck Drivers, Helpers & Warehouse Workers Union (Indep.) Pension Fund v. Tasemkin, Inc., 59 F.3d 48 (7th Cir. 1995). Similar to ERISA obligations, employer obligations arising under the

ERISA suggests that state law has been preempted; however, it could be argued that the lack of an express successor liability provision indicated Congress' intent to permit the state rules to apply. It could also be argued that state rules would result in more certainty and fairness, so that businesses could predict their acquired liability for ERISA obligations in the same manner as other liabilities and obligations.

B. Intellectual Property: Federal Copyright and Patent Statutes

In 1989, the Supreme Court in *Community for Creative Non-Violence v. Reid*,[140] relied on "the general common law of agency, rather than on the law of any particular State" to define terms such as "employee" and "employer" as used in the Copyright Act.[141] The Court noted that "federal statutes are generally intended to have uniform nationwide application."[142] While acknowledging that where there is no conflict between federal policy and the application of state law, a mere federal interest in uniformity is insufficient to justify displacing state law in favor of a federal common law rule,[143] the Court found that the federal copyright laws broadly preempted state laws, indicating the intent to impose uniformity.[144] Referring to various sections of the Restatement for guidance on the general common law, the Court found that a sculptor was an independent contractor, not an employee, and therefore a statue was not a work for hire, thus the sculptor retained the copyright.[145] In 1994, the

Black Lung Benefits Act are not subject to state common law de facto merger analysis. *See* Kentland Elkhorn Coal Corp. v. Hall, 287 F.3d 555 (6th Cir. 2002) (imposing liability on the purchaser of substantially all assets of a mine).

[140] Community for Creative Non-Violence v. Reid, 490 U.S. 730 (1989).

[141] *Id.* at 740.

[142] *Id.* (quoting Mississippi Band of Choctaw Indians v. Holyfield, 490 U.S. 30, 43 (1989)).

[143] *Id.* at 140; *accord* B.F. Goodrich v. Betkoski, 112 F.3d 88, at 91.

[144] Community for Creative Non-Violence v. Reid, 490 U.S. at 740.

[145] *Id.* at 751-53.

Court further restricted the need for uniformity as a decisive factor in *O'Melveny*.

While the Supreme Court appears to sanction the use of federal common law in copyright cases, actions arising under the patent laws are less certain. The Court has found that the federal patent laws did not preempt state trade secret laws[146] or state statutes of limitations.[147] The lower federal courts have not been consistent in deciding whether federal or state law governs. In 2001, the Federal Circuit applied federal common law to determine the transfer of ownership of a patent license.[148] The Court found:

> [C]ourts generally have acknowledged the need for a uniform national rule that patent licenses are personal and non-transferable in the absence of an agreement authorizing assignment, contrary to state common law that contractual rights are assignable unless forbidden by an agreement. This is so because federal patent policy seeks to encourage the disclosure of new, useful, and non-obvious inventions by granting the inventor the excusive right to exclude others from making, using, or selling the invention for a period of years . . . allowing free assignability of patent licenses would frustrate the purpose because every licensee would become a potential competitor with the licensor-patent holder in the market for the invention.[149]

The Court emphasized the importance of a uniform national rule, contrary to the O'Melveny decision.[150]

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[146] *See* Kewanee Oil Co. v. Bicron Corp., 416 U. S. 470 (1974).

[147] *See* Agency Holding Corp. v. Malley-Duff & Assocs., 483 U. S. 143 (1987) (supporting the power of the states to impose statutes of limitations that have a neutral effect on federal rights).

[148] *See* Rhone-Poulenc Agro, S.A. v. DeKalb Genetics Corp. and Monsanto Co., 271 F.3d 1081 (Fed. Cir. 2001); *accord*, *In re* CFLC, Inc., 89 F.3d 673, 677-79 (9th Cir. 1996).

[149] Rhone-Poulenc, 271 F.3d at 1088.

[150] *See generally* Note, *Antiassignment Clauses, Mergers, and the Myth about Federal Preemption of Application of State Contract Law to Patent License Agreements*, 50 DRAKE L. REV. 639 (2002) (arguing that state law should determine patent license disputes).

Conversely, the Sixth Circuit applied state law in a case involving a judgment creditor of a bankrupt debtor seeking enforcement of a patent infringement judgment against an asset purchaser.[151] Notwithstanding the comprehensive nature of the federal patent laws, the Court found no conflict between state and federal law, and no need for national uniformity, citing *Bestfoods*.[152]

C. Title VII of the Civil Rights Act of 1964

Contrary to the long line of *Erie* cases where the Supreme Court limited the creation of federal common law, the Supreme Court has been more willing to create federal common law when implementing Title VII. In the 1998 case, *Burlington Industries, Inc. v. Ellerth*, the Court found that federal general common law controlled a sexual harassment case.[153] The Court found that the determination of when an employer would be responsible for an employee's actions within the scope of employment under Title VII required a uniform and predictable standard. Thus the Court looked at the federal general common law of agency, rather than the law of any particular state.[154] The Court distinguished the situation where federal common law is used as a "judicial creation of a special federal rule of decision," which the Court found to be different from the situation at hand, where the Court was merely interpreting a federal statute.[155] The Court relied on the Restatement as a "useful beginning," and then reviewed interpretations by several Circuit Courts.[156]

Even under Title VII, the authority to create federal common law is limited. In 1980, in *Northwest Airlines, Inc. v. Transport Workers Union of America*, the Court addressed the issue of whether an employer could seek contribution

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[151] *See* Mickowski v. Visi-trak Worldwide, LLC, 415 F.3d 501 (6th Cir. 2005).

[152] *Id.* at 511-15.

[153] Burlington Industries, Inc. v. Ellerth, 524 U.S. 742, 754 (1998).

[154] *Id.*

[155] *Id.* at 755.

[156] *Id.* at 756.

from labor unions for liability under Title VII.[157] Although the statute was silent as to such a right of contribution, the Court explored whether such a right could have been implied by Congress.[158] The factors examined by the Court in determining such an implied right were "the language of the statute itself, its legislative history, the underlying purpose and structure of the statutory scheme, and the likelihood that Congress intended to supersede or supplement existing state remedies."[159] The Court noted that a contribution right may have "become part of the federal common law through the exercise of judicial power to fashion appropriate remedies for unlawful conduct."[160] This "exercise of judicial power" appears to be in direct conflict with the *Erie* doctrine, because *Erie*, proclaiming the absence of federal general common law, denied the existence of such judicial power. The Court concluded that a right of contribution was not implied and therefore federal common law did not play a role.[161] The Court found "the comprehensive character of the remedial scheme expressly fashioned by Congress strongly evidences an intent not to authorize additional remedies."[162] Only after reaching this conclusion did the Court admit that federal common law existed.[163]

D. ADA

In the 2003 case *Clackamas Gastroenterology Assoc. v. Wells*, the Supreme Court applied federal common law as a gap filler for interpretation of the term "employee" as used in the Americans with Disabilities Act of 1990, once again relying on the Restatement to determine common law.[164] The

[157] Nw. Airlines, Inc. v. Transport Workers Union of Am., 451 U.S. 77 (1980).

[158] *Id.* at 91.

[159] *Id.*

[160] *Id.* at 90.

[161] Nw. Airlines, 451 U.S. 77 at 90.

[162] *Id.* at 93-94.

[163] *Id.* at 95.

[164] Clackamas Gastroenterology Assoc. v. Wells, 538 U.S. 440 (2003).

Court did not discuss whether it was applying state or federal common law, yet it did not refer to the laws of any particular state in making the determination. Instead, the Court cited other Supreme Court decisions that applied federal common law.[165] It could be argued that a consistent rule, whereby a business would be an employer of an individual for all purposes, would be preferable to the potential situation created by this case where an individual of a business could be deemed an employee for purposes of the ADA but not for other benefits or obligations arising under state law.

i. International Trade Regulation

The creation of federal common law to impose successor liability on asset purchasers for violations of export and import regulations is problematic.[166] Because the relevant federal statutes are silent as to successor liability, the imposition of such liability by the court is contrary to state law, violates due process, and "creates unnecessary economic deadweight losses to society by discouraging the free movement of capital to more efficient uses."[167]

E. CERCLA

CERCLA does not expressly provide for successor liability,[168] but instead refers to "covered persons," which have been renamed by the courts as "potentially responsible parties," or PRPs.[169] The Circuit Courts of Appeal that have

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[165] *Id.* at 448-49.

[166] *See* Aaron Xavier Fellmeth, *Cure Without a Disease: The Emerging Doctrine of Successor Liability in International Trade Regulation,* 31 YALE J. INT'L LAW 127 (2006).

[167] *Id.* at 186.

[168] *See* United States v. Gen. Battery, 423 F.3d 294, 298 (3d Cir. 2005); Smith Land and Improvement Corp. v. Celotex Corp., 851 F.2d 86, 91 (3d Cir. 1988).

[169] 42 U.S.C. § 9607(a) (2006); United States v. Davis, 261 F.3d 1, 16 (1st Cir. 2001) ("42 U.S.C. § 9613(f) . . . allows one potentially responsible party (PRP) to bring an action for contribution against other PRPs.").

addressed the issue agree that successors in interest to contaminating corporations are liable.[170] The courts differ on the limitations of such successor liability in asset purchase situations.

Federal common law has been created and applied in several determinations arising under CERCLA. One reason may be the need for interpretation or reconciling the internal inconsistencies of this statute, which has been described by some courts as "incomprehensible" and the product of "poor drafting."[171] For example, a federal common law standard of joint and several liability has been applied to CERCLA litigation.[172] Courts have found that uniform interpretation of CERCLA presents a "uniquely federal interest" requiring the application of federal common law, in the following determinations: (1) whether a dissolved corporation may be liable for cleanup costs, pursuant to FRCP 17(b); (2) whether the corporate veil should be pierced to find a parent corporation liable for the actions of its subsidiary; and (3) whether an asset purchaser is liable as the successor to the selling corporation.[173]

i. Rule 17 (b): Whether a dissolved corporation may be liable for cleanup costs

Rule 17(b) of the FRCP provides that the "capacity of a corporation to sue or be sued shall be determined by the law under which it was organized."[174] The Seventh and Ninth Circuits have interpreted this to mean that state law governs the issue of whether a dissolved corporation is liable under

[170] General Battery, 423 F.3d at 298, n.3; Vine Street, LLC v. Keeling, 460 F. Supp. 2d 728, 740 (E.D. Tex. 2006); United States v. Mex. Feed & Seed Co., 980 F.2d 478, 486 (8th Cir. 1992).

[171] *See* Acushnet River & New Bedford Harbor Proceedings re Alleged PCB Pollution, 716 F. Supp. 676, 681 (D. Mass. 1989); Artesian Water Co. v. New Castle County, 851 F.2d 643, 648 (3d Cir. 1988).

[172] United States v. Chem-Dyne Corp., 572 F. Supp. 802, 809-10 (S.D. Ohio 1983).

[173] *See* Acushnet, 716 F. Supp. 676 (agreeing that the determination of when damages occur under CERCLA was a uniquely federal interest).

[174] Fed. R. Civ. P. 17(b).

CERCLA.[175] Numerous district courts in the other circuits have reasoned that CERCLA has preempted Rule 17(b), and created federal common law to ensure uniform application.[176] As Professor Bernadette Bollas Genetin stated, "silence in the CERCLA statute regarding the scope of corporate liability implicates the federal courts' reduced authority in a sphere that is not legislative, but is within the federal courts' adjudicatory function of determining cases and controversies."[177] Professor Genetin argues that the majority of the federal decisions addressing the CERCLA Rule 17(b) question should be overturned, because courts will need to analyze the creation of federal common law with an increasing dependency on textual congressional authorization.[178] The lower federal courts have expanded the scope of federal common law in derogation of the Supreme Court's mandate in *O'Melveny*[179] that federal common law should be restricted.

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[175] *See* Citizens Electric Corp. v. Bituminous Fire & Marine Ins. Co., 68 F.3d 1016 (7th Cir. 1995); Louisiana-Pacific Corp. v. ASARCO, Inc., 5 F.3d 431 (9th Cir. 1993); Levin Metals Corp. v. Parr-Richmond Terminal Co., 817 F.2d 1448 (9th Cir. 1987).

[176] *See* Town of Oyster Bay v. Occidental Chem. Corp., 987 F. Supp. 182, 199 (E.D.N.Y. 1997); Idylwoods Assocs. v. Madar Capital, Inc., 915 F. Supp. 1290, 1304 (W.D.N.Y. 1996); AM Properties Corp. v. GTE Prods. Corp., 844 F. Supp. 1007 (D.N.J. 1994); BASF Corp. v. Central Transport, Inc., 830 F. Supp. 1011 (E.D. Mich. 1993); City and County of Denver v. Adolph Coors Co., 813 F. Supp. 1471 (D. Colo 1992); Travers Bay Area Intermediate School Dist. v. Hitco, Inc., 762 F. Supp. 1298 (W.D. Mich. 1991); United States v. Distler, 741 F. Supp. 643 (W.D. Ky. 1990); United States v. Sharon Steel Corp., 681 F. Supp. 1492 (D. Utah 1987); *c.f.* United States v. SCA Services of Indiana, Inc., 837 F. Supp. 946 (N.D. Ind. 1993) (finding that the state corporate capacity laws were less restrictive than CERCLA, therefore preemption of Rule 17(b) by CERCLA was not considered); *see also* Burcat & Wilson, *supra* note 108.

[177] Bernadette Bollas Genetin, *The Powers That Be: A Reexamination of the Federal Courts' Rulemaking and Adjudicatory Powers in the Context of a Clash of a Congressional Statute and a Supreme Court Rule*, 57 BAYLOR L. REV. 587, 679-80 (2005).

[178] *Id.*

[179] O'Melveny & Myers v. Fed. Deposit Ins. Corp., 512 U.S. 79, 87 (1994).

ii. Piercing the Corporate Veil to find a parent corporation liable for actions of its subsidiary

There is a lack of uniformity as to whether federal common law or state rules pertaining to veil piercing should apply when CERCLA liability is at issue. The Eastern District Court of New York decided in 1997 that federal common law should decide whether the corporate veil should be pierced to find a parent corporation liable under CERCLA.[180] Several district courts in other circuits have agreed that federal common law should apply in this situation.[181] The factors that have been used by lower federal courts to determine whether to pierce a corporate veil under federal common law are: (1) inadequate capitalization in light of the purposes for which the corporation was organized; (2) extensive or pervasive control by the shareholder or shareholders; (3) intermingling of the corporation's properties or accounts with those of its owner; (4) failure to observe corporate formalities and separateness; (5) siphoning of funds from the corporation; (6) absence of corporate records; and (7) nonfunctioning officers and directors.[182]

These federal veil-piercing factors are not always applied by state courts. For example, courts applying Massachusetts state law consider the following twelve factors to determine whether the corporate veil should be pierced: (1) insufficient capitalization; (2) nonobservance of corporate formalities; (3) nonpayment of dividends; (4) insolvency of the corporation at the time of litigation; (5) siphoning of corporate funds; (6) nonfunctioning of corporate officers and directors; (7) absence of corporate records; (8) use of corporation for

[180] Town of Oyster Bay v. Occidental Chem. Corp., 987 F. Supp. 182, 198-200 (E.D.N.Y. 1997).

[181] *See id.*; United States v. Nicolet, Inc., 712 F. Supp. 1193, 1200-03 (E.D. Pa. 1989); 915 F. Supp. 1290, 1304-07 (W.D.N.Y. 1996); City of New York v. Exxon Corp., 112 B.R. 540, 552-53 (S.D.N.Y. 1990), *aff'd in part* 932 F.2d 1020 (2d Cir. 1991).

[182] Town of Oyster Bay, 987 F. Supp. at 203 (quoting In re Acushnet River & New Bedford Harbor Proceedings, 675 F. Supp. 22, 33 (D. Mass. 1987)).

transactions of the dominant shareholder; (9) fraud or injustice; (10) confused intermingling of business activity; (11) common ownership; and (12) pervasive control.[183]

The Sixth Circuit held that state law should govern veil piercing under CERCLA, in *Carter-Jones Lumber Company v. LTV Steel Co.*[184] The court noted that courts applying federal common law would be more likely to disregard the corporate veil and impose liability.[185] Finding that the result would have been the same under federal common law as under Ohio law, the court applied Ohio law.[186] The risk of acquiring unforeseen CERCLA liability when subsidiaries are acquired has the potential to disrupt a significant sector of the U.S. economy and increase the costs of doing business. State rules for piercing the corporate veil should be applied to all liabilities, without creating a different standard for CERCLA liabilities.

iii. Successor liability and the de facto merger doctrine

The application of federal common law to determine successor liability for CERCLA obligations has resulted in extensive litigation, and is the topic of extensive scholarship.[187] While most of such scholarship focuses on

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[183] *See* Pepsi-Cola Metro. Bottling Co., Inc. v. Checkers, Inc., 754 F.2d 10, 16 (1st Cir. 1985).

[184] Carter–Jones Lumber Co. v. LTV Steel Co., 237 F.3d 745, 746-47 n.1 (6th Cir. 2001).

[185] *Id.* at 747 ("[F]ederal common law generally gives less respect to the corporate form than does the strict common law alter ego doctrine.") (quoting Brotherhood of Locomotive Eng'r v. Springfield Terminal Ry. Co., 210 F.3d 18, 26-27 (1st Cir. 2000) (internal quotation marks omitted)).

[186] *Id.*

[187] *See, e.g.*, Rosenberg, *supra* note 74, at 462-68 (discussing the federal circuit courts of appeals' willingness to create and apply federal common law); Clermont, *supra* note 126 (discussing the extent of federal law applicable in state court); Richard A. Smolen, Casenote, *Get the Lead Out: Innocent Successor Corporations Responsibility Under CERCLA*, 25 TEMP. J. SCI. TECH. & ENVT'L L. 137 (2006) (discussing successor liability under CERCLA); Kenneth K. Kilberth, *Successor Liability Under CERCLA: Whither Substantial Continuity?*, 14 PENN ST. ENVTL. L. REV. 1

CERCLA and the *Erie* doctrine, this Article suggests a different focus, relying on the state doctrine of de facto merger for all successor liability questions, regardless of whether such liability arises under CERCLA or from another source. The issue of successor liability under CERCLA should not be decided differently from any other source of successor liability; the state de facto merger theory is appropriate, as will be discussed in the following section. Otherwise, acquiring corporations may be protected from the seller's obligations in all other areas, but unable to avoid liability for environmental contamination caused by the seller pursuant to CERCLA. The costs and uncertainties which may result are inequitable and disruptive to the economy.

V. FEDERAL COMMON LAW OF SUBSTANTIAL CONTINUITY VERSUS THE STATE DE FACTO MERGER DOCTRINE

Pursuant to the common law of most states, the four situations in which an asset purchaser may be liable for the obligations of the seller are: (1) the purchaser expressly or impliedly agreed to assume the liability; (2) the purchaser is a mere continuation of the seller; (3) the purchase of assets is deemed to be a fraudulent attempt to avoid such liability; or (4) the transaction is a de facto merger.[188] Although CERCLA is silent on the issue of successor liability, most courts have held that the same four situations apply to impose successor liability on an asset purchaser in CERCLA situations.[189] Some jurisdictions have created a fifth

(2005) (analyzing CERCLA successor liability); Burcat & Wilson, *supra* note 108 (discussing CERCLA liability of shareholders after corporate dissolution); Aronovsky & Fuller, *supra* note 29 at 455 (analyzing liability of parent corporations for CERCLA obligations of subsidiaries); Griffith & Goutman, *supra* note 66 (analyzing federal common law jurisprudence).

[188] New York v. Nat'l Servs. Indus., Inc., 352 F.3d 682, 685 (2d Cir. 2003).

[189] *See* Aluminum Co. of Am. v. Beazer East, 124 F.3d 551, 565 (3d Cir. 1997); Smith Land & Improvement Corp. v. Celotex Corp., 851 F.2d 86, 91-92 (3d Cir. 1988); *see also* Rosenberg, *supra* note 74 at 463-64

exception, referred to as the "substantial continuity test," imposing liability on an asset purchaser who "maintains the same business, with the same employees doing the same jobs, production processes, and produces the same products for the same customers."[190] Successor liability under federal common law has been described by courts as broader than state law because it allows suits against "even a genuinely distinct purchaser of a business, if (1) the successor had notice of the claim before the acquisiton; and (2) there was a 'substantial continuity of the operations of the business before and after the sale.'"[191] The Ninth Circuit found that in developing this common law rule, federal courts have "created conflicts and uncertainties" not only regarding the necessity of a continuation in ownership, but also regarding the requirement of the purchaser's notice of the potential liability.[192] This broader theory of successor liability has been described as "grounded in labor law decisions and appears to have little or no application outside of the employment context."[193] Nonetheless, this theory has been

(discussing common law exceptions necessary to avoid abuse of asset-purchaser non-liability); Lynda J. Oswald, *Bifurcation of the Owner and Operator Analysis under CERCLA,* 72 WASH. U.L.Q. 223, 281-82 (1994).

[190] Nat'l Servs. Indus., Inc., 352 F.3d at 685 (quoting B.F. Goodrich v. Betkoski, 99 F.3d 505, 519 (2d Cir. 1996)); *see also* Kilberth, *supra* note 187.

[191] Chicago Truck Drivers, Helpers & Warehouse Workers Unions (Indep.) Pension Fund v. Tasemkin, 59 F.3d 48, 49 (7th Cir. 1995). *See also* Brend v. Sames Corp., 2002 WL 1488877 (N.D. Ill July 11, 2002); *but see* Nat'l Servs. Indus., 352 F.3d 682 (holding that after *Bestfoods,* the substantial continuity test cannot be applied to determine successor liability under CERCLA); *contra* Ferguson v. Arcata Redwood Co., LLC, No. C03-05632, 2004 WL 2600471 (N.D. Cal. Nov. 12, 2004) (recognizing the substantial continuity test but finding that the test does not exist in the Ninth Circuit (quoting Atchison, Topeka & Santa Fe Ry. Co. v. Brown & Bryant, Inc., 159 F.3d 358, 364 (9th Cir. 1998))).

[192] Atchison, 159 F.3d at 364 (citing United States v. Atlas Minerals and Chem., Inc., 824 F. Supp. 46, 50 (E.D. Pa. 1993); Atl. Richfield Co. v. Blosenski, 847 F. Supp. 1261, 1287 (E.D. Pa. 1994).

[193] Storage and Office Sys., LLC v. United States, 490 F. Supp. 2d. 955, (S.D. Ind. 2007).

applied to situations involving non-labor liabilities of the asset seller, including CERCLA liability.

This federal substantial continuity test is similar to the rule adopted by some states, whereby liability may be imposed on successors where there is no continuity of ownership.[194] The substantial continuity theory referred to by federal courts is called the "continuity of the enterprise" theory by some state courts, and has been described as an expansion of the second traditional exception from the rule of non-liability, referred to as "mere continuation," or as a deviation from the de facto merger exception.[195]

The creation of a federal rule that is more likely than state rules to impose liability on an asset purchaser is contrary to the Federal Rules of Decision Act, the

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[194] The "mere continuation" theory has been adopted in Alabama (Turner v. Wean United Inc., 531 So. 2d 827 (Ala. 1988)); Michigan (Foster v. Lenawee Cone-Blanchard Mach. Co., 560 N.W.2d 664 (Mich. Ct. App. 1997)); New Jersey (Woodrick v. Jack J. Burke Real Estate, 703 A.2d 306 (N.J. Super. Ct. App. Div. 1997)); Ohio (McGaw v. South Bend Lathe, 598 N.E.2d 18 (Ohio 1991)); and Pennsylvania (Dawejko v. Jorgensen Steel Co., 434 A.2d 106 (Pa. Super. 1981)). It has been rejected in Arkansas (Swayze v. A.O. Smith Corp., 694 F. Supp. 619 (E.D. Ark. 1988); Colorado (Johnston v. Amsted Indus., Inc., 830 P.2d 1141 (Colo. Ct. App. 1992); Delaware (Elmer v. Tenneco Resins, Inc., 698 F. Supp. 535 (D. Del. 1988); Indiana (Travis v. Harris Corp., 565 F.2d 443 (7th Cir. 1977)); Iowa (Pancratz v. Monsanto Co., 547 N.W.2d 198 (Iowa 1996)); Illinois (Green v. Firestone Tire, 460 N.E.2d 895 (Ill. App. Ct. 1984)); Kentucky (Conn. v. Fales Div. of Matheson Corp., 835 F.2d 145 (6th Cir. 1987)); Maryland (Nissen Corp. v. Miller, 594 A.2d 564 (Md. 1991)); Minnesota (Niccum v. Hydra Tool Corp., 438 N.W.2d 96 (Minn. 1989)); Missouri (Chem. Design, Inc. v. Am. Standard, Inc., 847 S.W.2d 488 (Mo. Ct. App. 1993)); Nebraska (Jones v. Johnson Mach. & Press Co., 320 N.W.2d 481 (Neb. 1982)); New Hampshire (Simoneau v. South Bend Lathe, Inc., 543 A.2d 407 (N.H. 1988)); New York (Schumacher v. Richards Shear Co., Inc., 59 N.Y.2d 239 (1983)); North Dakota (Downtowner, Inc. v. Acrometals Products, Inc., 347 N.W.2d 118 (N. D. 1984)); South Dakota (Hamaker v. Kenwel-Jackson Mach., Inc., 387 N.W.2d 515 (S. D. 1986)); Vermont (Ostrowski v. Hydra-Tool Corp., 144 Vt. 305, 479 A.2d 126 (1984)); Virginia (Harris v. T.I. Inc., 243 Va. 63, 413 S.E.2d 605 (1992)); and Wisconsin (Fish v. Amsted Indus., Inc., 126 Wis. 2d 293, 376 N.W.2d 820 (1985)).

[195] Ferguson v. Arcata Redwood Co. LLC, No. C03-05632, 2004 WL 2600471, at *4-5 (N.D. Cal. Nov. 12, 2004).

Constitution, and the decisions of the Supreme Court. As the Court stated in 1945, where a federal court is exercising jurisdiction solely because of the diversity of citizenship of the parties, the outcome of the litigation in the federal court should be substantially the same, so far as legal rules determine the outcome of a litigation, as it would be if tried in a State court.[196]

The question of whether the more restrictive state de facto merger doctrine or the broader federal substantial continuity test should govern may have serious consequences for asset purchasers. Under the state de facto merger test, an asset purchaser will generally not be liable for CERCLA response costs if there is a genuine change in ownership. Under the federal rule, the same asset purchaser, who played no role in the contamination, may be liable even though the ownership of the business has changed, if the business is operated in substantially the same manner.[197] The lower federal courts have varied in their approaches, some finding that the federal policy underlying CERCLA is the imposition of liability on the greatest number of defendants.

The Second, Third, Fourth, and Eighth Circuits have applied federal law when determining successor liability under CERCLA;[198] however, the Second and Eighth Circuits have recently reconsidered the issue in light of recent Supreme Court decisions in *O'Melveny* and *Bestfoods*.[199] District Courts within the Fifth Circuit also apply federal common law, although the Fifth Circuit has never decided

[196] Guar. Trust Co. v. York, 326 U.S. 99, 109 (1945).

[197] *See* Rosenberg, *supra* note 78, at 466.

[198] *See* B.F. Goodrich v. Betkoski, 99 F.3d 505, 518-20 (2d Cir. 1996); United States v. Mexico Feed & Seed Co., 980 F.2d 478, 487 n.9 (8th Cir. 1992); United States v. Carolina Transformer Co., 978 F.2d 832, 837-38 (4th Cir. 1992); Smith Land & Improvement Corp. v. Celotex Corp., 851 F.2d 86, 90-92 (3d Cir. 1988).

[199] *See* New York v. Nat'l Servs. Indus., Inc., 460 F.3d 201 (2d Cir. 2006); K.C. 1986 Ltd. P'ship v. Reade Mfg., 472 F.3d 1009, 1022 (8th Cir. 2007).

the issue directly.[200] The Seventh Circuit has not decided the issue.[201] The First, Sixth, and Ninth Circuits have applied state law to determine successor liability under CERCLA.[202] The Eleventh Circuit also appears to be leaning in this direction, finding that state law applied to determine whether a limited partner should incur CERCLA liability for the actions of the partnership.[203]

A. Application of federal common law to determine successor liability under CERCLA

The Third Circuit was one of the first courts to address the issue of whether federal common law successor liability rules should be applied in a CERCLA case. The court applied federal common law in *Smith Land & Improvement Corp. v. Celotex Corp.*[204] The court was concerned with national uniformity because, if state law governed, "CERCLA aims may be evaded easily by a responsible party's choice to arrange a merger or consolidation under the laws of particular states which unduly restrict successor liability."[205]

Subsequently, in *United States v. General Battery Corporation*,[206] the Third Circuit again applied federal common law. The United States alleged CERCLA liability where the defendant was a successor of a corporation which

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[200] *See* Vine Street LLC v. Keeling, 460 F. Supp. 2d 728, 740 (E.D. Tex. 2006).

[201] *See* Citizens Elec. Corp. v. Bituminous Fire and Marine Ins. Co., 68 F.3d 1016, 1019 (7th Cir. 1995).

[202] *See* United States v. Davis, 261 F.3d 1, 54 (1st Cir. 2001); Atchinson, Topeka & Santa Fe Ry. Co. v. Brown & Bryant, Inc., 159 F.3d 358, 383 (9th Cir. 1998); Anspec Co. Inc. v. Johnson Controls, Inc., 922 F.2d 1240, 1245-48 (6th Cir. 1991).

[203] *See* Redwing Carriers Inc. v. Saraland Apartments, 94 F.3d 1489, 1501-02 (11th Cir. 1996).

[204] Smith Land & Improvement Corp. v. Celotex Corp., 851 F.2d 86, 90-92 (3d Cir. 1988).

[205] *Id.* at 92.

[206] United States v. Gen. Battery Corp., Inc., 423 F.3d 294 (3d Cir. 2005).

purchased a small, privately-held battery manufacturer.[207] The battery manufacturer was sold for cash and stock to a buyer, who then merged with the defendant.[208] The issue was whether the first cash and stock transaction was a de facto merger that would make the defendant liable.[209] The court held that CERCLA required application of a uniform federal standard, rather than the law of a particular state, in order to determine environmental liability of a successor company pursuant to the de facto merger theory.[210] The court referred to its earlier decision in *Smith Land* where national uniformity was the paramount reason for creating a federal common law standard of successor liability, rather than "the excessively narrow statutes which might apply in only a few states."[211] The court referred to its earlier decision in *Smith Land*, where it stated: "the district court must consider national uniformity; otherwise, CERCLA aims may be evaded easily by a responsible party's choice to arrange a merger or consolidation under the laws of particular states which unduly restrict successor liability."[212]

It is important to note that *Smith Land* was not a de facto merger case, but a statutory merger case, and therefore the court's reliance is questionable.[213] Notwithstanding the court's insistence on federal common law, the court rejected the more expansive substantial continuity test in light of *Bestfoods*, stating that "substantial continuity is untenable as a basis for successor liability under CERCLA."[214] The court decided that the acquisition constituted a de facto merger because the original owner had a role with the successor company as a result of the stock received; therefore the purchaser and its successor, the defendant, was liable

[207] *Id.* at 296.

[208] *Id.*

[209] *Id.* at 305.

[210] *Id.* at 298.

[211] *Id.*

[212] Smith Land & Improvement Corp. v. Celotex Corp., 851 F.2d 86, 92 (3d. Cir. 1988).

[213] *Id.*

[214] *See* Gen. Battery, 423 F.3d at 309.

under CERCLA for the actions of the battery manufacturer.[215] The court defined the federal successor liability test as identical to the state de facto merger test:

> The de facto merger exception to non-liability for acquiring corporations applies where: (1) there is a continuation of the enterprise of the seller corporation, so that there is a continuity of management, personnel, physical location, assets, and general business operations; (2) there is a continuity of shareholders which results from the purchasing corporation paying for the acquired assets with shares of its own stock, such that shareholders of the seller corporation become a constituent part of the purchasing corporation; (3) seller corporation ceases its ordinary business operations, liquidates, and dissolves as soon as legally and practically possible; and (4) purchasing corporation assumes those obligations of the seller ordinarily necessary for the uninterrupted continuation of normal business operations of the seller corporation.[216]

Although the court insisted that it was applying federal common law, the result would have been the same under state law, because the element of continuity of shareholders was present. The substantial continuity test was therefore not decisive.

The *General Battery* decision is important because it was decided after the Supreme Court decisions in *O'Melveny* and *Bestfoods*, which limited federal common law authority.[217] The *General Battery* court, in referring to the impact of *Bestfoods* on the authority to create federal common law, noted the "Supreme Court has neither addressed nor disturbed" the Third Circuit Court's earlier decisions that federal common law controlled successor liability under

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[215] *Id.* at 298.

[216] *Id.*

[217] O'Melveny, 512 U.S. at 87; Bestfoods, 524 U.S. at 63.

CERCLA.[218] The *General Battery* court also limited *O'Melveny*, referring to that case as an action arising under state tort law, although it involved a federal banking statute, unlike CERCLA, which is a federal cause of action.[219] The Court noted, "[a]pplying a particular state's law requires a state-by-state interpretation of the federal liability statute–a result, in the case of successor liability under CERCLA, that we believe conflicts with the statutory objectives."[220] The court cited cases decided under the ADA and Title VII, applying federal common law to define terms in the federal statutes, as authority for creating federal common law to define the term "successor corporation" in CERCLA.[221] The court failed to mention that the term "successor corporation" is not used in CERCLA. It is not clear after this case what the reach of federal common law of successor liability will be in the Third Circuit. If substantial continuity is no longer the rule, but state law does not control, then the result could be that the federal common law rule is more favorable to asset purchasers, at least in those states that do not require a continuation of shareholders for successor liability.

Continuing the trend of applying federal common law, in 1996 the Second Circuit in *B.F. Goodrich v. Betkoski* decided that federal common law was more consistent with the goals of CERCLA, and therefore adopted the "substantial continuity" test.[222] The substantial continuity test articulated in *Betkoski*, referring to Supreme Court decisions in labor law issues, analyzes whether "the successor maintains the same business, with the same employees doing the same jobs, under the same supervisors, working

[218] Gen. Battery, 423 F.3d at 298.

[219] *Id.* at 300.

[220] *Id.*

[221] *Id.*

[222] B.F. Goodrich v. Betkoski, 99 F.3d 505, 519 (2d Cir. 1996), *decision clarified on reh'g by* B.F. Goodrich v. Betkoski, 112 F.3d 88, 91 (2d Cir. 1997). A more recent Second Circuit case avoided consideration of the issue in light of later Supreme Court decisions, finding the successor would not be liable under either federal or State laws. *See also* New York v. Nat'l Serv. Indus., Inc., 460 F.3d 201 (2d Cir. 2006).

conditions, and production processes, and produces the same products for the same customers."[223] The court reversed a grant of summary judgment in favor of the successor because of the application of the more restrictive state law rule.[224] After a later decision by the Second Circuit called into question the use of federal common law, citing *O'Melveny* for the proposition that a federal interest in uniformity alone is insufficient reason for the creation of a federal common law, the Second Circuit affirmed its *Betkoski* decision in 1997, explaining:

> Although we noted the desirability of uniformity in the CERCLA context, our primary reason for adopting a federal common law rule was our concern that allowing state law rules such as the inflexible and easily evaded "identity" rule to control the question of successor liability would defeat the goals of CERCLA.
>
> Each of the *Kimbell Foods* factors supports our decision—there is a significant need for a uniform rule, allowing lenient state law rules to control would defeat federal policy, and we perceive no danger that our decision to adopt a federal rule of "substantial continuity" will unduly upset existing corporate relationships.[225]

The *Betkoski* court may have been unrealistic in suggesting that the imposition of potentially millions of dollars in CERCLA liability on an asset purchaser would not upset existing corporate relationships.

More recently, in *New York v. National Services Industries, Inc.*, the Second Circuit rejected the substantial continuity test, finding that "the substantial continuity doctrine is not a part of general federal common law and, following *Bestfoods*, should not be used to determine whether a corporation takes on CERCLA liability as the result of an

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[223] B.F. Goodrich, 99 F.3d at 519.

[224] *Id.* at 530.

[225] B.F. Goodrich, 112 F.3d at 91.

asset purchase."[226] The court avoided the issue of whether federal or state common law would apply in future cases, but the court noted that *Betkoski* was no longer good law.[227]

The *Betkoski* decision raises the question of whether it is proper for a federal court to create federal common law to impose liability on a defendant who would not be liable under "lenient" state law. The Sixth Circuit has stated that "the mere fact that the 'substantial continuity' test of federal common law is more encompassing than the 'mere continuation' test of state common law does not demonstrate a 'significant conflict between some federal policy or interest and the use of state law.'"[228] The court suggested that the ability to impose CERCLA liability on a greater number of defendants was not a federal policy. The Ninth Circuit accused courts of "creat[ing] conflicts and uncertainties over . . . whether to adopt the expanded 'continuity of enterprise' theory . . . ; the importance of the purchaser's knowledge of the seller's CERCLA liabilities . . . ; and whether continuity of ownership is a prerequisite to successor liability . . . ." [229]

The substantial continuity test as used in *Betkoski* and rejected by *New York v. National Services Industries* was further explained by the Eastern District of New York in *Town of Oyster Bay v. Occidental Chemical Corp.* to include an analysis of the following eight factors:

> (1) retention of the same employees; (2) retention of the same supervisory personnel; (3) retention of the same production facilities in the same location; (4) production of the same product; (5) retention of the same name; (6) continuity of assets; (7) continuity of general business operations; and (8) whether the

[226] New York v. Nat'l Servs. Indus., Inc., 352 F.3d 682, 687 (2d Cir. 2003).

[227] *Id.*

[228] Mickowski v. Visi-Trak Worldwide, LLC, 415 F.3d 501, 512 (6th Cir. 2005).

[229] Atchison, Topeka & Santa Fe Ry. Co. v. Brown & Bryant, Inc., 159 F.3d 358, 363 n.5 (9th Cir. 1998) (citations omitted).

> successor holds itself out as the continuation of the previous enterprise.[230]

These eight factors, sometimes labeled the "federal common law standard," are assumed to have a broader reach to impose liability on asset purchasers.[231] This eight-factor test is well established in labor law disputes, but is more subject to controversy in non-labor cases, including CERCLA litigation.[232]

Another recent example of a lower federal court using federal common law for successor liability is *Action Manufacturing Co. Inc. v. Simon Wrecking Co.*[233] The court relied on the Third Circuit decision in *Smith Land* and *General Battery* for the proposition that federal common law of successor liability applied, without discussion as to the reason.[234] The court found successor liability, concluding that a de facto merger existed.[235] Again, reliance on *Smith Land* may be misplaced because that is not a de facto merger case. In *Action Manufacturing*, the asset purchaser acquired all of the assets of the seller except for two parcels of land and continued to operate an identical scrap metal business from the same location, using the seller's plant and equipment and retaining the same employees, management, and ownership.[236] The court found a de facto merger notwithstanding the fact that the selling corporation continued to exist, because it was a mere shell that was

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[230] Town of Oyster Bay v. Occidental Chem. Corp., 987 F. Supp. 182, 206 (E.D.N.Y. 1997) (citing United States v. Carolina Transformer Co., 978 F.2d 832, 838 (4th Cir. 1992)); *see also* United States v. Davis, 261 F.3d 1, 53 (1st Cir. 2001).

[231] *Mickowski*, 415 F.3d at 514; *Davis*, 261 F.3d at 53.

[232] *See, e.g.*, Fall River Dyeing & Finishing Corp. v. NLRB, 482 U.S. 27 (1987) (applying a substantial continuity test, "based upon the totality of the circumstances").

[233] Action Mfg. Co. v. Simon Wrecking Co., 428 F. Supp. 2d 288 (E.D. Pa. 2006).

[234] *Id.* at 334-35.

[235] *Id.* at 335.

[236] *Id.*

prevented from formally dissolving by the outstanding environmental liabilities.[237]

Applying federal common law in a de facto merger case is a further deviation from the *Erie* doctrine and the rule in *Texas Industries* because there is no federal statute authorizing such development of common law. Courts have relied on the federal policy of uniformity, contrary to *O'Melveny*, or on a finding of a uniquely federal interest, as will be discussed in the following section. Asset purchasers require the certainty of state law rules of de facto merger to ensure the economic feasibility of merger and acquisition activity. The application of a broader federal rule of substantial continuity denies the reasonable expectations of businesses that have structured their asset purchases to avoid state de facto merger liabilities.

In light of the *National Services Industries* decision, it is not clear precisely what is the federal standard to be applied in future cases, and how this test may be more encompassing than the state de facto merger doctrine. If the substantial continuity test from *Betkoski* is dead, then it may be time for these circuits to abandon the federal common law standard and adopt the state de facto merger doctrine as defined in the relevant jurisdiction.

[237] *Id.* Responsible parties who are charged with CERCLA cleanup costs are eager to find their claims to be divisible, rather than joint and several. The Restatement (Second) of Torts § 433A addresses the issue of divisibility. Under Secion 433A, "a defendant can avoid joint and several liability if it proves (a) there are distinct harms, or (b) there is a reasonable basis determining the contribution of each cause to a single harm." RESTATEMENT (SECOND) OF TORTS § 433A (1965). Courts that have relied on the Restatement in determining liability include United States v. Hercules, Inc., 247 F.3d 706, 717 (8th Cir. 2001); United States v. R.W. Meyer, Inc., 932 F.2d 568, 577-78 (6th Cir. 1991); United States v. Vertac Chem. Corp., 364 F. Supp. 2d 941, 950 (E.D. Ark. 2005).

B. Application of State Common Law De Facto Merger Analysis to Determine Successor Liability Under CERCLA

Several circuit courts have applied state de facto merger analysis in determinations of successor liability under CERCLA. In *Atchison, Topeka & Santa Fe Railway Co. v. Brown & Bryant, Inc.*, the Ninth Circuit decided that the previous rule of applying federal law as discussed in *Louisiana-Pacific*[238] was called into question by recent Supreme Court decisions.[239] The *Atchison, Topeka* court applied the rule from *O'Melveny* that in cases arising under a "comprehensive and detailed" federal statute, issues left open by the statute should be presumed to be decided under state law.[240] The court further found that "the dissolution and continuing liability of corporations are traditional areas of state law."[241] The court found that although the need for uniformity was often invoked in the context of successor liability under CERCLA, "there has been no real explanation of the need for uniformity . . . especially since state law will in many other instances determine whom the EPA may or may not look to for compensation."[242] The court admitted that the need for uniformity arose not from a great disparity among treatment of successor liability by the states, but rather "from the alleged need for a more expansive view of successor liability than state law currently provides . . . ." [243] The court accused courts of "creat[ing] conflicts and uncertainties over . . . whether to adopt the expanded 'continuity of enterprise' theory . . . ; the importance of the purchaser's knowledge of the seller's CERCLA liabilities . . . ; and whether continuity of ownership is a prerequisite to

[238] Louisiana-Pacific Corp. v. Asarco, Inc., 909 F.2d 1260 (9th Cir. 1990).

[239] Atchison, Topeka & Santa Fe Ry. Co. v. Brown & Bryant, Inc., 159 F.3d 358 (9th Cir. 1998).

[240] *Id.* at 364.

[241] *Id.* at 363.

[242] *Id.*

[243] *Id.*

successor liability . . . ."[244] The court found there was no evidence that application of state law would frustrate CERCLA objectives, stating, "It is unrealistic to think that a state would alter general corporate law principals to become a peculiarly hospitable haven for polluters."[245] The court then rejected the substantial continuation test, which is not in use in California, and found that such a test would not be used in the Ninth Circuit even if federal common law applied.[246] The court found no liability under CERCLA for an asset purchaser where there was no continuity of shareholders.[247]

The Sixth Circuit in *Anspec Co. v. Johnson Controls, Inc.* decided that state corporate law would control successor liability under CERCLA.[248] In response to the argument that state law would conflict with the federal policy underlying CERCLA, Judge Kennedy, in her concurring opinion, stated:

> Any fears that states will engage in a "race to the bottom" in their effort to attract corporate business and enact laws that limit vicarious liability are in my opinion groundless. States have a substantial interest in protecting their citizens and state resources. Most states have their own counterparts to CERCLA and the EPA and they share a complementary interest with the United States in enforcement of laws like CERCLA that are used to remedy environmental contamination. I see no necessity to create federal common law in this area to guard against the risk that states will create safe havens for polluters.[249]

Judge Kennedy also noted that CERCLA does not purport to be a source of corporate law, and that

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[244] *Id.* at 363 n.5.

[245] *Id.* at 364.

[246] *Id.*

[247] *Id.*

[248] Anspec Co. v. Johnson Controls, Inc., 922 F.2d 1240, 1245 (6th Cir. 1991).

[249] *Id.* at 1250 (Kennedy, J., concurring).

> this is an area where the states have a substantial interest in having their own law resolve these issues. Private parties have relied on state corporation law when making corporate acquisitions and in forming and dissolving corporations. The prices paid by the buyers to the sellers in those transactions undoubtedly reflected, in part, the parties' understanding concerning who retained the seller's liabilities.[250]

Reasonable business expectations, economic efficiency, and predictable results are among the many reasons that this article advocates against the preemption of state de facto merger analysis by federal common law.

Although not a successor liability case, the Eleventh Circuit addressed the issue of a limited partner's liability for the obligations of the partnership pursuant to CERCLA in *Redwing Carriers, Inc. v. Saraland Apartments*.[251] The court adopted state law to fill the gap in CERCLA, which lacks any mention of the liability of limited partners of an owner.[252] Applying the three-part test of *Kimbell Foods*, the court found no need for national uniformity, stating:

> Adopting a uniform rule would, perhaps, expedite enforcement of CERCLA by decreasing uncertainty in assessing liability under the statute. But this argument could be made for adopting a uniform rule

[250] *Id.* at 1250-51 (Kennedy went on to note that "in enacting CERCLA Congress deliberately left room for the operation of state law, thus acknowledging that nationwide uniformity was not required on all liability issues. For example, in section 107(e), Congress expressly preserved the efficacy of private indemnification agreements and thereby preserved the associated body of state law under which such agreements are interpreted. *See* Mardan v. C.G.C. Music, Ltd., 804 F.2d 1454 (9th Cir. 1986). Similarly, section 113(f)(1) of CERCLA provides that claims for contribution shall be brought 'in accordance with the Federal Rules of Civil Procedure.' Those rules, in turn, provide that 'The capacity of a corporation to sue or be sued shall be determined by the law under which it was organized.' Fed.R.Civ.P. 17(b).").

[251] Redwing Carriers, Inc. v. Saraland Apartments, 94 F.3d 1489, 1501-02 (11th Cir. 1996).

[252] *Id.* at 1502.

> in the context of just about any federal statute. If this interest was sufficient in every case, then the Supreme Court would not, as it did in *Kimbell Foods,* have sanctioned adopting state law as the federal rule of decision.[253]

The court noted that CERCLA is not a source of partnership law, and thus not in direct conflict with the state law of partnership.[254] The same argument could be made for corporate successor liability law. Further, the court stated that state law was not contrary to the policy of CERCLA, notwithstanding that some defendants, such as limited partners, would avoid liability under state law.[255] The court was concerned with the parties' expectations under state law, stating, "we hesitate to upset the expectations investors have under current state law rules by adopting a federal common law rule."[256] Again, this statement applies to asset purchases, where purchasers structure the transaction to avoid state de facto merger liability. Based on the court's reasoning in *Redwing Carriers*, it appears reasonable to assume that the Eleventh Circuit would be unlikely to find that federal common law preempts state de facto merger analysis.

In 1999, the Southern District of Ohio used state law to determine whether a de facto merger had occurred so that CERCLA liability could be imposed on the corporate successor, in *Miami County Incinerator Qualified Trust v. Acme Waste Management Co.*[257] The court referred to an earlier Sixth Circuit case where the court decided that state law, rather than federal law, would control.[258] The *Miami County Incinerator* court found that the substantial continuity test was not applicable in CERCLA liability issues

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[253] *Id.* at 1501.

[254] *Id.*

[255] *Id.*

[256] *Id.* at 1502.

[257] Miami County Incinerator Qualified Trust v. Acme Waste Mgmt. Co., 61 F. Supp. 2d 724 (S.D. Ohio 1999).

[258] *Id.* at 728 (citing City Mgmt. Corp. v. U.S. Chem. Co., 43 F.3d 244, 250 (6th Cir. 1994)).

because Ohio courts had not recognized the expanded mere continuation test in products liability actions.[259] The court found that the defendant who had purchased assets of a waste hauler was not liable for contribution of clean up costs under CERCLA.[260] This decision is consistent with the position of the Sixth Circuit in veil piercing cases arising under CERCLA, in which that court has consistently applied state law. [261]

Following *Atherton*, *Bestfoods*, and *O'Melveny*, in 2005, the Sixth Circuit in *Mickowski v. Visi-Trak Worldwide, LLC* applied the laws of Ohio to determine that successor liability should not be imposed on an asset purchaser.[262] The plaintiff argued that the more favorable federal common law standard should govern because of the need for uniformity in a collection suit for a patent infringement judgment.[263] The court disagreed, stating "the mere fact that the 'substantial continuity' test of federal common law is more encompassing than the 'mere continuation' test of state common law does not demonstrate a 'significant conflict between some federal policy or interest and the use of state law.'"[264] This position is contrary to the Second Circuit's 1996 decision in *Betkoski*. Comprehensive federal patent laws, which certainly preempt state laws, are silent as to successor liability.[265] The federal substantial continuity test was limited by the court to labor law, employment discrimination, and pension benefit litigation.[266] Finding no successor liability, the court pointed to the lack of the "key element" of a "common identity of stockholders, directors, and stock."[267]

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[259] *Id.* at 730.

[260] *Id.*

[261] *See* Carter-Jones Lumber Co. v. LTV Steel Co., 237 F.3d 745 (6th Cir. 2001).

[262] Mickowski v. Visi-Trak Worldwide, LLC, 415 F.3d 501 (6th Cir. 2005).

[263] *Id.* at 513.

[264] *Id.* at 512.

[265] *Id.*

[266] *Id.* at 515

[267] *Id.* at 510.

The Sixth, Ninth, and Eleventh Circuit courts agree that national uniformity is not a valid reason for the creation of a federal common law rule of substantial continuity to preempt state rules of de facto merger. Courts that rely on national uniformity as an excuse to create federal common law have not explained precisely why a uniform rule is preferable. It may be more helpful for businesses to evaluate potential liabilities if state de facto merger analysis were consistently applied to all acquired liabilities. These decisions reflect a concern with investment expectations and authority of the states to govern corporations. These courts are supported by the Supreme Court decisions of *Erie* and its progeny, which have suggested that state law should govern issues where Congress has not acted.

C. Jurisdictions that are undecided on whether federal or state law should govern successor liability under CERCLA

The continuing viability of the federal substantial continuity theory of corporate successor liability as a creation of federal common law was seriously questioned by the Supreme Court in *United States v. Bestfoods*. In that case, the Court held that CERCLA does not grant authority to rewrite the settled rules of state corporation law simply because the cause of action is based upon a federal statute.[268] The Court described the limited liability of shareholders as "deeply 'ingrained in our economic and legal systems.'"[269] The non-liability of asset purchasers is likewise deeply ingrained in state corporation law.[270]

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[268] United States v. Bestfoods, 524 U.S. 51, 63 (1998).

[269] *Id.* at 61 (citing William O. Douglas & Carrol M. Shanks, *Insulation from Liability Through Subsidiary Corporations*, 39 YALE L.J. 193 (1929)).

[270] *See, e.g.*, United States v. Davis, 261 F.3d 1, 54 (1st Cir. 2001) ("[T]he 'mere continuation' test is an exception to the common law rule that the buyer of a corporation's assets (as opposed to its stock) does not incur liability for the divesting corporation's debts . . . . We see no evidence that application of state law . . . would frustrate any federal objective.").

Bestfoods does not directly address corporate successor liability[271] because the decision is based on piercing the corporate veil. The Court also avoided deciding whether state or federal law should apply.[272] The decision has been interpreted as indicating that federal courts are not authorized by CERCLA to ignore state corporation law in favor of creating a federal common law of successor liability.[273] This indicates a return to the *Erie* doctrine, limiting the authority of federal courts to create federal common law. Notwithstanding the Supreme Court's suggestion that state corporate law should govern, some lower federal courts have stubbornly refused to abandon the concept of a federal common law of substantial continuity.

The Second Circuit in *New York v. National Service Industries*, decided in 2003, rejected the substantial continuity test, finding it was not part of the "general federal common law."[274] The court avoided the issue of whether federal or state common law would apply in future cases, but noted that *Betkoski* was no longer good law,[275] indicating that future decisions may be more likely to apply state de facto merger analysis. This does not decide the issue of whether continuity of shareholders is required in New York's version of the de facto merger.

The New York Court of Appeals has not decided whether continuity of shareholders is critical to the finding of a de facto merger, and intermediate New York courts have issued conflicting decisions.[276] In *Town of Oyster Bay v. Occidental Chemical Corp.*, the Eastern District of New York applied federal common law, citing *Betkoski*, and defined the

[271] *See* K.C. 1986 Ltd. P'ship v. Reade Mfg., 472 F.3d 1009, 1022 (8th Cir. 2007).

[272] Bestfoods, 524 U.S. 51 at 64 n.9.

[273] *Id.*

[274] New York v. Nat'l Servs. Indus., Inc., 352 F.3d 682, 687 (2d Cir. 2003).

[275] *Id.*

[276] In *City of New York v. AAER Sprayed Insulations, Inc.*, the First Department found the existence of a de facto merger in the absence of continuity of ownership. 722 N.Y.S.2d 20 (N.Y. App. Div. 2001).

relevant test as including eight factors: (1) retention of the same employees; (2) retention of the same supervisory personnel; (3) retention of the same production facilities in the same location; (4) production of the same product; (5) retention of the same name; (6) continuity of assets; (7) continuity of general business operations; and (8) whether the successor holds itself out as the continuation of the previous enterprise.[277] The court mentioned two other factors, in addition to the above eight, that have been considered by some courts: (9) "the purchasing corporation's notice of the seller's potential liabilities" and (10) "whether the purchasing corporation has 'substantial ties' to the selling corporation."[278] The court found both of these factors lacking in *Oyster Bay*, and also found that the asset purchaser did not hold itself out as the successor, did not market the same product, and did not use the same name.[279] There was no continuation of shareholders in this case, and this court was not willing to find a de facto merger in the absence of same.[280]

In a contrary ruling, the Northern District of Illinois described the federal common law of successor liability as "broader" than state law, because substantial continuity plus notice was sufficient to impose liability.[281] In 2004, the Western District of New York granted summary judgment to a defendant who purchased the assets of numerous corporations, even though those corporations had contributed to the hazardous waste in a landfill that

[277] Town of Oyster Bay v. Occidental Chem. Corp., 987 F. Supp. 182, 206 (E.D.N.Y. 1997) (citing United States v. Carolina Transformer Co., 978 F.2d 832, 838 (4th Cir. 1992)); *see also* United States v. Davis, 261 F.3d 1, 53 (1st Cir. 2001).

[278] Town of Oyster Bay, 987 F. Supp. at 206 (citing United States v. Mexico Feed & Seed Co., 980 F.2d 478, 489 (8th Cir. 1992)); *see also* United States v. Pierce, 1995 WL 356017 (N.D.N.Y. Feb. 21, 1995).

[279] Town of Oyster Bay, 987 F. Supp. at 206.

[280] *See id.* at 205 (citing Louisiana-Pacific Corp. v. Asarco, 909 F. 2d 1260, 1264-65 (9th Cir. 1990)).

[281] *See* Brend v. Sames Corp., No. 00-CC4677, 2002 WL 1488877, at *3 (N.D. Ill. 2002).

generated $35 million in CERCLA clean up costs.[282] The court rejected the substantial continuity test in a suit seeking contribution from an asset purchaser, citing *National Services Industries*.[283] The court referred to the traditional four elements of a de facto merger, but did not state whether federal or state law governed.[284]

The Seventh Circuit, in *Citizens Electric Corp. v. Bituminous Fire and Marine Insurance Co.*, discussed a dissolved corporation's capacity for CERCLA liability.[285] The court suggested alternatively that (1) federal common law was not permitted under CERCLA in this determination; or (2) courts should adopt state law as the federal common law.[286] The Seventh Circuit again reserved the federal common law issue without deciding it in a 1998 CERCLA case, *North Shore Gas Co. v. Salomon*, but applied federal common law because the parties had assumed that federal law governed.[287]

The Eighth Circuit has not decided the issue, but in a 2007 case found that "there may yet be contexts in which the [federal] substantial continuity test could survive" in CERCLA cases.[288] The court noted that *Bestfoods* did not directly address successor liability.[289] The court did not need to decide the issue, because the defendant in the case at

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[282] *See* Pfohl Bros. Landfill Site Steering Comm. v. Browning-Ferris Ind. of New York, Inc., No. 95-CV-956A(f), 2004 WL 941816, at *8 (W.D.N.Y. 2004); *see also* Morgan V. Powe Timber Co., 367 F. Supp. 2d 1032 (S.D. Miss. 2005) (refusing to find a parent corporation responsible for the pre-acquisition liabilities of its wholly owned subsidiary in a classic triangular merger).

[283] *See* Pfohl Bros., 2004 WL, at *8.

[284] *Id.*

[285] Citizens Elec. Corp. v. Bituminous Fire & Marine Ins. Co., 68 F.3d 1016, 1019 (7th Cir. 1995).

[286] *Id.*

[287] N. Shore Gas Co. v. Salomon, Inc., 152 F.3d 642, 651 (7th Cir. 1998).

[288] K.C. 1986 Ltd. P'ship v. Reade Mfg., 472 F.3d 1009, 1022 (8th Cir. 2007).

[289] *Id.*

hand would not be liable even under the broader federal substantial continuity test.[290]

In an earlier Eighth Circuit case, *United States v. Mexico Feed & Seed Co.*, the court applied federal common law. The court noted: "The issue of whether federal or state law should be used in analyzing successor liability was not raised by the parties and we do not decide it. However, considering the national application of CERCLA and fairness to similarly situated parties, the district court was probably correct in applying federal law."[291] The court did not find the defendant liable under the broader federal substantial continuity test because it had no knowledge of the CERCLA liability.[292]

Although the Fifth Circuit has not decided the issue, the Southern District of Texas recently stated, "the Court believes that the Third Circuit test is the more prudent approach in that it is consistent with current Supreme Court precedent, and that the continuity of enterprise theory has recently been rejected . . . ."[293] Citing *United States v. General Battery*, the court analyzed the facts under both state and federal successor liability theories.[294]

In summary, the Third and Fourth Circuits apply federal law when determining successor liability under CERCLA.[295] The Second and Eighth Circuits have applied federal law in the past, but may be reexamining the issue.[296] The First, Sixth, and Ninth Circuits have applied state law in these

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[290] *Id.*

[291] United States v. Mexico Feed & Seed Co., 980 F.2d 478, 487 n.9 (8th Cir. 1992).

[292] *Id.* at 489-90.

[293] Tex Tin Corp. v. United States, No. G 96-247, 2006 WL 1118587, at *4 (S.D. Tex. 2006).

[294] *Id.*

[295] *See* United States v. Carolina Transformer Co., 978 F.2d 832, 837-38 (4th Cir. 1992); Smith Land & Improvement Corp. v. Celotex Corp., 851 F.2d 86, 91-92 (3d Cir. 1988).

[296] *See* B.F. Goodrich v. Betkoski, 99 F.3d 505, 519 (2d Cir. 1996); United States v. Mexico Feed & Seed Co., 980 F.2d 478, 487 n.9 (8th Cir. 1992); K.C. Ltd. P'ship v. Reade Mfg., 472 F.3d 1009, 1022 (8th Cir. 2007).

determinations.[297] The Eleventh Circuit also appears to be leaning in this direction, finding that state law applied to determine whether a limited partner should incur CERCLA liability for the actions of the partnership.[298] The Fifth Circuit has not yet decided the issue, but at least one district court seems to prefer federal law.[299] This confusion between circuits creates uncertainty and adds unnecessary expense to merger and acquisition transactions. A return to the mandate of *Erie* that there is no federal general common law would eliminate these problems. The Supreme Court has been consistent in recent years in restricting the creation of federal common law; the lower federal courts' refusal to follow is creating unnecessary litigation and expense.

VI. UNIQUELY FEDERAL INTERESTS

One justification for the creation of federal common law to determine successor liability under CERCLA and other federal statutes is that such liability is a uniquely federal interest. In 1988, the Supreme Court in *Boyle v. United Technologies Corp.* held that federal courts may create federal common law when application of state law would significantly conflict with a "uniquely federal interest."[300] The Court found a uniquely federal interest in limiting the liability of military contractors.[301]

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[297] *See* United States v. Davis, 261 F.3d 1, 54 (1st Cir. 2001); Atchinson, Topeka & Santa Fe Ry. Co. v. Brown & Bryant, Inc., 159 F.3d 358, 363-64 (9th Cir. 1998); Anspec Co. v. Johnson Controls, Inc., 922 F.2d 1240, 1248 (6th Cir. 1991).

[298] *See* Redwing Carriers Inc. v. Saraland Apartments, 94 F.3d 1489, 1501 (11th Cir. 1996).

[299] *See* Tex Tin Corp. v. United States, No. G 96-247, 2006 WL 1118587, at *4 (S.D. Tex. Apr. 25, 2006).

[300] Boyle v. United Techs. Corp., 487 U.S. 500, 507 (1988); *see also* Hudgens v. Bell Helicopter, 328 F.3d 1329, 1333 (11th Cir. 2003).

[301] Boyle, 487 U.S. at 507. The Southern District of New York has held that the *Boyle* decision does not extend to non-military government contractors. *See In re* Chateaugay Corp., 146 B.R. 339, 348-49 (S.D.N.Y. 1992).

The implications of *Boyle*, in authorizing the creation of federal common law in limited circumstances, was subsequently restricted by the Supreme Court in the 2004 case of *Sosa v. Alvarez-Machain*. In this case, the Court declined to allow federal common law to expand the private right of action pursuant to the Alien Tort Statute.[302]

The *Boyle* uniquely federal interest doctrine was further restricted in 2006 by the Supreme Court in *Empire Healthchoice Assurance, Inc. v. McVeigh*, where the Court found no conflict between federal and state law and therefore no federal question jurisdiction.[303] A private insurance carrier sought reimbursement of benefits because the insured had received tort damages for his injuries.[304] The Court found that the plaintiff had not proven a "significant conflict between an identifiable federal policy or interest and the operation of state law."[305] The Court distinguished earlier cases where federal common law was used to interpret terms, including the sufficiency of notice pursuant to a federal tax code provision,[306] and where the United States was the plaintiff.[307] The Court found that the private plaintiff's reimbursement claim was "fact-bound and situation-specific," and not a "pure issue of law," in contrast to the interpretation of terms in the Internal Revenue Code.[308] (Similarly, the determination of a de facto merger is fact-bound and situation-specific,[309] not merely interpretation

[302] Sosa v. Alvarez-Machain, 542 U.S. 692, 726 (2004).

[303] Empire Healthchoice Assurance, Inc. v. McVeigh, 547 U.S. 677 (2006).

[304] *Id.* at 682.

[305] *Id.* at 692.

[306] *See* Grable & Sons Metal Products, Inc. v. Darue Eng'g & Mfg., 545 U.S. 308 (2005).

[307] *See* Clearfield Trust Co. v. United States, 318 U.S. 363, 366 (1943).

[308] Empire Healthchoice, 547 U.S. 677 at 701.

[309] *See, e.g.*, Chicago Truck Drivers, Helpers & Warehouse Workers Union (Indep.) Pension Fund v. Tasemkin, Inc., 59 F.3d 48, 49 (7th Cir. 1995) (The Court described successor liability as involving "myriad factual circumstances and legal contexts" and requiring "emphasis on the facts of each case." However, the Court applied federal common law because the case involved ERISA liability.).

of a statutory definition, and therefore state law, and not federal common law, should apply.) The *Empire* decision by Justice Ginsburg was a plurality opinion, with a compelling dissent by Justice Breyer stating that federal common law should apply, and therefore federal jurisdiction should be granted, because "the statute is federal, the program it creates is federal, the program's beneficiaries are federal employees . . . , the Federal Government pays all the relevant costs, and the Federal Government receives all relevant payments."[310] The reasoning of the dissent would not apply to de facto merger liability, because the federal government is rarely directly involved.

As the Sixth Circuit found in *Anspec Co. v. Johnson Controls, Inc.*, "relevant state corporation law . . . poses no significant threat to any identifiable federal policy or interest" in a case involving CERCLA successor liability.[311] Successor liability should be determined by state law in CERCLA cases in the same manner as liability from other sources.[312]

The Supreme Court limited the reach of uniquely federal interests in *O'Melveny*, describing such interests as the government's payment of checks, interpretation of government contracts, and other government transactions where the conduct of the government or its agents is at issue.[313] The Court also cautioned that a significant conflict between the state law and a specific federal policy must be found before federal common law could be created, and then state law may only be displaced to the extent required by federal policy.[314] The application of the federal substantial

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[310] *Empire Healthchoice*, 547 U.S. at 704 (Breyer, J., dissenting).

[311] Anspec Co. Inc. v. Johnson Controls, Inc., 922 F.2d 1240, 1250 (6th Cir. 1991) (Kennedy, J., concurring) (quoting Wallis v. Pan Am. Petroleum Corp., 384 U.S. 63, 68 (1966)).

[312] *See In re* Asousa, No. 01-12295DWS, 2006 WL 1997426, at *8 (Bankr. E.D. Pa. June 15, 2006) (applying state law to determine corporate successor liability for lease obligations).

[313] *See* O'Melveny & Myers v. Fed. Deposit Ins. Corp., 512 U.S. 79 (1994).

[314] *See id.* at 87-88.

continuity test merely to cast a wider net of liability is not required by any specific federal policy.

VII. SUMMARY OF LEGAL THEORIES RELEVANT TO THE CREATION AND APPLICATION OF FEDERAL COMMON LAW

This Article has explored several legal theories to explain why the lower federal courts should not continue to create federal common law to preempt state law, particularly in the area of de facto merger and successor liability. A summary of these theories follows.

A. Cooperative federalism: state and federal governments working together

Professor Robert Glicksman described the "race to the bottom" debate, as noted by Justice Kennedy in his concurrence in the Sixth Circuit's opinion in *Anspec.*[315] Glicksman explained that the risk is that states will adopt more lenient environmental laws to attract new business. The same reasoning applies to more restrictive successor liability laws that limit liability for environmental contamination.[316] The cooperative federalism model is a response to this risk, whereby the federal and state governments share responsibility for pollution control.[317] This allows states to adopt more stringent environmental laws.[318] For example, many states have aggressively pursued greenhouse gas emission control, because "the federal government completely abdicated its responsibility."[319] In response, the federal government has attempted to thwart the states by reducing state regulatory power, and thus

[315] Robert L. Glicksman, *From Cooperative to Inoperative Federalism: The Perverse Mutation of Environmental Law and Policy*, 41 WAKE FOREST L. REV. 719 (2006).

[316] *See id.* at 736.

[317] *See id.* at 738.

[318] *See id.* at 743.

[319] *Id.* at 800.

cooperative federalism has faltered.[320] Professor Glicksman suggests, "Through doctrines such as the dormant Commerce Clause, preemption, and regulatory takings, the federal courts have constrained the ability of state and local governments to achieve levels of environmental and resource protection that exceed those required by federal legislation."[321] Preemption of state de facto merger doctrines by federal common law is an example of the constraint imposed by federal courts on state courts as described by Professor Glicksman.

It is unlikely that state courts will adopt overly lenient successor liability rules to attract polluters or asset purchasers of polluting companies. It is more likely that courts will impose equitable successor liability rules relevant to all forms of potential liability, and enforce these rules without regard to the nature of such liability. This preemption also constrains state legislatures. States have proven their ability and willingness to enact legislation to contribute to environmental protection.[322] Preemption of state de facto merger doctrine is not required to protect the environment because it is unlikely that states will race to the bottom to become a haven for polluters.[323] State de facto merger doctrines are not overly lenient and are effective in allocating liability for hazardous waste contamination, as well as for other areas of liability. Cooperative federalism suggests that federal courts should be hesitant to preempt state laws that are effective in contributing to the goal of environmental protection.

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[320] *See id.* at 800-02.

[321] *Id.* at 802.

[322] *See, e.g.*, N.Y. ENVIRONMENTAL CONSERVATION LAW, § 71-2713 (1998) (providing that a knowing release of a hazardous substance so as to endanger public health is a felony).

[323] *See* Atchison, Topeka & Santa Fe Ry. v. Brown & Bryant, 159 F.3d 358, 363 (9th Cir. 1998).

B. Federal policy of imposing liability for environmental cleanup costs on the maximum number of defendants

The federal policy underlying CERCLA is sufficiently ambiguous that courts have used it as an excuse to impose liability on asset purchasers in circumstances where such liability would not exist under state de facto merger analysis. It is unreasonable to assume that federal policy favors the imposition of liability on the maximum number of defendants to ensure that hazardous waste will be remedied. Although CERCLA is intended to identify responsible parties to pay for the costs of such remediation, there is inherent in such identification the exclusion of non-responsible parties. If Congress intended to share the costs of hazardous waste cleanup among all businesses, it could have merely imposed an environmental tax on all businesses. It would be more reasonable to assume that the lack of a corporate successor liability provision within CERCLA indicates an intent that the state rules limiting liability in certain circumstances, such as the non-liability of shareholders in the absence of veil piercing factors, and the non-liability of asset purchasers in the absence of de facto merger factors, should prevail.

One method of justifying the creation of federal common law to supplement CERCLA is Professor Caleb Nelson's discussion of "policy bundles," defined as "clusters of issues that policymakers are presumed to treat as a package and that choice-of-law analysis therefore lumps together."[324] He suggests that "when Congress has explicitly federalized one issue, the concept of policy bundles helps us identify the related questions that can plausibly be thought to have been federalized at the same time."[325] The federal courts that apply federal law to determine corporate successor liability in CERCLA cases have in effect decided that all issues of liability are in the CERCLA federal policy bundle. This policy bundle argument should not be extended to encompass

[324] Caleb Nelson, *The Persistence of General Law*, 106 COLUM. L. REV. 503, 538 (2006).

[325] *Id.*

all CERCLA issues. In *Atherton*, the Supreme Court found that the implementation of a federal statute did not require that all issues be decided under federal law.[326] The *Atherton* Court used state common law of negligence in determining the liability of officers and directors of federally chartered banks pursuant to a federal statute.[327] Similarly, state corporation rules for de facto merger should determine successor liability issues under CERCLA and other federal statutes. The *Bestfoods* decision, using state law of veil piercing, similarly limits the policy bundle argument in CERCLA cases.[328] It may be more appropriate to include the issue of corporate successor liability pursuant to CERCLA and other federal statutes in the same policy bundle with corporate successor liability arising from other sources, under exclusive authority of the states.

C. Horizontal federalism

It has been argued that Justice Brandeis's reference to the individual states as laboratories of democracy where "a single courageous State" could experiment without risking the entire country can have inequitable results in a national commercial market.[329] Professors Issacharoff and Sharkey have suggested the risk that state law will infringe on the authority of other states justifies the use of federal common law.[330] While this may be a legitimate concern in many areas of legislation, the risk is minimal in de facto merger analysis. Because state law governs most other aspects of corporate governance and responsibility, there is little risk that the application of state law to determine corporate successor liability will unduly infringe on the laws of other states, to

[326] Atherton v. F.D.I.C., 519 U.S. 213, 218 (1997).

[327] *Id.*

[328] United States v. Bestfoods, 524 U.S. 51, 63 (1998).

[329] Samuel Issacharoff & Catherine M. Sharkey, *Backdoor Federalism*, 53 U.C.L.A. L. REV. 1353 (2006) (arguing that federal substantive law diminishes the risk of a state encroaching upon the decisional authority of another state).

[330] *Id.*

any greater extent than other state corporate statutes. Choice of law rules applicable to other corporate issues are adequate to govern asset purchase disputes, without the added choice of federal common law. The decision to reserve for the states the authority to create and regulate corporations should be presumed to include the regulation of successor liability and the definition of de facto merger. If Congress intended a standard of successor liability different from the state de facto merger rules, then such a federal standard should have been expressed in CERCLA and other relevant federal statutes, thus avoiding the current split in authority in the lower federal courts.

D. Due Process

The Fifth Amendment Due Process Clause includes the right to be free from arbitrary and unreasonable deprivations of property.[331] The imposition of successor liability on a good faith purchaser of assets, where such liability would not be imposed under state law, could be a violation of due process. As Professor Aaron Fellmeth argued, the imposition of successor liability should be analyzed under the strict scrutiny test, whereby rules must be narrowly tailored to further a compelling government interest.

The federal common law substantial continuity test cannot meet the burden of being "narrowly tailored."[332] An innocent asset purchaser may be held responsible for CERCLA or other liabilities under federal common law, for which such purchaser would not be liable under state de facto merger analysis.[333] An asset purchaser that did not

[331] *See* Fellmeth, *supra* note 166 at 182.

[332] Aaron Xavier Fellmeth, *Cure Without a Disease: The Emerging Doctrine of Successor Liability in International Trade Regulation*, 31 YALE J. INT'L L. 127, 185 (Winter 2006).

[333] *See, e.g.*, United States v. Carolina Transformer Co., 978 F.2d 832, 837 (4th Cir. 1992) (imposing liability on a successor based on the broader federal substantial continuity test, yet noting that under state de facto merger analysis, the successor would not be liable because there was no continuity of stock ownership); Bradford C. Mank, *Should State Corporate*

own stock in the polluting company that sold the assets will not be liable for the obligations of the seller under the de facto merger rules in many states, yet may be liable under CERCLA, the ADA, and other obligations pursuant to federal common law. This assignment of liability to an asset purchaser who carefully structured the transaction to avoid such liability, and who played no role in the creation of such liability, can only be deemed arbitrary and unreasonable. The state de facto merger rules have developed over time to reasonably impose liability only where the asset purchaser is in fact the same company as the seller, in a different guise. Thus, the state rules for successor liability are substantially effective substitutes because these rules are effective for liability from other sources. The state rules are also less burdensome on asset purchasers because state de facto merger rules protect asset purchasers in circumstances where the federal substantial continuity rule would impose liability; therefore the federal common law standard for successor liability is not narrowly tailored.[334] Furthermore, the creation of a federal common law rule that would impose liability for CERCLA or ADA obligations where an asset purchaser would be immune from other liabilities can only be deemed arbitrary and unreasonable. The inclusion of federal common law in determining de facto mergers or successor liability is not narrowly tailored to further a compelling government interest. The result is an arbitrary rule that may deprive asset purchasers of due process.

E. Judicial Amnesia

If a scholar examined only cases of the U.S. Supreme Court, she must assume that all courts confronting the issue

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Law Define Successor Liability?: the Demise of CERCLA's Federal Common Law, 68 U. CIN. L. REV. 1157, 1197 (2000) ("In a few cases . . . only the substantial continuity approach would enable the EPA to reach a successor corp . . . .").

[334] *See Fellmeth*, *supra* note 332, at 185 (arguing that successor liability should not be imposed in international trade regulation, because it is not authorized by the relevant statutes, does not advance a public policy, and violates due process).

of the successor liability of an asset purchaser under CERCLA would be decided based on the rule set forth in *Kimbell Foods* and *O'Melveny*.[335] Pursuant to this rule, a court must first examine the state law for successor liability of an asset purchaser and decide whether such rule substantially conflicted with CERCLA policy. If no such conflict exists, state law should govern.[336] Only if state law is in conflict should courts have the authority to create and apply federal common law.[337] Notwithstanding these clear guidelines set forth by the Supreme Court, Professor Ronald Rosenberg suggests the federal circuit courts appear to have "judicial amnesia," which may be caused by a lack of understanding of the Supreme Court rule, a tendency to characterize their decisions as mere interpretation of the federal statute, a wish to reach a fair conclusion, a desire to carry out the goals of CERCLA to find potentially responsible parties in spite of the ambiguities within CERCLA, or simple judicial defiance of the Supreme Court's directive.[338] Regardless of the reason, it is undeniable that some federal courts have not followed the directives of the Supreme Court that federal law can be created only in a "few and restricted" circumstances; nor have these courts followed the decisions in *Bestfoods* and *Kamen* that state corporate law should not be preempted.[339]

The doctrine of stare decisis and respect of precedent are foundations of jurisprudence in this country, and the well reasoned decisions of the Supreme Court should not be ignored. The significance of renegade federal courts ignoring the Supreme Court cannot be overstated. The suggested

[335] United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979); O'Melveny & Myers v. Fed. Deposit Ins. Corp., 512 U.S. 79 (1994).

[336] *See id.*

[337] *See id.*

[338] Ronald H. Rosenberg, *The Ultimate Independence of the Federal Courts: Defying the Supreme Court in the Exercise of Federal Common Law Powers*, 36 CONN. L. REV. 425, 508-09 (Winter 2004).

[339] *See, e.g.*, United States v. General Battery Corp., 423 F.3d 294, 298 (3d. Cir. 2005) (finding that successor liability under CERCLA was a matter of federal law because of the need for uniformity).

solution is for the application of state laws of successor liability in all situations where Congress has not otherwise instructed.

F. Separation of powers

In *Sosa*, Justice Scalia's concurring opinion set forth the position that creation of federal common law is in derogation of the separation of powers doctrine.[340] Justice Scalia stated:

> We Americans have a method of making the laws that are over us. We elect representatives to two Houses of Congress, each of which must enact the new law and present it for the approval of a President, whom we also elect. For over two decades now, unelected federal judges have been usurping this lawmaking power by converting what they regard as norms of international law into American law.[341]

Although Justice Scalia refers to international law as the source of federal common law, as was at issue in the *Sosa* case, the same statement could be made with reference to other sources of law, such as the federal common law of successor liability. It can be argued that Congress should be called upon to provide more guidance in implementing statutes such as CERCLA, so that federal courts are not forced to do the job of lawmaking.

Professor Martin Redish has asserted that "there can be no such thing as 'federal common law,' at least to the extent it is used to provide a 'rule of decision' and to the extent the phrase 'common law' is construed as a category of lawmaking distinct from constitutional or statutory interpretation."[342] Because there is no statutory interpretation involved in CERCLA, where all courts agree that the statute is silent as

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[340] Sosa v. Alvarez-Machain, 542 U.S. 692, 750 (2004) (Scalia, J., concurring).

[341] *Id.*

[342] Martin H. Redish, *Federal Common Law, Political Legitimacy, and the Interpretive Process: An "Institutionalist" Perspective,* 83 NW. U. L. REV. 761, 765 (1989).

to successor liability, there should be no federal common law to determine successor liability in these controversies. As Professor Bradford Clark noted, "creation of federal common law raises constitutional concerns because it bears a troublesome resemblance to the exercise of legislative power—power apparently reserved by the Constitution to the political branches."[343] Notwithstanding these constitutional concerns, Professor Clark argues that much of federal common law is mischaracterized as such, and instead governs "matters beyond the legislative competence of the states" or serves to "further some basic aspect of the constitutional scheme."[344]

The issue of corporate successor liability is certainly not beyond the competence of state lawmakers, as all other matters of corporate creation and governance are within the authority of the state legislature; it would be difficult to construct a "constitutional scheme" that would be furthered by a rule of corporate successor liability. The doctrine of separation of powers leads to the conclusion that corporate successor liability is beyond the authority of the federal courts, but is within the authority of state legislatures. Professor Paul Lund argues that federal common law's displacement of state law is not relevant when construing a federal statute; however CERCLA and other federal statutes are silent as to successor liability and therefore are not being construed or interpreted, but rather supplemented or amended.[345] Additionally, the Supreme Court has stated that Congress legislates against a backdrop of state law.[346] The creation of a federal common law of substantial continuity to preempt state de facto merger analysis could violate the separation of powers doctrine.

[343] Bradford R. Clark, *Federal Common Law: A Structural Reinterpretation*, 144 U. PENN L. REV. 1245, 1249 (1996).

[344] *Id.* at 1271.

[345] Paul Lund, *The Decline of Federal Common Law*, 76 B.U. L. REV. 896 (1996).

[346] *See* Atherton v. FDIC, 519 U.S. 213, 218 (1997).

G. Control of lower courts

In *Erie*, the Supreme Court expressed concern over federal judges ignoring state law when it conflicted with their own personal views.[347] While the Supreme Court has consistently limited the authority of the federal courts to create federal common law, the courts of appeals and district courts have continued to take a more expansive view of federal common law, which may reflect the personal views of the judges. In *Bestfoods* and other similar cases, the Supreme Court has attempted to curb the lower courts' development of court-made rules by applying a presumption that Congress intended to use traditional state law to fill the interstices of a federal statute where a conflicting congressional intent or specific statutory policy was lacking.[348] As attorneys Rodney Griffith and Thomas Goutman have observed, "the Court sought to reduce separation of powers and federalism concerns by restraining the lower federal courts' development of federal common law."[349] If the decisions of the lower federal courts are in conflict with the Supreme Court, it will not be possible for business people to predict their potential liability. More importantly, the public's faith in the judicial system will be undermined if it appears that decisions are made based on the personal views of a judge, and not based on clear precedent.

H. Reasonable investment expectations in commercial transactions

The Supreme Court has expressed awareness that business people expect their commercial transactions to be governed consistently with state law, and the imposition of inconsistent federal common law could be disruptive to the

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[347] Erie R.R. Co. v. Tompkins, 304 U.S. 64, 77-78 (1938).

[348] *See* Rodney B. Griffith and Thomas M. Goutman, *A Hiccup in Federal Common Law Jurisprudence:* Sosa, Bestfoods, *and the Supreme Court's Restraints on Development of Federal Rules of Corporate Liability*, 14 U. MIAMI BUS. L. REV. 359 (Spring 2006).

[349] *Id.* at 415.

economy.[350] In *Kamen v. Kemper Financial Services*, the Court noted the presumption that state corporate law should be adopted as the federal law because parties would expect state law to govern their business transactions.[351] With similar reasoning in a much earlier case, *United States v. Brosnan*, the Court expressed concern regarding "the severe dislocation to local property relationships which would result from our disregarding state procedures. Long accepted nonjudicial means of enforcing private liens would be embarrassed, if not nullified where federal liens are involved, and many titles already secured by such means would be cast in doubt."[352] The issue in *Brosnan* was whether state foreclosure proceedings by a mortgagee would extinguish federal tax liens. The Court adopted state law as the federal common law.[353] The Court continued this reasoning in a more recent case, *Wilson v. Omaha Indian Tribes*, adopting state law rather than creating new federal law in a determination of property rights where the relocation of a stream affected state boundaries and the boundary of an Indian reservation.[354] The Court again was concerned with disruption of business transactions, noting "States have substantial interest in having their own law resolve controversies . . . Private landowners rely on state real property law when purchasing real property . . . There is considerable merit in not having the reasonable expectations of these private landowners upset . . . ."[355]

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[350] *See* Kamen v. Kemper Financial Services, Inc., 500 U.S. 90, 98 (1991) ("The presumption that state law should be incorporated into federal common law is particularly strong in areas in which private parties have entered legal relationships with the expectation that their rights and obligations would be governed by state-law standards."); United States v. Kimbell Foods Inc., 440 U.S. 715, 728-29 (1979) ("[O]ur choice-of-law inquiry must consider the extent to which application of a federal rule would disrupt commercial relationships predicated on state law.").

[351] *Kamen*, 500 U.S. 90 at 98.

[352] United States v. Brosnan, 363 U.S. 237, 251-52 (1960).

[353] *Id.*

[354] Wilson v. Omaha Indian Tribes, 442 U.S. 653 (1979).

[355] *Id.* at 674.

The creation of a federal successor liability test to preempt state de facto merger doctrine has the potential to disrupt merger and acquisition transactions and cause inequitable and unforeseeable results. Business people rely on state law in structuring their transactions to avoid state de facto merger liability. Although one commentator has taken the position that "federal law can apply whenever federal interests require a federal solution,"[356] corporate successor liability does not necessarily implicate federal interests. Other issues of corporate governance and liability are adequately addressed by state law. If the state solutions, including de facto merger analysis, are not adequate, perhaps Congress, and not the lower federal courts, should propose a federal solution. Lacking such a Congressional action, the use of state de facto merger analysis is supported by decades of Supreme Court decisions favoring the preservation of state corporate law.

VIII. CONCLUSION

Corporate successor liability is more appropriately determined by state law, as the Supreme Court has repeatedly suggested, and not federal common law. This choice is supported by the three part test from *Kimbell Foods*, which requires analysis of: (1) the need for national uniformity; (2) whether state law would "frustrate specific objectives of the federal program;" and (3) whether federal rules would "disrupt commercial relationships predicated on state law."[357]

(1) In *O'Melveny*[358] the Supreme Court cautioned that national uniformity was not a valid reason to create federal common law in the absence of a "genuinely identifiable (as opposed to judicially constructed) federal policy."[359] The Sixth and Ninth Circuits have found there is no need for

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[356] Martha A. Field, *Sources of Law: The Scope of Federal Common Law*, 99 HARV. L. REV. 881, 884-90 (1986).

[357] United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979).

[358] O'Melveny & Myers v. Fed. Deposit Ins. Corp., 512 U.S. 79 (1994).

[359] *Id.*

national uniformity of de facto merger analysis.[360] Although several circuit courts have used uniformity as an excuse to create federal common law in determinations of successor liability under CERCLA and other federal statutes, these decisions have lacked a detailed analysis of why uniformity is required.[361] Furthermore, if uniformity was key to implementation of all issues implicating federal statutes, then the federal interests could hardly be deemed "unique."

The greater need for uniformity may exist not in a federal successor liability doctrine, but rather uniformity in the liability of particular asset purchasers. This means that an asset purchaser is either liable for all responsibilities of the asset seller or none of them. Imposing liability for CERCLA obligations when the asset purchaser is protected from all other liabilities may lead to un-bargained for results. The same argument can be made for other areas where federal common law has been created, including successor liability in international trade regulations, intellectual property, ERISA, labor issues, and piercing the corporate veil for CERCLA liability. Federal successor liability rules are more appropriate when used to decide controversies in labor law, employment discrimination, and pension benefit, as the Sixth Circuit decided in *Mickowski*,[362] or better yet, restricted to "such narrow areas as those concerned with the rights and obligations of the United States, interstate and international disputes implicating the conflicting rights of States or our relations with foreign nations, and admiralty cases,"[363] as the Supreme Court directed in *Texas Industries v. Radcliff*. State legislatures and courts are competent to create standards for corporate successor liability.

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[360] *See* Anspec Co. v. Johnson Controls, Inc., 922 F.2d 1240, 1250 (6th Cir. 1991); Atchison, Topeka & Santa Fe Ry. Co. v. Brown & Bryant, Inc., 159 F.3d 358, 364 (9th Cir. 1998).

[361] *See* B. F. Goodrich v. Betkoski, 112 F.3d 88 (2d Cir. 1997).

[362] Mickowski v. Visi-Trak Worldwide, LLC, 415 F.3d 501, 515 (6th Cir. 2005).

[363] Texas Indus., Inc. v. Radcliff Materials, Inc., 451 U.S. 630, 640 (1980).

(2) With regard to frustration of the objectives of the federal programs, where nothing in the text or legislative history indicates Congressional intent to impose successor liability, it should not be presumed that the imposition of state rules of successor liability would frustrate any purpose of the federal legislation. Congress has not provided for a successor liability rule in CERCLA and other federal statutes. The assumption that federal policy favors the imposition of liability on the greatest number of defendants leads to illogical results; this argument should not be persuasive in creating federal common law. There is no indication that state de facto merger rules are contrary to federal policy.

(3) As for the third *Kimbell Foods* factor, the application of a federal de facto merger doctrine is likely to cause disruptions in commercial relationships, as mergers and acquisitions have traditionally been governed by state law and asset purchasers rely on state laws in structuring their transactions.

Where a federal statute is silent as to the liability of successor corporations for violations of the statute, state law should resolve the issue of the successor liability of an asset purchaser. A federal common law doctrine of successor liability creates uncertainty and adds to the costs of mergers and acquisitions. The creation of a federal common law of successor liability rule also raises due process concerns, and could violate the separation of powers doctrine. The use of federal common law of successor liability may also be contrary to the Supreme Court's reasoning in the decisions following *Erie*, including *Bestfoods* and *O'Melveny* and may conflict with the Rules of Decision Act.