Discussion: "The Limits of Limited Liability"

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The paper

- The Supreme-Court decisions in *United States v. Bestfoods* established that a parent company is not liable to an environmental bill left by a subsidiary
- Using a diff-in-diff methodology, it is documented that flowing the decision:
  - plants increased ground emission by $5 - 9\%$
  - channel: reduced investment in abatement
    - plants decreased production-related abatement by $15 - 17\%$
- The execution of the paper is careful and pedantic
  - I focus on interpretation

The law and economics of *Bestfoods*

- The specific dilemma: does limited liability require special treatment, i.e. a power to pierce the corporate veil, in cases of environmental damage
- In fact, *Bestfoods* raises more fundamental questions regarding
  - the relationship between environmental law and corporate law
  - on the division of labor between courts, regulators and legislators
  - legal formalism

The facts of *Bestfood*

- Ott II, a subsidiary of CPC (the parent), "owned and operated" a chemical facility near Muskegon, Michiganin, that left behind clean-up bill "well into the tens of millions of dollars"
  - and, then, went bankrupt
  - the parent still operate
- The US environmental agancies ask the courts to pierce the parent's corporate veil
  - so as to pay for the enironmental damage caused by the subsidiary

The legal dilemma: substance versus formalism (i)

- Making polluters pay for the cleanup is sound environmental policy
  - §107(a)(2) of CERCLA (environmental law): "any person who operates a polluting facility is directly liable for the costs of cleaning up the pollution."
- It is a bedrock "principle of corporate law that a parent corporation ... is not liable for the acts of its subsidiaries ...But there is an equally fundamental principle ... that the corporate veil may be pierced and the shareholder held liable for the corporation's conduct when, *inter alia*, the corporate form would otherwise be misused to accomplish certain wrongful purposes, most notably fraud."
  - the whole point of limited liability is to allow an owner, corporate or real person, to limit liability to actions of a company that he/it owns

The legal dilemma: substance versus formalism (ii)

- The district court seems to have been willing to go in the direction of substance
  - the Sixth Circuit and then the supreme court reversed the decision
  - (as well as clarified the extent to which CPC was directly involved, and hence liable, in operating the cite)
- With some material effect
  - as the paper demonstrates: pollution levels increased following the decision

Is limited liability, in cases, too strong? Yes

- In private cases, it can be softened
  - by the parties, by way of a contract
  - along the lines of the Coase Theorem
- It is very common, for owners of SME companies, to personally guarantee debt of companies they own
  - or pledge their homes as security against debt created by their companies
- In tort cases, there is no counter party that demands that limited liability is relaxed
- Why shouldn't the court do it?
  - common-law system, a different decisions in Bestfood could have created a precedent that would lead, eventually, to substantial changes in limited liability law

Is there a non-piercing way to resolve the environmental problem in cases like *Bestfood*?

- Require environmental indemnity from any polluting industry
- To create BIS-like regulations in polluting industries
  - making environmental debt senior to any other debt
    - as is already the case with other tax liabilities
  - with regulatory power to shut down a plant once it equity is insufficient to pay for clean-up bills
- Notice that a *Bestfood* problem may arise even if the polluter is not a subsidiary of another company

Is market failure a necessary consequence when tort interacts with limited liability? Certificate of Financial Responsibility (COFR)

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- General principle in public finance: address market failure at source, as close as possible to the missing-market

Back to *Bestfood*

Conjecture

Since the problem seems to be well understood, and since sensible solutions were devised by US legislators and regulators, there might have been further responses to Bestfood (out of the four years covered by this paper), which might have had a material effect on pollution (a question that can be answered using the authors' methodology), and might put the Supreme-Court decision in Bestfood in a different perspective