BNA

ANALYSIS AND PERSPECTIVE

CERCLA LIABILITY OF FRANCHISORS

By Michael B. Gerrard and Stephen L. Kass *

The net of hazardous waste liability now threatens to ensnare yet another class of entities—franchisors. A recent decision from a federal court in Florida—*Hillsborough County v. A & E Road Oiling Service Inc.*[1]—found that the Roto-Rooter Corp. might be liable for contamination caused by an independent contractor that used its service mark. This and earlier decisions established numerous criteria to be used by the courts in the very fact-based inquiry concerning franchisors' liability.

The Comprehensive Environmental Response, Compensation and Liability Act bestows liability upon several types of entities, including facility "owners," "operators," and "any person who by contract, agreement, or otherwise arranged for disposal or treatment" of hazardous substances.[2] Truck loads of companies of every size and shape have fallen prey to these very broad definitions, but until now franchisors had apparently escaped.

This article discusses the recent Florida decision and some of its precursors. It concludes with reflections on what franchisor liability says about the structure of CERCLA, and suggestions for how franchisors can attempt to avoid CERCLA liability.

At stake in the *Hillsborough* case was allocation of the $8.6 million cleanup bill for the Sydney Mine Waste Disposal Site, a facility operated by the county for disposal of all manner of liquid wastes. Under orders from the U.S. Environmental Protection Agency (EPA), the county and several other large companies undertook to decontaminate the site. The county then sued some 170 entities whose wastes had been disposed at the site or that had transported wastes there. One of these defendants was Roto-Rooter, which was named because its franchisee, Dolfran Inc., had apparently sent waste to the disposal site in connection with its sewer, drain and pipe cleaning services.

Roto-Rooter moved for summary judgment on the grounds that it "did not assume control and did not have the ability or obligation to control any of Dolfran's activities or decisions regarding its waste disposal activities."[3] Judge Elizabeth A. Kovachevich of the U.S. District Court for the Middle District of Florida, sitting in Tampa, found that the franchise agreement between Roto-Rooter and Dolfran "is critical to determining the extent of the control the franchisor retained over the franchisee."[4] Reviewing this agreement, she found:

> Based on the franchise agreement, Dolfran was required to actively advertise the Roto-Rooter system and the methods, techniques and services employed by Roto-Rooter. In addition, the agreement included language referring to the use of service marks 'as directed by' Roto-Rooter, and the performance of services 'as permitted by Roto-Rooter.' The agreement further stipulated that Dolfran use Roto-Rooter sewer, pipe and drain cleaning services, as well as machines and accessories manufactured by the company or their equivalent. The agreements also provided that Roto-Rooter would retain title to all that equipment which its franchisees were required to use. Roto-Rooter required the Dolfran service man be in clothes so as to be easily identifiable 'as bona-fide Roto-Rooter service men,' and that service vehicles be 'readily identifiable as Roto-Rooter vehicles.'
>
> Lastly, Roto-Rooter agreed to provide to its franchisees 'advice and instructions to licensees with respect to proper use of the Roto-Rooter system and service marks and soliciting and performing sewer, drain and pipe cleaning services.'[5]

The court found that these facts gave rise to a genuine issue of material fact, such that summary judgment was inappropriate. Thus Roto-Rooter will have to stay in the case and, perhaps, go to trial to avoid liability to Hillsborough County for the waste generated by Dolfran.

Decision Relies On 'Aceto'

In her analysis, Judge Kovachevich relied heavily on a celebrated 1989 decision from the Eighth Circuit, *U.S. v. Aceto Agricultural Chemicals Corp.*[6] That court had considered how to allocate more than $10 million in cleanup costs for a pesticide formulation facility in Iowa operated by the Aidex Corp., which had gone into bankruptcy. Aidex was a "toll manufacturer"—it received chemicals from its customers; mixed and reformulated them; and shipped back commercial-grade pesticides. Aidex left behind a badly contaminated site. EPA and the State of Iowa, unable to recover from the bankrupt Aidex, sued eight of these customers, including several large chemical companies. The companies countered that they had contracted with Aidex for the processing of a valuable product, not the disposal of waste, and that Aidex alone controlled the processes used in formulating the pesticides and in disposing of the wastes.

The Eighth Circuit, accepting the plaintiffs' allegations as true for the purposes of the defendants' motion to dismiss, found that the defendants retained ownership of the materials that came into the Aidex plant, the work in process, and the resulting pesticide. Plaintiffs had also alleged that generation of hazardous substances "is an 'inherent' part of the formulation process through spills, cleaning of equipment, mixing and grinding operations, production of batches which do not meet specifications, and other means."[7] Based on this, the Eighth Circuit said that the defendants should not be allowed "to simply 'close their eyes' to the method of disposal of their hazardous substances,"[8] and it found them potentially liable.

In *Hillsborough County*, Judge Kovachevich read *Aceto* to impose liability "on those who had the authority to control the disposal, even without ownership or possession."[9]

'Aamco Transmissions'

Aceto was also the focus of much attention by the Second Circuit in 1992 in another important case on the CERCLA liability of franchisors, *General Electric Co. v. Aamco Transmissions Inc.*[10] Acting under the federal superfund law, New York State had required GE to clean up a storage site near Albany, known as the Waite Road site, to which waste from GE and many other companies had been hauled and allowed to leak into a freshwater wetland. GE spent more than $1.6 million on the cleanup and sought contribution from other companies that had used the Waite Road site. In 1990, GE sued 30 gasoline service stations that had allegedly arranged for waste oil to be sent to Waite Road. A few months later it amended its complaint to add three major oil companies which were franchisors of or otherwise related to the service stations. GE alleged that the oil companies were liable as "arrangers" within the meaning of CERCLA.

The Second Circuit disagreed. It found that "it is the *obligation* to exercise control over hazardous waste disposal, and not the mere ability or opportunity to control the disposal of hazardous substances that makes an entity an arranger under CERCLA's liability provision."[11] The oil companies "had no obligation to exercise control over the manner in which their dealers disposed of waste motor oil."[12] Unlike the facts in *Aceto*, "the oil companies did not own the hazardous substance, nor did they control the process by which waste motor oil was generated. In fact, while the oil companies may have encouraged their dealers to sell as much of their petroleum products as they could, the uncontroverted evidence demonstrates that they did not require their dealers to perform oil changes."[13] The Second Circuit went on to say:

> It was a matter of practice for each dealer to collect the waste oil and store it in an underground tank until it was disposed of. The fact that the oil companies leased the underground storage tanks to their dealers is not sufficient to make them liable as arrangers under CERCLA. The oil companies did not provide by contract that they would have any responsibility for the disposal of the waste oil collected by each of the dealers. As evidenced by the 'independent business' language appearing in all three leases, the decision of whether or not to perform oil changes, and the manner in which the waste oil collected would be disposed of, would be left entirely to the dealers.[14]

In a case with very similar facts, in late 1992 a federal district court in Minnesota followed the Second Circuit's decision in *General Electric* in holding oil companies not liable for their dealers' waste oil disposal methods.[15]

Franchisors' Dilemma

General Electric, in its papers to the Second Circuit, cited *U.S. v. Fleet Factors Corp.*,[16] which contained dictum suggesting that the mere capacity to control a site was enough to confer liability. *Fleet Factors*, a lender liability case, turned out to be the apogee of CERCLA liability; subsequent cases have turned away from its extremely expansive reading.[17] The Second Circuit distinguished *Fleet Factors* as a case arising in the context of "owner or operator" liability, while both *General Electric* and *Aceto* concerned "arranger" liability.

The court in *Hillsborough* did not focus on the somewhat troublesome distinction between "owner or operator" liability and "arranger" liability. Instead, Judge Kovachevich analyzed the extent of Roto-Rooter's control over its franchisee Dolfran. The extent of control is relevant to *both* "owner or operator" or "arranger" analysis, and it is also a touchstone of the common law principles of franchisor/franchisee liability.[18]

---

* Michael B. Gerrard is a partner in the New York City office of Arnold & Porter, an adjunct professor of environmental law at Columbia University School of Law, and author of "Whose Backyard, Whose Risk: Fear and Fairness in Toxic and Nuclear Waste Siting" (MIT Press 1994). Stephen L. Kass is a partner in the New York City law firm of Berle, Kass & Case.

[1] 853 F.Supp. 1402 (M.D.Fla. 1994).

[2] 42 U.S.C. § 9607(a).

[3] 853 F.Supp. at 1412.

[4] 853 F.Supp. at 1413.

[5] Id.

[6] 872 F.2d 1373 (8th Cir. 1989). *Similarly, see Jones-Hamilton Co. v. Beazer Materials & Services Inc.*, 959 F.2d 126 (9th Cir. 1992).

[7] 872 F.2d at 1378.

[8] 872 F.2d at 1382.

[9] 853 F.Supp. at 1412.

[10] 962 F.2d 281 (2d Cir. 1992).

[11] 962 F.2d at 286. Emphasis in original.

[12] 962 F.2d at 287.

[13] Id.

[14] Id.

[15] *U.S. v. Arrowhead Refining Co.*, 829 F.Supp. 1078 (D.Minn. 1992). *See also Rodenbeck v. Marathon Petroleum Co.*, 742 F.Supp. 1448 (N.D. Indiana 1990) (oil company not liable for contamination to owner of property on which service station is located, where owner had given oil company a release).

[16] 901 F.2d 1550 (11th Cir. 1990), cert. den. 111 S.Ct. 752 (1991).

[17] *See* Stephen L. Kass & Michael B. Gerrard, "The Taming of EPA Under Superfund," TXLR, Sept. 1, 1993.

[18] *See* Heidi E. Brieger, "LUST [Leaking Underground Storage Tanks] and the Common Law: A Marriage of Necessity," 13 B.C. Envtl. Aff. L. Rev. 521 (1986).

0887-7394/94/$0+$1.00

0887-7394/94/$0+$1.00

The "extent of control" test is valid under the prevailing cases. However, it puts franchisors under the same dilemma as that faced by lenders confronted with the issue of how to limit their CERCLA liability. A responsible franchisor or lender will want to ensure that its franchisees or borrowers handle hazardous wastes in an environmentally sound manner. Unfortunately, while simply requiring compliance with the law does not pose risks, becoming too involved in the franchisee's or borrower's operations can subject one to CERCLA liability (whether as an owner, operator, or arranger), and the place where excessive involvement starts is often difficult to discern. Since the first CERCLA lender liability cases in the mid-1980s, lenders have had to perform an eggshell dance—trying to make sure that their borrowers did not mishandle hazardous wastes, but not becoming so involved that the lenders themselves could become liable in the event of a borrower's misstep. Franchisors may now be subjected to the same dance.

This dilemma, in our view, exposes one of the underlying problems with the current CERCLA liability scheme. A major purpose of this scheme is to allow EPA to rummage through as many pockets as possible in search of reimbursement for cleanup costs, so that these costs do not come from the federal superfund budget. Moral culpability has almost nothing to do with it; an entity is liable even if its actions were perfectly legal (even legally mandated) at the time performed, so long as the entity was involved (as, for example, an owner, operator or arranger). Determining culpability would involve huge transaction costs and delays for EPA, and thus this step is skipped; it is the connection to the contaminated site that counts.

This focus on connection rather than culpable conduct creates incentives that are, from the perspective of environmental responsibility, counter-productive. It induces lenders, franchisors, corporate parents, and others who might face vicarious CERCLA liability to avert their gaze, to hand down broad directives but to keep their hands off the actual operation for fear of becoming legally soiled.

As long as this remains the rule, however, franchisors seeking to avoid CERCLA liability should take heed. They run little risk in informing their franchisees of the environmental laws and insisting that these laws be followed. However, specific directions as to how hazardous wastes are to be handled and disposed of could turn the franchisor into an "arranger" or an "operator," and thus should be undertaken only if the franchisor is sure that they are more or less foolproof and will be honored in practice.

Nevertheless, these are some specific measures that franchisors should consider if they are in businesses that are especially exposed to environmental liability. These include:

- Requiring franchisees to furnish prompt notice of any environmental notices, complaints or problems. (Lenders' monitoring of borrowers' activities has been deemed acceptable under CERCLA; the same concept should apply to the franchise relationship.)
- Prohibiting specified environmentally risky activities.
- Trying to arrange for title to materials to pass to franchisees upon delivery.
- If there are particular operations that are especially likely to lead to CERCLA liability, and if those operations are not central to the business, writing the franchise agreements so that these operations are optional with the franchisee.
- Before entering into a franchise arrangement, performing due diligence to make sure that the site of the proposed facility is not contaminated or otherwise subject to environmental liabilities. If there is any possibility of contamination, and if another site cannot be utilized instead, try to secure an explicit release of CERCLA liability from the seller; an indemnification would be even better if the seller has a deep pocket.
- Where possible, conveying title rather than a leasehold in real property to franchisees (retaining a security interest, if desired); do not provide for automatic reversion of title in the event of a default, but rather allow for a pre-reversion environmental audit.

The sands of environmental liability shift so quickly that franchisors should be continually vigilant for changes affecting their industry, but the above suggestions are likely to provide reasonable protection for at least the near term.

0887-7394/94/$0+$1.00

JOURNAL

November 29-30 – "Sixth Annual Product Liability Conference," Madison, Wisc. (The College of Engineering, University of Wisconsin-Madison, 702 Langdon St., Madison, WI 53706; 1 (800)462-0876; FAX 1 (800) 442-4214).

November 30-December 1 – "Environmental Risk Management: Building Quality EH&S Programs: Avoiding Liabilities," Washington, DC (RTM, 1020 N. Fairfax St., Suite 201, Alexandria, VA 22314; (703) 549-0977; FAX (703) 548-5945).

December 1-2 – "Federal Environmental Law Today," Bally's Grand Casino Hotel, Atlantic City, NJ (Federal Publications Inc., 1120 20th St., NW, Washington, DC 20036; 1 (800) 922-4330; FAX (202) 775-9304).

December 5-6 – "Environmental Due Diligence," Hotel del Coronado, Coronado, Calif. (Federal Publications Inc., 1120 20th St., NW, Washington, DC; 1 (800) 922-4330; FAX (202) 775-9304).

December 8-9 – "Federal Environmental Law Today," Palmer House Hilton, Chicago, Ill. (Federal Publications Inc., 1120 20th St., NW, Washington, DC 20036; 1 (800) 922-4330; FAX (202) 775-9304).

December 8-9 – "Insurance Coverage and Practice," Marriott Marquis Hotel, New York City, NY (Defense Research Institute Inc., 750 N. Lake Shore Dr., Suite 500, Chicago, IL 60611; (312) 944-0575).

December 15-16 – "14th Annual RCRA/CERCLA and Private Litigation Update," Omni Shoreham Hotel, Washington DC (ABA Section of Natural Resources, Energy and Environmental Law, 750 N. Lake Shore Dr., Chicago, IL 60611; (312) 988-5724; FAX (312) 988-5572).

February 9-10, 1995 – "Products Liability," Fairmont Hotel, San Francisco, Calif. (DRI, 750 N. Lake Shore Dr., Suite 500, Chicago, IL 60611; (312) 944-0575).

February 15-18, 1995 – "Environmental Law," Washington, D.C. (ALI-ABA, 4025 Chestnut St., Philadelphia, PA 19104-3099; 1 (800) CLE-NEWS; FAX (215) 243-1664).

April 20-21, 1995 – "Environmental & Chemical Exposure," Marriott Inner Harbor, Baltimore, Md. ((DRI, 750 N. Lake Shore Dr., Suite 500, Chicago, IL 60611; (312) 944-0575).

May 4-5, 1995 – "Drug and Medical Device Litigation," Sheraton Seattle, Seattle, Wash. (DRI, 750 N. Lake Shore Dr., Suite 500, Chicago, IL 60611; (312) 944-0575).

Toxics Law Reporter
0887-7394/94/$0+$1.00