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BILL ANALYSIS

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Senate Bill 591 (Substitute S-3 as reported)
Sponsor: Senator Wayne Kuipers
Committee: Judiciary

Date Completed: 12-3-07

RATIONALE

As a rule in this country, according to statute or case law, when one corporation is merged into another, the "successor corporation" can be held liable for the torts, or civil wrongs, of the predecessor corporation. In this situation, the amount of damages that may be awarded to parties harmed by the predecessor corporation is not limited to the value of that firm, as it would be if the acquisition had not occurred or if the corporation were operated as a subsidiary. Rather, the maximum amount that plaintiffs might recover is the total value of the successor corporation, even if it did nothing to create the liability and the wrongful activity of the predecessor terminated before the merger took place. Many people believe that this rule of successor liability can result in significant injustice, especially in mass tort situations--such as asbestos litigation--involving numerous claimants and many defendants, including some that are bankrupt.

One successor corporation in particular, Crown Cork & Seal, evidently is the subject of hundreds of thousands of claims due to asbestos-related activity of a predecessor corporation that Crown acquired in the 1960s. Reportedly, Crown paid approximately $7 million for all of the predecessor's assets and, as the result of the merger, has paid almost $600 million in asbestos-related claims. (For more information about this acquisition, please see **BACKGROUND**, below.)

To address this situation and others like it, the American Legislative Exchange Council (ALEC) drafted model legislation to limit the asbestos-related liability assumed by a corporation as the result of a merger. According to ALEC, laws based on this proposal have been enacted in six states since 2001. It has been suggested that Michigan should follow suit.

CONTENT

The bill would add Chapter 30 (Limitation of Successor Asbestos-Related Liability) to the Revised Judicature Act to establish limits on the asbestos-related liability of a corporation that assumed or incurred the liability as a result of a merger or consolidation with another corporation before 1972. The bill would do all of the following:

-- Limit the successor corporation's cumulative asbestos-related liability to the fair market value of the transferring corporation's total gross assets.
-- Describe how fair market value of total gross assets would be established and adjusted.
-- Exclude from the limitation a workers' compensation claim and an obligation under the National Labor Relations Act or a collective bargaining agreement.
-- Require Michigan courts to apply liberally the liability limitation in actions that included successor asbestos-related liability, and to apply retroactively procedural provisions of Chapter 30 unless that application would unconstitutionally affect a vested right.

Chapter 30 would apply to asbestos claims in actions filed on or after the

bill's effective date, and in actions pending but whose trial had not begun as of that date.

Liability Limitation

Except as provided below, the cumulative "successor asbestos-related liability" of a corporation would be limited to the fair market value of the total gross assets of the transferor, determined at the time of the merger or consolidation, and adjusted as prescribed in the bill. The corporation would not have any responsibility for successor asbestos-related liability in excess of this limitation.

If the transferor assumed or incurred successor asbestos-related liability in connection with a prior merger or consolidation with a prior transferor, the limitation of liability of the successor corporation would be the fair market value of the total assets of the prior transferor, determined at the time of that merger or consolidation, and adjusted as prescribed in the bill.

The limitation would apply to a corporation that became a successor before January 1, 1972, or that was a successor to such a corporation.

The limitation would not apply to any of the following:

-- A claim for workers' compensation benefits paid by or on behalf of an employer to an employee under the Worker's Disability Compensation Act or a comparable workers' compensation law of another jurisdiction.
-- A claim against a corporation that was not a successor asbestos-related liability.
-- An obligation under the National Labor Relations Act or under a collective bargaining agreement.

"Successor asbestos-related liability" would mean a liability, whether known or unknown, asserted or unasserted, absolute or contingent, accrued or unaccrued, liquidated or unliquidated, or due or to become due, that is related in any way to an asbestos claim and that was assumed or incurred by a corporation as a result of, or in connection with, a merger or consolidation or a plan of merger or consolidation with or into another corporation or that is related in any way to an asbestos claim based on the exercise of control or the ownership of stock of the other corporation before the merger or consolidation. The term would include liability that, after a merger or consolidation for which the fair market value of total gross assets is determined under Chapter 30, is paid or otherwise discharged, or is committed to be paid or otherwise discharged, by or on behalf of the corporation, by a successor of the corporation, or by or on behalf of a transferor, in connection with a settlement, judgment, or other discharge of liability in this State, another state, or a foreign nation.

"Corporation" would mean a corporation organized for profit, whether organized under the laws of this State, another state, or a foreign nation. "Successor" would mean a corporation that assumes or incurs, or has assumed or incurred, a successor asbestos-related liability. "Transferor" would mean a corporation from which a successor asbestos-related liability is assumed or incurred.

"Asbestos claim" would mean a claim for damages, loss, indemnification, contribution, or other relief arising out of, based on, or in any way related to asbestos. The term would include a claim based on the health effects of exposure to asbestos, including a claim for any of the following:

-- Personal injury or death,.
-- Mental or emotional injury.
-- Risk of disease or other injury.
-- The costs of medical monitoring or surveillance, to the extent such a claim is recognized under State law.

"Asbestos claim" also would include the following:

-- A claim made by or on behalf of a person exposed to asbestos, or by or on behalf of a representative, spouse, parent, child, or other relative of the person.
-- A claim for damages or loss caused by the installation, presence, or removal of asbestos.

Fair Market Value of Total Gross Assets

The fair market value of total gross assets could be established by any method reasonable under the circumstances,

including by reference to any of the following:

-- The going concern value of the assets.
-- The purchase price attributable to or paid for the assets in an arm's-length transaction.
-- The value of the assets recorded on a balance sheet, if there were no other readily available information from which fair market value could be determined.

In determining the fair market value of total gross assets, total gross assets would include both intangible assets and the amount of any liability insurance issued to the transferor that provided coverage for successor asbestos-related liabilities. If the total gross assets included an amount for liability insurance, following provisions would apply.

Chapter 30 would not affect the applicability, assignability, terms, conditions, and limits of the insurance, and would not otherwise affect the rights and obligations of a transferor, successor, or insurer under an insurance contract or related agreements, including rights and obligations under settlements reached before the bill's effective date between a transferor or successor and its insurers resolving liability insurance coverage and the rights of an insurer to seek payment for applicable deductibles, retrospective premiums, or self-insured retentions or to seek contribution from a successor for uninsured or self-insured periods or periods for which insurance was uncollectible or otherwise unavailable.

If a dispute concerning the insurance coverage between the transferor or successor and its insurers were settled before the bill's effective date, the amount of the settlement would be the amount of the liability insurance to be included in the total gross assets.

Adjustment of Fair Market Value

In determining a limit of liability under Chapter 30, the fair market value of total gross assets at the time of a merger or consolidation would have to be increased, for each year since the merger or consolidation, by a percentage equal to 1% plus the adjusted prime rate for the six-month period ending March 31 of that calendar year. An increase could not be compounded.

The adjustment would continue until the date the adjusted value was first exceeded by the cumulative amounts of successor asbestos-related liabilities paid or committed to be paid by or on behalf of the corporation or a predecessor, or by or on behalf of a transferor, after the time of the merger or consolidation for which the fair market value of total gross assets was determined.

The amount of any liability insurance coverage included in the total gross assets could not be included in the adjustment.

Application of Chapter 30

To the fullest extent permissible, a court would have to apply liberally the liability limitation under Chapter 30 in an action that included successor asbestos-related liability. A court would have to apply procedural provisions of Chapter 30 retroactively. If the application of a provision would unconstitutionally affect a vested rights, however, the provision would have to be applied prospectively only.

Chapter 30 would apply to an action that included an asbestos claim to which either of the following applied:

-- The action was filed on or after the bill's effective date.
-- The action was pending but trial of the action had not yet commenced as of the bill's effective date.

Severability

Chapter 30 would be severable as provided in Section 5 of Chapter 1 of the Revised Statutes of 1846 (MCL 8.5). (Under that section, if a court finds that any portion of an act or its application to any person or circumstance is invalid, the invalidity does not affect the remaining portions or applications of the act that can be given effect without the invalid portion or application, provided the court does not determine the remaining portions to be inoperable.)

Proposed MCL 600.3001-600.3008

BACKGROUND

The American Legislative Exchange Council is the source of the following information.

Crown Cork & Seal, the inventor of the bottle cap, purchased a majority of the stock of Mundet Cork in November 1963. Mundet was another company that made bottle caps. Before the acquisition, Mundet also had a small side business making, selling, and installing asbestos insulation. By the time of the stock purchase, Mundet had shut down its insulation operations.

Within 93 days after Crown obtained its stock ownership in Mundet for approximately $7 million, that company sold off what was left of its insulation division, including idle machinery, leftover inventory, and customer lists. Mundet also signed a covenant not to get into the insulation business again after the sale. Subsequently, Crown acquired all of Mundet's stock and Mundet, having only bottle-cap operations, was merged into Crown in January 1966.

The merger of Mundet Cork into Crown has led to more than 300,000 asbestos-related claims against Crown. As the successor corporation, Crown has paid almost $600 million in asbestos-related costs.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

In some circumstances, such as the case of Crown Cork & Seal, the rule of successor liability can cause a tremendous injustice to the successor corporation, as well as its shareholders, employees, lenders, and other stakeholders. Although Crown never manufactured, sold, or installed a single asbestos-containing product in its 100-year history, the company has been named in a multitude of asbestos-related lawsuits because of its acquisition of a predecessor corporation more than 40 years ago. In addition to paying nearly $600 million in costs to date, Crown has had its credit rating reduced and has been forced to pay higher-than-prevailing interest rates on its borrowing. At present, the company is fighting to avoid bankruptcy in order to protect the business as well as its employees and retirees.

The successor liability law is outdated and makes no sense as legal or economic policy. Testimony presented by ALEC quotes from a textbook by Professor Richard Epstein of the University of Chicago: "To see the business pitfalls that this rule holds for the unwary, assume that corporation A with assets of $10 million is merged into corporation B with assets of $1 billion. Let corporation A make some dangerous product that poses risk of future harms, and all assets of corporation B may be seized to pay for any wrongs that A committed before the merger…A better rule would hold B liable as a successor only for the assets descended from the acquired firm (augmented by a suitable rate of return over time), without exposing its separate assets to A's pre-merger liabilities." As the text points out, if corporation B operated A as a separate subsidiary, instead of liquidating it, "B could continue to insulate its assets from pre-merger liabilities".

The application of the successor liability rule may be particularly unjust in asbestos cases. According to ALEC, "Studies have shown that up to 90 percent of recent asbestos claimants are not sick. Those who are sick face a depleted pool of assets as asbestos lawsuits have bankrupted an estimated 85 companies" ("Asbestos and Silica Litigation Reform: Helping the Sick, Curbing Fraud, and Providing Liability Fairness, *The State Factor*, February 2007). As a result of these bankruptcies, plaintiffs are unjustly singling out successor corporations for wrongs they did not do.

By revising the rule of successor liability for asbestos-related claims, the bill would limit plaintiffs' damages awards to the amount the injured parties could have recovered from the predecessor if no merger had occurred: the fair market value of total gross assets of that company at the time of the merger, subject to an upward adjustment for the passage of time. The successor would receive credit for the settlements or judgments it had paid or committed to pay since the merger, and its liability would cease when it had paid or committed to pay as much as the predecessor's gross assets presently would be worth. The limitation would apply only to situations in which a merger or consolidation

took place before 1972, when the U.S. Occupational Safety and Health Administration issued a permanent standard regulating occupational exposure to asbestos. Before that time, the dangers of asbestos were not well known, and an acquiring company's due diligence investigation would not necessarily have disclosed asbestos-related liability.

According to ALEC, laws based on its model legislation have been enacted in Florida, Georgia, Mississippi, Ohio, Pennsylvania, South Carolina, and Texas since 2001, and the Council of State Governments approved the Florida and South Carolina laws as Suggested State Legislation in December 2006. Based on changes to Pennsylvania's laws, 376 pending cases against Crown Cork & Seal were dismissed in that state in 2002. In Michigan, about 1,000 cases reportedly are pending against Crown. Enacting Senate Bill 591 (S-3) would help protect the viability of this company, and possibly others that similarly acquired asbestos-related liability before 1972.

Opposing Argument

Applying the bill retroactively to causes of action, or claims, that already have accrued would be unconstitutional. The Michigan Supreme Court addressed the issue of retroactivity in 1982 in response to a Certified Question from the U.S. Court of Appeals for the Sixth Circuit. According to the Supreme Court, "[R]etrospective application of a law is improper where the law 'takes away or impairs vested rights acquired under existing laws…'", and, "The general rule against retrospective application has been applied in cases where a new statute abolishes an existing cause of action. It is clear that once a cause of action accrues,--*i.e.*, all the facts become operative and are known--it has become a 'vested right'" (*Karl* v *Bryant Air Conditioning Co.*, 416 Mich 558).

In 2004, in a case involving Crown Cork & Seal, the Pennsylvania Supreme Court specifically addressed the retroactivity of that state's law limiting the asbestos-related liability of successor corporations (*Ieropoli* v *AC&S Corporation*, 577 Pa 138). The Court held that the retroactive application of the law violated a "remedies clause" in Pennsylvania's constitution. The Court found that each cause of action brought against Crown was a remedy, or the vehicle by which parties pursued redress for an alleged injury. Since the statute prevented the parties from obligating Crown to pay damages on those causes of action, it essentially extinguished each cause of action. "Under…[the Pennsylvania constitution], however, a statute may not extinguish a cause of action that has accrued."

Although the Michigan Constitution does not have a "remedies clause", individuals in this State do enjoy the constitutional guarantees of due process and equal protection, and the Michigan Supreme Court also has made it clear that a statute cannot extinguish an accrued cause of action.

Under the bill, the liability of Crown Cork & Seal would be limited to the total gross assets of Mundet at the time of the merger, as adjusted for the passage of time. According to the Pennsylvania Supreme Court, when Crown filed a "Global Motion for Summary Judgment" in 2002, it stated that the value of Mundet's assets was approximately $11 million to $12 million at the time of the merger; as adjusted for inflation, the value was in the range of $50 million to $55 million; and Crown had paid out $336 million on asbestos-related claims. The amount of claims paid is now estimated to approach $600 million—a figure that far exceeds what the present adjusted value of what Mundet's assets would be. Therefore, Crown would have no liability under this legislation, which essentially would abolish the accrued cause of action, or vested right, of those who already have filed lawsuits against the corporation.

Response: The bill states that, if the application of a provision would unconstitutionally affect a vested right, the provision could be applied prospectively only. In addition, if a court invalidated a provision or the application of a provision, the remainder of proposed Chapter 30 would remain operable (unless the court found that it could not be severed). Thus, if a court decided that applying Chapter 30 retroactively would be improper, the liability of a successor corporation still would be limited in regard to actions filed after the bill took effect, without impairing vested rights.

Opposing Argument

The bill would unfairly deny injured parties the ability to recover compensation from a corporation that is legally liable. Although

there might be multiple defendants to a lawsuit, the portion of damages attributable to a predecessor corporation, such as Mundet Cork, could not be collected from them. This is because Michigan in 1995 abolished the rule of joint and several liability, in most cases. With joint and several liability, each defendant can be held liable for the full amount of damages. This State's law, however, limits each defendant's liability to that party's own percentage of fault. As a result, if Crown Cork & Seal could not be held liable for injuries caused by Mundet, or another acquired corporation that caused asbestos-related injuries, damages for those injuries could not be recovered from any other defendant.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

Fiscal Analyst: Stephanie Yu