APF **ALEC Focus: Tort Reform**

Successor Asbestos-Related Liability Fairness Act

By Mark A. Behrens

The Asbestos Litigation Crisis

Asbestos litigation is now the longest-running mass tort liti gation in the United States. In the "early stages" of the litigation, the defendants were primarily asbestos mining companies, manufacturers and sellers of asbestos insulation products, or installers of such products. These defendants are often referred to as "traditional defendants."

The enormity of the litigation forced virtually all of the early defendants into bankruptcy. Already, over seventy companies have declared bankruptcy due to asbestos-related liabilities. Many of these bankruptcies have occurred within the past few years. The process is accelerating due to the "piling on" nature of asbestos liabilities. Additional bankruptcy filings are virtually certain to occur.

As a consequence, a newer generation of "peripheral defendants" – companies far removed from the scene of any putative wrongdoing – is becoming ensnarled in the litigation. The RAND Institute for Civil Justice ("RAND") has identified more than 8,600 asbestos defendants, up from only 300 in 1982. The list of defendants includes construction contractors, automotive parts manufacturers, refineries and textile mills, retailers and insurers. Asbestos litigation now touches firms in industries engaged in almost every form of economic activity that takes place in the economy.

At least 300,000 asbestos claims are pending – more than double the number of a decade ago. Over 100,000 claims were filed in 2003 – the most in a single year. Before the litigation ends, at least one million more claims may be filed, according to RAND. The United States Supreme Court has said that this country is in the midst of an "asbestos-litigation crisis."

Today, most claimants are diagnosed through plaintiff-lawyer arranged mass screenings programs targeting possible exposed asbestos-workers and attraction of potential claimants through the mass media. Plaintiffs are recruited through exaggerated ads, such as "Find out if YOU have MILLION DOLLAR LUNGS!" Currently, up to ninety percent of the claimants who file asbestos cases have no medically cognizable injury or impairment.

Asbestos litigation has caused widespread economic devastation. According to RAND, $70 billion had been spent on the litigation through the end of 2002. Tillinghast-Towers Perrin, an actuarial firm, puts the remaining future cost of the litigation at $130 billion. Former U.S. Attorney General Griffin Bell has said that asbestos litigation costs will exceed the cost of "all Superfund sites combined, Hurricane Andrew, or the September 11th terrorist attacks."

Moreoever, Nobel Prize-winning economist Joseph Stiglitz and two colleagues found that asbestos-related bankruptcies cost nearly 60,000 people their jobs and up to $200 million in wages between 1997 and 2000. National Economic Research Associates found that workers, communities, and taxpayers will bear as much as $2 billion in additional costs, due to indirect and induced impacts of company closings related to asbestos. Goldman Sachs Managing Director Scott Kapnick testified before the U.S. Congress that "the large uncertainty surrounding asbestos liabilities has impeded transactions that, if completed, would have benefited companies, their shareholders and employees, and the economy as a whole."

Litigation Unfairness: The Story of Crown Cork & Seal

Crown Cork & Seal (Crown) – the inventor of the bottle cap – is the world's leading manufacturer of packaging products for consumer goods, making one out of every five beverage cans in the world and one out of every three food cans used in North America and Europe. The company employs almost 30,000 people worldwide, and has major manufacturing operations in Connecticut, Florida, Illinois, Indiana, Massachusetts, Maryland, Minnesota, Mississippi, Nebraska, Hew Hampshire, New York, Oregon, Ohio, Pennsylvania, South Carolina, Texas, Utah, Virginia, Washington, West Virginia, Wisconsin, and Wyoming.

Crown never manufactured, sold, or installed a single asbestos-containing product in the company's 100-year history. Yet, in recent years, the company has been named in an increasing number of asbestos-related lawsuits because of its brief association with a dormant division of Mundet Cork Co. decades ago.

In November 1963, Crown purchased a majority of the stock of Mundet Cork, a company that made bottle caps, just as Crown did. Before the acquisition, Mundet also had a small side business making, selling and installing asbestos insulation. Mundet had just $500,000 in annual sales of insulation products. By the time of Crown's stock purchase, however, Mundet had shut down its insulation operations. Crown never operated the insulation manufacturing operation.

Within ninety-three days of Crown's obtaining its stock ownership interest for $7 million in Mundet, what was left of the Mundet insulation division – idle machinery, leftover inventory, and customer lists – was sold off by Mundet. Thereafter, Crown acquired all of Mundet's stock and Mundet, now having only bottle-cap operations, was merged into Crown in January 1966.

As a result of this brief passive ownership, the merger of Mundet into Crown created a "windfall" defendant out of Crown that has spawned approximately 300,000 asbestos-related claims against Crown, even though the merger with Mundet occurred before any federal OSHA regulations on asbestos were ever established. Crown has been sued in asbestos-related case solely as a successor to Mundet Cork. Crown's initial investment in Mundet nearly forty years ago has cost Crown approximately half a billion dollars in asbestos-related payments.

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These claims threaten Crown's viability, even though Mundet's asbestos insulation manufacturing operations had already been shut down by the time Crown purchased its first share of Mundet stock. Because of the threat posed by asbestos litigation, Crown's credit rating has been reduced to "junk bond" status and the company has been forced to pay double-digit interest rates.

As the prevalence of asbestos litigation has spread, Crown's payments have increased forty-fold, from an average of $2 million per year from 1977 through 1997 to approximately $80 million per year over the last four years. Crown's story illustrates the unfairness of asbestos litigation. More specifically, Crown is a "poster child" for the need for asbestos successor liability reform. As former U.S. Senate Judiciary Committee Chairman Orrin Hatch said on the Senate floor on April 20, 2004: "The trial lawyers have made Crown Cork & Seal pay dearly for the 90 days it owned the insulation division of Mundet.... They should never have had to pay a dime to begin with."

Successor Asbestos-Related Liability

By statute or court decision, it has become the general rule that when a predecessor corporation merges with a successor corporation, the successor can be held liable for the torts of the dissolved predecessor. In some circumstances, the rule can cause a tremendous injustice, as in Crown's case. Even if the successor was entirely unaware of any potential liability at the time of a merger, the innocent successor can become liable for so-called "long-tailed" future liabilities, including asbestos claims. The successor can be liable even if it itself did nothing wrong — and even if the activity of the predecessor that created the liability was terminated before the merger.

In such circumstances, when the predecessor is a small company and the successor a large company, an overwhelming injustice can strike employees, shareholders, lenders and other stakeholders of the larger successor, as even the largest of successor corporations can be threatened with bankruptcy.

For example, consider a corporation that has engaged in some kind of business activity that eventually gives rise to a long-tailed liability. If the total gross asset value of that corporation were, for example, $10 million, the maximum amount plaintiffs could collect from that company (even if the plaintiffs could take priority over all the creditors of the company) would be the total asset value of the company. But assume the same $10 million corporation merges into a successor corporation worth $1 billion. Even though that successor itself did nothing wrong, it could be liable for up to its entire value of $1 billion solely because of merging the predecessor into it. In mass torts situations like asbestos, when there are many claimants and many defendants are already bankrupt, joint and several liability can allow an innocent successor corporation to be unjustly singled out and bankrupted for wrongs it did not do.

Restoring a Sense of Fairness to the Asbestos Runaway Train

The successor liability law in most states contains an inherent unfairness that forces companies, such as Crown, to be held responsible for hundred of millions of dollars in asbestos claims for which these companies, in fairness, should bear no liability.

Recognizing this unfairness, an increasing number of states have acted to limit a successor company's responsibility that arises through no fault of its own. So far, laws providing litigation fairness to companies like Crown have been enacted in Pennsylvania (2001), Texas (2003), Mississippi (2004), and Ohio (2004).

These laws specifically place a cap on the payments that a company *as a successor by merger* must pay as a result of asbestos claims. In Crown's case, that cap is limited to the value of Mundet's assets at the time of the merger, adjusted for inflation from the time of the merger.

In adopting successor liability reform, state legislatures have sought to strike a balance, reducing the jeopardy of innocent corporations by fairly altering (but not extinguishing) remedies available to asbestos plaintiffs.

Without reform, innocent companies like Crown could face bankruptcy, like so many other asbestos defendants. If this were to occur, thousands of current and former employees could be threatened with loss of jobs and retiree benefits. The communities where these companies have operations likewise could suffer devastating impacts.

ALEC's Model Successor Asbestos-Related Liability Fairness Act

ALEC has developed a model Successor Asbestos-Related Liability Fairness Act to lessen the injustice from outdated successor liability laws. The Act would place a principled and realistic limit upon the wholly vicarious asbestos liability of a successor corporation following a merger. Plaintiffs wronged only by the predecessor would be able to collect from the successor no less than the same amount they could have collected if no merger had occurred: the total gross asset value of that predecessor at the time of the merger. The total gross asset value of that predecessor would even be adjusted upward by an interest factor to take account of the time elapsed since the merger. The successor would get credit for all the settlements or judgments it has paid or committed to pay since the merger. The successor's liability would cease when it had paid or committed to pay as much as the predecessor's gross assets would now be worth (adjusted upward as described for the passage of time).

The model legislation would apply to lawsuits against both domestic corporations and foreign corporations that have done business or have registered to transact business in a state. Companies incorporated in other states are included because they play so important a role in the economies of most states — in jobs and incomes, as well as taxes paid to a state.

The model legislation's limits on asbestos-related successor liability apply only to wrongs of the predecessor. Any successor that itself independently commits a tort — whether before or after a merger — could still be held liable to the full extent of its own assets for any harm it does itself.

This legislation deals with an injustice arising from the law of mergers that has been increasingly recognized — a recognition perhaps accentuated by the scores of bankruptcies of major corporations already caused by asbestos-related liabilities.

Scholars such as the highly regarded University of Chicago Dean and torts Professor Richard Epstein have argued that a failure to limit liability to the value of the predecessor makes no sense either as legal or economic policy. As Professor Epstein has explained in his torts textbook about successor liability arising from a merger or consolidation:

The black letter rule holds the surviving entity responsible for the torts of all of its predecessor entities. 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. Yet by operating A as a separate subsidiary, B could continue to insulate its assets from pre-merger liabilities, and perhaps its post-merger liabilities as well. Keeping an acquired corporation alive as a separate subsidiary instead of liquidating it into the acquiring firm typically turns on tax or corporate law considerations unrelated to issues of products liability law. Yet the current regime of successor liability exacts a high price for corporate consolidations that may well make sense for other business or tax reasons. *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.* (The consolidation should be treated as an assumption of the post-merger liabilities.) (Emphasis added).

That is just what the ALEC model bill would do. On the next page are the specifics of the bill.

Successor Asbestos-Related Liability Fairness Act

Section Summaries

Section 1: Applicability

The model legislation would place limits on the merger-related liability for asbestos imposed upon domestic corporations and foreign corporations doing business (creating jobs, income, retiree and health benefits, plus tax revenues) in that state. Those limitations, however, would not apply to:

✓ *Workers' compensation benefits;*
✓ *Any claim other than those for injuries caused by asbestos;*
✓ *An insurance corporation already regulated under state law; or*
✓ *Obligations arising under the National Labor Relations Act or a collective bargaining agreement.*

Section 2: Limitations on Successor Liabilities

The model bill would limit a successor's liability for asbestos claims arising solely from a merger or consolidation to the entire gross asset value of the predecessor from whom those liabilities arose. The liabilities of successors in subsequent mergers or consolidations would also be limited to the gross asset value of the original transferor. Plaintiffs would then be similarly situated as if the merger had not occurred. They could recover from a successor the entire asset value of the company that allegedly caused them harm. The successor would not be forced into bankruptcy as a result of unknown asbestos liabilities arising solely from a merger or consolidation.

Section 3: Fair Market Value

The model legislation would place plaintiffs in a better position than if no merger had occurred. Absent a merger, the liable predecessor would be bankrupted once tort liabilities plus liabilities to creditors exceeded its total value. The model bill would, however, permit plaintiffs to recover a greater amount from successors than they could have recovered from a bankrupted predecessor. The asbestos plaintiff could recover from the successor the gross asset value of the predecessor — the value of total assets without any reduction for the predecessor's liabilities to creditors and other claimants.

The model also includes in the definition of a transferor's gross asset value:

✓ *Any remaining liability insurance of the transferor available to a successor to pay asbestos claims arising from the transferor; and*
✓ *All intangible assets.*

The model would allow a successor to establish the fair market value of total gross asset value by any reasonable means.

Section 4: Adjusting Fair Market Value for the Passage of Time

The fair market value of a transferor's total gross assets — other than liability insurance — would be adjusted upward annually by an uncompounded prime plus one to take account of the passage of time. Therefore, plaintiffs would actually be able to recover more than if the original transferor had been forced into bankruptcy.

Section 5: Codifying the Choice-of-Law Determination

To ensure the application of a state's limitation to foreign corporations doing business there, the model act makes the substantive successor liability law of the state a codified choice of law.

Model Legislation

Successor Asbestos-Related Liability Fairness Act

Title __ of the ____ Code is amended by adding Chapter ___ to read as follows:

CHAPTER ___. LIMITATIONS of Asbestos LIABILITIES RELATING TO CERTAIN MERGERS OR CONSOLIDATIONS

Section 1. DEFINITIONS. –

(a) "Asbestos claim" means any claim, wherever or whenever made, for damages, losses, indemnification, contribution, or other relief arising out of, based on, or in any way related to asbestos, including:
  (1) the health effects of exposure to asbestos, including any claim for:
    (A) personal injury or death;
    (B) mental or emotional injury;
    (C) risk of disease or other injury; or
    (D) the costs of medical monitoring or surveillance, to the extent such claims are recognized under state law;
  (2) any claim made by or on behalf of any person exposed to asbestos, or a representative, spouse, parent, child, or other relative of the person; and
  (3) any claim for damage or loss caused by the installation, presence, or removal of asbestos.

(b) "Corporation" means a corporation for profit, including a domestic corporation organized under the laws of this state, or a foreign corporation organized under laws other than the laws of this state.

(c) "Successor" means a corporation that assumes or incurs, or has assumed or incurred, successor asbestos-related liabilities.

(d) "Successor asbestos-related liabilities" means any liabilities, whether known or unknown, asserted or unasserted, absolute or contingent, accrued or unaccrued, liquidated or unliquidated, or due or to become due, that are related in any way to asbestos claims (as defined by this Act, as well as any claims for damage or loss caused by the installation, presence, or removal of asbestos) and that were assumed or incurred by a corporation as a result of or in connection with a merger or consolidation, or the plan of merger or consolidation related to the merger or consolidation, with or into another corporation or that are related in any way to asbestos claims (including property damage claims) based on the exercise of control or the ownership of stock of the corporation before the merger or consolidation. The term includes liabilities that, after the time of the merger or consolidation for which the fair market value of total gross assets is determined under Section 4, were or are paid or otherwise discharged, or committed to be paid or otherwise discharged, by or on behalf of the corporation, or by a successor of the corporation, or by or on behalf of a transferor, in connection with settlements, judgments, or other discharges in this state or another jurisdiction.

(e) "Transferor" means a corporation from which successor asbestos-related liabilities are or were assumed or incurred.

Section 2. APPLICABILITY.

(a) The limitations in Section 3 shall apply to: a domestic corporation or a foreign corporation that has had a certificate of authority to transact business in this state or has done business in this state and that is a successor or which is any of that successor corporation's successors.

(b) The limitations in Section 3 shall not apply to:
  (1) workers' compensation benefits paid by or on behalf of an employer to an employee under this State's workers' compensation act or a comparable workers' compensation law of another jurisdiction;
  (2) any claim against a corporation that does not constitute a successor asbestos-related liability;
  (3) an insurance corporation, as that term is used in the Insurance Code; or
  (4) any obligations under the National Labor Relations Act (29 U.S.C. Section 151 et seq.), as amended, or under any collective bargaining agreement.

Section 3. LIMITATIONS ON SUCCESSOR ASBESTOS-RELATED LIABILITIES.

(a) Except as further limited in Subsection (b), the cumulative successor asbestos-related liabilities of a corporation are limited to the fair market value of the total gross assets of the transferor determined as of the time of the merger or consolidation. The corporation does not have any responsibility for successor asbestos-related liabilities in excess of this limitation.

(b) If the transferor had assumed or incurred successor asbestos-related or liabilities in connection with a prior merger or consolidation with a prior transferor, then the fair market value of the total assets of the prior transferor, determined as of the time of such earlier merger or consolidation, shall be substituted for the limitation set forth in Subsection (a) for purposes of determining the limitation of liability of a corporation.

Section 4. ESTABLISHING FAIR MARKET VALUE OF TOTAL GROSS ASSETS.

(a) A corporation may establish the fair market value of total gross assets for the purpose of the limitations under Section 3 through any method reasonable under the circumstances, including: (1) by reference to the going concern value of the assets or to the purchase price attributable to or paid for the assets in an arm's-length transaction, or (2) in the absence of other readily available information from which fair market value can be determined, by reference to the value of the assets recorded on a balance sheet.

(b) Total gross assets include intangible assets.

(c) Total gross assets include the aggregate coverage under any applicable liability insurance that was issued to the transferor whose assets are being valued for purposes of this Section and which insurance has been collected or is collectable to cover successor asbestos-related liabilities (except compensation for liabilities arising from workers' exposure to asbestos solely during the course of their employment by the transferor). A settlement of a dispute concerning such insurance coverage entered into by a transferor or successor with the insurers of the transferor before the enactment of this chapter shall be determinative of the aggregate coverage of such liability insurance to be included in the calculation of the transferor's total gross assets.

Section 5. ADJUSTMENT.

(a) Except as provided in Subsections (b), (c), and (d), the fair market value of total gross assets at the time of a merger or consolidation increases annually at a rate equal to the sum of: (1) the prime rate as listed in the first edition of the *Wall Street Journal* published for each calendar year since the merger or consolidation, unless the prime rate is not published in that edition of the *Wall Street Journal*, in which case any reasonable determination of the prime rate on the first day of the year may be used, or (2) one percent.

(b) The rate in Subsection (a) is not compounded.

(c) The adjustment of fair market value of total gross assets continues as provided under Subsection (a) until the date the adjusted value is 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 is determined.

(d) No adjustment of the fair market value of total gross assets shall be applied to any liability insurance otherwise included in the definition of total gross assets by subsection 4(c).

Section 6. SCOPE OF CHAPTER.

The courts in this state shall apply, to the fullest extent permissible under the United States Constitution, this state's substantive law, including the limitation under this chapter, to the issue of successor asbestos-related liabilities.

Section 7. EFFECTIVE DATE.

This Act shall take effect on its date of enactment. The Act applies to all asbestos claims filed on or after the effective date. This Act also applies to any pending asbestos claims in which trial has not commenced as of the effective date.