

Successor Liability in Asset Sale Transactions

Dean Manson
VP, General Counsel & Secretary
Hughes Network Systems

April 24, 2006

1

Sources of Successor Liability Law

- Products Liability
- Foreign Corrupt Practices Act
- Export Control
- Environmental Law
- Bankruptcy Law
- Labor & Employment Law

2

General Rule

When one company sells or transfers its assets to another company, the acquiring company is not liable for the debts and liabilities of the selling company

3

Traditional Exceptions

- Purchaser agrees
- Fraud
- De Facto Merger
 - Continuity of shareholders
 - Prompt dissolution of the selling company
- “Mere continuation” of selling company
 - Use of same name, location and employees
 - Common identity of stockholders and directors

4

Products Liability

5

Continuity Exception

- *Turner v. Bituminous Casualty Co.*, 244 N.W.2d 873 (Mich.1976)
- “Continuity of business enterprise”
- Expands upon “de facto merger” doctrine
 - Applies even to purchases for cash rather than stock
 - Focuses on factors such as ownership, management, personnel, location, assets, trade name and general business operation

6

Product Line Exception

- *Ray v. Alad Corp.*, 560 P.2d 3 (Cal. 1977)
- Strict product liability imposed on acquiring company if three factors can be shown:
 - Virtual destruction of plaintiff's remedies
 - Successor able to assume risk spreading role
 - Fairness: successor continues to profit from goodwill of original business
- Split among states

7

Foreign Corrupt Practices Act (FCPA)

8

Titan/Lockheed (2005)

- Sept 2003: Lockheed agrees to purchase Titan for \$1.8 billion
- Lockheed's due diligence uncovers Titan FCPA violations in Africa, Asia and Middle East
- Feb 2004: joint disclosure to DOJ and SEC
- Lockheed drops purchase price by \$200 million
- June 2004: Lockheed terminates merger agreement
- DOJ, SEC and IRS investigate Titan
- March 2005: Titan settled with DOJ for \$28.5 million in criminal and civil fines

9

General Electric / InVision

- March 2004: GE agreed to acquire InVision Technologies, a maker of airport bomb detection equipment
- July 2004: InVision voluntarily disclosed to DOJ and SEC possible FCPA violations discovered during due diligence
- Closing delayed until December 2004 when InVision reached settlement with DOJ for \$800,000
- Feb 2005: GE InVision settled with SEC for \$1.1 million

10

ABB

- October 2003: ABB agrees to sell its upstream oil, gas, and petrochemical equipment business
- Late 2003: Due diligence uncovers \$1.1 million in bribes to government officials in Nigeria, Angola, and Kazakhstan; ABB discloses to DOJ and SEC
- Closing delayed for additional due diligence
 - more than 100 lawyers, four million documents, and 100 interviews in approx. 20 countries
- July 2004: deal closes after ABB pays \$16 million in fines and penalties

11

DOJ's FCPA Opinion Procedure Release 2003-01

Provides benchmark target of the standards that DOJ will hold an acquirer to when it buys a target with contingent or unresolved FCPA liability :

- Continue cooperating and disclosing
- Discipline implicated employees
- Adopt comprehensive compliance program and internal controls

12

Export Control

13

Sigma-Aldrich (2002)

- Commerce Dept ALJ opinion established the principle of successor liability for violations of the Export Administration Regulations (EAR)
- a company whose assets were acquired by Sigma Aldrich had made allegedly illegal exports of biological toxins to end-users in Europe
- After ALJ opinion, Sigma Aldrich settled for a penalty of \$1.76 million
- Commerce: “corporations will be held accountable for violations of U.S. export control laws committed by companies that they acquire”

14

Recent Cases

15

Peterson v. Titan (1 of 2)

- *Peterson Manufacturing Co. v. Titan International, Inc.*, Cal. Ct. App. 2d Dist. No. B176630, 8/17/05 (2005 Cal. App. Unpub. LEXIS 7413)
- Pre-1993: Dotson Wheel Corp mfd a wheel assembly, which it sold to Peterson, who added discs and incorporated it into a John Deere front end loader
- 1993: Titan purchased substantially all of Dotson's assets; Dotson became a shell co and changed its name to Saltville Group, Inc.

16

Peterson v. Titan (2 of 2)

- July 2000: Dustin Lockhart is injured while working on the John Deere loader
- 2001: Lockhart sues Titan and Peterson
- Trial court grants summary judgment to Titan, on basis that the asset purchase did not destroy Lockhart's remedy since Dotson continued to exist in the form of Saltville
- Applying *Ray v. Alad*, Ct. of Appeal reversed, finding there were triable issues of fact whether Titan's acquisition of Dotson destroyed Lockhart's remedy

17

General Battery (1 of 2)

- *United States v. General Battery Corp.*, 423 F.3d 294 (3d Cir. 2005)
- 1930-1966: Price Battery Corp manufactured and disposed of lead batteries
- 1966: General Battery Corp acquired substantially all assets of Price for cash & stock
- 1992: EPA discovered 5 disposal sites, incurred cleanup costs of \$6.5 million, and ultimately determined Price to be responsible
- 2000: General Battery merges into Exide Corp

18

General Battery (2 of 2)

- U.S. sues General Battery and Exide, alleging “de facto merger” of Price into General Battery
- 3rd Circuit found that CERCLA’s objective of uniformity requires application of federal common law, rather than state law, to question of successor liability
- Applying federal law, 3rd Circuit found that a “de facto merger” existed between Price and General Battery, and therefore GB/Exide are liable for CERCLA cleanup costs

19

Berg Chilling Systems (1 of 2)

- *Berg Chilling Systems, Inc. v. Hull Corporation*, 435 F.3d 455 (3d Cir. 2006)
- To support its contract with a Chinese customer, Berg subcontracted with Hull to provide freeze-dryers
- Hull’s performance was delayed and defective
- Meanwhile, Hull agreed to sell its food & drug division to SPI
- Berg’s customer filed an arbitration demand against Berg and ultimately prevailed

20

Berg Chilling Systems (2 of 2)

- Berg filed suit for indemnity & contribution against Hull and SPI
- Applying Pennsylvania law, the 3rd Circuit (opinion by Judge Alito) found no “de facto merger”, since the deal was an asset sale for cash rather than stock
- Therefore, no successor liability for SPI

21

Mitigation Techniques

22

Techniques to Minimize Risk of Successor Liability

- Thorough due diligence
- Strong reps, warranties & indemnities
- Ensure accuracy of reps in purchase agreement and SEC filings
- “Leave behind” problematic assets or contracts
- Express waiver and consent of unions (to address potential employee claims)

23