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Chapter 3

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Allocating Responsibility for Unknown Liabilities in Stock and Asset Transactions: Lessons from the Coal Industry Retiree Health Benefit Act

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Synopsis

§ 3.01. Introduction.

[1] — Who Bears the Risk of Liability Which Does Not Exist at Closing?

Sellers exiting an industry or selling a particular operation typically want to shield themselves from future liability arising from their prior ownership. Toward this end they may be willing to sell stock or assets at a discount, provided the buyer will assume responsibility for unmatured liabilities related to the business. Buyers, on the other hand, like to know what they are getting for their money. They will resist accepting responsibility for liabilities that cannot be quantified and factored into the sale price.

Traditionally, through due diligence, bargaining, and careful drafting, contracting parties identify and allocate responsibility for the seller's liabilities, including those which have not yet matured. These measures are usually sufficient to avoid litigation, provided the post-sale liability was at least within the realm of the parties' contemplation. But what happens if the later imposed obligation was not conceivable at the time of the transaction, yet relates back in whole or in part to events that occurred when the business was under the seller's control?

In the past 25 years, Congress has enacted numerous legislative programs which, in effect, impose liability retroactively. These statutory schemes are often unforeseeable to pre-enactment contracting parties. In the extreme, the new liability may relate back to events which occurred decades earlier.[1] The imposition of new liability for events that occurred in the past generates uncertainty in the marketplace because contracting parties cannot anticipate or quantify the eventual cost of compliance, and cannot factor it into their bargained-for price. Since neither party has willingly agreed to absorb the financial impact of new obligations tied to pre-sale events, such legislative impositions are a recipe for high stakes cost-shifting litigation. When post-sale liability allocation disputes do arise, their resolution will turn on the specific language in the indemnity or

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1 In the context of reviewing the constitutionality of the Coal Industry Retiree Health Benefit Act of 1992 (CIRHBA), 26 U.S.C. §§ 9701 *et seq*. (Supp. 1996), one court noted:

> [i]t was reasonably foreseeable that Congress would take action to ensure that the [United Mine Workers of America] benefit trust would remain solvent and capable of meeting its obligations. But it was a good deal less foreseeable that the legislation chosen to solve the problem would reach back to conduct which occurred 30 years ago in order to enforce a 'promise' [the coal operator] never actually made.

In re Blue Diamond Coal Co., 174 B.R. 722, 728 (Bankr. E.D. Tenn. 1994), *aff'd*, 79 F.3d 516 (6th Cir. 1996).

release provisions in the parties' transaction documents. This chapter reviews caselaw applying and construing indemnity provisions where the liability arises from post-sale legislative enactments which relate back to pre-sale conditions. It advocates that parties tailor transaction documents to account for liability that does not now exist, and cannot be anticipated, but which may come into existence. Toward this end, the authors offer some general observations that contracting parties should consider when drafting their indemnification agreements.

[2] — Retroactive Liability is Not New to the Coal Industry.

Coal mine operators are not strangers to retroactive legislation intended to "adjust the burdens and benefits of economic life. . . ."[2] The coal industry's first experience with new liability grounded in past events was the Black Lung Benefits Act of 1972,[3] which required operators to compensate former employees disabled by pneumoconiosis and their survivors "even though the operators had never contracted for such liability, and the employees involved had long since terminated their connection with the industry."[4]

In the landmark case *Usery v. Turner Elkhorn Mining Co.,*[5] the Supreme Court made it clear that Congress faced few limitations when creating new liability tied to prior events. The Supreme Court began its analysis by noting that legislation readjusting rights and burdens was not unlawful "solely because it upsets otherwise settled expectations" even where the effect was "to impose a new duty or liability based on past acts."[6] The Court acknowledged that prior to enactment of the Black Lung Act, operators were under no legal duty to compensate afflicted miners, and acknowledged that the liability imposed by the Act for disabilities suffered by former employees who had long since left the industry was not anticipated at the time of actual employment. Nonetheless, the Court ruled that "the imposition of liability for the effects of disabilities bred in

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2 Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 15 (1976).

3 Black Lung Benefits Act of 1972, 30 U.S.C. §§ 901 *et seq.* (1986).

4 Connolly v. Pension Ben. Guar. Corp., 475 U.S. 211, 223 (1986).

5 Usery v. Turner Elkhorn Mining Co., 428 U.S. 1 (1976).

6 *Id.* at 16.