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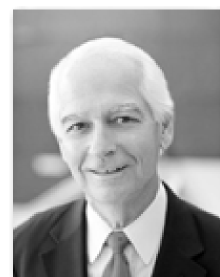
AHMAD, ZAVITSANOS, ANAIPAKOS, ALAVI & MENSING P.C.

STIKEMAN ELLIOTT LLP

Adrienne Braumiller
adrienne@BraumillerLaw.com
+1 214 348 9306


Bruce Leeds
bruce@BraumillerLaw.com
+1 214 348 9306

Ashley McCauley
ashley@BraumillerLaw.com
+1 214 348 9306

Buying Import & Export Violations: Successor Liability Risk & Its Impact on the Bottom-line

By Adrienne Braumiller, Bruce Leeds & Ashley McCauley

When you think of mergers and acquisitions, what are the highest risk areas that spring to mind? While companies routinely understand and prepare for liability pertaining to tort litigation, taxes, and contract disputes, the same companies often overlook potential liability for violations of import and export laws. Unfortunately, this can prove to be one of the most expensive oversights made during a merger or acquisition due diligence review, as the penalties for import and export violations can be significant. Consequently, any such due diligence review should include an audit for potential import and/or export liability concerns. While the threat of "buying" import or export violations through a merger or acquisition is no longer new, the risk of acquiring or merging with a company with past violations remains high due to a number of factors, including the ongoing Export Control Reform (ECR) efforts. A look at successor liability enforcement actions in both import and export contexts should clearly illustrate two critical points to companies: first, that successor liability is a concept that is alive and well in import and export law and second, that enforcement agencies will not hesitate to employ the concept in issuing penalties for import or export violations.

The Growth of Successor Liability in Import and Export Law

Many companies may overlook import/export successor liability as it is a relatively recent import to international trade law. Successor liability for violations of import /export law was first explored in the late 1980s. The events on 9/11 marked a new era for national security programs, which sought to expand their domains and increase their flexibility. While successor liability for import/export violations existed prior to this time, it was not until post-9/11 that import and export enforcement agencies began ramping up the number of penalty cases enforced via this concept.

Similarly, the same companies may overlook import/export successor liability because the concept is not codified in customs and export laws (with limited exceptions in the export regulations. On the contrary, case law has shaped the development of successor liability in these areas. Successor liability in the 1990s was largely driven by decisions in environmental and labour laws. Looking to ensure compliance with international trade, governmental agencies began to build upon the common law principle of successor liability and use it as a way of enforcing import and export regulations. Consequently, a scan of the Code of Federal Regulations, for example, is very insufficient as a means of informing a company of its need to conduct a thorough and effective import or export due diligence review in a merger or acquisition.

A Brief Overview of Successor Liability

So what is successor liability? In corporate law, successor liability is created when a succeeding company acquires another company through an actual merger or acquisition. It is critical to understand that while successor liability is not created by a mere sale of assets or stocks, there are exceptions under which the concept of successor liability can still be applied. These include when 1) there is an agreement to assume liability, explicit or implicit; 2) it is a de facto merger; 3) the transaction is a mere continuation of the predecessor business; and 4) the transaction was fraudulent and used to escape liability.

In an international trade law context, we often see companies confused by, or caught by, the exceptions related to de facto mergers and mere continuances of a prior business. A de facto merger occurs when a company sells all of its assets and then dissolves. A substantial continuation applies

when one of the following actions occurs 1) retention of the same employees, supervisory personnel, same production facilities and same location; 2) the same products are produced; 3) the same business name is retained; 4) the same assets and business operations exist; and/or the new company holds itself out to the public as a continuation of the previous corporation. Note that this brief explanation of successor liability simply serves to provide context for the explanations and examples below.

Successor Liability in Import and Export Cases

One of the first cases to address the concept of successor liability in import laws was the 1989 case of United States v. Shield Rubber Corp. In this case, Shields Rubber Corporation was charged with violating several customs laws by removing country of origin markings. Shields Rubber Corporation had not actually performed these acts; rather, its predecessor company had removed the markings. Shields Rubber Corporation had merged with Shields Rubber Corporation II, and the successor thus protested it should not be liable for the actions of its predecessor. However, the U.S. Supreme Court found that the principles of merger law applied, and that the successor was liable for the violations of the predecessor. Even though this situation did not involve a sale of assets, it is important in case law history that it upholds the merger law doctrine.

In the recent Court of International Trade (CIT) case of United States v. Adaptive Microsystems, without even asking whether successor liability applies to import cases, the CIT found a company liable for the transgressions of the company it had acquired under the mere continuation principle. In this case, Adaptive Microsystems, LLC went into bankruptcy and was acquired by another company, which ultimately continued Adaptive Microsystems operations with the same name and with the same employees. Although the board of directors had changed (except for one person, who retained a fraction of the stocks he had in the previous company and his position on the board), CIT found that these facts rendered the company similar enough to the previous company to warrant holding the successor liable under the mere continuation doctrine. As a result, Adaptive Microsystems, LLC was liable to the government for the unpaid duties of the former company.

In BLG's experience, there are certain factors that make it more or less likely that Customs and Border Protection (CBP) will pursue a claim under successor liability for import violations. These include variables such as the amount of the lost revenue to CBP (such as unpaid duties), public policy considerations including the type of harm caused by the violation, and the possibility of the violation recurring under the predecessor, to name a few. In one recent case handled by BLG, a successor company was being investigated by CBP. The company had bought the assets of the prior company, and the prior company had then dissolved. According to common law, this would be considered a de facto merger and the successor might be on the hook for paying the lost revenue. However, in this instance, the amount was relatively little, totaling approximately $10,000. In addition, the asset agreement included an absolution of liabilities and debt for the purchasing company. Given the factors of a low dollar amount and the agreement to absolve liabilities, CBP accepted the argument that successor liability would not attach. With this in mind, it is important to remember that CBP analyses successor liability on a case-by-case basis.

Successor liability is even more commonly seen in export cases. One of the seminal cases in export law is the Sigma-Aldrich case from 2002. In this situation, Sigma-Aldrich Corporation (SAC) and Sigma-Aldrich Business Holdings (SABH) had purchased the partnership interests of another company and transferred the assets to Sigma-Aldrich Research Biochemicals (SARB). Through an investigation after the sale, the Bureau of Industry and Security (BIS) found that the acquired company had exported biological toxins without a

license. BIS then charged the three Aldrich-Sigma companies with the violations under successor rules. The judge held that all three Sigma-Aldrich companies were liable for the violations of the predecessor company, and assessed a $1.76 million fine to settle the charges against them.

The Department of State has also used successor liability to enforce export controls. In one case, the Department of State found that Hughes Space & Communications Company, a subsidiary of Hughes Electronics, had violated provisions of the International Traffic in Arms Regulations (ITAR) by not obtaining an export license for information released to certain foreign nationals in the mid 1990's. In 2000, Hughes Electronics sold Hughes Space & Communications Company to Boeing. As part of the sale, Hughes Electronics agreed to be liable for any liabilities of Hughes Space & Communications Company. However, the Department of State still charged both Boeing as the successor and Hughes Electronics as the predecessor with the violations. In 2003, Boeing and Hughes Electronics agreed to a $32 million fine for the violations.

Import and Export Successor Liability Challenges in 2014

The cases above demonstrate that for some time, U.S. government agencies have enforced import and export violations against companies through principles of successor liability.

So, while the risk of buying import and export violations is not new, it may be a heightened risk in 2014. In April 2013, the Department of State Directorate of Defense Trade Controls (DDTC) issued the first final rule implementing major provisions of the President's Export Control Reform Initiative. This final rule, which primarily involved shifting the jurisdiction of defense articles previously controlled under the ITAR to the jurisdiction of the Export Administration Regulations (EAR), represents the first significant revision of U.S. export controls in a very long time. What this means for prospective M&A due diligence reviews in an international trade context is an even more heightened risk of buying export violations. The number of changes occurring under ECR, and the significance of those changes, has resulted in a period of uncertainty for many companies engaged in exporting. To further complicate matters, more ECR changes will continue to be finalised on a rolling basis over the course of the next few years creating a foundation of uncertainty (as it relates to export compliance) that will continue to exist for quite some time.

The export violation cases referenced above all occurred well before the advent of the ECR initiative; therefore the possibility for export violations, whether intentional or inadvertent, is even higher due to the unknown terrain in which many companies affected by ECR are operating.

As companies struggle to learn how they are impacted by ECR, the combination of several factors including increased efforts by foreign nations to illegally procure U.S. origin goods and technology, along with the increased enforcement efforts by many U.S. export control agencies, has produced an environment ripe with potential violations.

Consequently, it is critical for a merger or acquisition due diligence review to include a thorough review of a company's import and/or export history in order to identify any potential compliance concerns.

Braumiller Law Group, PLLC (BLG) is a highly respected law firm devoted exclusively to the practice of Customs and International Trade Law and has been a recognised leader in this field for over 20 years. A Dallas-based firm with affiliates in Houston, Los Angeles, Toledo and San Luis Potosí, Mexico, we offer the highest quality legal services at competitive rates.

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WWW.BRAUMILLERLAW.COM

Adrienne Braumiller is the co-founder of Braumiller Law Group,PLLC and an innovative force in the international trade law arena. With more than 20 years of experience, she is widely recognized as a leading authority in Customs, import, export, foreign-trade zones, free trade agreements and ITAR compliance.

Bruce Leeds has decades of experience in international trade law and has successfully served his clients in diverse capacities, from classification and due diligence to ITAR compliance and drawback. He has significant expertise with importing and exporting technology.

Ashley is located in the firm's Houston, Texas office and specializes in guiding domestic and foreign companies on U.S. international trade law issues.

She has extensive experience advising clients on international trade matters regulated under the International Traffic in Arms Regulations, the Export Administration Regulations, laws enforced by U.S. Customs and Border Protection, and the U.S. sanctions programs and embargos administered by the Office of Foreign Assets Controls.