MOUNT DIABLO MERCURY MINE

PROSECUTION TEAM'S REBUTTAL BRIEF –

CORPORATE SUCCESSOR LIABILITY

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Sunoco and Kennametal merged with their wholly owned subsidiaries upon dissolution of those subsidiaries and thereby assumed all of their liabilities.

Sunoco and Kennametal both argue that they cannot be held liable for the acts of their wholly owned subsidiaries because those companies were dissolved with no assets. Both claim that they are protected from liability as successors in interest and shareholders. As a result, they contend that they should not be named on a Cleanup and Abatement Order issued pursuant to California Water Code section 13304, which would find them liable for cleanup costs given their ownership or activities, or the activities of their legal predecessors. The Prosecution Team disagrees with this contention and argues that both can be named in this order as successors in interest. This position comports with the long-standing position of the Water Boards to liberally apply the rules of corporate successor liability and the State and Regional Board's unwillingness to allow corporate entities to shift liability onto the general public by business transactions that elevate form over function. Finally, it is the Prosecution Team's position that these arguments are simply another way to argue that liability should be apportioned, and that Sunoco and Kennametal's portion should be zero. The facts and law will demonstrate otherwise.

I. Cleanup and Abatement Orders Issued Pursuant to California Water Code Section 13304 Must be Supported by Substantial Evidence in the Record.

The applicable State Water Resources Control Board (State Water Board) precedents hold that, in order to issue orders under Water Code section 13304, the Central Valley Water Board's findings must be supported by "substantial evidence in the record" and not a "preponderance of evidence." The State Water Board has addressed the applicable legal standard on several occasions, each time holding that the "substantial evidence" standard governs regional board proceedings. For example, in *Exxon Company, USA* (Order No. WQ 85-7), the State Water Board upheld an order by the Central Valley Water Board, noting:

> [A]ny findings made by an administrative agency in support of an action must be based on substantial evidence in the record. (*See, e.g., Topanga Association for a Scenic*

Community v. County of Los Angeles (1974) 11 Cal.3d 506.) Thus, while we can independently review the Regional Board record, in order to uphold a Regional Board action, we must be able to find that finding of ownership was founded upon substantial evidence.

(Id. at p. 6 [emphasis added].) Later, in a matter involving a cleanup order issued by the San Francisco Bay Regional Water Board, the State Water Board affirmed its application of the "substantial evidence" test, rejecting arguments that the "preponderance of evidence" test should apply. (*Stinnes-Western Chemical Corporation*, Order No. 86-16.) In subsequent cases, the State Water Board has held to the principle that the "substantial evidence" standard applies to Regional Board and State Water Board proceedings. (*Aluminum Company of America*, Order No. WQ 93-9; *In re: Sanmina Corporation*, Order No. WQ 93-14.)

The State Water Board has defined substantial evidence to mean "credible and reasonable evidence." *(In re: Sanmina Corp*, Order No. WQ 93-14.) "Substantial evidence does not mean proof beyond a doubt or even a preponderance of evidence. Substantial evidence is evidence upon which a reasoned decision may be based." (*In re: Robert S. Taylor, et al. and John F. Bosta, et al.*, Order No. WQ 92-14, at p. 5.)

Despite this well settled principle, Sunoco argues that it is settled law in both California and Nevada that the party seeking to have the corporate entity disregarded has the burden of proving by a preponderance of the evidence that the alter ego theory should be applied. (Sunoco, Inc.'s Hearing Brief, at p. 12.) In the first case cited by Sunoco, the United States Court of Appeals for the Ninth Circuit held that the party seeking to have the corporate entity disregarded bears the burden of proof regarding alter ego theory. (*In the Matter of Christian & Porter Aluminum Co.* (1978) 584 F.2d 326, 338.) That court, however, did not establish what that standard of proof is in its holdings or dicta. (*Id.*) In the other case Sunoco cites, the Supreme Court of Nevada held that the party relying on the alter ego doctrine must establish the elements by a preponderance of the evidence. *(Ecklund v. Nevada Lumber Co.* (1977) 93 Nev. 196.) Even if this latter case is

controlling in California, its holding does not reach all legal proceedings, such as criminal proceedings or administrative adjudications. Both of the cases cited by Sunoco are civil court cases in which the standard of proof, except in very limited circumstances, is a preponderance of the evidence standard. (*U.S. v. F/V Repulse* (1982) 688 F.2d 1283, 1284; *Addington v. Texas* (1979) 441 U.S. 418, 423.) Sunoco ignores this context and erroneously extrapolates from the two cases that the standard of proof in regard to the alter ego doctrine is a preponderance of the evidence in administrative proceedings before the Water Boards.

Therefore, the findings and naming of parties pursuant to California Water Code section 13304 must be supported by substantial evidence, which the Prosecution Team has done in this matter.

II. Sunoco's and Kennametal's Acquisition of the Corporate Assets of Their Respective Wholly Owned Subsidiaries Resulted in a *De Facto* Merger and Thereby They Assumed All of the Liabilities Of their Wholly Owned Subsidiaries.

The ordinary rule of law states that the purchaser does not assume the seller's liabilities unless (1) there is an express or implied agreement of assumption, (2) the transaction amounts to a consolidation or merger of the two corporations, (3) the purchasing corporation is a mere continuation of the seller, or (4) the transfer of assets to the purchaser is for the fraudulent purpose of escaping liability of the sellers debts. (*Ortiz v. South Bend Lathe* (1975) 46 Cal.App.3d 842, 846.) With respect to Cleanup and Abatement Orders, the State Board has liberally applied the rules of corporate successor liability.

In this matter, Sunoco and Kennametal took all of the assets of their wholly owned subsidiaries, upon which time their subsidiaries were dissolved, and left no consideration which could be made available to meet the claims of the subsidiaries' creditors.

Kennametal took Nevada Scheelite's only asset, its remaining mine in Rawhide Nevada.

Sunoco also received all of Cordero's assets and accepted liabilities in the form of Cordero's Retirement and Stock Purchase Plans.

This absorption of assets and acceptance of liability in Sunoco's case, without consideration is effectively a de facto merger. As a result, Sunoco and Kennametal must legally assume the liabilities of their wholly owned subsidiaries, in this case, liability for contamination at the Mount Diablo Mercury Mine site.

The Supreme Court stated in *Ray v. Alad Corp.*, the *de facto* consolidation or merger exception[1] is invoked:

> Where one corporations takes all of another's assets without providing any consideration that could be made available to meet claims of the other's creditors [citation omitted] or where the consideration consists wholly of shares of the purchaser's stock which are promptly distributed the seller's shareholders in conjunction with the seller's liquidation [citation omitted.]

(*Id.* at 28.) The *de facto* merger exception articulated by the Court in *Ray v. Alad*, which has been applied and relied on in Water Board matters, focused on the nature of the transaction. The *de facto* merger exception addresses the circumstances where, for all intents and purposes, two companies have in fact, if not in law, merged. Like a *de jure* merger[2], only the acquirer and the shareholders of the acquired company benefit. While this may be acceptable, the courts have crafted the de facto merger doctrine so that the acquiring company in a *de facto* merger succeeds to all of the liabilities of the acquired company just as if the transaction was a more formal merger.

[1] The Supreme Court in *Ray v. Alad Corp*., (1977) 19 Cal.3d 22 recognized four traditional exceptions to the general rules that an acquirer of corporate assets takes free of corporate liabilities, to wit (1) assumption of liabilities, (2) de facto consolidation or merger, (3) mere continuation and (4) fraudulent purpose (*Id*. at 28,) and to these added a "special" fifth exception in circumstance involving strict tort liability for defective products. (*Id*. at 30-34.)

[2] Versus a merger in fact.

The Prosecution Team's and Responsible Parties' submissions establish that Sunoco and Kennametal merged with their respective wholly owned subsidiaries and therefore succeeded to all of their liabilities, including Cordero and Nevada Scheelite's contingent liabilities for the discharge of contaminants at Mount Diablo Mercury Mine. This has been established through evidence showing the dissolution of the wholly owned subsidiaries and the absorption of those assets, and in Sunoco's case some liabilities, by the parent company.[3] Given the injustice that would result if a company were allowed to only take the assets of another company, leaving nothing behind for creditors, acceptance of the assets obligates both companies to acceptance of the liabilities.

"It is a general rule that a corporation formed by consolidation or merger is answerable for the debts and liabilities of the constituent corporations, whether they arise ex contracu or ex delicto." (*Moe v. Transamerica Title Ins. Co.* (1971) 21 Cal.app.3d 289, 304.) It has been repeatedly stated in case law that "[t]he crucial factor in determining whether a corporate acquisition constitutes either a de facto merger or a mere continuation is the same: whether adequate cash consideration was paid for the predecessor corporation's assets." (*Franklin v. USX Corp.* (1st Dist. 2001) 87 Cal.app.4th 615, 625.)

In this case there was no consideration paid for the assets received by the parent companies. The dissolved company's assets were absorbed by the parent company in conjunction with the dissolution. For the reasons states above, the Prosecution Team's initial submissions, and the Responsible Parties' submissions it is clear, Sunoco and Kennametal effected a *de facto* merger and as a consequence, both succeeded to all the liabilities of their wholly owned subsidiaries, including liabilities for discharges at the Mount Diablo Mercury Mine.

A. Sunoco and Kennametal Should Not Be Afforded Protection of the Corporate Veil As It Would Be Inequitable

[3] *See* Sunoco Exhibits 8 & 12 and Prosecution Team's Rebuttal, Exhibit A.

It is true that generally a parent corporation is not liable for the actions of its subsidiary. Like any stockholder it is protected from liability by the corporate veil (*McLaughlin v. L. Bloom Sons Co.* (1962) 206 Cal.App.848, 24 Cal.Rptr.311.) However, that corporate veil may be pierced if it is determined that the parent is really the alter ego of the subsidiary. (6 Witkin *Summary of California Law* (8th Edition 1974) Corporations Section 11, p. 4323). The conditions under which a corporate entity may be disregarded are founded in equity and vary depending on the special circumstances of the case. (*Goldsmith v. Tub-O-Wash* (1959) 199 Cal.App.2d 132, 18 Cal.Rptr. 446, 451.) As set forth in *Ray v. Alad* and adopted by the State Board in *Spitzer, et al.*, WQ Order 89-8, the California Supreme Court has stated that the principle that if one corporation acquires all the assets of another corporation without paying substantial consideration for the assets, the purchasing corporation is liable for the pre-purchase activities of the selling corporations. *(Ray v. Alad*, (1997) 19 Cal.3d 22, 136 Cal.Rptr. 574; *Malone v. Red Top Cab*, (1936) 16 Cal.App.2d 268, 60 P.2d 543; *see Schoenberg v. Benner* (1967) 251. App. 2d 154, 59 Cal.Rptr. 359.) The principle applies here. Sunoco and Kennametal acquired control of the assets of their wholly owned subsidiaries.[4] The subsidiaries then dissolved, leaving no corporate assets or ongoing business to pursue for the obligations of those subsidiaries. As a result, it would be inequitable to afford Sunoco and Kennametal the protection of the corporate veil of their subsidiaries. At its most basic level, where injustice would result but for the finding of alter ego liability, courts tend to find for piercing the veil, especially in the context of a tort. (*Mesler v. Bragg Management Co.* (1985) 39 Cal.3d 290, 300.) "The essence of the alter ego doctrine is that justice be done." (*Mesler, supra*, 39 Cal.3d at 301.)

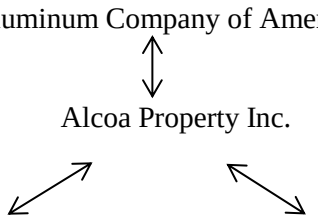
Kennametal and Sunoco have pointed to *In the Matter of the Petitions of Aluminum Company of America, et al.*, WQ Order 93-9 (*Alcoa*) in support of their position. This Order does

[4] *See* Prosecution Team Rebuttal, Exhibit A and Sunoco's Exhibits 8 & 11, showing that all assets of Cordero and Nevada Scheelite, and in Sunoco's case the remaining liabilities, were distributed to Sunoco and Kennametal respectively.

not support their position and is distinguishable on its facts due to the corporate structure employed by Alcoa.

In the Matter of the Petitions of Aluminum Company of America, et al., WQ Order 93-9, deals with the establishment of cleanup and closure requirements for an inactive sulfur mining site located in the Oakland Hills. Alcoa Aluminum Company of America (Alcoa) was named as a former owner. Alcoa filed a petition for review of the order alleging it was improperly named as a discharger because it was never an owner or operator of the mine and could not be considered liable as either the success or later ego of CDI or ACS. However, unlike the situation in this matter, Alcoa's connection to these two entities was through an intermediary, Alcoa Property Inc.

The following diagram shows the corporate structure in *Alcoa*:



Therefore, CDI and ACS were wholly owned subsidiaries of Alcoa Property Inc., not Alcoa.

In this matter, Nevada Scheelite Corporation (Nevada Scheelite) and Cordero Mining Company (Cordero) are the wholly owned subsidiaries of Kennametal and Sunoco respectively . *In Alcoa*, ACS and CDI were subsidiaries of Alcoa Properties Inc., which is the exact relationship between Sunoco and Kennametal and their respective subsidiaries. And with respect to Alcoa Properties, Inc., the State Board points out that "if any assets of a dissolved corporation have been distributed to the shareholders, in this case, Alcoa Properties, Inc., an action may be brought against the shareholders. *See* Corps Code Sec. 2011(a)(1)(B*)." (In the Matter of the Petitions of Aluminum Company of America, et al.*, WQ Order 93-9, footnote 6.)

In this case, the assets of Nevada Scheelite when dissolved were distributed to Kennametal.[5] Upon dissolution, the remaining assets, and liability in the form of responsibility of the Cordero Retirement and Stock Purchase Plans, of Cordero were distributed to its sole shareholder, Sun Oil. [6] Therefore, *In the Matter of the Petitions of Aluminum Company of America, et al.*, WQ Order 93-9 does not support Kennametal's and Sunoco's argument, but instead upholds the long-standing policy of naming them pursuant to Corps Code Sec. 2011(a)(1)(B) and Water Code section 13304.

III. Sunoco's and Kennametal's Corporate Successor Argument Is Merely A Request for Apportionment.

Sunoco's and Kennametal's claim they cannot be named in the Order is essentially a request for apportionment of liability, which is contrary to Regional and State Board interpretation of Water Code section 13304 and should be disallowed.

The State Board has consistently found that liability is joint and several under the Water Code. For example:

> In a series of prior Orders, we have established certain principles regarding liability for groundwater cleanups. Cleanup liability is broad and may extend, depending on the facts of the case, to old landowners, present landowners, old tenants, and present tenants. In cases involving several potentially responsible parties, it is appropriate to name in a cleanup order all parties for which there is reasonable evidence of responsibility for each party named. In reviewing an action of a Regional Board, we look at the record to determine whether, in light of the record as a whole, there is a reasonable and credible basis to name a party.

(*U.S. Cellulose and Louis J. and Shirley D. Smith*, WQ Order No. 92-04 (pg. 2) [emphasis added].)

[5] *See* Prosecution Team Rebuttal, Exhibit A, deposition of George Heideman, pgs 4, 14 & 15, wherein he stated that Nevada Scheelite's assets were taken over by Kennametal.
[6] *See* Sunoco Exhibit 12.

The State Water Board has consistently applied joint and several liability in cleanup matters. In part, this conserves time and seeks to maximize limited resources of the state agency that must prioritize its actions and act on behalf of all members of the public to address serious water quality issues, while still allowing the private parties the opportunity to seek redress through a contribution action if one is needed. In *Union Oil Company of California*, WQ Order No. 90-2, the State Water Board stated that the Regional Board is authorized:

> To issue either one order, or several orders with coordinated tasks and time schedules, to all persons it finds are legally responsible, requiring any further investigating and cleanup which is necessary.

(State Water Board Order WQ No. 90-2, at p. 3.) The Board went on to say that, "while we consider all dischargers jointly and severally liable for discharges of waste, it is obviously not necessary for there to be duplication of effort in investigation and remediation." *Id.* at p. 4 [emphasis added].

> An agency interpretation of the meaning and legal effect of a statute is entitled to consideration and respect by the courts … the binding power of an agency's *interpretation* of a statute or regulation is contextual: Its power to persuade is both circumstantial and dependent on the presence or absence of factors that support the merit of the interpretation … An "administrative interpretation … will be accorded great respect by the courts and will be followed if not clearly erroneous…."

(*Yamaha Corp. of America v. State Bd. Of Equalization* (1998) 19 Cal.4th 1, 7 [emphasis in original].) Accordingly, although courts independently review the text of a statute, they must "tak[e] into account and respect[t] the agency's interpretation of its meaning, of course, whether embodied in a formal rule or less formal representation." (*Id.*) Relevant factors for deference include "the particular agency offering the interpretation …[factors] 'indicating that the agency has a comparative interpretive advantage over the courts' [e.g., factors that "assume the agency has expertise and technical knowledge, especially where the legal text to be interpreted is

technical, obscure, complex, open-ended, or entwined with issues of fact, policy, and discretion"] and [factors] 'indicating that the interpretation in question is probably correct' [e.g., "careful consideration by senior agency officials … evidence that the agency 'has consistently maintained the interpretation in question, especially if [it] is long-standing'"…]. (*Id*. at pp. 7-13.) Similarly, under the primary jurisdiction doctrine, where issues are placed within the "special competence of an administrative body, limited review is more rationally exercised by "preliminary resort for ascertaining and interpreting the circumstances underlying legal issues to agencies that are better equipped than courts by specialization, by insight gained through experience, and by more flexible procedure." *Palmer v. University of California*, 107 Cal.App.4th 899, 906-07 (2003).

Cleanup and abatement orders issued pursuant to California Water Code section 13304 impose joint and several liability on all those named in the order. Despite this policy and well established interpretation of section 13304, the dischargers are attempting to apportion their liability to 0%, even though the other parties are not present and/or able to respond. The result of Sunoco's and Kennametal's argument would be that they have no liability as successors, thus increasing the liability the Regional Board is assigning to those named in the Order. This is essentially an end-run around joint and several liability.

Consistent with the Regional and State Board's long held and applied principles regarding Cleanup and Abatement Orders issued pursuant to California Water Code section 13304, Sunoco and Kennametal are jointly and severally liable and thus should not be allowed to have their liability apportioned to the detriment of the other named responsible parties.

IV. Public Policy Dictates Naming Sunoco and Kennametal in the Cleanup and Abatement Order for Contamination Caused by Their Respective Wholly-Owned Subsidiaries

California Water Code section 13000 provides, "that the state must be prepared to exercise its full power and jurisdiction to protect the quality of waters in the state from degradation originating inside or outside the boundaries of the state." To that end, the Water Board liberally

applies the rules of corporate successor liability. For example, in *Spitzer* it held that a company that had purchased the assets of a direct discharger would be named in a cleanup order. The State Board has also held that Corporations Code 2010(a) provided authority to name a dissolved corporation in a cleanup order.[7] This is in keeping with the strong public policy of holding those that contributed to the contamination responsible for the cleanup, regardless of corporate machinations to limit and/or absolve and entity from liability. Essentially these Responsible Parties are asking the Regional Board to shift the cost of the cleanup of their contamination at the site from Nevada businesses to the citizens of California. That cannot stand and would result in Nevada businesses performing actions harmful to California water quality with no responsibility for the contamination. This is contrary to the Water Code and its mandate to protect the quality of waters in the state from degradation originating inside the bounds of its state.

CONCLUSION

Based on the above, Kennametal and Sunoco are properly named in the Order as successors in interest to their wholly owned subsidiaries.

[7] *Arthur Spitzer et al.*, Order WQ 89-8 (SWRCB 1989). *Trams-Tech Resources, Inc*., Order WQ 89-14 (SWRCB 1989).