FILE NAME: Cape Asbestos (CAPE)

DATE: 1975 Oct 3

DOC#: CAPE155

DOCUMENT DESCRIPTION: Letter to Solicitor of Cape Industries Ltd. RE strategies to minimize exposure to litigation by transferring business to Cape Canada [Legal - Tibbs Case Exhibit 53]

ELECTRONICALLY FILED - 2023 Oct 18 12:13 PM - RICHLAND - COMMON PLEAS - CASE#2023CP4001759

TO 616

October 3, 1975

Mr. A. J. Penna
Group Solicitor
Cape Industries Limited
114 Park Street
London W 1 Y 4AB

Dear Tony: Re: NAAC

This is a private and confidential reply to the questions raised by Dr. Gaze when he was here this spring, and by your letter of June 25, 1975.

The objective under consideration is an attempt to limit NAAC's and Cape's exposure to future United States litigation. At some point in the past the potential danger of working with asbestos fibers must have been publicized and became generally so well known that sales thereafter should have been at the buyers' risk, and not result in any further liability. Of course, anyone can file a lawsuit at very little cost even though the chance of success is minimal.

In the light of Dr. Gaze's coming trip to Chicago I wanted you and him to have the benefit of the discussion herein before he leaves.

INSURANCE: At Dr. Gaze's suggestion when he was here I immediately contacted NAAC's insurance broker and with one of our product liability experts discussed the possible extension of NAAC's insurance coverage even though the corporation might be liquidated. For weeks I had no answer, and finally I was advised that the insurance coverage could be continued if NAAC were to continue as a shell corporation with officers and directors, even though no longer carrying on business. I advised the broker that this is not really what we had in mind; that he should try again to see if there could be coverage of the corporation for two years after dissolution, and of the officers and directors for a longer period. After considerable time I checked again and was advised that the present insurance carrier would not do this, but that another company might. I was

told that I could expect a more definite answer within a week or two but I still have not heard.

STATUTE OF LIMITATIONS: Under Illinois law actions for damages for an injury to the person must be commenced within two years after the cause of action accrued. The question, of course, is when the two-year statute starts to run. I understand this is one of the issues in the Yandle case in Texas; however, the majority rule and the rule in Illinois seems to be that the cause of action accrues when the "cumulative effect" of the exposures causes disablement. Another way of stating the rule is that the claim accrues when the injury occurs, and the injury occurs when the plaintiff knows or should know of his right to sue the defendant for the injury. It does not accrue upon delivery of the asbestos. Under separate cover I have mailed to you a Cornell Law Review article entitled "Effect of Corporate Dissolution on Products Liability Claims - Volume 56 - July 1971 - No. 6". This comprehensive article discusses pre-dissolution and post-dissolution claims. The dissolution of NAAC would seem to be helpful only with respect to post-dissolution claims. The statute of limitations on pre-dissolution claims would expire before the two-year period that the corporation remains alive for purposes of being sued after dissolution. However, post-dissolution claims might be barred by the expiration of the two-year statute of limitations. Thus it seems to me that our primary concern is about liability from sales made 3, 5 - 10 years ago which might result in disablement to some potential claimant more than two years from now. Claims for disablement prior to that time could be filed within the two-year period after dissolution.

NAAC LIQUIDATION: Enclosed herewith is a copy of the Illinois Business Corporation Act. Note the following provisions. Sec. 80 provides that before filing Articles of Dissolution all debts, liabilities and obligations of the corporation must have been paid or discharged or adequately provided for, including provision for the satisfaction of any judgment which may be entered against it in any pending suit. Sec. 94 provides that any action or proceeding on a claim existing or liability incurred prior to dissolution may be commenced within two years after the date of dissolution. Sec. 42.3 provides that the directors of a corporation who vote for or assent to the distribution of assets to shareholders after filing an intent to dissolve without adequate provision for payment and discharge of all liabilities shall be jointly and severally liable to the corporation to the extent that such liabilities are not thereafter paid and discharged. Sec. 42.6 provides that directors who fail to mail to a known creditor a notice of filing a statement of intent to dissolve shall be jointly and severally liable to such creditor for any loss or damage occasioned thereby. Sec. 42.11 provides that any director who is held liable under various provisions, including 42.3 above, is entitled to contribution from other directors who are likewise liable and from shareholders who knowingly accepted or received any such distribution of assets. Sec. 42.8 provides that the directors who vote or assent to any distribution of assets to shareholders prohibited by this act shall be guilty of conspiracy and may be punished under the Criminal Code.

To the extent that there is adequate insurance coverage it would seem that the directors would be safe in distributing NAAC's assets in liquidation; however, it seems to me that there is a great deal of uncertainty regarding potential claims against the corporation.

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Although the directors may not actually know of additional claims, if they should know that there is a good chance that there will be additional claims, they too must be provided for. There have been cases where the court held that the liquidation of a corporation was not effective where claims which were known or should have been known were not provided for, and thus the corporation remained in being for purposes of being sued, and the claimants were not limited to the two-year period after liquidation.

Any claimants might have a difficult time pursuing assets if the corporation were actually liquidated and the assets distributed out of the country. In such a case, however, it is most likely that the directors would then be named as defendants individually for permitting such a distribution to take place without adequately providing for claims. The general rule is that directors can be sued individually only if they are negligent beyond the scope of their duties as directors. Normally only the corporation is sued if its assets are intact; however, if its assets were distributed, any claimant is almost certain to allege that directors did not adequately provide for claims that they should have known would arise and that they therefore are individually liable. Further, NAAC's insurance coverage extends to officers and directors only "while acting within their duties as such."

There also seems to be little doubt that liability would be transferred through to any new corporate entity set up to replace NAAC, particularly if it could be shown that the activities, president and principal shareholders were the same. This same risk would probably also be present if the new entity were outside the United States although, as will be mentioned below, any claimant might have to prove his case in the courts of the country of the new entity.

REPLACEMENT FOR NAAC: If the replacement for NAAC had an office and one or more employees in the U.S. it would have to qualify to do business in the state or states of its activities and would be subject to the jurisdiction of the U.S. courts the same as if it were a U. S. corporation. For example, if NAAC's business were transferred to Cape Canada but Cape Canada maintained the same office that NAAC has here with substantially the same employees there would be nothing gained insofar as products liability cases in the U. S. are concerned. It would be the same as if the local office were an Illinois corporation as at present; in fact, someone in Illinois would have to be designated as agent of Cape Canada for service of process in Illinois. Even if only a warehouse were maintained in the U.S. and no other office or employees, it is likely that the warehouse would be considered as a place of business in the U.S. and subject the foreign corporation to the jurisdiction of U.S. courts.

It would be impossible to use a Mexican corporation as a replacement for NAAC because under the current foreign investment law in Mexico a sales company of the type under consideration cannot be more than 49% owned by non-Mexican shareholders; further, there are heavy penalties for Mexicans who act as nominees for non-Mexican shareholders. The total tax rate on income, including the withholding rate on dividends to get the income out of the country, would be 53.6%, as follows:

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Corporate Income Tax	42%
Dividend withholding tax (rates from 15 to 20% at the rate of 20%)	11.6%
Total effective tax rate	53.6%

There is also a Gross Receipts Tax of 4%

Canada too has a new Foreign Investment Review Act, part of which is just becoming effective. However, since Cape Canada is already in existence, I think there would be no problem if it were merely to extend its activities and continue to be wholly owned by non-Canadian shareholders. The following corporate income taxes are in effect:

Canadian Federal Tax	48%
Provincial Effective Tax (Ontario and Quebec have a 12% corporate income tax but the Canadian federal tax allows a credit of 10%)	2%
	50%
Dividend withholding tax at 15%	7.5%
Effective Tax Rate	57.5%

There is also a Canadian federal sales tax of approximately 12%.

If the Canadian corporation were subject to U.S. taxes under the treaty between Canada and the United States, the Canadian company would get a credit against the Canadian taxes for the U. S. taxes paid. The corporate rates in the two countries are substantially the same. The Canadian corporation would probably not be subject to U.S. taxes on the sales in Mexico although it would be subject to Canadian taxes. So far NAAC has been successful in not subjecting itself to Mexican taxes. Presumably a Canadian corporation could continue in the same manner.

If it were possible to operate without an office or employees in the United States it would seem to be better to operate directly from some company in England, the mining companies in South Africa or, if an office is needed near North America, from some Caribbean or Central American country that has very low income tax rates; e.g. Netherlands Antilles. Mr. Morgan's predecessor, Robert Cryor, and I used to talk occasionally about such an operation and we considered the tax savings that might result; however, it was always decided that it was not possible to operate in the United States without an office here, or at least without an employee traveling regularly in the United

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States with authority to negotiate contracts. This would result in the profits being subject to U.S. taxes and therefore there appeared to be nothing to be gained by operating from a country outside the United States.

ENFORCEMENT of U.S. JUDGMENTS by FOREIGN COURTS: The U.S. courts are continuing extending the length of their "long arm jurisdiction". It has reached the point where merely selling into a state, without any other activities in the state, will give rise to jurisdiction of the state court if the product sold results in damage in that state. Along with a copy of the Cornell Law Journal article on product liability, and the Illinois Business Corporation Act, I have also sent under separate cover the current issue of the Corporation Journal containing an article on Long Arm Jurisdiction.

Many countries have a reciprocal enforcement of foreign judgments law. Many, including South Africa, do not. In a country which does not have such a provision the defendant can usually raise in the suit on the judgment all of the defenses he could have raised at the original trial in the U.S.; thus, in taking a default judgment in the U.S. all defenses can still be raised in the suit in the foreign court on the judgment.

Your information with respect to Quebec law is apparently correct. A foreign default judgment is not executory in Quebec. Any defense which might have been raised in the original action is available in an action on the judgment; thus, if it is decided to operate in the U.S. through Cape Canada it may well be desirable to transfer Cape Canada from Ontario to Quebec.

SUMMARY: It is possible that some protection as to future actions could be obtained by liquidating NAAC and operating in the future through a Canadian or other foreign corporation; however, no protection would be obtained if it were necessary to have an office or employees in the United States, or even to have a non-resident employee who continually travels in the U.S. with authority to conclude contracts.

There would be no protection as to suits which might be commenced in the next two years, and it is a judgment question as to whether, in the light of the now public knowledge with respect to asbestos fibers, it is likely that there will be claims accruing and suits arising more than two years from now.

We will try to have more definite information on insurance coverage by the time Dr. Gaze arrives late this month but there appears to be danger to the directors who approve the distribution of assets in liquidation unless they can show that they do not have a reasonable expectation that additional claims against the company exist or might be filed in the future.

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We are looking forward to Dr. Gaze's visit and hope to discuss these matters further at that time.

Sincerely,

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