



SUCCESSOR LIABILITY IN ASSET ACQUISITIONS

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GENERAL RULES

- A successor corporation is liable for the debts and liabilities of its predecessor where there is a merger or consolidation of the two entities.
- In contrast, a purchaser (“Asset Purchaser”) of all or substantially all of the assets of a seller does not by operation of law assume the liabilities of the seller (“Seller”).



SUCCESSOR LIABILITY

COMMON LAW EXCEPTIONS

- Asset Purchaser is vicariously liable for the debts and liabilities (including environmental and product liability) of Seller if one or more of the following common law exceptions apply:
 - Asset Purchaser expressly or impliedly agrees to assume the debts or liabilities of Seller
 - The transaction amounts to a de facto merger or consolidation
 - Asset Purchaser is a mere continuation of Seller
 - The transaction is an effort to fraudulently avoid liability



OTHER THEORIES

- Courts may also hold Asset Purchaser liable beyond the bounds of the common-law rules if:
 - There is substantial identity between the operations of Seller and Asset Purchaser
 - Asset Purchaser manufactures same product line as Seller



EXPRESS/IMPLIED ASSUMPTION OF LIABILITIES

- If Asset Purchaser expressly agrees to assume the liabilities of Seller, Asset Purchaser will be liable for the liabilities expressly assumed.
- In determining whether Seller's liabilities have been impliedly assumed by Asset Purchaser, courts:
 - Use general principles of contract interpretation to interpret ambiguous language
 - Review Asset Purchaser's post-acquisition conduct



De Facto Merger

- Under the de facto merger exception, a court looks beyond the form of an asset sale to determine whether there has in substance been a merger or consolidation. If so, Asset Purchaser is responsible for Seller's liabilities.



De Facto Merger (Continued)

- To determine if a de facto merger/consolidation has occurred, the following 4 factors are relevant:
 - Continuation of Seller's enterprise evidenced by a continuity of:
 - Management
 - Personnel
 - Physical location
 - Assets
 - General business operations
 - Continuity of ownership of Asset Purchaser and Seller
 - Dissolution of Seller as soon as possible after the transaction
 - Asset Purchaser's assumption of Seller's obligations necessary for uninterrupted operation of the business



MERE CONTINUATION OF SELLER

- Asset Purchaser is responsible for Seller's liabilities if it is merely a restructured or reorganized form of Seller. Its not simply the business of Seller that continues, but the corporate entity itself.

- To determine if Asset Purchaser is a “mere continuation” of Seller, the following factors are relevant:
 - Common ownership of Asset Purchaser and Seller
 - Common identity of officers and directors of Asset Purchaser and Seller
 - Similar function of officers and directors
 - Inadequate consideration paid for assets



FRAUDULENT TRANSACTIONS

- The fraudulent transaction exception looks to state fraudulent transfer statutes to determine if Asset Purchaser should be responsible for Seller's liabilities.
- These statutes impose liability if the transaction was entered into to defraud, hinder or delay Seller's creditors or stockholders.
- This exception is rarely applied. Generally, if a transaction is conducted at arms-length and is commercially reasonable, this exception will not be applied.



FRAUDULENT TRANSACTIONS

(Continued)

- Factors that favor a determination that Asset Purchaser should be responsible for Seller's liabilities include:
 - Seller was insolvent at the time of transfer
 - Consideration paid was inadequate
 - Seller was undercapitalized



SUBSTANTIAL CONTINUATION

- Asset Purchaser is responsible for liabilities of Seller where there is an identity between the operations of Seller and Asset Purchaser. The goal is to prevent evading liability by structuring subsequent asset sales.



SUBSTANTIAL CONTINUATION (Continued)

- The following factors favor a finding of liability based on the Substantial Continuation Theory:
 - Continuity of employees, directors and officers and physical location
 - Continuity of assets and business operations
 - Continuity of business address and customers
 - Manufacture of the same product
 - Retention of name
 - Asset Purchaser holding itself as a continuation of Seller
 - Activity that resulted in liability continues after sale
 - Asset Purchaser had knowledge, or notice of, potential liability or has substantial ties w/ Seller
 - Asset Purchaser was not previously in same business as Seller
 - Transaction was not arms-length
 - Absence of other responsible parties from whom to recover



PRODUCT LINE TEST

- Asset Purchaser is responsible for product liability claims against Seller where Asset Purchaser:
 - Continues to manufacture the same product line as the Seller
 - Uses the same name as Seller
 - Doesn't outwardly indicate a change in ownership of Seller's business



RECOMMENDATIONS

- Asset Purchasers are advised to take the following measures to minimize the risk of being held responsible for Seller's liabilities:
 - In the Purchase Agreement, provide that all liabilities remain with Seller and require Seller to make financial provision for such liabilities
 - Provide an indemnity to Asset Purchaser for liabilities not expressly assumed
 - Identify a new operating entity, distinct from Seller
 - Don't install officers, directors, etc. in same roles
 - Don't pay for assets in stock of Asset Purchaser
 - Change locations, employees, management and operations
 - Require Seller to maintain existence and a minimum net worth after sale
 - Don't adopt corporate/trade name of Seller



RECOMMENDATIONS

(Continued)

- In a Section 363 purchase in bankruptcy, the Asset Purchaser can purchase the Seller's assets "free and clear of all liens." However, this does not act as an absolute bar against the imposition of future liability. Therefore, in the bankruptcy context, Asset Purchaser should also:
 - Provide extensive notice of the proceedings, in national papers, rather than just local papers
 - Incorporate sale into reorganization plan, even in a 363 sale
 - Request bankruptcy court retain jurisdiction over disputes related to asset sale
 - Seek injunction from bankruptcy court preventing Seller's creditors from suing Asset Purchaser
 - Require Seller to set up a trust for unknown future claims