

DEALING WITH TROUBLED COMPANIES

Does Purchasing Assets Avoid Seller Liabilities?

A common strategy for acquiring the business of a troubled company is to purchase assets rather than acquire all outstanding capital stock of the target, based on the general principle that a purchaser of assets is not responsible for liabilities of its seller absent an express or implied assumption. Does the strategy work? Depending on the liability and circumstances, the answers are "No" and "Maybe," and sometimes a qualified "Yes." In troubled economic times, buyers may reconsider whether they are willing to rely upon indemnity by the seller or its owners, particularly since doctrines of public policy may render such an indemnity unenforceable in certain situations.

- **State and Local Taxes.** At least 25 of the 50 states impose successor liability on a purchaser of assets with respect to unpaid taxes of the seller, unless the purchaser either (i) withholds the taxes from the purchase price or (ii) obtains a clearance certificate from the government. Usually, but not always, the transaction must involve substantially all the assets of the business or a termination of business by the seller.
- **Bulks Sales Act.** Failure to comply with a state bulk sales act, if applicable, generally results in liability for the purchaser to creditors of the seller.
- **Certain Product Liabilities.** A buyer may inherit seller product liabilities pursuant to judicial doctrine.
- **Collective Bargaining Agreements.** A purchaser of assets may be required to recognize and bargain with a union that represented the seller's employees
- **Certain Underfunded Pensions.** If the seller participates in an underfunded multiemployer union pension plan, a sale of its assets results in immediate withdrawal liability. Some courts hold a buyer liable for a seller's delinquent contributions and withdrawal liability despite disclaimer in the asset purchase agreement.
- **Environmental Liabilities.** A buyer may be liable for seller liabilities under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 or other environmental laws.
- **Regulated Industries.** If the seller engages in a business subject to special governmental regulation, then additional issues arise concerning potential exposure of an asset purchaser to seller liabilities.
- **De Facto Merger or "Mere Continuation" of Seller.** Pursuant to common law developed by the courts, a seller and buyer may be considered to have undergone a "*de facto* merger" or the buyer may be considered a "mere continuation" of the seller, with the result that the buyer is liable to creditors of the target.
- **Fraudulent Transfers.** Obviously an actually fraudulent sale can create successor liability. However, both state and federal law may treat a transfer as "fraudulent" -- and thereby expose the buyer to liabilities of its seller -- in various circumstances, most commonly where the seller is insolvent before or after the transfer.

Sheppard Mullin lawyers have decades of extensive experience representing sellers, buyers, creditors and other parties with respect to purchase, loan, licensing and other transactions with troubled companies or businesses that later suffer financial reversal. Please speak with your Sheppard Mullin contact or feel free to call any of our lawyers for help. A listing of our practice group leaders and office administrative partners appears on the following page.

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