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(Asset) Buyer Beware

Warning to buyers of going businesses: you may be buying some of your sellers' liabilities. Here are some notable risks, along with steps buyers can take to protect themselves.

By Sherwin D. Abrams

When purchasing an ongoing business, the buyer often finds it more advantageous to purchase the assets of the corporate seller than its outstanding shares of stock because "[t]he well-settled general rule is that a corporation that purchases the assets of another corporation is not liable for the debts or liabilities of the transferor corporation."[1] But buyer beware; there are a number of exceptions under which the asset buyer is responsible for the seller's liabilities.

First, there are four exceptions set forth in *Vernon v Schuster*. The asset buyer is obligated for the seller's liabilities where (1) there is an express or implied agreement of assumption, (2) the transaction amounts to a consolidation or merger of the purchaser or seller corporation, (3) the purchaser is merely a continua tion of the seller, or (4) the transaction is for the fraudulent purpose of escaping liability for the seller's obligations.[2]

These exceptions have been discussed in prior *Illinois Bar Journal* articles.[3] Here, briefly, are other exceptions and some suggested ways the buyer can protect itself.

Product line exception. In *Ray v Alad Corp,* 19 Cal 3d 22, 560 P2d 3 (1977), the California supreme court held that a company that acquired the manufacturing operations of the seller and continued its general business operations was liable for injuries caused by defective products sold by the seller. Illinois has consistently rejected the product line exception,[4] but the seller's products may have caused injury in a state that has adopted the exception, and a court is likely to apply the substantive law of the state where the injury occurred.

Employment discrimination exception. In *Musikiwamba v ESSI, Inc*, 760 F2d 740 (7th Cir 1985) the court held that because there is an overriding federal policy against unfair and arbitrary employment practices, the question is not whether the successor doctrine may be applied in claims for discrimination arising under the Civil Rights Act of 1866[5] but when.

The court recognized that the asset buyer was an innocent party. The buyer had not engaged in illegal conduct, but then neither had the employee. The court said that each case depends on its particular facts.

Assuming that the buyer substantially continues the seller's operations, the two most important factors to consider are whether the buyer knew of the discrimination claim prior to the purchase and whether the employee could obtain relief from the seller. If the buyer did not know of the claim, or the seller remained solvent after the sale and could provide relief, the buyer would not be liable.

The seventh circuit extended the *Musikiwamba* exception to employment discrimination cases arising under Title VII of the Civil Rights Act of 1964 (42 USC section 2000e).[6]

Labor law exception. The extent to which successor liability is imposed on an asset purchaser under the Labor Management Relations Act and the National Labor Relations Act remains unclear, although certain rules do apply. While the buyer is probably not bound by the substantive provisions of the seller's collective bargaining agreements, the buyer may be required to bargain with the union recognized by the seller.

Moreover, the buyer may be required to arbitrate the extent to which it will be bound by the provisions of the contract.[7] The buyer may be liable for unfair labor practices committed by the seller if the buyer knew of the labor dispute.[8]

MPPAA exception. In *Upholsterers' Intl Union Pension Fund v Artistic Furniture of Pontiac*, 920 F2d 1323 (7th Cir 1990) the court held that the buyer could be liable for the seller's obligation to contribute to a multiemployer pension plan under the Multiemployer Pension Plan Amendments Act.[9]

Environmental law exception. In *North Shore Gas Co v Salomon Inc*, 152 F3d 642 (7th Cir 1998),[10] the court held that successor liability could be imposed for clean-up costs under CERCLA.

The asset buyer cannot absolutely prevent being held liable as a successor, but it can take steps to protect itself. The asset purchase agreement (APA) should give the buyer access to the seller's records as part of the buyer's due diligence. The APA should include the seller's warranties that it has no undisclosed liabilities and that it is a party to no undis-closed contracts.

The APA should also include provisions whereby the seller agrees to indemnify the buyer for breaches of such warranties. Part of the purchase price should be retained in escrow for some time after closing, and the seller should be required to maintain its existence and retain substantial assets for some time after closing.

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1. *Vernon v Schuster*, 179 Ill 2d 338, 344-345, 688 NE2d 1172, 1175 (1997).
2. Id at 345, 688 NE2d at 1175-76.
3. Raymond P. Kolak, *The Dangers of Successor Liability When Buying Illinois Business Assets*, 93 Ill Bar J 640 (Dec 2005); George W. Kuney, *Successor Liability in Illinois*, 96 Ill Bar J 148 (Mar 2008).
4. Most recently in *Diguilio v Goss Intl Corp*, 389 Ill App 3d 1052, 906 NE2d 1268 (1st D 2009).
5. 42 USC § 1981.
6. *Wheeler v Snyder Buick, Inc*, 794 F2d 1228 (7th Cir 1986).
7. *NLRB v Burns Intl Sec Servs, Inc*, 406 US 272 (1972).
8. *Golden State Bottling Co, Inc v NLRB,* 414 US 168 (1973).
9. 29 USC § 1381 et seq.
10. Overruled on other grounds, *Envision Healthcare, Inc v PreferredOne Ins Co*, 604 F3d 983 (7th Cir 2010).