Successor Company Liability: What An Asset Purchaser Needs to Know

By: Douglas B. Lang, Esquire[1]

When a prospective corporate purchaser is considering a purchase of some or all of the assets of an existing Florida corporation extreme care should be undertaken to avoid inadvertently assuming the liabilities of the predecessor corporation, especially with regard to product liability. This article which is the first of a series will discuss the risk of incurring such liability when a corporation acquires the assets of another business entity.[2]

In a sale of corporate assets, the acquiring business may purchase some or all of the corporate assets, and the transferred assets may include tangibles such as machinery and intangibles such as accounts receivable.[3] In an asset purchase, the liabilities and responsibilities of each party would be set forth in the parties' agreement.[4] A corporation that sells its assets may continue in existence, may dissolve, or may merge with the entity that purchased its assets.[5]

A corporation that acquires the assets of another business entity does not as a matter of law assume the liabilities of the prior business.[6] Florida follows the traditional corporate law rule which does not impose the liabilities of the selling predecessor upon the buying successor company **unless** (1) the successor expressly or impliedly assumes obligations of the predecessor, (2) the transaction is a de facto merger, (3) the successor is a mere continuation of the predecessor, or (4) the transaction is a fraudulent effort to avoid liabilities of the predecessor.[7] The imposition of liability upon a successor corporation is based on the notion that no corporation should be permitted to commit a tort or breach of contract and avoid liability through corporate transformation in form only.[8] All of the theories under which successor liability will be imposed by Florida courts will be discussed below with the exception of express or implied assumption of the predecessors liabilities. Express or implied assumption theory is not discussed because it is generally a straightforward matter of contract and can arise as a matter of law by merger or statutory consolidation.[9]

1. De Facto Merger

A de facto merger occurs where one corporation is absorbed by another, but without compliance with the statutory requirements for a merger. To find a *de facto* merger there must be: (a) continuity of the selling corporation evidenced by the same management, personnel, assets and physical location; (b) a continuity of the stockholders, accomplished by paying for the acquired corporation with shares of stock; (c) a dissolution of the selling corporation; and (d) an assumption of the liabilities. All of the events, such as dissolution, need not occur at the same time.[10] The crucial question is whether there has been a change in form, but not in substance. The finder of fact may look to any other factors reasonably indicative of commonality or of distinctiveness. "The bottom-line question is whether each entity has run its own race, or whether there has been a relay-style passing of the baton from one to the other." [11]

In *Orlando Light Bulb Serv., Inc. v. Laser Lighting & Elec. Supply, Inc.*, [12] the Court considered an argument of *de facto* merger and held that evidence did not support the trial court's finding that two corporations- namely, Orlando Light Bulb Service, Inc. (OLB) and LBM Enterprises, Inc. (LBM) were obligated for debts of wholesaler's distributor American Delta Corporation, d/b/a Lite World on theory that two corporations had engaged in transaction which amounted to de facto merger. In reaching its decision the Florida District Court Of Appeals found that: 1) neither of the two corporations took over business of distributor, 2) the purchase of some inventory of the distributor by one of corporations was purchased and paid for at fair market value; and 3) neither of the two corporations acquired all or even substantially all of distributor's assets.

The Court in *Orlando* also stated that none of the elements of *de facto* merger or mere continuance were present. Neither OLB nor LBM took over the business of Lite World. OLB, a corporation owned by two shareholders who were completely unrelated to Lite World, purchased $2,000 worth of inventory, a copier and some furniture from Lite World. It was undisputed that the inventory was purchased and paid for at fair market value, established by a distributor price book. The evidence further indicated that before this purchase, Lite World had between $5,000 and $6,000 in inventory. Additionally, Lite World had approximately $22,000 in receivables, at least $10,000 of which were later collected by one of its corporate officers. The Court concluded that there was no factual support for Laser's (i.e. a creditor) assertion that OLB and LBM acquired all or even substantially all of Lite World's assets. There was never any commonality of shareholders between OLB and LBM on the one hand, and Lite World on the other, nor was OLB formed for the purpose of taking over Lite World's business, because it had been engaged in the same business for approximately ten years before this transaction took place.

Liability may also arise where all the stock of the predecessor is purchased and the predecessor's assets are stripped by the acquiring corporation. In *Kelly v. American Precision Industries, Inc.,* [13]an action for personal injuries was brought against successor corporation on theory that it had assumed liability of its predecessor in delivering allegedly defective garbage truck. The Court ruled that a successor corporation was responsible for liability of a predecessor corporation in delivering allegedly defective garbage truck where the successor purchased all of predecessor's stock and stripped it of all its assets, with the benefit going solely to successor which was tantamount to a *de facto* merger.

It is often necessary to go to great lengths and significant detail to be able to avoid a claim of successor corporate liability and to avoid the personal jurisdiction of Florida courts. For example, in *Viking Acoustical Corp. v. Monco Sales Corp*., [14] the Court considered the following circumstances. In 1995, Viking entered into an agreement with Monco to purchase a laminating system and equipment for $ 146,500. Later that year, it purchased an improvement to the system for an additional $ 30,000. Viking paid Monco in full. However, the equipment which it purchased did not work. In 1996, Monco sold its business to Black in an asset sale. Ultimately, Viking brought suit in Florida against Black and others under, among other theories, *de facto* merger.

Robert Stachlewitz, Black's Vice-President, in an affidavit alleged that it had purchased from Monco "the rights to specific assets involved in the manufacture and sale of a line of laminating equipment" so it could "produce a laminating line similar to the line manufactured by Monco," including "the rights to a patent and drawings for the line of laminating equipment" and some "of the finished inventory from the laminating line." He maintained that it had purchased "the right

to produce a laminating line." He denied that it had bought Monco's "welders, lathes, mills, grinders, drills, chrome plating equipment, painting equipment and assembling equipment such as overhead cranes and material handling equipment" or a paper laminator and a temperature and humidity controlled room used to house the paper laminator.

Stachlewitz also alleged that (1) Black did not purchase from Monco its real estate, buildings or fixtures, non-laminating line inventory, processing equipment, accounts receivables, computer equipment, office assets or company cars; (2) it did not purchase Monco's entire business and continue it under Black's name; (3) it has never sold any Monco manufactured equipment, including laminating equipment; (4) it does not employ Monco's employees; (5) there are no common shareholders between Black and Monco.

In addition, he alleged that Monco had advised Black in writing that it had intended to continue its laminating business with its real estate, buildings and equipment, including its paper laminator. Stachlewitz further denied that Black had employed any of Monco's employees, with the exception of Thomas Potchen, whom he maintained was an independent contractor. Additionally, he alleged that Black had, before the sale, contacted some of Monco's customers, including Viking, to inquire about any existing claims. According to Stachlewitz, Viking's Production Manager, Tom Kraft, had indicated that Viking "had a few minor problems with the Monco equipment, but nothing more than the usual start-up situations with new equipment."

In finding no personal jurisdiction over Black the Court found no *de facto* merger stating, in relevant part:

> *Although Viking maintains that a de facto merger occurred when Black bought most of its assets, it failed to meet its burden of proving personal jurisdiction under that theory. Specifically, Black did not assume any of Monco's liabilities. There is no identity of officers, directors or shareholders and the location of Black's business is in Illinois rather than Florida. Black employed Thomas Potchen but only in the capacity of a consultant; Potchen has no control over the business. Moreover, it appears that Monco has continued its business under a new name. We agree with the trial court that, based on the undisputed facts, a de facto merger did not occur.*

Successor liability under a *de facto* merger theory was also considered and rejected in a commercial rent claim case. In *Serchay v. NTS Fort Lauderdale Office Joint Venture*[15], a law firm organized as a professional association was found not liable for debts of another law firm that had previously operated in same rented office space. The Court reached this result despite the presence of several indicia of a *de facto* merger including : (a) the second law firm continued doing business in same office; (b) it used some of the same office equipment and some of the same office personnel; and (c) it made payments to and demands on landlord under lease agreement long after first law firm had ceased to exist, However, in finding no *de facto* merger the *Serchay* Court was swayed by the following: (a) one officer and shareholder of second law firm was not an officer and shareholder of first firm; (b) there was no evidence that second firm acquired assets and the liabilities of first firm, and (c) the first firm's dissolution was involuntary.

2. Continuation Theory

Under the mere continuation theory, liability is imposed when the successor corporation is merely a continuation or reincarnation of the predecessor under a different name.[16] The key is that there is a change in form, but not in substance.[17]

A continuation of business resulting in liability of the successor corporation for its predecessor's debts occurs when the successor corporation is merely a continuation or reincarnation of the predecessor corporation under a different name.[18] The "purchasing corporation must not merely be a 'new hat' for the seller, with the same or similar entity or ownership."[19] While having common attributes does not automatically impose liability on a successor corporation, merely repainting the sign on the door and using new letterhead certainly gives the appearance that the new corporation is simply a continuation of the predecessor corporation.[20]

In *Serchay v. NTS Fort Lauderdale Office Joint Venture*[21] an accounting firm organized as a professional association was found liable for debts of dissolved accounting firm on theory of successor liability. The Court found that the successor entity was a clear continuation of the dissolved company because it had the same assets, management, personnel, stockholders, location, equipment, and clients.

However, in *Bernard v. Kee Mfg. Co., Inc.*, [22]Court declined to impose product liability on a successor corporation under a continuation theory even though it had purchased the assets of the manufacturer of a defective product and continued the product line under the same trade name. Continuation was not found because it had discontinued the allegedly defective product model after acquisition.

3. Fraudulent Transfer of Assets

Under the Uniform Fraudulent Transfer Act (UFTA), any transfer made with "actual intent to hinder, delay or defraud" any present or future creditor is a fraudulent transfer. [23] Because of the difficulty in proving actual intent of a fraudulent transfer, case law and the UFTA look to indicia of fraudulent intent commonly referred to as "badges of fraud." [24] The fraudulent nature of the transaction may be found to exist in the transfer of assets of a corporation without consideration or for grossly inadequate consideration to a successor corporation to the prejudice of creditors for the benefit of the same individuals who constitute the beneficial owners of each of the corporations involved. [25]

The Court considered the fraudulent transfer theory of successor liability in *Lab. Corp. v. Prof'l Recovery Network*.[26] In *Lab Corp,* Professional Recovery Network, Inc. (PRN) sought to hold PRN liable for debts incurred to Lab Corp by Drug Programs Management, Inc. (DPM). In its suit, Lab Corp asserted, among other things, that PRN was formed for the purpose of defrauding DPM's creditors. The Court in considering the fraudulent transfer claim stated that at least several "badges of fraud" can be found in the record, including the transfer of DPM's customers, receivables, accounting system and database to PRN without consideration, and the transfer of DPM's vehicles to McKown at far less than fair market value. Only a trial will allow a full explanation of the relationship between DPM and PRN, and a determination of PRN's liability, if any, for DPM's debts.

Illustrative of a case where disparity in purchase price was sufficient to support a fraudulent transfer claim is *Graef v. Hegedus*,[27] where a passenger injured in an automobile collision sued drivers, city, and engineering company i.e. Florida Land Design and Engineering, Inc. ("FLDE") which designed and constructed intersection, and filed amended complaint adding engineering company's successor corporation, Dames and Moore as defendant. The Court held that given the disparity in the value of the FLDE assets and the consideration paid for the purchase by Dames and Moore that genuine issues of material fact remain unresolved as to whether this transaction constitutes a fraudulent transfer under section 726.105, Florida Statutes (1989), of the Uniform Fraudulent Transfer Act

However, mere knowledge that the seller is indebted to another or even knowledge of the existence of a valid and pending cause of action against the seller may be insufficient to show the purchaser's participation in a fraudulent conveyance. In *Orlando Light Bulb Service v. Laser Lighting* [28], a wholesaler brought an action against two corporations to recover on debt owed by one of its distributors alleging, among other claims, a fraudulent transfer of assets. The Court held that there is no evidence that OLB knew of the writ of attachment. The testimony of one of OLB's shareholders shows that at best, he was only aware of Laser's [the creditor] claim against Lite World. This is insufficient to hold OLB liable for a fraudulent transfer. Also, Browning, [a corporate officer] remained an employee of Lite World until November 13. In sum, his knowledge could not be imputed to OLB when the sales were made on October 31. Thus, the Court found that there was no basis for imposing liability against the defendants based on the sale of some of Lite World's furniture and inventory of light bulbs.

Fraud is generally a question of fact for the fact-finder. Courts will carefully scrutinize the evidence alleged in deciding whether there is sufficient evidence of fraudulent transfer to withstand a summary judgment motion or directed verdict. The Court in *Orlando Light* found that there were insufficient "badges of fraud" so as to establish as a matter of law that OLB intended to defraud Lite World. Laser cited to the various badges of fraud present in this case, i.e., insufficient consideration for the transfer of the copier machine, LBM's knowledge of pending litigation and the close business relationship between Browning and the defendants. The Court observed that while these badges of fraud, standing alone, unrebutted and uncontradicted could support a finding that the conveyance relating to the furniture was fraudulent, the presence of fraud is to be determined by the particular facts surrounding a particular conveyance and not every conveyance of property by one against whom suit is pending will be deemed fraudulent. Here, the trial judge, as the finder of fact, specifically found no fraud or fraudulent intent.[29]

Another example of the Court dismissing a fraudulent transfer claim as a basis for successor liability before verdict is *Reina v. Gingerale Corp.* [30] In *Reina* the Court found that a successor corporation was not liable for predecessor's debts and liabilities under fraudulent transaction exception to successor corporation rule. The court stated that even assuming that successor had actual knowledge at time of sale of a pending suit against the predecessor, an assumption which, nonetheless, was not sufficiently supported by factual allegations to withstand summary judgment motion.

4. Applicability to Strict Liability Claims for Personal Injury and Property Damage

Florida courts apply the traditional corporate rule in determining product liability of a successor corporation.[31]

In *Bernard v. Kee Mfg.*, the plaintiff brought an action against Kee Manufacturing Co., Inc. (Kee, Inc.), claiming that a lawnmower manufactured and sold by the predecessor to the present company, Kee Manufacturing Co., in 1967, caused an injury in 1976. Kee, Inc., was incorporated in 1972, when it purchased the assets of Kee Co. from the owner. The assets purchased included the manufacturing plant, the inventory and the right to use the company name. The previous owner had no interest in the new company, and Kee, Inc., assumed no liabilities or obligations of its predecessor. Kee, Inc., continued to manufacture lawnmowers, maintaining the same factory personnel and using the same trade name--in essence, the entire manufacturing process was effectively continued, but under a new owner and management. The present company provided replacement parts for the subject mower, and in its brochures stated that it had been manufacturing lawnmowers since 1948.[32]

In agreeing to extend liability to a successor for products liability the Court held:

> *Extending liability to the corporate successor is not consistent with at least one major premise of strict liability, which is to place responsibility for a defective product on the manufacturer who placed that product into commerce. The corporate successor has not created the risk, and only remotely benefits from the product. The successor has not invited usage of the product or implied its safety. Since the successor was never in a position to eliminate the risk, a major purpose of strict liability in modifying a manufacturer's behavior is also lost.*[33]

However, the Court in *Bernard* held that the purchaser of the assets of the manufacturing firm, as successor to manufacturer of lawn mower which allegedly caused injury in question could not be held liable on strict liability claim under traditional corporate law rule, even though assets acquired from predecessor included manufacturing plant, inventory, goodwill, and right to use same trade name because the successor corporation did not assume liabilities or obligations of its predecessor and had discontinued manufacture of the defective product model.[34]

A similar result was reached by the Court in *Brown v. Glade and Grove Supply, Inc.*[35]*,* where the estate of tractor purchaser's employee who was killed in roll-over accident brought a products liability action against tractor's manufacturer, tractor's distributor/seller, and distributor/seller's successor Glade and Grove. Concerning the liability of Glade and Grove, the Court found that it had entered into an agreement to purchase the Glades Equipment dealership in 1978. The purchase of the dealership took place during the same time frame that the subject tractor was delivered to U.S. Sugar. However, it concluded that there was no basis to impose liability on Glade and Grove as a successor corporation under any of the exceptions set forth in *Bernard v. Kee Manufacturing Co*. It also noted that contract for the sale of the dealership from Glades Equipment to Glade and Grove provided that this transaction was solely for the purchase of personal property, including inventory, "as [Glades Equipment] has on hand at the time of the closing of such sale and purchase." Therefore, no theory of strict liability could be made applicable to Glade and Grove under the facts of this case.

However, in *Anders for Anders v. Jacksonville Elec. Authority*[36], found that a claim for successor liability had been made . In *Anders* an action was brought for negligent design and manufacture of crane. The Court stated that a complaint alleging that manufacturer of defective crane merged with another corporation which acquired manufacturer's assets and liabilities stated a claim against the successor corporation for negligent design and manufacture of the crane.

5. Application to Worker's Compensation Immunity

In *Percy v. Falcon Fabricators, Inc*[37], an employee injured by explosion of pressure cooker in workplace sued her employer for personal injuries. The Court held that an injured employee may sue her employer in tort, despite claim of workers' compensation exclusivity, when that employer is a corporate successor to the manufacturer of allegedly defective product that caused injury and product was manufactured before corporate merger. In reaching this result the court stated:

> *When Ms. Percy was injured by the allegedly defective product, she sued her employer, which had merged with the manufacturer. When K.F.C. Manufacturing merged with K.F.C. National, K.F.C. National assumed, by operation of law, all of the liabilities and obligations of the subsumed corporation--the third-party tortfeasor. § 607.1106(1)(c), Fla.Stat. (Supp.1990) (formerly § 607.231(3)(e), Fla.Stat. (1979)). If the product was manufactured before the merger and Ms. Percy had never been employed by that manufacturer, the successor corporation cannot claim any inherited immunity from the manufacturer.*[38]

6. Liability for Punitive Damages

The Florida Supreme Court has also determined that a successor corporation can be held liable for punitive damages based upon the conduct of a predecessor. In *Celotex Corp. v. Pickett*[39], a shipyard insulator who suffered asbestos-related lung injury brought personal injury action on the grounds of negligence and strict liability against corporate successor to asbestos cement manufacturer. The Court stated that because of its merger agreement with Panacon, the predecessor whereby "all debts, liabilities and duties" of Panacon are enforceable against Celotex, and because of the effect of section 607.231(3), the liability imposed upon Celotex is direct, not vicarious. Liability for the reckless misconduct of Philip Carey/Panacon legally continues to exist within, and under the name of, Celotex. It further stated:

> *Celotex, as the present embodiment of Philip Carey/Panacon, is being punished for the reckless conduct giving rise to this suit. Further, allowing punitive damages in this instance may well deter other corporations from seeking to merge with other companies which have engaged in reckless conduct detrimental to the public health and thereby have the potential for the imposition of punitive damages.*[40]

The *Celotex* court observed that corporations are in a very real sense, "molders of their own destinies" in acquisition transactions, with the full panoply of corporate transformations at their disposal. When a corporation, such as Celotex here, voluntarily chooses a formal merger, it will take the "bad will" along with the "good will. [41] It is also likely that the Courts would hold a successor liable for punitive damages where it found a *de facto* merger, a fraudulent transfer of assets to a successor, a continuation of the predecessor or an assumption of the predecessor's liabilities.

Conclusion

There are very real dangers associated with the purchase of assets, including be exposed to punitive damages based upon the predecessor's conduct. Careful drafting of documents is critical to avoid assuming such liabilities. However, as shown above careful drafting alone is not enough. Recognize that the closer the identity between the predecessor and successor in the assets, management, personnel, stockholders, location, trade name, equipment, and clients, the more likely that successor liability will be found. Even if there is sufficient dissimilarities to avoid liability under a *de facto* merger or continuation theory, the purchaser needs to be able to avoid transactions where grossly inadequate consideration is paid by a successor corporation to the prejudice of creditors under circumstances which benefits the same individuals who constitute the beneficial owners of each of the corporations involved. By following this path, a prospective asset purchaser will significantly reduce potential liability for the predecessor's debts and tortious conduct.

---

[1] Partner, Angelo, Barry & Banta P.A., Fort Lauderdale © 2005 All rights reserved. This article is for general information purposes. The article does not constitute or contain legal advice. This article should not be considered as a legal opinion nor as a substitute for legal counsel. No representation or warranty is made by the author as to the accuracy of the information contained in the article.

[2] This article does not address, among other issues, the enforceability of non-compete provisions in employment agreements by successor corporations, nor parent-subsidiary transactions. These subjects may be covered in a future article.

[3] See § 607.1202(1), Fla. Stat. (2004) ("*A corporation may sell, lease, exchange, or otherwise dispose of all, or substantially all, of its property . . . .*").

[4] See William Meade Fletcher et al., *Fletcher Cyclopedia of the Law of Private Corporations*, § 7122 (perm. ed., rev. vol. 1990) ("*The general rule . . . is that where one company sells or otherwise transfers all its assets to another company, the latter is not liable for the debts and liabilities of the transferor. . . . An express agreement, or one that can be implied, to assume the other company's debts and obligations, is necessary . . . .")*

[5] See *Best Towing & Recovery, Inc. v. Beggs*, 531 So. 2d 243, 245 (Fla. 2d DCA 1988) (noting that pursuant to an agreement, a transfer of assets may immediately dissolve a corporation).

[6] See *Bernard v. Kee Mfg. Co*., 409 So. 2d 1047, 1049 (Fla. 1982).

[7] See *Sens v. Slavia, Inc.,* 304 So. 2d 438 (Fla.1974*)*

[8] *Amjad Munim, M.D., P.A. v. Azar,* 648 So. 2d 145, 154 (Fla. 4th DCA 1994). See *also Chicago Title Ins. Co. v. Alday-Donalson Title Co. of Florida, Inc*., 832 So.2d 810 (Fla. 2nd DCA 2002)

[9] Florida corporation law provides that the effect of a merger or consolidation i.e. share exchange is "the surviving corporation shall thenceforth be responsible and liable for all the liabilities and obligations of each corporation party to the merger". West's F.S.A. § 607.1106. We note that "A professional corporation or limited liability company organized under this act shall exchange shares or merge only with other domestic professional corporations or limited liability companies organized under this act to render the same specific professional service, and a merger or consolidation with any foreign corporation or limited liability company is prohibited". West's F.S.A. § 621.13

[10] *Id.* at 153-54 (citations omitted)

[11] *300 Pine Island Assoc. v. Steven L. Cohen & Assoc*., 547 So. 2d 255, 256 (Fla. 4th DCA 1989) (citation omitted)

[12] 523 So. 2d 740 (Fla. 5th DCA 1988)

[13] 438 So.2d 29 (Fla. 5th DCA 1983)

[14] 767 So. 2d 632 (Fla. 5th DCA 2000)

[15] 707 So.2d 958 (Fla. 4th DCA 1998)

[16] *Amjad Munim, M.D., P.A. v. Azar* , *supra* at 154.

[17] *Id*

[18] *Munim*, 648 So. 2d at 154 (citing *Bud Antle, Inc. v. E. Foods, Inc.*, 758 F.2d 1451, 1458 (11th Cir. 1985) (en banc)).

[19] *Id.*
[20] *Lab. Corp. v. Prof'l Recovery Network*, 813 So. 2d 266, 269 (Fla. 5th DCA 2002)
[21] 707 So.2d 958 (Fla. 4th DCA 1998)
[22] 409 So.2d 1047,1048 (Fla.1982).
[23] § 726.105(1)(a), Fla. Stat. (2004).
[24] § 726.105(2), Fla. Stat. (2004); *Cleveland Trust Co. v. Foster*, 93 So. 2d 112 (Fla. 1957).
[25] *Munim*, 648 So. 2d at 154.
[26] 813 So. 2d 266 (Fla. 5th DCA 2002)
[27] 698 So.2d 655 (Fla. 2nd DCA 1997)
[28] 523 So. 2d 740 (Fla.5th DCA 1988)
[29] *Id.*
[30] 472 So.2d 530 (Fla. 3rd DCA 1985)
[31] *Bernard v. Kee Mfg. Co., Inc*., 409 So.2d 1047 (Fla.1982).
[32] *Id*. at 1048
[33] *Id.* at 1050.
[34] *Id*.
[35] 647 So.2d 1033 (Fla. 4th DCA 1994)
[36] 443 So.2d 330 (Fla. 1st DCA 1984)
[37] 584 So.2d 17 (Fla. 3d DCA 1991)
[38] *Id*. at 18-19
[39] 490 So.2d 35 (Fla. 1986)
[40] *Id*. at 38
[41] *Id.*