Success or Liability?
BUYER BEWARE

When buying a business, the purchaser is often focused on looking forward – to new profits, new product lines and new opportunities. But without careful planning, the new company will be looking backward at successor liability issues that can haunt them. This is particularly true in the context of employee obligations.

A business can be bought as either a purchase of the assets or the purchase of the entity's stock (if a corporation). State law provides that, as a general rule, an asset purchaser is not liable for the debts of the seller. Exceptions to this rule focus on whether (1) the buyer has implicitly or explicitly assumed the obligations, (2) the sale is merely a merger or corporate reorganization that leaves real ownership unchanged, (3) there are certain employment and environmental liabilities, or (4) the sale is fraudulent as it relates to creditors.

Federal common law dealing with successor liability is much broader. Federal successor liability has its roots in traditional labor law and generally provides that a buyer will be liable for the seller's labor related debts if: (1) the successor had notice of the claim before the acquisition and (2) there was "substantial continuity" in the operation of the business before and after the sale. In *Equal Employment Opportunity Commission v Vucitec*, the Court of Appeals for the Seventh Circuit wrote that the issue of successor liability is "dreadfully tangled, reflecting the difficulty of striking the right balance between the competing interests at stake." In *Vucitec*, the Court of Appeals reversed the lower court's ruling and held that the defendant-asset purchaser was liable as a successor-employer. This case highlights the importance of successor liability claims in order to prevent parties from avoiding the costs of their misconduct by selling their assets free of any liabilities and distributing the proceeds to their shareholders.

Without careful planning, successor companies can become liable for ERISA plans, multiemployer pension funds, and retiree medical insurance – among other employee or labor liabilities of the acquired company.

In addition, there are other areas of concern for a successor company. ERISA section 510 makes it "unlawful to… discharge, fine, suspend, expel, discipline, or discriminate against a participant (in a qualified plan) or beneficiary for exercising any right that he is entitled to under the provisions of employee benefit plan." Failure to comply with a section 510 request can lead to civil and criminal penalties.

If a successor employer has more than 50 employees, it is covered by the Family Medical Leave Act (FMLA). FMLA raises successor liability concerns as it specifically defines an employer as including any "successor in interest of the employer." Even in an asset sale, where former employees have COBRA benefits, the successor employer will be responsible for the remaining period of coverage.

What does all this mean?

There is no certainty that a purchaser of assets will be shielded from liability for benefits promised to the seller's employees.

So what is a buyer to do?

Conduct careful due diligence. Analyze and understand the seller's benefit plans. And work with experienced legal counsel to structure a transaction that limits successor liability as much as possible.

Call us if you have questions about successor liability, taxes or employee benefits.

Tax + Employee Benefits
Kal Goren 248.267.3267