Successor Liability and Fraudulent Transfer Actions as Collection Tools

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You have a claim or a judgment against a commercial debtor which is purportedly out of business. However, at the same address of your debtor is a (supposedly) new corporation, with the same ownership, the same management, the same employees, engaged in the same line of business. You call the debtor business and the phone answers with the new company's name. You ask what happened to your debtor company and you are told "we bought them out," or perhaps "it's under new management" or "we changed our name" or "that used to be us." Whatever the purported excuse, you are being stonewalled, and led to believe that your debtor is out of business. Do you have any remedies?

Successor liability action

The short answer is "quite possibly." As a general rule, the purchaser of the assets of a corporation is not liable for the debts of the seller corporation. However, it is possible to overcome this general rule if ***any*** of five exceptions to that rule can be established. Here are the five exceptions to which I am referring:

1. The "purchaser" of the business expressly or implicitly agreed to assume the liabilities of the "selling" corporation. (This is rare in a collection setting);
2. The transaction whereby the "buyer" purchased the assets amounted to a consolidation or a *de facto* merger with the "selling" corporation (also known as the de facto merger doctrine);
3. The "purchasing" corporation was merely a continuation of the "selling" corporation (the "mere continuation" doctrine);

4. The transaction was fraudulently entered into by the "seller" corporation in order to escape liability (fraudulent transfer action); OR
5. The transfer of the "selling" corporation's assets was made without reasonably equivalent vslue, and no provisions were made for creditors of the "selling" corporation (fraudulent transfer).

Let analyze what the elements are of the four, more difficult to prove exceptions (because there is no express assumption by the buyer of the liabilities of the seller).

1. *De facto merger* doctrine

The following elements comprise a de facto merger:

a. There must be continuity of ownership between the selling corporation and the purchasing corporation. This is a ***key*** element that must be shown.
b. There must be a cessation of the ordinary business by, and dissolution of, the predecessor/seller corporation as soon as practicable;
c. The successor/buyer corporation must have assumed the liabilities ordinarily necessary for the uninterrupted continuation of the business; AND
d. There must be continuity of the management, personnel, physical location and the general business operation from the seller corporation to the buyer corporation.

All four of the above elements *must* be established to prove a *de facto merger*. See *Fizzano Brothers Concrete Products, Inc. v. XLN, Inc.,* 973 A.2d 1016 (Pa. Super., 2009)

2. *Mere continuation* doctrine

The elements to establish the *mere continuation* exception are set forth in *Fiber-Lite*

Corporation v. Molded Acoustical Products of Easton, 186 B.R. 603 (E.D. Pa., 1994), aff'd 186 F. 3d 603 (3d Cir., 1995), and consist of the following:

1. The purchasing corporation has essentially the same officers and directors as the selling corporation;
2. The purchasing corporation produced and sold the same or similar product or service as the selling corporation;
3. The purchasing corporation used the same facility as the selling corporation;
4. The purchasing corporation hired all individuals previously employed by the selling corporation; *and*
5. The selling corporation was dissolved.

The *mere continuation* doctrine is similar to the *de facto* merger doctrine, except the *mere continuation* doctrine makes no reference to continuity of ownership, or to assumption of liabilities ordinarily necessary for uninterrupted operation of business.

Fraudulent transfer action brought pursuant to the Uniform Fraudulent Transfer Act – 12 Pa.C.S.A. §5101, et seq.

If the purchase and sale transaction was fraudulently entered into for the seller corporation escape liability, *or* if the transfer of assets from the seller corporation to the buyer corporation was made without the seller receiving reasonably equivalent value, and no provisions were made for creditors of the selling corporation, then the general rule that the purchaser of the assets of a corporation is not liable for the debts of the seller corporation, also can be overcome.

A transfer made by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made if the debtor made the transfer without receiving a reasonably equivalent value in exchange for the transfer and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer. 12 Pa.C.S.A. §5105. What is considered to be "reasonably equivalent value?" *Value* is given by the purchaser for a transfer of the assets if, in exchange for the transfer, property is transferred to the seller or an antecedent debt owed by the seller to the buyer is secured or satisfied. A buyer gives *reasonably equivalent* value if the buyer acquires an interest of the seller/debtor in an asset pursuant to a regularly conducted, noncollusive foreclosure sale or the exercise of a power of sale for the acquisition or disposition of the interest of the seller/debtor upon default under a mortgage, deed of trust or security agreement or pursuant to a regularly conducted, noncollusive execution sale. 12 Pa.C.S.A. §5103(b).

The seller/debtor is insolvent if the sum of the debtor's debts is greater than all of the debtor's assets. 12 Pa.C.S.A. §5102(a). If the seller/debtor is generally not paying the debtor's debts as they become due, it is presumed to be insolvent. This presumption will impose on the seller/debtor the burden of proving that the nonexistence of insolvency is more probable than its existence. 12 Pa.C.S.A. §5102(b). In valuing the seller/debtor's assets, it should be kept in mind that the term does not include (1) property to the extent it is encumbered by a valid lien, (2) property to the extent it is generally exempt under nonbankruptcy law; or (3) an interest in property held in tenancy by the entireties to the extent it is not subject to process by a creditor holding a claim against only one tenant. 12 Pa.C.S.A. §5101(b).

However, even if the "assets" transferred by the seller corporation fall into one of the above exclusions, you can still rely on the *de facto* merger doctrine or the *mere continuation* doctrine if the facts so warrant.

The bottom line is, when a creditor encounters those situation when a debtor suddenly changes its name and everything else about it appears to be the same, keep the above strategies in mind. A vigilant creditor need not be frustrated by a debtor closing its doors and "re-appearing" as a "new" company. There may be remedies available depending on the facts surrounding the "sale" of the debtor business. Dig into the details!