Continuity of Enterprise is Enough for Successor Parties to be Liable

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Successor liability is often a concern for the acquirer when purchasing substantially all of a seller's assets. While this risk is well known, the circumstances under which an acquirer will be found liable under the theory of successor liability are less clear. The recent decision in ***Call Center Techs., Inc. v Grand Adventures Tour & Travel Pub. Corp., 2014 U.S. Dist. Lexis 29057, 2014 WL 85934*** *(D. Conn. 2014),* sheds helpful light on this issue by defining the continuity of enterprise theory of successor liability.

Under the continuity of enterprise theory, the acquirer can be found liable for claims against the seller brought subsequent to closing for presale conduct of the seller, even when there was no fraud or continuity of ownership. The "continuity of enterprise" theory is Connecticut's approach to the common law "mere continuation" theory of successor liability.

In *Call Center*, Interline, a corporation owned by two secured creditors and previous consultants to the debtor company, Grand Adventures Tour & Travel (GATT), acquired all of GATT's assets in a foreclosure sale Interline conducted. After taking ownership of GATT's assets, Interline operated the same inter-airline travel business, in the same location, with mostly the same employees and management. Call Center Technologies subsequently brought a breach of contract claim against GATT, and Interline as GATT's successor, at which point the court was forced to decide this successor liability issue.

Previously, the Second Circuit Court of Appeals identified six relevant factors for determining whether successor liability exits under the continuity of enterprise theory – namely, 1) continuity of management, 2) continuity of personnel, 3) continuity of physical location, 4) continuity of assets and liabilities, 5) continuity of the general business operations of the companies, and 6) purpose of forming the alleged successor company. *Call Center Techs. v Grand Adventures Tour, 635 F.3d 48, 53 (2d Cir. Conn., 2011)*. The plaintiff does not have to establish every factor and the court will look to substance over form.

In evaluating these factors on remand, the District Court in *Call Center* found that in this case "assets" included office equipment, contracts with vendors and utilities, customer lists, phone numbers, and websites. Continuity of "liabilities" included liabilities implicitly recognized such as vacation time accrued prior to the foreclosure sale and discounts given to customers who had lost trip deposits because of the sale. Continuity of the “business operations” of the companies meant operating the same core business and whether there was a meaningful break in service. Lastly, the court determined the essential question regarding purpose of forming the alleged successor company is whether it was formed for the purpose of acquiring the debtor’s assets, not whether its purpose was lawful. Hence, the District Court concluded that the plaintiff had established the existence of all the factors for continuity of enterprise, and thus held that Interline was the proper defendant for the contract breach claim even though the events leading to the claim occurred before Interline acquired the assets.

This case highlights a trap for the unwary for buyers contemplating the operation of the same or similar business after an asset purchase. However, these concerns may be addressed by careful planning. For example, the buyer may wish to consider new management, new physical locations, new service providers, new websites, etc. so as to mitigate the risk that its new business would be viewed as a continuation of the seller’s business. The Buyer should also be mindful when conducting diligence of the target company to investigate whether there are any active claims against the seller or circumstances suggesting that unasserted claims may exist. Additionally, during negotiations of the asset purchase agreement, the buyer may wish to negotiate for protection against successor liability claims (e.g., by seeking an indemnity, a letter of credit, a hold-back on the sale proceeds or other financial accommodation) or discount the purchase price to account for the risk of successor liability claims. Finally, the buyer should consider whether the transaction merits incurring the expense, delay and publicity surrounding an acquisition done in a Chapter 11 bankruptcy case, in exchange for the additional protections afforded to the buyer by a court order authorizing the sale.

Careful planning on the front end will go a long way towards to mitigating risk on the back end.

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