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Beware of Successor Liability Claims in Connection with Family-Owned Businesses

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A corporation ordinarily is not liable for the debts of other entities or for the debts of its owners in the absence of an express agreement, such as a guarantee. However, a creditor of one company may try to impose liability on one or more non-debtor entities under “alter ego” or “successor liability” theories in certain circumstances. In these circumstances, a creditor often alleges that there has been a transaction between a predecessor debtor entity and successor non-debtor entity through which: (1) the successor expressly or impliedly has assumed the liabilities of the predecessor; (2) the transaction has resulted in a *de facto* merger between the entities; (3) the successor is a mere continuation of the predecessor; or (4) the transaction is a fraudulent effort to avoid liabilities of the predecessor. If the creditor is successful, a non-debtor entity may then become liable for debts that it did not incur in its own name and that non-debtor entity’s assets also may be reachable to satisfy the debts.

In *Longo v. Associated Limousine Services, Inc.*, a District Court of Appeal of Florida recently addressed a creditor’s attempt to hold certain non-debtor entities and individuals liable for payment of a debt owed to the creditor. Creditor, Frederick Longo, had obtained a judgment of more than $620,000 against debtor, Associated Limousine Services, Inc. When Associated Limousine did not pay the judgment, Longo sought to implead (bring into the case) Robert Boroday, as sole officer of Associated Limousine, three other members of the Boroday family, and eight business entities connected to the Boroday family (collectively, the “impleader defendants”).

Longo alleged that the impleader defendants “were operating a business that was a continuation of the judgment debtor’s business” and that the eight business entities were “alter egos” of American Limousine. In support of this claim, Longo alleged that the impleader defendants:

- Conspired to organize and operate alternate business entities that would acquire the accounts and clients of the judgment debtor, while avoiding creditors;
- Comingled assets with each other and the judgment debtor;
- Acted and operated as a single business entity;
- Used fictitious names that were similar to and substantially the same as the judgment debtor; and
- Profited from the judgment debtor’s business, procured the judgment debtor’s clients for their own benefit, and attempted to conceal the transactions to prevent existing creditors from

collecting from the judgment debtor.

The trial court denied Longo’s request to bring the impleader defendants into the case on the basis that Longo failed to file an affidavit describing the property of the judgment debtor that allegedly was in the hands of the impleader defendants, as required by an applicable Florida statute. On appeal, the District Court of Appeal reversed that decision and remanded the matter to the trial court. The Court of Appeal’s order provided that, on remand, Longo would be allowed to submit an affidavit describing any property of any impleader defendant that allegedly should be available to satisfy the judgment under an alter ego theory.

In support of its decision, the Appeals Court stated “[t]he concept of alter ego or continuation of business ‘arises where the successor corporation is merely a continuation or reincarnation of the predecessor corporation under a different name.’” The Court further noted that a third party’s liability is “premised on the notion that the judgment debtor and third party should be treated as the same entity.” The Court left it to the trial court on remand to determine, on a more fully developed record, whether sufficient grounds for successor liability existed in this case, so as to subject the impleader defendants’ assets to further collection efforts.

Outcomes of successor liability claims will vary from state to state, depending on how the law in each state has developed.

However, common factors that courts typically consider in evaluating potential successor liability include: continuity of directors, officers, stockholders, personnel, physical location, assets, and general business operations between the predecessor and successor corporations; whether the predecessor corporation has been dissolved; the continued existence of only one corporation after the transfer of assets; and the assumption by the successor corporation of those obligations necessary for the continuation of normal business operations of the predecessor corporation.

In the context of family-owned businesses that may have multiple operating entities, steps should be taken to maintain both the appearance and the reality of separateness. To the extent one entity intends to acquire the assets of another entity, the parties also should document the transaction appropriately to identify the consideration provided for any assets and should be able to justify any continuity of business operations, ownership and management between the entities. It may be impossible to avoid all claims of successor liability by creditors. But having clear separation between entities and documentation of the value conferred and received in any transfers of assets to a successor corporation may be instrumental in the defense of such claims.

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