SUCCESSOR LIABILITY

Successor liability is a mere continuation of its predecessor liability and the successor is held liable for obligations of the predecessor if any of the following factors are present:

- Common officers, directors and stockholders
- Same management
- Same personnel
- Same assets and location
- Same phone number
- Same inventory
- Same "key" personnel
- Disposition of accounts receivable
- One newly formed entity exists after the sale
- Continuation of seller's business practices and policies
- Sufficiency of consideration paid to the seller
- Asset transfer to insiders, including relatives
- Detrimental Reliance as an implied acceptance of liability by another entity
- Commingling of assets among entities
- Arm's length asset transfer
- Merger
- An entity purchaser of Corporate Stock
- Decision makers remain the same
- A buyer of assets failing to exercise "good faith"
- Any asset transfer or purchase outside the "normal course of business"

Arm's length asset transfer means "within the reach of buyer and seller." There must be no confidentiality connection between any buyer and any seller.

Under the Uniform Fraudulent Transfer Act if a transferee fails to act in "good faith" then the transferee becomes liable. If any debtor entity assets are transferred or purchased, third party collection should commence immediately.

FRAUD – WHAT CONSTITUTES BUSINESS FRAUD AND SUCCESSOR LIABILITY

There are two primary factors both of which must be present to constitute fraud. One factor is the presence of a "badge" and the other is "fraudulent intent." One can find some "badges of fraud" within the Fraudulent Transfer Act (formerly known as the Fraudulent Conveyance Act), which has been adopted by 41 states. Other "badges of fraud" include what defines "Reclamation" and also "insolvency." Business fraud is a badge, condition, trait or characteristic that must be present together with "fraudulent intent" in a business transaction. Fraudulent intent is a "proven" predetermined, premeditated action that contradicts a truth. The "burden of proof" rests entirely upon the party alleging fraud (plaintiff or attorney general). The types of proof accepted are falsified documents, insider testimony or testimony, which can be corroborated by independent, indifferent third parties. An example of a "proof" is a falsified Balance Sheet and Operating Statement submitted to induce a creditor to extend an open line of credit. Another form of "proof" would be to state erroneous information on a credit application. A false income tax return would be another example. If an "insider" gave testimony as to a debtor's premeditated plan to deceive creditors for personal gain, this too would be an acceptable form of proof.

A debtor being deceitful, dishonest or “not volunteering” incriminating information is not considered sufficient proof of business fraud. However, if a document is produced containing false statements whereby this detrimental reliance resulted in damages, then a fraudulent act has been committed.

Fraud is considered a criminal act that is supposed to be pursued by a county or state’s attorney general’s office. Unfortunately, business fraud is not high on the public service agenda because typically an unrealistic burden is placed upon the party alleging fraud to have first practiced “due diligence” and “seller beware” procedures.

Accordingly, part of a seller’s diligence is to determine at every sale the makeup and present financial condition of the buyer. Although the burden rests with the buyer to inform the seller of an entity change in the credit granting relationship, courts have ruled this can indirectly take place by subtle inconspicuous changes such as the addition of an “Inc.” in the business name on a business account check. Filing incorporation papers without notice is another one of those inconspicuous changes that a buyer is expected to know about.

Taking legal action against a party for committing business fraud is outside of the scope of what is considered commercial collection activity. The legal steps associated with contingent commercial collection efforts fall entirely within the realm of civil litigation whereas fraudulent pursuit is considered criminal litigation. The pursuit of fraud initiated by a creditor, beyond the efforts of public enforcement officials, requires separate compensation to counsel that pursues this cause. It is recommended that a creditor first approach the county or state Attorney General’s office for their opinion or possible pursuit.

Successor liability is the act of pursuing those parties benefiting from a transaction that lacks an “arm’s length” distance. “Arm’s length” means there are no ties between the “buyer in good faith” and the “seller of assets.” If such a transaction is not of “arm’s length” then if certain conditions are present, the buyer, seller, assets and proceeds can be civilly pursued by creditors without such pursuit being considered criminal.

The buyer of assets must be a “purchaser in good faith.” If a buyer is a relative, family member or had management duties under the seller then the “successor” entity becomes liable. Former “Key Personnel” of the seller who have taken on the role of purchasers would be subject to successor liability.

The purchaser must give adequate consideration for the assets to the seller. Inadequate or less than fair value consideration is just one of many factors that can create successor liability.

Should credit department personnel determine that any factor is present to pursue successor liability or that fraud has been committed, then the claim should be placed with Williams & Williams, Inc. immediately.