



Legal Spotlight

Successor Liability under Colorado Law A trap for the Unwary



Mark D. Changaris, Partner
Berg, Hill, Greenleaf & Ruscitti, LLP
mdc@bhgrlaw.com

As a general rule, where a corporation acquires the assets of another corporation, the acquiring corporation does not become liable for target's debts. *Bd. of Cty. Comm'ns v. Park Cty. Sportsmen's Ranch, LLP*, 271 P.3d 562, 572-73 (Colo. App. 2011). It is for this reason that many parties opt to structure their acquisitions as asset purchases instead of stock purchases. One of the primary benefits of asset purchases over stock purchases is the potential to limit the liability the acquiring party assumes.

Like every rule, however, there are exceptions. And these exceptions can prove costly to buyers and can lead to unexpected results.

Under Colorado law, there are four exceptions to the above general rule. Successor corporations can be held liable for the debts of the target if one of the following

exceptions applies: (1) the successor expressly or impliedly assumes liability; (2) the transaction results in a merger or consolidation of the two corporations; (3) the successor is a mere continuation of the seller; or (4) the transfer is for the fraudulent purpose of escaping liability. *CMCB Enters., Inc. v. Ferguson*, 114 P.3d 90, 93 (Colo. App. 2005).

Generally, in order to trigger successor liability, there has to first be an asset transfer from one entity to the successor entity. *Id.* (noting that Tenth Circuit has held that "a prerequisite for the imposition of liability against a corporation as a mere continuation of a predecessor is a sale or transfer of . . . the assets of the latter to the former"). Once a transfer of assets has been shown, the next question is whether any of the four exceptions applies to the transfer.

Express or implied assumption.

Determining whether there has been an express or implied assumption of liability is somewhat fact sensitive. To determine whether there has been an express assumption, the analysis is fairly straightforward and will center upon the language of the transaction document itself to determine whether there is language which can be construed as an assumption of the target's liabilities.

The determination of whether an implied assumption has occurred is more nuanced and complex. Generally, Courts will look to whether the conduct of the parties evidences an intention to assume the obligation. *See Ruiz v. ExCello Corp.*, 653 P.2d 415 (Colo. App. 1982). Thus, if the acquiring

ATTORNEYS AT LAW	BOULDER, CO 1712 Pearl Street, 80302 DENVER, CO 1525 17 th Street, 80202	OFFICE 303.402.1600 FAX 303.402.1601	BHGR ^{LAW} .COM
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corporation pays the target's debts, expresses an intention to pay the target's debts, or takes action which imply or evidence an intention to pay the target's debts, successor liability may attach.

Merger or consolidation.

The determination of whether a merger or consolidation has occurred is normally straightforward and will depend upon the structure of the transaction and the specific transaction documents. When a merger has been found to occur, the surviving entity is responsible for all of the debts and liabilities of the merging entities. See C.R.S. § 7-90-204.

Mere continuation.

The "mere continuation" exception applies when there is a continuation of directors and management, shareholder interest,

and, in some cases, inadequate consideration. *Alcan Aluminum Corp., Metal Goods Div. v. Elec. Metal Products, Inc.*, 837 P.2d 282, 283 (Colo. App. 1992). Thus, the test for determining whether this exception applies focuses on whether the purchasing corporation is, in effect, a continuation of the selling corporation, and not whether there is a continuation of the seller's business operation. *Id.*

In analyzing this exception, courts look to whether the successor company: (1) acquires all of the assets of the previous company; (2) shares the same management team and employees; (3) shares the same business name; or (4) shares the same ownership and control. *Id.*; see also, *CMCB Enters.*, 114 P.3d at 93; *Bd. of Cty. Comm'ns v. Park Cty. Sportsmen's Ranch, LLP*, 271 P.3d 562, 572-73 (Colo. App. 2011).

While no single factor is determinative, the Court will weigh the evidence and make a determination based on these factors. See, e.g., *Sportsmen's Ranch, LLP*, 271 P.3d at 573 (finding mere continuation where successor company had same owners, both companies had same business purpose, successor acquired all assets of prior company, and prior company was left unable to pay its debts).

Fraud.

A purchaser will be held liable for the debts and liabilities of a seller if the transaction was a subterfuge to commit fraud or other wrongdoing. Generally speaking, this is a judicial recognition of the principles underlying the Colorado Uniform Fraudulent Transfer Act, C.R.S. § 38-8-101, *et seq.*, and its federal equivalent codified in the bankruptcy code.

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At a high level, a purchaser or seller who has attempted to carry out an asset sale for the purposes of avoiding liability or frustrating the ability of creditors to recover will face exposure for potential fraudulent transfer claims. Applying these principles, a purchaser or seller cannot structure an asset sale for the purpose of escaping liability to their creditors. To do so would invite litigation under CUFTA or its equivalent.

Tips to Minimize Potential Liability

There are steps that you can take to proactively manage the risk of successor liability. These include: (i) performing detailed due diligence of the target's assets, business, credit history, and business activities; (ii) having a properly drafted asset purchase agreement that specifically details

the liabilities of the seller and expressly allocates responsibility for such liabilities; (iii) maintaining corporate formalities post closing, including operating both companies as distinct entities, minimizing common ownership between the entities, minimizing common management between the entities, and avoiding if possible the immediate dissolution of the selling entity post-close.

It is also important for parties to evaluate whether the asset purchase agreement should contain a covenant requiring the selling entity to obtain a tail insurance policy covering post-closing claims. These types of policies can provide a good degree of protection to the parties and can help mitigate the risk of unexpected losses stemming from successor liability issues.

Perhaps the most important step you can take to mitigate exposure to successor liability in connection with a transaction is to ensure that you have competent and experienced legal counsel in your corner. Successor liability issues are complex and it is important to proactively address them through legal analysis and due diligence before problems arise.

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