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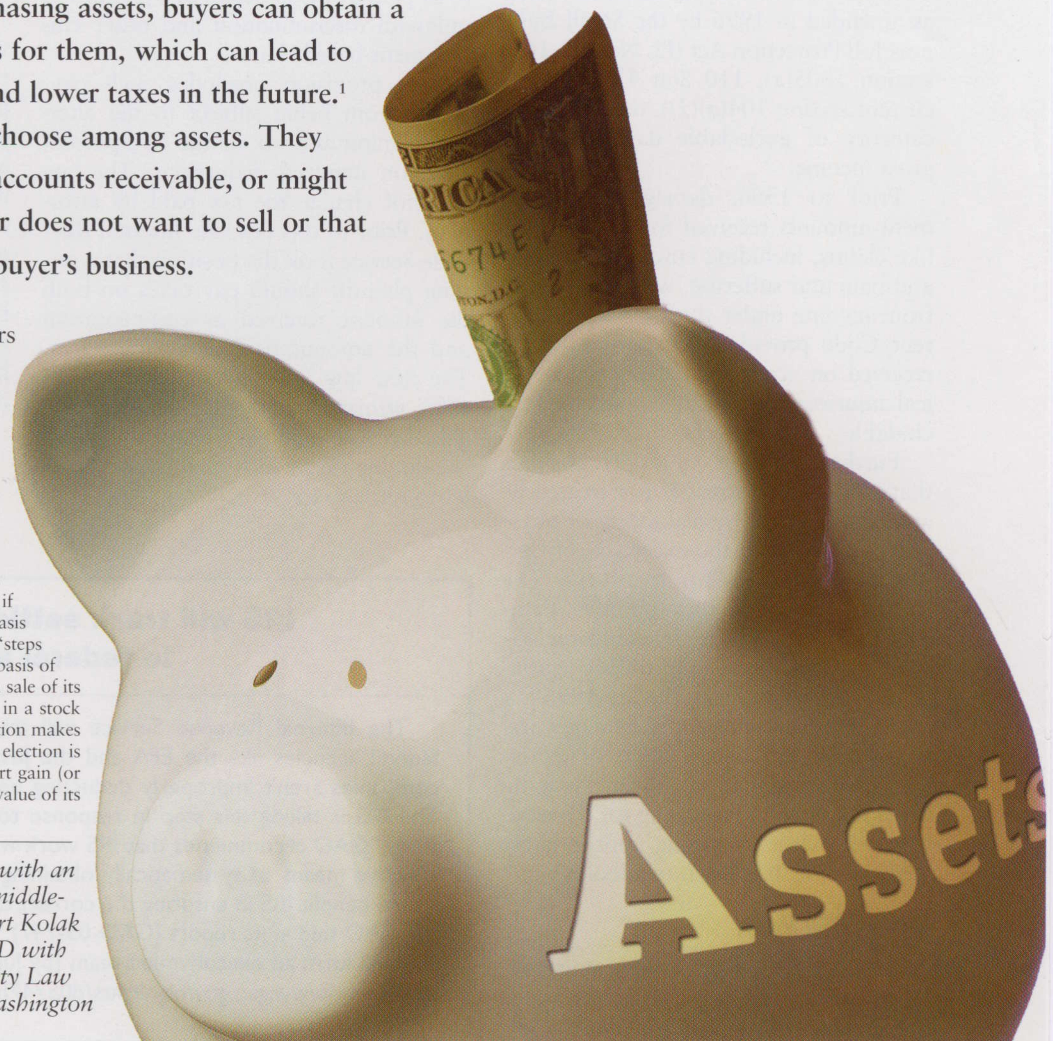
Buying the assets, rather than the stock, of a business does not always protect the buyer from the seller's liabilities. This article shows when buyers are exposed and tells how to protect them from that risk.

The Dangers of Successor Liability When Buying Illinois Business Assets

The oldest maxim of the merger and acquisition lawyer is that sellers like to sell stock and buyers like to buy assets. By purchasing assets, buyers can obtain a stepped up tax basis for them, which can lead to greater depreciation deductions and lower taxes in the future.[1] In addition, buyers can pick and choose among assets. They might choose not to buy cash or accounts receivable, or might opt to exclude assets that the seller does not want to sell or that would not be a good fit with the buyer's business.



But perhaps the chief reason buyers like to buy assets is to avoid liability for the seller's obligations. A purchaser of stock acquires an intact interest in the seller corporation, including all assets and liabilities. A buyer

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1. The tax basis of property is generally its cost to the taxpayer under IRC §1012 (26 USC §1012), so if a buyer pays a price for assets greater than the tax basis of the seller, the tax basis of the assets for the buyer "steps up" to equal the purchase price. In contrast, the tax basis of a corporation's assets does not change merely upon a sale of its stock from one shareholder to another. It is possible in a stock deal to get a stepped-up basis in assets if the corporation makes an election under IRC §338 (26 USC §338), but the election is not always made because the corporation must report gain (or loss) equal to the difference between the fair market value of its assets and its tax basis.

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entering into a merger or consolidation with the selling corporation similarly receives the benefit and burden of all of the seller's assets and liabilities through the Illinois Business Corporation Act.[2] But a buyer of assets, according to the common belief of merger and acquisition lawyers, takes only the assets specified in the asset purchase agreement and none of the seller's scary liabilities or obligations, known or unknown.

This article tests that hypothesis. Do merger and acquisition lawyers serve clients well by assuring them that an asset purchase will avoid exposure to the seller's liabilities? The answers are surprising and should give buyers' attorneys pause in an asset deal.

As used in this article, the term "seller" refers to a corporation selling its assets, while "buyer" refers to the corporation buying the assets of the seller, unless a different legal structure is specified. Since this article is intended for Illinois lawyers, the emphasis is on Illinois law, although the law of other states will be discussed when necessary to understand Illinois law.

The proper place to begin is with the most recent Illinois Supreme Court case on this issue. In the 1997 case *Vernon v Schuster*,[3] the supreme court set forth the general rule with which all corporate lawyers are familiar: "The well-settled general rule is that a corporation that purchases the assets of another corporation is not liable for the debts or liabilities of the transferor corporation."[4]

This statement is echoed in many other Illinois Appellate Court cases[5] and in treatises.[6] But consider the four exceptions to this general rule, also stated in *Vernon*:[7] (1) Where the transaction is for the fraudulent purpose of escaping liability for the seller's obligations; (2) Where there is an express or implied agreement of assumption; (3) Where the transaction amounts to a consolidation or merger of the purchaser or seller corporation; or (4) Where the purchaser is merely a continuation of the seller. We will consider these four exceptions in this article.

Fraudulent transfer

It should surprise no one that the law of fraudulent transfers applies to sales of business assets just as to any other property. Fraudulent transfers are governed in Illinois under the Uniform Fraudulent Transfers Act,[8] which gives a creditor remedies if a fraudulent transfer occurs.

In general, a fraudulent transfer can occur in two cases. The first is when the transfer is made with actual intent to hinder, delay, or defraud any creditor of the debtor.[9] The second is when the debtor makes the transfer without receiving a reasonably equivalent value in exchange and either (1) the remaining assets of the debtor were unreasonably small in relation to the transaction or (2) the debtor believed that he would incur debts beyond his ability to pay as they became due.[10]

Under the Uniform Fraudulent Transfers Act, a creditor of the seller can assess the seller's liability against the buyer of the assets only up to, not above, the value of the assets transferred.[11] In contrast, the exceptions for express or implied agreement of assumption, defacto merger, and mere continuation do not limit the creditor's claim to just the value of the assets transferred.[12]

There are few Illinois cases on this method of obtaining successor liability. In *Standard Distilling & Distributing Co v Jones & Adams Co*,[13] a buyer purchasing assets at an inadequate consideration was held liable for the seller's debts up to the value of the assets received.

Express or implied agreement of assumption

The method for avoiding this route to successor liability ought to be obvious: just instruct the buyer not to assume any liabilities in the asset purchase agreement. This is easier said than done, however, since assumption of some liabilities makes good business sense. For example, the buyer will usually want to assume liabilities for outstanding purchase orders placed by the seller's customers and assume trade liabilities to allow the buyer to retain the good will of the seller's suppliers.

The case law on assumption of liabilities is instructive to the practitioner in several respects. For example, in *Kessinger v Grefco, Inc*,[14] the buyer bought the mining division of the seller, and agreed "to pay, perform and discharge all debts, obligations, contracts and liabilities" of the division, excluding certain tax liabilities.[15] About 23 years later, both the buyer and seller were sued on account of asbestos mined by the seller, which, understandably, argued in defense that the buyer had assumed all obligations of the mining division. The seventh circuit held that "all debts, obligations, contracts and liabilities" meant "all," and so the buyer would be liable in tort to the plaintiff.[16]

The best protection against successor liability is not to buy "the business" as an ongoing entity at all, but rather to buy individual assets used in the business as if sold on a liquidation basis.

An even more extreme example of the long-term exposure of a buyer assuming liabilities is found in *North Shore Gas Co v Salomon, Inc.*[17] In this case, the seller sold all of its assets to the buyer except for one division, and the buyer agreed to "assume liabilities and obligations of every kind and character" of the seller "accrued to or existing on the date of transfer."[18] The buyer faced environmental contribution liability 56 years later on account of the division that was *not* purchased. The United States Dis-

2. 805 ILCS 5/11.50(4).
3. 179 Ill 2d 338, 688 NE2d 1172 (1997).
4. Id at 344-45, 688 NE2d at 1175, relying on *Nilsson v Continental Machine Mfg Co*, 251 Ill App 3d 415, 417, 621 NE2d 1032, 1034 (2d D 1993); and *Donahue v Perkins & Will Architects, Inc*, 90 Ill App 3d 349, 351, 413 NE2d 29, 31 (1st D 1980).
5. See, for example, *Gray v Mundelein College*, 296 Ill App 3d 795, 695 NE2d 1379 (1st D 1998); *Park v Townson & Alexander, Inc*, 287 Ill App 3d 772, 679 NE2d 107 (3d D 1997); *Steel v Morgan Marshall Industries, Inc*, 278 Ill App 3d 241, 662 NE2d 595 (1st D 1996); *Hoppa v Schermerhorn & Co*, 259 Ill App 3d 61, 630 NE2d 1042 (1st D 1994); *Nilsson v Continental Machine Mfg Co*, 251 Ill App 3d 415, 621 NE2d 1032 (2d D 1993).
6. William M. Fletcher, 15 *Fletcher Cyclopedia of Private Corporations* §7122 (Thomson/West perm ed 1999).
7. *Vernon* at 345, 688 NE2d at 1175-76.
8. 740 ILCS 160/1 et seq.
9. 740 ILCS 160/5(a)(1).
10. 740 ILCS 160/5(a)(2).
11. Fletcher, 15 *Fletcher Cyclopedia of Private Corporations* §7122 (cited in note 6).
12. See generally, text accompanying notes 14-49.
13. 239 Ill 600, 88 NE 236 (1909).
14. 875 F2d 153 (7th Cir 1989).
15. Id at 154.
16. Id.
17. 963 F Supp 694 (ND Ill 1997).
18. Id at 701.

trict Court for the Northern District of Illinois held for the buyer, stating that it would defy logic that the buyer would assume the liabilities of assets it had expressly excluded under the asset purchase agreement.[19]

Defacto merger

The Illinois Business Corporation Act sets forth statutory means for merger or consolidation,[20] but the courts will recognize a defacto merger imposing the seller's liabilities on the buyer even if the procedure for merger under the Act is not followed. *Hoppa v Schermerhorn & Co*[21] is good example.

In *Hoppa*, a personal injury plaintiff obtained a default judgment against the seller, which had sold its assets to a new corporation. The judgment was left unsatisfied because the seller had dissolved, and so the plaintiff sought to have the buyer added to the judgment.[22] The appellate court held that the buyer was liable under defacto merger since the buyer owned all of the assets of the seller, had essentially the same shareholders, had the same employees, management, location, telephone numbers, and customer lists, and managed the same buildings.[23]

The basic concept of the defacto merger doctrine, then, is that the statutory merger rules on assumption of liabilities will apply to two corporations that effect the merger via a sale of assets under certain circumstances, even though the specific statutory process for merger is not followed.

The debate over defacto mergers was heightened in 1977 with the decision of the California Supreme Court in *Ray v Alad Corp*.[24] In *Ray*, the seller sold its assets to the buyer for cash, the seller dissolved, and under the corporate laws of California at the time, all remedies against the seller effectively ended.[25] The buyer used the seller's name, business location, assets, employees, management, and goodwill.[26] To the outside world and the public, therefore, the buyer appeared to be the same business as had been operated by the seller for many years. After closing, a consumer was injured by a product (manufactured by the dissolved seller), and filed suit against the buyer.

The California Supreme Court held that the buyer could potentially be liable on three grounds for a product admittedly manufactured by the seller. The first was that the seller no longer existed, and that if the buyer was not liable, the injured consumer would have no remedy against any party.[27] The second was based on fairness: since the buyer succeeded to all the benefits of ownership of the seller's assets, it was only fair to impose the burdens of the seller's obligations upon the buyer.[28] Finally, the court deemed it better for public policy reasons to place the burden of the injured consumer's injuries on the buyer, which had greater financial resources and could spread the burden of the potential damages on others through insurance.[29]

The decision in *Ray* must have been a great surprise to the buyer corporation, which thought it was buying only the seller's assets and not its problems and liabilities. *Ray* is still the law in California, and the *Ray* product-line exception or similar doctrines expanding successor liability are generally followed in Alabama, Michigan, Mississippi, New Hampshire, New Jersey, New Mexico, Ohio, South Carolina, Pennsylvania, and Washington.[30]

Ray appears not to be the law in Illinois, however. *Ray* was forcibly argued to a long string of Illinois appellate court panels and rejected by at least 10 decisions.[31] The Illinois Supreme Court has never ruled on *Ray*, so the issue is technically still open in Illinois.

Perhaps the best discussion of the reasons for and against the *Ray* doctrine is found in *Manh Hung Nguyen v Johnson Machine & Press Corp*.[32] *Nguyen* had the same fact pattern as *Ray*: seller sells assets for cash and then dissolves, and the plaintiff injured by the seller's product sues the buyer.[33] The first district appellate court rejected *Ray* and set forth the requirements for defacto merger in Illinois:

(1) there is a continuity of the business enterprise between seller and buyer, including management, employees, location, and assets;

(2) there is a continuity of shareholders, in that shareholders of the seller become shareholders of the buyer;

(3) the seller ceases operations and dissolves as soon as possible after the transaction; and

(4) the buyer assumes those liabilities and obligations necessary for the uninterrupted continuation of the seller's business.[34]

In *Nguyen*, the second requirement, continuity of shareholders, was absent because the assets were purchased for cash and not exchanged for stock and other securities.[35] The court examined both strict tort liability principles and corporate law to reject *Ray*. With regard to tort liability, the court stated that the buyer did not create the risk of harm because it had nothing to do with placing the product that injured the plaintiff into the stream of commerce, and so the court concluded that one who has done nothing to create a risk of injury cannot usually be burdened with the duty of preventing that injury. To do otherwise, according to the court, would be to create a liability without duty.[36]

The court refused to accept the argument that the buyer would be deemed to have assumed the liabilities of the seller, making an important distinction between the legal entity (the corporation) and the business operations of the seller, which do not constitute a legal entity:

> When one corporation merely sells its assets to another, the corporate entity that had liabilities does not become a part of the successor....The successor has paid a substantial price for the assets of the predecessor, and the law should not require the successor to pay a greater price, es-

19. Id.
20. 805 ILCS 5/11.05.
21. *Hoppa* (cited in note 5).
22. Id at 62, 630 NE2d at 1043-44.
23. Id at 66, 630 NE2d at 1045-46.
24. 19 Cal 3d 22, 560 P2d 3 (Cal SC 1977).
25. Id at 31, 560 P2d at 9.
26. Id at 26, 560 P2d at 5-6.
27. Id at 32, 560 P2d at 9.
28. Id at 34, 560 P2d at 10-11.
29. Id at 32, 560 P2d at 9-10.
30. See Restatement (Third) of Torts: Prod Liab §12 Comment c (1998); Richard L. Cupp, Jr., *Redesigning Successor Liability*, 1999 U Ill L Rev 845, 852-54 (1999).
31. *Nilsson* (cited in note 5); *Myers v Putzmeister, Inc*, 232 Ill App 3d 419, 596 NE2d 754 (1st D 1992); *Kaleta v Whittaker Corp*, 221 Ill App 3d 705, 583 NE2d 567 (1st D 1991); *Green v Firestone Tire & Rubber Co, Inc*, 122 Ill App 3d 204, 460 NE2d 895 (2d D 1984); *Gonzalez v Rock Wool Engineering and Equip Co, Inc*, 117 Ill App 3d 435, 453 NE2d 792 (1st D 1983); *Manh Hung Nguyen v Johnson Machine & Press Corp*, 104 Ill App 3d 1141, 433 NE2d 1104 (1st D 1982); *Barron v Kane and Roach, Inc*, 79 Ill App 3d 44, 398 NE2d 244 (1st D 1979); *Domine v Fulton Iron Works*, 76 Ill App 3d 253, 395 NE2d 19 (1st D 1979); *Hernandez v Johnson Press Corp*, 70 Ill App 3d 664, 388 NE2d 778 (1st D 1979); *Johnson v Marshall and Huschart Mach Co*, 66 Ill App 3d 766, 384 NE2d 141 (1st D 1978).
32. *Nguyen* (cited in note 31).
33. Id at 1142-43, 433 NE2d at 1105-06.
34. Id at 1143, 433 NE2d at 1106-07.
35. Id, 433 NE2d at 1107.
36. Id. Recognizing that lack of continuity of shareholders will prevent a finding of defacto mergers, some plaintiffs have looked for other legal theories to impose liability on the buyer, such as a duty to warn of defects present in the seller's products. The plaintiff waived the issue on appeal in *Nguyen*. Id at 1151, 433 NE2d at 1112. There is no duty to warn unless there is a continuing relationship between the buyer and the customers of the seller. *Gonzalez* at 437-38, 453 NE2d at 795.

> pecially after the fact of sale when it is impossible for the successor to return to negotiations to change the price....Of course, if the predecessor chooses to dissolve, with dissolution comes the destruction of all pre-existing liabilities....Nevertheless, the legislature has given a party with a claim against the dissolving corporation two years following dissolution in which to assert his claim.[37]

In 1988, the Illinois Business Corporation Act was amended to expand the two-year period to five years, possibly in response to this issue.[38]

The only element of successor liability that saved the buyer in *Nguyen* was lack of continuity of shareholders. All of the other three elements required for successor liability in defacto mergers were present. There was continuity of business enterprise between the seller and buyer, the seller ceased operations and dissolved within two years after the sale occurred, and the buyer assumed the liabilities and obligations of the seller necessary for the uninterrupted continuation of the business.[39]

What degree of shareholder continuity is necessary to create a de facto merger? Must the seller receive only stock for the assets, or is some stock, accompanied by cash, notes, or other property sufficient? The first district appellate court partially answered this question in *Fenderson v Athey Products Corp, Kolman Div*,[40] in which it held that stock comprising about 22 percent of the total consideration given for the assets was enough to impose successor liability. It was not necessary, in the court's view, that stock constitute even a majority of the consideration given.[41]

A token amount of stock is not enough, however. *Kaleta v Whittaker Corp*[42] held that a transfer of the buyer's stock worth $1,200 to the president of the seller was not enough to satisfy the continuity of shareholder requirement for defacto merger where the purchase price for the assets was $290,000, and the stock was received by the president as employee compensation rather than as payment for the assets. Similarly, *Donahue v Perkins & Will Architects, Inc*[43] held that a buyer that took a security interest in the seller's stock and held voting rights in the stock under a voting trust did not have an interest equivalent to stock ownership for successor liability purposes.[44]

The "mere continuation" doctrine

The mere continuation doctrine started as a concept analytically distinct from defacto merger, but over time, particularly in Illinois, has been blurred together with defacto merger. *Vernon* held that mere continuation did not make the buyer liable for the sole proprietor seller's obligations on the basis that what must be continued is the business entity, not the business operations:

> Although purporting to apply the continuation exception to this case, the appellate court did not accurately state the test of continuation. In determining whether one corporation is a continuation of another, the test used in the majority of jurisdictions is whether there is a continuation of the *corporate entity of the seller* – not whether there is a continuation of the *seller's business operation*, as the dissent appears to emphasize....Common identity of ownership is lacking when one sole proprietorship succeeds another.[45]

Justice Bilandic offered a strong dissent, arguing that the identity of business operations between the two sole proprietors constituted circumstances demonstrating that the mere continuation exceptions should in fairness apply.[46]

Mere continuation was found in *Park v Townson & Alexander, Inc*,[47] in which the seller and buyer had the same address, fax number, motto, Fed Ex number, telephone number, major customer, primary activity, check signatory, and customer contact person. Mere continuation, like de facto merger, requires a continuity of shareholders.[48] However, for not-for-profit corporations that lack shareholders, mere continuation has been found where the seller organized the buyer, and the seller's officers became officers of the buyer.[49]

Although Illinois law on successor liability is generally favorable to buyers, remember that Illinois law does not always apply to Illinois buyers.

37. *Nguyen* at 1148, 433 NE2d at 1110.
38. 805 ILCS 5/12.80.
39. *Nguyen* at 1142, 433 NE2d at 1106.
40. 220 Ill App 3d 832, 581 NE2d 288 (1st D 1991).
41. Id at 837, 581 NE2d at 292.
42. 221 Ill App 3d 705, 583 NE2d 567 (1st D 1991).
43. 90 Ill App 3d 349, 413 NE2d 29 (1st D 1980).
44. Id at 352, 413 NE2d at 32.
45. *Vernon* at 346-47, 688 NE2d at 1176 -77. In *Plaza Express Co v Middle States Motor Freight, Inc*, 40 Ill App 2d 117, 189 NE2d 382 (1st D 1963), a sole proprietor transferred his business assets to a corporation and took back all of its stock. The corporation was held liable for the tort of the sole proprietor under a mere continuation theory. The case can be distinguished from *Vernon* in that the same person (the sole proprietor) held the equity ownership in both businesses.
46. *Vernon* at 350-51, 688 NE2d at 1177-79 (Bilandic dissenting).
47. 287 Ill App 3d 772, 679 NE2d 107 (3d D 1997).
48. *Nilsson* at 418, 621 NE2d at 1034 (although continuity of the business enterprise existed, mere continuation did not apply because there was no continuity of shareholders). *Accord, Green* (cited in note 31).
49. *Kraft v Garfield Park Community Hosp*, 296 Ill App 613, 16 NE2d 306 (1st D 1938).

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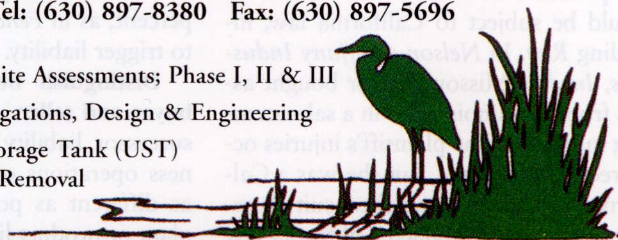

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Illinois law might not apply to Illinois corporations

In view of the material change in result from *Ray* to cases like *Nugyen*, determining which state's law applies is critical to determining whether the buyer is liable in tort cases. Unfortunately, the merger and acquisition lawyer does not control which state's law applies. The mere fact that the buyer is an Illinois corporation or that the asset purchase agreement is governed by Illinois law does not mean that Illinois law will be applied to determine successor liability.

In *Barron v Kane and Roach, Inc*,[50] a business broker seeking to impose successor liability in a tort case filed in Illinois argued that Pennsylvania law should apply, since the buyer was a Pennsylvania corporation and the asset purchase agreement, by its terms, was governed by Pennsylvania law (Pennsylvania had by then adopted *Ray*, which would have been favorable to the broker). The first district appellate court held that the choice of law rules applicable to torts should apply to determine which state's law applies to successor liability. Since the injured plaintiff resided in Illinois and the injury occurred in Illinois, the Illinois law of successor liability applied. Illinois courts had by then rejected *Ray*, so the buyer was held not liable.[51]

In *Ruiz v Blentech Corp*,[52] the seventh circuit held that while Illinois choice of law rules would apply California corporate law to interpret an asset purchase agreement between California corporations, the Illinois rules apply Illinois tort law to an injury occurring in Illinois to an Illinois resident, even though the product causing the injury was part of a product line sold from one California corporation to another.[53]

If tort choice of law rules apply to successor liability cases, then an Illinois corporation doing business or selling products in a state like California would be subject to California law, including *Ray*. In *Nelson v Tiffany Industries, Inc*,[54] a Missouri buyer bought assets from an Illinois seller in a sale occurring in Illinois. The plaintiff's injuries occurred in Minnesota, but she was a California resident and so filed suit there. The ninth circuit applied California law as established in *Ray* to the Missouri buyer, and remanded to determine if all of the elements in *Ray* were met.[55]

Thus, Illinois merger and acquisition lawyers cannot assume that *Ray* will not apply to their Illinois buyer, unless the buyer's products or services never leave Illinois. If the buyer has operations outside Illinois, or if its products are shipped outside Illinois, then *Ray* and cases like it can impose successor liability on an Illinois buyer, even if no stock was exchanged in the deal.

Practice pointers

As this review of Illinois law shows, buyers of assets do not enjoy the all-inclusive protection against the seller's liabilities that they may have previously believed.[56] How, then, to protect the buyer in an asset sale?

Proceed with caution when assuming liability. First, exercise great care in drafting clauses on assumption of liabilities. Your buyer should probably never assume "all liabilities of the seller," since an assumption that broad would bring in product liability torts and environmental claims that were not in the contemplation of either buyer or seller and may not become apparent until decades later.

A better practice would be to assume only specified liabilities. Another approach would be to assume liabilities as reflected on an audited balance sheet of the seller (after checking the notes to the financial statements for contingent liabilities). The buyer could also set a time limit for assertion of any of the assumed liabilities against the buyer.

Avoid transferring buyer's stock as payment for the assets. Assuming that the string of Illinois Appellate Court decisions rejecting *Ray* are eventually followed by the Illinois Supreme Court, stock ownership will be an essential element of a defacto merger, and if there is no stock given, then there can be no defacto merger. Be aware that giving even a relatively small proportion of stock (22 percent, as in *Fenderson*) can be enough to trigger liability.

Distinguish business operations of buyer and seller. Another way to avoid successor liability is to make the business operations of the seller and buyer as different as possible. If a particular plant or product line is likely to generate a claim, do not buy it. In the best case, there should be no overlap between the directors and officers in the buyer and seller corporations. Ideally, management should also be different. In all likelihood, the buyer will want to keep the same employees and business name. To the extent that the product lines and location of operations are different, the ability to defend against a defacto merger case would be enhanced.

To this end, the buyer should purchase specific named assets of the seller, rather than buying "the business" of the seller. Practitioners, in an effort to be all-inclusive, sometimes include the term "the business" in the list of assets to be purchased, but doing so will work against the buyer in avoiding successor liability.

Buy specific assets, not "the business." Indeed, the best protection against successor liability would be not to buy "the business" as an ongoing entity at all, but rather to buy individual assets used in the business as if sold on a liquidation basis. Even *Ray* requires that there be a continuity of enterprise, so if the business operations (assets, employees, location, business name, etc.) do not continue from seller to buyer, there will be no successor liability imposed on the buyer.[57]

Non-Illinois law sometimes applies.

50. 79 Ill App 3d 44, 398 NE2d 244 (1st D 1979).
51. Id at 48-49, 398 NE2d at 246-47.
52. 89 F3d 320 (7th Cir 1996).
53. See also *Kramer v Weedhopper of Utah, Inc*, 204 Ill App 3d 469, 477, 562 NE2d 271, 276 (1st D 1990) (*Ray* not applied to California corporation; rather, Illinois law applies since the injury occurred in Illinois and the relationship of all the parties is centered in Illinois).
54. 778 F2d 533 (9th Cir 1985).
55. Id at 534-38. See also *Gee v Tenneco, Inc*, 615 F2d 857 (9th Cir 1980) (*Ray* applied to Delaware buyer of assets, which included product line injuring California plaintiff). See John T. Hundley, *Business Expansion Through Asset Acquisition: Some Problems Posed by Product Liability Doctrines*, 77 Ill B J 492, 492-93 (1989).
56. This article has not even touched on the federal law imposing successor liability, which tends to be more liberal. See, for example, *Golden State Bottling Co, Inc v NLRB*, 414 US 168 (1973) (buyer must remedy seller's unfair labor practice); *John Wiley & Sons, Inc v Livingston*, 376 US 543 (1964) (buyer must collectively bargain with seller's union); *Upholster's Intl Union Pension Fund v Artistic Furniture of Pontiac*, 920 F2d 1323 (7th Cir 1990) (buyer liable for seller's ERISA obligation to contribute to pension fund); *Musikiwamba v ESSI, Inc*, 760 F2d 740 (7th Cir 1985) (buyer liable for race discrimination claim against seller); *Continental Grain Co v Pullman Standard, Inc*, 690 F Supp 628 (ND Ill 1988) (buyer liable for RICO claims against seller); *Goldstein v Gardner*, 444 F Supp 581 (ND Ill 1978) (buyer liable for securities law 10b-5 claims against seller).
57. If the buyer purchases only some of the business assets of the seller, the buyer is not a corporate successor and will not be liable for the seller's torts. *Domine* (cited in note 31).

Although Illinois law on successor liability is generally favorable to buyers, remember that Illinois law does not always apply to Illinois buyers. California law will apply to an Illinois buyer if the seller produced a product causing injury in California. Illinois buyers are also subject to the federal law on successor liability, which has special, liberal rules that impose liability in labor, ERISA, and discrimination cases.

Do normal due diligence. Buyers are well advised to take advantage of the normal procedures designed for their protection. Due diligence, long an underrated function, should be emphasized. The buyer should insist on getting a claims history from the seller for as far back as available. Escrows for claims could be set up. The buyer could negotiate for a right to set-off claims against notes, employment contracts, non-competition agreements, or other deferred payments due from the buyer to the seller.

These classic methods provide good protection for claims which might be asserted against the buyer within a relatively short period of time, but would probably not work for some of the product liability and environmental claims in the cases discussed in this article, which came up as many as 50 years after the acquisition occurred.

Consider buying insurance. Ideally, the seller should stay in existence (as a target to attract claims) after closing. Buyers, however, generally lack such ability to control the seller after closing, and many sellers will dissolve as soon as possible.

The buyer could require that the seller maintain insurance for tort claims following the sale of the business. In many cases, the seller could obtain a products liability tail policy for a one-time premium that covers tort claims occurring after closing. The seller could name the buyer as an additional insured on that tail policy, and the buyer could make receipt of a certificate of insurance evidencing such coverage a condition to closing. The buyer should also verify that its own commercial liability insurance policy would protect it against assertion of successor liability claims. Most policies provide such coverage.

Include an indemnification clause. Finally, the ultimate protection for a buyer is the indemnification clause in the asset purchase agreement. In the clause, the seller should indemnify the buyer for any actions or omissions of the seller that take place before closing. There should be no de minimus basket or time limitation attached to the indemnification; while a de minimus basket and a time limitation are often given with respect to the warranties and representations section of the asset purchase agreement, they should not apply to actions or omissions of the seller taking place before closing.

Reliance on an indemnification clause, of course, has its limitations. If the indemnifying party is the seller corporation, the corporation may be dissolved and out of existence before a claim arises.[58] Even if the seller shareholders join in the indemnification obligation, they may have died or disappeared by the time the claim arises. In the end, it is a question of the assessment of the business risks and rewards involved in the acquisition, which is a judgment call for both attorney and client. ■

58. In *Huschart* (cited in note 31), the defective product was manufactured 36 years before suit, and the business had been sold 6 times. The court was influenced by the long time lapse and the fact that the original seller had long since dissolved, in holding that the last buyer was not liable under successor liability.

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