

When Actions Speak Louder Than Words: Implied Assumption of Debt of an Acquired Business

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The availability of a claim for the implied assumption of debt gives creditors the ability to potentially hold a purchaser responsible for the seller's obligations. The authors of this article discuss the law in the area of implied assumption of debt.

When considering whether to acquire a business through an asset sale, it is important for the purchaser to analyze what, if any, of the seller's liabilities it must assume to continue the seller's operations. Prudent purchasers examine a multitude of factors in deciding whether to assume debt, including whether more cost effective alternatives exist for the space, goods or services. Ideally, when a purchaser decides to assume a seller's debt, it does so expressly and in writing. However, unwitting purchasers may be found to have impliedly assumed liabilities, potentially having an immediate and adverse effect on profitability and turning a good deal into a bad one.

The determination of whether a purchaser impliedly assumed the seller's debt depends on the facts of each particular case and there are no precise rules defining when implied assumption of debt occurs. The law, however, does provide some general guidelines.

A purchaser may be considered to have impliedly assumed the liabilities of the seller when the conduct or representations of the purchaser demonstrate the intent to pay the debt of another. Whether such intent exists must be determined from the circumstances of each case. Courts have found intent to assume debt when the purchaser's officers or other representatives are aware of the liability, when the purchaser continues a business relationship with the seller's creditor, and where the seller's creditor relied on the purchaser's conduct and words that indicated the assumption of the debt.

Facts Supporting a Finding of Implied Assumption of Debt

An example of where a court found a purchaser to have impliedly assumed the liabilities of the seller is found in *Bird Hill Farms, Inc. v. United States Cargo Carrier*.¹ This lawsuit involved an asset sale of a business from

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Courier Unlimited, Inc. (“Courier”) to United Cargo & Courier Services, Inc. (“United Cargo”).

In the Asset Purchase Agreement, Courier agreed to obtain the consent from its landlord, Bird Hill Farms, to assign the lease to United Cargo on terms subject to United Cargo’s approval. While the parties attempted to negotiate acceptable lease terms, United Cargo paid rent to Bird Hill Farms for 11 months. Ultimately, the parties were unable to reach an agreement, and United Cargo abandoned the premises, taking the position that it was not liable for the continued payments under the lease because it was not a party to that document and because it never expressly assumed the debt.

Nonetheless, the court entered summary judgment in favor of the landlord, finding that the purchaser impliedly assumed the seller’s lease obligations because its conduct indicated an intent to assume the lease. The court also found the record demonstrated that the landlord relied on the purchaser’s actions to its detriment when it acquiesced to the assignment of the lease from Courier to United Cargo and that the landlord implicitly released Courier from its contractual obligations.

The *Bird Hill* case demonstrates that a purchaser’s actions can speak louder than words when it comes to determining liability for debt of the selling company. In many ways, United Cargo’s actions in abandoning the property are logical. After all, it never expressly assumed the existing lease or signed a new lease with the landlord.

Additionally, United Cargo paid the landlord for the period in which it occupied the premises. However, the court ruled that its

payment of rent to Bird Hill Farms for 11 months coupled with Bird Hill Farm’s consent to the assignment of the lease and release of Courier from its lease obligations, something that it had no legal obligation to do, supported the conclusion that United Cargo had expressly assumed the debt to the landlord.

Facts Not Supporting a Finding of Implied Assumption of Debt

To fully understand the parameters of a claim for the implied assumption of debt, it is also important to consider cases in which courts have found against a seller’s creditor and in favor of the purchaser of a business.

In *Phase III Mktg., Inc. v. EZ Paintr Co.*,² EZ Paintr purchased all the assets of Adams Brush Manufacturing Company, Inc. (“Adams”), a paint products company. Before the sale of the business, Phase III Marketing served as Adams’ sales agent. Following the sale, EZ Paintr continued to use Phase III Marketing as an agent for a particular buyer and paid a commission to Phase III Marketing at the same rate previously paid by Adams. Sometime thereafter, EZ Paintr terminated Phase III Marketing as its sales agent and decided to deal directly with the buyer. Phase III Marketing sued EZ Paintr, alleging that EZ Paintr had assumed its contract with Adams and breached that contract by failing to pay commissions due from the sale of the products. EZ Paintr moved for summary judgment on Phase III Marketing’s claims, and the court granted that motion.

In support of its decision, the court relied on evidence that EZ Paintr was unaware of the prior agreement between Adams and Phase III Marketing, statements from EZ Paintr

representatives that they did not believe EZ Paintr was bound by the prior agreement, and the lack of any language in the Asset Purchase Agreement between EZ Paintr and Adams mentioning the prior agreement. Additionally, the court's decision was supported by the lack of evidence demonstrating that Phase III Marketing and EZ Paintr ever discussed the prior agreement with Adams. Accordingly, the court ruled that as a matter of law, EZ Paintr did not intend to assume Adams' contract with Phase III Marketing.

Admittedly, the facts in cases in which courts find a purchaser did not impliedly assume the seller's obligations can be difficult to distinguish from the facts in cases in which courts find no implied assumption. However, there are key differences between the *Bird Hill* case and the *Phase III Mktg.* case worth noting.

In *Bird Hill*, the purchaser was admittedly aware of the seller's lease and made payments under it while attempting to negotiate new terms, and in *Phase III Mktg.* the purchaser was unaware of the prior contract. In *Bird Hill*, the creditor relied on the purchaser's actions in paying rent under the seller's lease by releasing the seller from its obligations. In *Phase III Mktg.*, there was no such reliance by the creditor. Finally, in *Bird Hill*, the Asset Purchase Agreement made specific mention of the lease, while in *Phase III Mktg.*, the Asset Purchase Agreement made no mention of the agency agreement.

Potential Strategies to Avoid Impliedly Assuming Debt

Although the implied-assumption theory might feel like an unavoidable trap for purchasers of businesses, there are ways to help avoid being held liable for unwanted debt.

Purchasers can include in their asset purchase agreements an express disclaimer regarding the assumption of the seller's liabilities and expressly state that the agreement can only be amended in writing and signed by each party.

To the extent possible, a purchaser should also avoid taking possession of property, buying goods or using services from a third party to whom the seller owes money unless and until the third party agrees not to hold the purchaser responsible for the seller's obligations.

To the extent that the sale of the business occurs before the purchaser can negotiate a new agreement with the seller's creditors and the purchaser needs or desires the space, goods or services of the seller's creditors, the purchaser should consider entering into a pre-negotiation agreement, having the creditor waive any right to make the implied assumption argument and acknowledge that it cannot rely on the purchaser's actions in releasing the seller.

Equally important, purchasers should be cautious when discussing prior debts with sellers' creditors and avoid giving appearances of accepting responsibility for debt that has not been expressly assumed in writing.

Conclusion

The availability of a claim for the implied assumption of debt gives creditors the ability to potentially hold a purchaser responsible for the seller's obligations. The conduct of a purchaser can be used to establish that it intended to assume some or all of the seller's debt — even without an express agreement to do so. Moreover, to the extent that the pur-

chaser's words or conduct indicate an intent to assume the seller's debt and the seller's creditor relies on that conduct, a purchaser could be held to have impliedly assumed the seller's obligations. However, purchasers of businesses who are aware of the implied assumption of liability theory can take intelligent steps to mitigate the risk of being found liable to assume a debt that they did not want to assume.

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¹*Bird Hill Farms, Inc. v. U.S. Cargo & Courier Service, Inc.*, 2004 PA Super 66, 845 A.2d 900 (2004).

²*Phase III Marketing, Inc. v. EZ Paintr Co.*, 2000 WL 33252113, *1 (W.D. Mich. 2000).