

THE PRODUCT LINE EXCEPTION TO SUCCESSOR LIABILITY RULES IN THE UNITED STATES

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In the United States, the general rule is that the purchaser of a business by way of an asset purchase is only responsible for those liabilities that it expressly or impliedly assumes from the seller. However, Canadian companies buying U.S. assets should be aware that there are a number of common law and statutory exceptions to this general rule. One common law theory of successor liability is the “product line” exception. Under the product line exception, purchasers have been found liable for contract-based product warranty claims and tort-based product defect claims (e.g., personal injury) arising from products and services sold by the seller before closing. The underlying basis for this theory can be summed up as follows: a purchaser who benefits from the goodwill associated with a particular product should be held responsible for any harm caused to consumers by that product if the original seller is no longer around or able to provide compensation. Purchasers may also be liable for punitive damages associated with any tort claims if the persons involved in the seller’s tortious conduct continue to be involved in the purchaser’s business.

The following due diligence may help identify potential product line liability: a) conduct litigation and judgment searches against the seller in appropriate jurisdictions to identify current claims and past judgments; b) review the seller’s records to identify past, current, and threatened lawsuits, arbitrations, and mediations; c) review the seller’s records to identify customer complaints, warranties, warranty claims, and insurance claims; and d) obtain a loss run from the seller’s insurer.

If a potential claim or related risk is identified during due diligence, then relevant state law should be reviewed and applied to the deal at hand. It is important to note that the choice of law clause in the asset purchase agreement may not govern this type of successor liability claim. The claim will more likely be governed by the law of the state where the damages occurred or the law governing the underlying contract between the seller and the third party (if applicable). This expands the scope of potential common law successor liability claims in any asset purchase to all states where the target company does business or its products or services are sold.

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If the purchaser's analysis indicates that there is potential for successor liability, then the transaction may need to be structured differently to avoid successor liability. Alternatively, safeguards such as tail insurance, indemnification, and related escrow or holdback of funds may need to be added or adjusted.

