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# Successor Liability Presents A "Risky Gambit" to Private Equity Firm

A Federal District Court recently called investments in private companies a "risky gambit" because of the potential for successor liability. Successor liability is the concept used to describe liability imposed on the purchaser of part or all an acquired company. Successor liability is often imposed by statute, case law, or other methods not contained in a purchase contract. Because the genesis of successor liability is often found outside of the purchase contract, these types of liabilities are sometimes called "hidden" liabilities. **Importantly, these liabilities can sometimes spread to the purchaser's parent/sponsor entity and other affiliates such as other portfolio companies. Two exemplary types of successor liability are discussed below.**

## Withdrawal Liability

Employers use Multiemployer Pension Plans (MPPs) to provide employee benefits or are otherwise required to contribute to these plans due to participating in union organizations. Contributing to these plans creates joint and several liability for each entity affiliated with the contributing employer. A purchaser can assume this liability when it acquires a business. If the business attempts to partially or completely exit the MPP, then an exit penalty known as "withdrawal liability," is imposed on the business and can spread to other affiliates.

Two private equity funds formed by Sun Capital Partners, a private equity firm, were recently held liable for a company's withdrawal liability even though each fund's ownership separately fell below the applicable statutory 80% control threshold. The court imposed the withdrawal liability on both funds because the funds were deemed active investors and there was evidence of a joint venture between the two Sun funds. The Sun decision is currently on appeal, and Sun could potentially prevail but not without spending significant sums on attorneys' fees.


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The Sun precedent poses a threat to acquirers. Firms should perform significant due diligence to ascertain the risk and exposure to withdrawal liability. Further, care should be taken to properly structure deals. There are at least 17 exceptions that reduce or eliminate withdrawal liability.

## Unpaid Taxes

One should be careful not to assume successor liability for a target's unpaid historical tax liabilities. In some cases, a purchaser can be liable for an unlimited amount – regardless of whether equity or assets are purchased and regardless of the purchase price or size of the deal. Thankfully, these liabilities can often be discovered during diligence through lien searches and tax clearance procedures. Where time, costs, or other constraints hinder performing adequate diligence, the purchaser should seek other protections such as indemnification enhanced by escrows, holdbacks, or guarantees when the selling entity will no longer exist or would not be left with sufficient assets to cover the indemnification. If an unpaid tax liability is overlooked, tax amnesty and voluntary disclosure programs can serve to limit the look-back period and to abate interest and penalties.

In the end, care must be taken to mitigate the chance that these and other successor liabilities do not come back to spoil the deal.

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