

# Pratt's Journal of Bankruptcy Law

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Victoria Prussen Spears

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# Eighth Circuit Rejects Successor Liability for Asset Purchaser at Foreclosure Sale

*By Stuart I. Gordon and Matthew V. Spero\**

*The U.S. Court of Appeals for the Eighth Circuit has issued a decision that can serve as a roadmap for companies seeking to avoid successor liability when acquiring assets at a secured creditor's private foreclosure sale.*

The U.S. Court of Appeals for the Eighth Circuit, in *Ronnoco Coffee, LLC v. Westfeldt Brothers, Inc.*,<sup>1</sup> recently ruled that a corporation that acquired substantially all of the assets of an unrelated competitor at a secured creditor's private foreclosure sale, where the sale agreement expressly stated that the purchaser was not assuming the competitor's liabilities, could not be held liable as the competitor's successor for unpaid pre-acquisition inventory the competitor had previously purchased from a third party.

The circuit court's decision illustrates the factors that courts typically consider when determining whether to impose successor liability in these kinds of circumstances. It also can serve as a checklist of the steps that asset purchasers should consider taking to increase the likelihood that they will be able to avoid successor liability when acquiring assets from troubled companies.

## THE CASE

As the Eighth Circuit explained, the case arose in 2013 when Scott Meader, the chief executive officer of Ronnoco Coffee, LLC, a Missouri-based coffee roasting company, traveled to Iowa to discuss a potential acquisition of U.S. Roasterie, Inc. ("USR"), a roasting company based in Des Moines. USR's president, Howard Fischer, expressed interest in the transaction.

Ronnoco's due diligence during negotiations in 2014 revealed that USR was in debt to various creditors, including its principal coffee supplier, Westfeldt

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<sup>1</sup> *Ronnoco Coffee, LLC v. Westfeldt Brothers, Inc.*, 939 F.3d 914 (8th Cir. 2019).

Brothers, Inc., a Louisiana corporation based in New Orleans. Westfeldt had begun selling coffee to USR in 2010. By August 2012, USR owed Westfeldt over \$3 million on open account coffee sales. Although aware of USR's financial difficulties, Westfeldt continued to sell coffee on unsecured credit. In April 2013, Westfeldt advised USR it would ship only upon payment of an amount greater than the value of the new shipment. Westfeldt applied subsequent USR payments to old unpaid invoices, reducing USR's debt to approximately \$2.9 million by August 2013. USR, however, refused to grant a security interest and Westfeldt never obtained a purchase money security interest in the coffee it shipped to USR.

In October 2014, Great Western Bank declined to extend over \$5 million in maturing secured loans to USR. Great Western subsequently foreclosed its security interests when USR did not comply with the bank's demand for repayment in full. Great Western's security interests covered USR's inventory, therefore including green coffee that had been sold to USR by Westfeldt.

Ronnoco determined that it would not purchase USR's assets directly from USR. Aware of USR's default on its Great Western loans, Ronnoco discussed the purchase of USR's assets at a Great Western private foreclosure sale and it formed Mid-America Roasterie, LLC, for this purpose.

On February 9, 2015, Great Western sold its collateral (USR's assets) at a private sale to Mid-America, consistent with the terms of its loans to USR and the governing provisions of the Iowa Uniform Commercial Code ("UCC"), which applied to the sale. Mid-America paid Great Western \$2,098,670.80 for the former USR assets (plus \$35,000 for vehicles) in what the parties subsequently conceded was a commercially reasonable transaction.<sup>2</sup> The February 2015 sale agreement expressly provided that Ronnoco and Mid-America (together, "Ronnoco") did not assume any of USR's liabilities or obligations.

After the foreclosure sale, approximately \$3,150,000 of USR's secured debt to Great Western and \$2,690,000 of USR's unsecured debt to Westfeldt remained unpaid.

Ronnoco continued operations at USR's Iowa location after it purchased USR's assets. It also retained most USR employees, employed USR's former president (Howard Fischer) for about 10 months, and employed its former chief financial officer (Chris Hodgson) for approximately six months. The USR corporate entity was not dissolved immediately after Great Western's foreclosure sale.

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<sup>2</sup> See Iowa Code Ann. § 554.9610.2.

Ronnoco thereafter asked the U.S. District Court for the Eastern District of Missouri to declare that it was not liable to Westfeldt for USR's debts and that it had not assumed USR's obligation to perform future coffee supply contracts.

In response, Westfeldt asserted, among other things, a successor liability claim against Ronnoco.

The district court ruled in favor of Ronnoco, dismissing Westfeldt's successor liability claim, and Westfeldt appealed to the Eighth Circuit. Westfeldt argued that the district court had erred and that successor liability should be imposed on Ronnoco.

### THE EIGHTH CIRCUIT'S DECISION

The Eighth Circuit affirmed the district court, finding no successor liability.

In its decision, the circuit court explained that the "well-settled general rule," adopted in virtually every state, was that "where one company sells or otherwise transfers all its assets to another company, the latter is not liable for the debts and liabilities of the transferor."<sup>3</sup> The circuit court then pointed out the following "well-recognized exceptions" to the general rule of nonliability in this situation:<sup>4</sup>

- Where the transaction included an express or implied agreement to assume liabilities;
- Where the transaction involved a de facto corporate merger or consolidation;
- Where the asset purchaser was a "mere continuation" of the seller; and
- Where the transaction was fraudulent.

Westfeldt contended that the "mere continuation" and fraud exceptions applied to Ronnoco, but the Eighth Circuit disagreed.

The circuit court noted that successor liability could be imposed under the mere continuation exception when the transferee corporation was "merely a continuation or reincarnation of the transferor corporation." It added that, in determining whether one corporation was a continuation of another, the test was whether there was a continuation of the corporate entity of the transferor—not whether there was a continuation of the transferor's business operation.<sup>5</sup>

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<sup>3</sup> 15 Fletcher Cyclopedia of Corporations § 7122, at 229–30 (2017 rev. ed.).

<sup>4</sup> See, e.g., *Pancratz v. Monsanto Co.*, 547 N.W.2d 198 (Iowa 1996); *Sinclair Refining Co. v. Raville Motor Co.*, 160 So. 179 (La. Ct. App. 1935).

<sup>5</sup> See, e.g., *Grand Labs., Inc. v. Midcon Labs of Iowa, Inc.*, 32 F.3d 1277 (8th Cir. 1994).



In this case, the Eighth Circuit reasoned, USR's assets were acquired by Ronnoco, another coffee roasting company, in an arm's-length transaction, and there was "no continuity of ownership or management" after the asset sale. The circuit court acknowledged that Ronnoco had retained USR employees after the acquisition, including two members of management for short periods, but the circuit court observed that this was "common after such acquisitions" and it ruled that it was not evidence of "mere continuation" of the company whose assets had been acquired.

Westfeldt contended that the foreclosure and asset sale were an effort by USR to escape liability to Westfeldt by placing assets beyond the reach of creditors; that Ronnoco, USR, and Great Western had "developed a plan" where USR would intentionally stop servicing its debt so Great Western could foreclose; and that there was sufficient evidence of mere continuation and fraud because Ronnoco effectively controlled USR by the end of their acquisition negotiations and, prior to the asset purchase, had directed USR to stop payment on an \$85,371.23 check to Westfeldt. The Eighth Circuit was not persuaded by this argument.

The Eighth Circuit found that Westfeldt had submitted no evidence supporting this theory. Moreover, it continued, the "essential contrary fact" was that Ronnoco had purchased USR's assets not from USR, but from Great Western, a secured lender that had foreclosed on USR's assets, in a transaction that had not fully repaid Great Western's secured debt.

The Eighth Circuit noted that it was "undisputed" that, when Great Western's loans to USR matured, Great Western declined to extend the loans, demanded repayment in full, foreclosed when USR failed to pay, and sold its collateral at a private foreclosure sale at a commercially reasonable price. In the circuit court's opinion, it was "clear" that Ronnoco was unwilling to risk assuming USR's debts to creditors such as Westfeldt by purchasing the assets of a going concern directly from USR. The circuit court then declared:

Buying USR assets from Great Western at a foreclosure sale in an agreement that disclaimed assumption of USR liabilities protected Ronnoco from claims that the asset purchase was tainted by commercially inadequate consideration. Great Western, acting in its own financial interest, made the decision to sell.

Moreover, the circuit court stated, there was "nothing inherently wrongful or fraudulent in purchasing assets at a foreclosure sale, free from encumbrances, rather than directly purchasing the assets." According to the Eighth Circuit, Ronnoco "had no duty to rescue [USR], much less [Westfeldt]."

The circuit court added that although an intervening foreclosure sale might

not afford an acquiring corporation an automatic exemption from successor liability if the acquiring corporation otherwise qualified as the debtor's successor,<sup>6</sup> that principle did not apply in this case because Westfeldt presented insufficient evidence of mere continuation or fraud on Ronnoco's part. Great Western's actions furthering its own interests as secured lender, the circuit court declared, "simply confirmed the legitimacy of an asset purchase by a purchaser that did not assume the former owner's liabilities."<sup>7</sup>

Finally, the Eighth Circuit decided that Westfeldt's fraud exception claim also failed to establish a case of successor liability because Westfeldt had offered no evidence that it had been prejudiced by the asset sale or that, absent the alleged fraud by Ronnoco, USR would have been able to pay off its entire debt to Great Western and then make payment to Westfeldt.

The circuit court reasoned that USR, which was in substantial debt to multiple creditors, was unable to make timely payments to either Great Western or Westfeldt; that Great Western, having obtained a priority interest in USR's assets, foreclosed and made a "valid financial decision" to sell its collateral to Ronnoco at a commercially reasonable price; that the sale proceeds did not satisfy USR's entire debt to Great Western; and that, after the sale, Great Western's unpaid secured claim continued to have priority over Westfeldt's unpaid unsecured claims.

The Eighth Circuit concluded that Ronnoco, as an independent purchaser, "had no duty to rescue USR or Westfeldt."

## CONCLUSION

As the Eighth Circuit's decision in *Ronnoco Coffee* makes clear, purchasing assets of a troubled company from a secured creditor at a private foreclosure sale should not necessarily open the acquiring company to successor liability. Indeed, the risk of successor liability can be limited by a carefully structured transaction, at a commercially reasonable price, that does not trigger any of the other warning signs highlighted, and ultimately rejected, by the Eighth Circuit.

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<sup>6</sup> See, e.g., *Ed Peters Jewelry Co. v. C & J Jewelry Co.*, 124 F.3d 252, 267 (1st Cir. 1997).

<sup>7</sup> Cf. *Bourque v. Lehmann Lathe, Inc.*, 476 So. 2d 1125, 1129 (La. Ct. App. 1985) ("[N]o discovered case from any of our sister states has ever premised successor liability on a connection as tenuous as a partial purchase of a dissolving firm's assets at a bankruptcy auction.").