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Avoiding Bulk Sales Pitfalls



■ GUEST COMMENTARY
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In a recent article published in the Business Journal, columnist Tom Ramsey described the following Catch-22 situation.

For the buyer of an ongoing concern to get the State Board of Equalization to issue requisite clearance for prior taxes owed by said ongoing concern, said buyer himself would have to pay said taxes to get clearance to proceed with the purchase, otherwise the board could seize assets equal to the amount of taxes owed.

This imbroglio, at least from the buyer's point of view, was occasioned by California's bulk sale law, which permits creditors to lay claim to assets before the sale was transacted.

Under state law Successor Liability stipulates that the buyer of a business can become liable for the business's pre-sale debts. As I see it, there are four ways to avoid this liability. Each alternative broaches its own issues and must be considered judiciously before its engagement. Only one of the four options offers a win-win outcome.

If awareness of several alternatives to such liabilities is too late to save the buyer \$30,000 in back taxes, at least this article can forewarn present readers to look before they leap into such a purchase.

One way a buyer of a business can avoid Successor Liability is to first obtain the creditors waiver of claims not covered by the purchase price. Often this solution proves costly. Moreover, it often provides individual creditors with leverage because one creditor's failure to consent can derail the whole sale.

The second way to get around Successor Liability, as Mr. Ramsey's article points out, is through the conditions required by the bulk sales law. As he has shown, however, not all tax liabilities can be avoided.

The third way to get around Successor Liability is via a bankruptcy declared prior to the sale. While a Chapter 11

reorganization can eradicate taxes free and clear, it often proves costly, highly regulated and time-consuming. Such conditions can disrupt the sale of the business. Unless the sale price is in the neighborhood of hundreds of thousands, if not millions, of dollars, transactional costs could squelch the sale of the purchase.

While a business can operate in a Chapter 11 filing, operations cease in a Chapter 7 filing. Thus, there is not only the filing delay but a cessation of operations as well. This delay occurs because creditors must be given advance notice of the sale. That usually means 45-120 days of non-operations which translates into lost revenue. Add to that transactional costs, attorneys' fees, trustees' fees, and you have a net loss not as high as in a Chapter 11 filing but high enough to give buyers pause to reconsider. This may offset any gain to be had were all creditor's claims, taxes included, erased.

The fourth way to get around Successor Liability is through a General Assignment. A General Assignment requires the consent of taxing authorities to relieve extant debt. A General Assignment confers a neutral third party with fiduciary control of a business and its assets, with the mandate to sell off said assets, and with the obligation to distribute the proceeds of the sale to the pecking order of creditors. Generally, the process is quicker, less costly, and realizes more than would be realized in a bankruptcy fire sale.

A General Assignment functions much like a bankruptcy but without the filing requirements, the vigorous regulatory oversight, the delay, and the high cost. Taxing authorities recognize a general assignment as analogous to bankruptcy and process their claims through a process similar, indeed, almost identical, to bankruptcy.

A General Assignment provides buyers with flexibility: the business can continue, delays can be avoided, and costs can be reduced if not avoided. All of which would make an otherwise unattractive purchase tenable if not downright prosperous.

The moral of the story is "Buyer Beware." Ensure that if you want to buy a business or represent someone who does, that you first identify all of a seller's debt and select the process that protects them or you from Successor Liability.

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