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Eighth Circuit Rules No Successor Liability for Buyer from Asset Foreclosure Sale

On September 19, 2019, the U.S. Court of Appeals for the Eighth Circuit affirmed a lower court's conclusion that a purchaser at a private foreclosure sale has no successor liability to a debtor's unpaid creditors.¹

BACKGROUND & DISTRICT COURT DECISION

In 2015, Great Western Bank ("Bank") commenced foreclosure proceedings with respect to its \$5,000,000 secured loan to Roasterie's, Inc., a coffee roasting company based in Des Moines, Iowa. The Bank sold substantially all of the assets of Roasterie pursuant to a private foreclosure sale to an affiliate of Ronnoco Coffee, LLC ("Ronnoco") for \$2,098,670.80, which left Bank with a deficiency claim in the amount of approximately \$3,150,000.² The sale agreement expressly provided that Ronnoco "did not assume [Roasterie's] liabilities or obligations."³ After the sale, Ronnoco continued operations at Roasterie's Iowa location and retained most of Roasterie's employees, including two executives for a short period.

After the foreclosure sale, Westfeldt Brothers, Inc., one of Roasterie's former vendors, retained an unsecured claim of over \$2,500,000. Ronnoco sued Westfeldt in federal district court, seeking a declaration that, among other things, Ronnoco is not liable to Westfeldt for Roasterie's debt. Westfeldt counterclaimed and asserted successor liability claims against Ronnoco arguing that either (i) Ronnoco was a continuation of the Roasterie's business, or (ii) the foreclosure sale was fraudulent. The district court granted summary judgment in Ronnoco's favor, finding that Ronnoco was not liable to Westfeldt.

DECISION ON APPEAL

On appeal, the Eighth Circuit, analyzing Iowa and Louisiana law, affirmed the district court's decision for three reasons. **First**, the court determined that Ronnoco was not a "mere continuation" of Roasterie simply because it bought all the debtor's assets.⁴ To determine whether one business is a continuation of another, "the test is whether there is a continuation of the



corporate entity of the transferor – not whether there is a continuation of the transferor’s business operation.”⁵

The Court found that Ronnoco’s business was not a continuation of Roasterie because the sale was an arm’s-length transaction to a true third party with no continuity of ownership or management after the sale. Although Ronnoco kept some of the debtor’s employees and retained its top executives for a few months, such a practice “is common after such acquisitions and is not evidence of ‘mere continuation’ of the company”⁶ The Court also noted that “Iowa courts ‘have never applied the mere continuation exception where the buying and selling corporations had different owners.’”⁷

Second, the Court determined that the foreclosure sale was not fraudulent. The Court concluded that “[t]here is nothing inherently wrongful or fraudulent in purchasing assets at a foreclosure sale, free of encumbrances, rather than directly purchasing the assets.”⁸

Lastly, the Court found that Westfeldt did not suffer any prejudice from the foreclosure sale because the amount of the Bank’s secured claim far exceeded the proceeds from the foreclosure sale. Westfeldt’s unsecured claim was junior to the Bank’s secured claim, and the Court concluded that “there is no evidence that, absent the alleged fraud by Ronnoco, [Roasterie] would have been able to pay off its entire debt to Great Western and then make payment to Westfeldt.”

CONCLUSION

In the Eighth Circuit and other jurisdictions applying state law consistent with Iowa and Louisiana, this decision confirms lenders’ and buyers’ ability to use a private foreclosure sale as a means to effectuate a sale of assets in a distressed context without necessarily giving rise to successor liability. Although “continuation of transferor’s business operations” may not rise to the level of successor liability, it is critical that (i) the foreclosure sale agreement expressly provide that the buyer does not assume any of the seller’s liabilities, (ii) such sale be an exercise of the lender’s enforcement rights under applicable law (*i.e.*, the Uniform Commercial Code), and (iii) such sale be on an arm’s-length basis pursuant to commercially reasonable terms.

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¹ *Ronnoco Coffee, LLC v. Westfeldt Bros., Inc.*, — F.3d —, No. 18-1498, 2019 WL 4492665, at *1, 4 (8th Cir. Sept. 19, 2019).

² *Id.* at *3.

³ *Id.*

⁴ *Id.* at *3.

⁵ *Id.* (citations omitted).

⁶ *Id.*

⁷ *Id.* (citation omitted).

⁸ *Id.* at *4.