Law that Governs Transfer of Debts and Liabilities on Sale of a Corporation

Related to Senate Bill 686 (2023)

When a Maryland business is sold, Maryland corporate law and the agreement between the seller and buyer determine whether the new company bears the debts or liabilities of the old company. ***With four exceptions, a corporation that acquires the assets of another corporation is not liable for the debts and liabilities of the predecessor corporation.*** *Baltimore Luggage Co. v. Holtzman*, 80 Md. App. 282, 290 (1989). Exceptions include when: 1) there is an express or implied assumption of liability; 2) the transaction is a consolidation or merger; 3) the buyer is a mere continuation of the seller; or 4) the transaction is entered into fraudulently to escape liabilities for debts. *Id.*

The first exception reflects that the parties' agreement about the sale of the business governs. *See* §3-115 (c)(1) of the Md. Corps. & Ass'ns Code Ann. ("[T]he successor is liable for all the debts and obligations of the transferor *to the extent provided in the articles of transfer*."). If the documents governing the sale provide for the transfer of debts and liabilities, the successor corporation will be liable for the predecessor's debts. If the documents governing the sale do not provide for transfer of liability, such transfer may be implied based on other communications or conduct of the parties. Without explicit or implied transfer, the purchaser is not responsible for the debts and liabilities of the seller.

The second exception is for mergers and consolidations. A corporate merger or consolidation is governed by §3-114 of the Md. Corps & Ass'ns Code Ann., which provides that "the successor is liable for all the debts and obligations of each nonsurviving corporation, partnership, limited partnership, limited liability company, and business trust." Corporations that merge or consolidate under this section are bound by these statutory conditions. *Ramlall v. Mobilepro*, 202 Md. App. 20 (2011).

The third exception, for mere continuance of a company, is the most complicated and litigated exception because it requires an examination of the facts of the transfer—how the business was owned and operated originally and how it is now owned and operated. If the successor corporation is "substantially the same" as the predecessor corporation, a creditor may recover against the successor. *Baltimore Luggage,* 80 Md. App. at 297. 'Substantially the same' is described as a "change in form without a significant change in substance." *Id.* This exception protects creditors against business reorganization for the purpose of avoiding debts and liabilities.

The final exception is likewise designed to prevent a change in business that is designed to escape debts and liabilities. This is similarly a fact-specific analysis and is intended to protect creditors against fraudulent reorganization. Maryland courts have not had occasion to explain how a determination of fraud would be made but the *Baltimore Luggage* court did suggest that the Maryland Uniform Fraudulent Conveyance Act, Md. Comm. Code Ann. Title 15, Subtitle 2, could be helpful in making such a determination. 80 Md. App. at 618. For example, under the Act, a transaction for which no fair consideration is exchanged for assets is considered prima facie fraudulent.

There is ample Maryland statutory and case law to determine whether and when the sale of a corporation includes transfer of debts and liabilities. Nowhere in the Maryland Code are these rules altered for a particular type of tort or other civil claim.

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