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BLOGS

Terminations

Buyer Not Obligated to Continue Under Distribution Agreement As “Mere Continuation” of Seller

In *Progressive Septic, Inc. v. SeptiTech, LLC*, 2011 U.S. Dist. LEXIS 27381 (D. Md. Mar. 15, 2011), a financially distressed manufacturer of septic systems sold the bulk of its assets to a new investor group. In the asset purchase agreement, the buyer explicitly declined to assume both the seller’s liabilities and its existing product distribution agreements. The buyer’s newly formed entity did adopt the trade name of the seller, however, and it hired several of the same management-level employees and continued to manufacture and distribute septic systems. The plaintiff was a distributor that previously had entered into an exclusive distribution agreement with the seller. After the sale, the new entity desired to move forward with the plaintiff distributor on a *nonexclusive* basis. In its suit, the plaintiff alleged that the new entity’s owners had orally agreed to keep the old distribution agreement in effect. The defendant countered that a letter had been sent to the plaintiff by the sales manager (of both the old company and the new one) stating that the new company would not be assuming presale distribution agreements.

The court found that the new entity had effectively terminated the old distribution agreement. That agreement permitted either party to terminate upon 60 days’ written notice. Because the letter from the sales manager notified the plaintiff that the new entity would not continue under the old agreement, and the company then stopped selling products to plaintiff for a period greater than 60 days, the letter served as an effective termination, despite not being styled as a termination notice. Even if this were not the case, the court determined that the new entity could be bound by the old distribution agreement only if: (a) it had expressly assumed the old agreement or (b) its business was found to be a “mere continuation” of the old (seller) entity. It was clear that the new entity had expressly rejected the distribution agreement, both in the asset purchase documents and in the letter sent to plaintiff. And the Maryland court in this case found that the new business was not a mere continuation of the seller because ample consideration was paid for the assets of the old business, there was no continuation of ownership and upper-level management, and there was no evidence of fraud or improper purpose in the asset purchase agreement. The court determined that successor liability would not apply unless the sale and the formation of the new entity amounted to a bad faith attempt by the old company’s owners to evade creditors. Summary judgment was granted.