IN THE

Indiana Supreme Court

Supreme Court Case No. 20S-CC-578

New Nello Operating Co., LLC,
Appellant (Defendant),

–v–

CompressAir,
Appellee (Plaintiff).

Argued: December 3, 2020 | Decided: April 22, 2021

Appeal from the St. Joseph Circuit Court
No. 71C01-1703-CC-826
The Honorable John E. Broden, Judge

On Petition to Transfer from the Indiana Court of Appeals
Case No. 19A-CC-603

Opinion by Justice Slaughter

Chief Justice Rush and Justices David, Massa, and Goff concur.

Slaughter, Justice.

In a typical asset purchase, the buyer acquires the seller's assets but not its liabilities. The general rule is not absolute, however, and this case turns on two exceptions. The first exception arises when the acquisition of assets amounts to a de facto merger; the second, when the buyer is a mere continuation of the seller. If either exception applies, the buyer is on the hook for all the seller's liabilities.

We hold that continuity of ownership between two companies is necessary for either exception to apply. Here, there are no overlapping owners; no equity holder of New Nello Operating Company owns any shares of Nello Corporation, or vice versa. Thus, neither exception applies, and New Nello Operating Company is not liable for Nello Corporation's debt to CompressAir. Having previously granted transfer, we reverse the trial court's judgment for CompressAir and remand with instructions to enter judgment for New Nello Operating Company.

I

Founded in 2002, Nello Corporation manufactured utility and cellphone towers. The company had seven shareholders; four of them, all senior officers, owned at least ninety-five percent of the shares. In 2016, Nello began relocating its multiple facilities to South Bend, Indiana. This consolidation took longer and cost more than expected, leaving Nello "cash-strapped" and "moving in the wrong direction". That fall, the company had few liquid assets and significant debt. Its debts included $1.4 million owed to the City of South Bend; $3.4 million to Live Oak Capital; and over $10 million to Fifth Third Bank. Nello's four senior officers had signed personal guarantees for the Fifth Third loan.

Later that year, Nello defaulted on the loan from Fifth Third, which held a first lien on Nello's assets—ensuring Fifth Third would be paid before other creditors. The bank demanded immediate payment in full. Nello could not repay the loan, so it considered several options, including filing for bankruptcy, finding another lender, and locating a buyer or investor.

After Nello defaulted, Live Oak Capital, another secured creditor, feared it would lose its investment. It reached out to a private-equity firm to see if Nello could survive as an ongoing business and avoid bankruptcy. The private-equity firm considered several alternatives, but none materialized. As Fifth Third was preparing to liquidate Nello's assets, the private-equity firm calculated Nello's likely liquidation value at about $3.1 million and offered Fifth Third a premium—about $3.7 million—to acquire all of Fifth Third's interests in Nello. Fifth Third accepted.

The private-equity firm then created two new entities—New Nello Acquisition, to buy Fifth Third's interests, and Defendant, New Nello Operating, to run the business as Acquisition's wholly owned subsidiary. After receiving the necessary consent from "Old Nello's" secured creditors, the New Nello entities proposed entering into a strict-foreclosure agreement with Old Nello under Chapter 9.1 of Indiana's uniform commercial code, see Ind. Code §§ 26-1-9.1-620 et seq. In a strict foreclosure, the borrower, in full or partial satisfaction of its debt, surrenders the collateral securing its debt to the secured creditor, which acquires that collateral without having to take legal action to possess and foreclose on it in a judicial sale. See *id*. § 26-1-9.1-620 cmt. 2.

In November 2017, Old Nello and the New Nello entities finalized the strict-foreclosure agreement. The agreement identified which liabilities New Nello Operating was assuming and which it was not. The assumed liabilities were those New Nello deemed necessary to continue the business; the unassumed liabilities, it deemed unnecessary.

Afterward, New Nello continued operating from Old Nello's former location without publicly announcing either the transition or the transfer of assets from Old Nello. New Nello retained about ninety percent of Old Nello's employees, including senior management. Although senior management had owned the lion's share (at least ninety-five percent) of Old Nello's shares, none of Old Nello's shareholders owned any equity interest in either New Nello entity. As part of the transition, the New Nello entities agreed not to enforce the personal guarantees against Old

Nello's four senior officers, all of whom agreed to remain in their positions at New Nello Operating.

Meanwhile, Plaintiff, CompressAir, had installed piping in Old Nello's South Bend facility in early 2016 but had not been fully paid for its work. In 2017, CompressAir sued to recover the unpaid balance and obtained a judgment against Old Nello. CompressAir then learned that Old Nello was defunct and had no assets, so it filed proceedings supplemental against New Nello Operating, which had not assumed Old Nello's debt to CompressAir.

In the proceedings supplemental, CompressAir argued that the strict foreclosure between Old Nello and New Nello was fraudulent, amounted to a de facto merger, and that New Nello was a mere continuation of Old Nello. The trial court rejected CompressAir's claim that the transfer was fraudulent. Instead, it found the transfer was "for legitimate business purposes" and that New Nello "chose the best option from among several bad alternatives as a result of Fifth Third Bank's decision to foreclose on the Note." Despite these findings, the court concluded that the transaction was a de facto merger and that New Nello was a "mere continuation" of Old Nello. The court entered judgment for CompressAir and against New Nello.

The court of appeals affirmed. Although it noted there was no continuity of ownership between Old Nello and New Nello, the court said this was not "fatal to a finding of a de facto merger." *New Nello Operating Co., LLC v. CompressAir*, 142 N.E.3d 508, 513 (Ind. Ct. App. 2020), trans. granted. The court looked instead to other factors, including the two companies' "continuity of management, as the entire management team from Old Nello continues in the same roles in New Nello." *Id*. Given its decision on de facto merger, the court did not address mere continuation. *Id*. at 513–14 n.4. New Nello then sought transfer, which we granted, 157 N.E.3d 520 (Ind. 2020), thus vacating the appellate opinion.

II

With an asset purchase, the buyer typically does not take on the seller's liabilities. *Winkler v. V.G. Reed & Sons, Inc.*, 638 N.E.2d 1228, 1233 (Ind. 1994). But this general rule has four exceptions:

- the buyer agrees (expressly or impliedly) to assume the seller's liabilities;
- the asset purchase is fraudulent, allowing the seller to evade liability;
- the purchase is a de facto merger or consolidation; or
- the buyer is a mere continuation of the seller.

Id. Two of these exceptions—de facto merger and mere continuation—are at issue here. The question is whether continuity of ownership between companies (typically, buyer and seller) is required for either exception to apply. We hold that it is.

A

The trial court held New Nello liable to CompressAir for Old Nello's debt based on the de-facto-merger exception. This exception applied, the court found, because New Nello and Old Nello shared the same name, business, location, employees, customers, products, and management team. What the two companies did not share, though, was the same ownership. In fact, the two companies have zero overlapping ownership: no shareholder of Old Nello owns an equity interest in either New Nello or its parent company. For purposes of the de-facto-merger exception, we hold, this difference makes all the difference—continuity of ownership is a required element of a de facto merger.

Today's holding is consistent with our case law treating continuity of ownership as the touchstone of the de-facto-merger analysis. In *Cooper Industries, LLC v. City of South Bend*, we considered whether a corporate reorganization into a new, combined company was a de facto merger. 899 N.E.2d 1274, 1288–90 (Ind. 2009). Concluding that it was, *id.* at 1290, we discussed factors like continuity of business operations, officers, and employees. *Id.* at 1289. Critically, we noted the "continuity of shareholders between" the predecessor and successor. *Id.* Likewise, in *Reed v. Reid*, we focused on whether the defendant owned both the predecessor and successor companies. 980 N.E.2d 277, 300–01 (Ind. 2012). We found that because the plaintiff designated evidence showing continuity of ownership, the plaintiff defeated summary judgment by creating a genuine issue for trial on whether there was a de facto merger. *Id.*

What these cases imply, we now make explicit: continuity of ownership between transacting companies is essential to the de-facto-merger exception in Indiana. This approach also is consistent with that of other states like New York. See, e.g., *Dritsas v. Amchem Prods., Inc.*, 94 N.Y.S.3d 264, 264-65 (App. Div. 2019) (finding no de facto merger because "there was no continuity of ownership between the two corporations"); *Cargo Partner AG v. Albatrans, Inc.*, 352 F.3d 41, 45–46 (2d Cir. 2003) (discussing four requirements under New York law to find a de facto merger, including "a continuity of stockholders").

Having concluded that continuity of ownership is necessary for the exception to apply, we leave for another day whether continuity of ownership alone is sufficient and how much overlapping ownership is required. Nor do we decide today whether the de-facto-merger exception would apply in situations like this one—a strict foreclosure—even were there continuity of ownership between lender and borrower. A statutory strict foreclosure differs from the typical de-facto-merger situation, which involves an asset-purchase agreement. Generally, an asset purchase transfers only the seller's assets and whatever liabilities the buyer assumes; the buyer does not become liable for all claims against the seller. In contrast, a stock purchase transfers the assets and liabilities of the entire company. Here, though, the transaction was neither an asset nor a stock purchase but a strict foreclosure. New Nello did not buy Old Nello's stock; it did not expressly assume all Old Nello's liabilities; and it did not "buy" Old Nello's assets. The transaction's only resemblance to an asset purchase was the outcome—the transfer of assets from Old Nello to New Nello.

Admittedly, a transaction's structure or label is not dispositive of its legal treatment. Under our law, we penetrate a transaction's form to its substance and treat it as a stock purchase or merger if its "economic effect … makes it a merger in all but name." *Cooper Indus.*, 899 N.E.2d at 1288. We do so to further the de-facto-merger exception's policy rationale, which is to prevent owners of a failing business from manipulating a transaction in a way that leaves creditors high and dry while allowing the same owners to run what amounts to the same business in a newly formed company. This rationale does not apply here. It was not Old Nello or its shareholders that set in motion the transfer of assets from Old Nello to New Nello but Fifth Third, one of Old Nello's secured creditors. The de-facto-merger exception would not have applied had Fifth Third itself strictly foreclosed on Old Nello's assets in (partial) satisfaction of what it was owed. The result is no different when New Nello, as Fifth Third's successor in interest, forecloses on them instead.

Simply put, it is irrelevant to the de-facto-merger inquiry that the underlying asset transfer arose after a private-equity firm intervened (at the urging of junior lienholder Live Oak Capital), acquired Fifth Third's interests, and then created the New Nello entities. As the trial court found, the transfer of assets to New Nello was not fraudulent. If Fifth Third had foreclosed on Old Nello's assets, CompressAir would have received nothing as an unsecured creditor. CompressAir is no worse off with New Nello initiating the foreclosure instead of Fifth Third. It would seemingly subvert the rationale underlying the de-facto-merger exception to treat such foreclosures differently or to penalize New Nello for keeping the company afloat and its employees paid by deploying the assets for their most economically productive use.

Because CompressAir cannot show continuity of ownership between Old Nello and New Nello, the de-facto-merger exception does not apply.

B

The trial court also found that New Nello is liable to CompressAir because it is a "mere continuation" of Old Nello. This exception asks "whether the predecessor corporation should be deemed simply to have re-incarnated itself". *Cooper Indus.*, 899 N.E.2d at 1290. Unlike the de-facto-merger exception, the mere-continuation exception considers not whether business operations continue from one entity to the next, but whether the initial entity itself continues. *Sorenson v. Allied Prods. Corp.*, 706 N.E.2d

1097, 1100 (Ind. Ct. App. 1999). An entity is a mere continuation of another where the buyer and seller share "a common identity of stock, directors, and stockholders" and the transfer means the other company no longer exists. *Id.*; see *Reed*, 980 N.E.2d at 300.

Critically, because the mere-continuation exception applies only where there exists this "common identity" of equity holders, continuity of ownership is a necessary element. See *Sorenson*, 706 N.E.2d at 1100 (finding no mere continuation because, among other reasons, there was no continuity of ownership); *Glentel, Inc. v. Wireless Ventures, LLC*, 362 F. Supp. 2d 992, 1005 (N.D. Ind. 2005) (applying Indiana law and finding no mere continuation because "there is no continuity of ownership or common identity of stock or stockholders"); *Travis v. Harris Corp.*, 565 F.2d 443, 447 (7th Cir. 1977) (declining to apply mere-continuation exception under Indiana law where there was no continuity of ownership between buyer and seller). This requirement of continued ownership exists in other jurisdictions, too. See *In re Emoral, Inc.*, 740 F.3d 875, 879–80 (3d Cir. 2014) (applying New Jersey and New York law and noting that for the mere-continuation exception to apply, there must be "continuity in . . . shareholders"); *Cargo Partner AG v. Albatrans Inc.*, 207 F. Supp. 2d 86, 95 (S.D.N.Y. 2002) (applying New York law and requiring "a common identity of . . . stockholders"), aff'd on other grounds, 352 F.3d at 48.

Based on these authorities, we hold that New Nello is not a mere continuation of Old Nello for the same reason the de-facto-merger exception does not apply—namely, because none of Old Nello's shareholders holds an equity interest in New Nello.

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For these reasons, we hold that continuity of ownership is necessary for the de-facto-merger and mere-continuation exceptions to apply. Because there was no continuity of ownership between Old Nello and New Nello, we reverse the trial court's entry of judgment for CompressAir and remand with instructions to enter judgment for New Nello.

Rush, C.J., and David, Massa, and Goff, JJ., concur.

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