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Minimizing Risk When Buying or Selling a Business

by Kenneth Ross

Wouldn't it be nice if manufacturers could sell the part of their business that had the biggest product liability risk and be done with it? Even manufacturers who buy such businesses would like to eliminate the product liability risk from any acquired company. Unfortunately, it is not that easy.

If you can convince the purchasing company ("buyer") to assume all current and future risks, and if it is still in business and can adequately cover the risk when an incident occurs, then the buyer would be protected. However, since the buyer usually does not want to assume risks on products that were sold prior to the date of their acquisition, the selling company ("seller") will have to defend cases on products it sold despite no longer owning the business. This raises serious potential problems for both buyers and sellers.

The buyer will usually inherit the personnel, documents and assets of the business that it acquires. As a result, the seller—who has to defend pending and future cases it still is responsible for—may not be able to defend itself easily.

After an acquisition, the buyer should immediately evaluate the quality and safety of the products it acquires and make appropriate changes for future production. As a result, it is likely that there will be improvements in various aspects of the product, including the design, warnings and instructions.

In reality, even if the buyer is not legally responsible for products sold before acquisition, the reputation of their products is a significant asset for the buyer, and the

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buyer wants it protected. To obtain such protection, the buyer might decide to make a safety improvement and want to offer the improvement to prior customers. Or it may want to undertake a retrofit or recall of products in the field. In either case, the buyer should be required to obtain the seller's permission.

These kinds of activities by the buyer can create big problems for the seller as it attempts to defend pending lawsuits. One way to prove that the product was defective at the time of sale is to show that the manufacturer improved its manufacturing procedures or started to sell products with improved designs, warnings and instructions sometime after the accident. Even though the buyer is a different company than the seller, the improvements show that they can be done and that the successor company considered the improvements necessary.

As a result, the seller needs to seriously consider the effect of the buyer's post-acquisition actions when entering into negotiations for the sale of the product or division. There should be an agreement as to when and how personnel and documents from the acquiring company are made available to the seller and whether the buyer will be compensated for its time and effort.

There should also be an agreement about whether the buyer needs to consult with the seller before making significant changes in manufacturing and design so the seller can at least be aware of it before it comes up in a lawsuit. Although the seller may not be able to stop a manufacturing or design change, it should be allowed to provide any input about the appropriateness of the changes and help the buyer assess any risks from making these changes.

In addition, there should be some agreement about whether the buyer needs the seller's permission before it reports a safety issue to the U.S. government or a foreign government entity. The matter of responsibility for the cost of any potential recall also needs to be discussed.

Of course, while all of these activities could seriously hamper the seller's ability to defend its cases, they could also damage the buyer's position in the marketplace and ability to defend its future cases.

In addition to the above agreements, the buyer and the seller should both agree to periodically discuss their litigation history and strategy. Adverse verdicts against one party will undermine the other's ability to defend itself in future litigation as well. Also, without this coordination, there are likely to be inconsistent positions taken on the products that are being defended by the buyer and seller.

As a result, given the significant potential problems identified above, the buyer should seriously consider assuming all liability going forward in order to that they control its own fate and eliminate the risk of sellers creating future risks.

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