LABOR & EMPLOYMENT

SUCCESSOR LIABILITY UNDER THE FLSA: SEVENTH CIRCUIT HOLDS PURCHASER OF ASSETS FROM RECEIVER OF COMPANY WHICH HAD VIOLATED FLSA LIABLE DESPITE "FREE AND CLEAR" NATURE OF SALE

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In a case which is sure to complicate the sale of companies (or discrete divisions thereof) and have widespread influence in other Circuits, the Seventh Circuit recently held that a company which acquired the assets (not stock) of another company at a receivership auction was liable for violations of the FLSA which occurred before the acquiring company purchased the assets. The Seventh Circuit reached this conclusion in spite of auction conditions that the assets were purchased "free and clear" of all liabilities generally, and specifically stipulated that the purchase was free of any liabilities arising out of the FLSA litigation pending against the predecessor company. *Teed, et. al., v. Thomas & Betts Power Solutions, LLC*, March 26, 2013, Seventh Circuit Court of Appeals, Posner, R.).

At the outset, Judge Posner, writing for the Seventh Circuit panel, acknowledged that the majority rule followed by most states – including in Wisconsin, the state whose law would otherwise apply in this case – would shield a purchaser of a company's assets from successor liability in the absence of an express assumption of the seller's existing liabilities. But, Posner noted, a more employee-friendly federal common law standard of successor liability has often been applied which trumps the majority state law rule "when liability is based on a violation of a federal statute relating to labor relations or employment," such as the NLRA, ADEA, Title VII, or FMLA. This federal standard has been applied even when the asset purchase is subject to a disclaimer of successor liability.

The threshhold issue according to Judge Posner was whether the federal successor liability standard should be applied "when the source of liability is the Fair Labor Standards Act." Finding that the statutory goals of the FLSA were every bit as deserving of protection as those of the NLRA, Title VII, and other federal statutes to which the more lenient federal standard has been applied, the Seventh Circuit held that the federal standard logically extended to suits to enforce the FLSA. Absent successor liability, the Court said, "a violator of the [FLSA] could escape liability, or at least make relief much more difficult to obtain, by selling its assets without an assumption of liabilities by the buyer … and then dissolving."

Having determined that the federal standard applied to FLSA actions, the Seventh Circuit found that it should be applied to the buyer in the case at hand "even [though] the buyer disclaimed liability when it acquired the assets in question – unless there are good reasons to withhold such liability." The Court found that the buyer's argument that it should not be held liable because the FLSA only imposes liability on "employers," and that it was not the "employer" when the violations occurred at the predecessor company, was not a "good reason" to avoid imposition of liability. The Court also rejected the buyer's argument that to hold it liable would be unfair since it relied on the auction disclaimers, and imposition of liability would effectively result in it having overpaid for the predecessor's assets. Finding that the buyer had notice of the pending lawsuit before the asset sale, that there was continuity between the operations and work force of the predecessor and buyer, and noting the "modest" nature of the liabilities and the buyer's ability to pay the judment, the Court concluded there was "no good reason to reject successor liability in this case," a result it characterized as "the default rule in suits to enforce federal labor or employment laws." As a result, the buyer, which thought it acquired the assets of the predecessor company "free and clear" of liabilities, also acquired the liability for a $500,000.00 judgment, plus costs and attorneys' fees.

A bad result for the buyer no doubt, but there remains more to the opinion than just the result. It is also important to focus, from an insolvency and creditors' rights standpoint, on what the Court specifically identified as the "good reasons" why successor liability might not be imposed for an FLSA claim in another case. Chief amongst these "good reasons" was the Court's recognition that applying successor liability might "upend the priorities of competing creditors."

In explaining this concept, the Court observed that allowing the relief sought by the employees seemingly "would enable the plaintiffs, whose wage claims are unsecured, to obtain a preference over a senior creditor, namely the bank, which had a secured claim". This followed from the notion that someone like the buyer would have theoretically paid *less* for the assets at the auction if it knew it would also have to pay the FLSA liability as a successor. Thus, imposing successor liability would effectively reduce the price payable to the senior secured creditor from the auction, and pay the FLSA claimants in full with funds that would have otherwise gone to the senior secured creditor. This result, which appeared to elevate the unsecured claim of the employees above the claim of the senior secured lender in the absence of a clear statutory provision that created such a result, was something that the Court seemed to clearly think was a "good reason" why successor liability shouldn't apply. However, the buyer in *Teed* didn't make such an argument said the Court—and it didn't in fact discount what it paid for the assets on account of the FLSA claim.

The Court went on to consider whether successor liability might complicate things for an insolvent company if the employees "seeing the handwriting on the wall. . . might decide to file a flurry of lawsuits, whether or not well grounded, hoping to substitute a solvent acquirer for their employer," something that might "scare off prospective buyers of the assets". While indicating this "would be another good reason for denying successor liability" the Court noted there was no suggestion that such a thing had occurred in the case before it. Finally, the Court mused that imposing successor liability might cause companies to

consider piecemeal liquidation of their assets, rather than sales as a going concern. However, the Court brushed this argument aside in fairly perfunctory fashion as a "theoretical rather than practical objection", apparently concluding that such a possibility did not constitute a "good reason" to avoid the application of successor liability.

In this broad context, a question exists as to whether or not the result in *Teed* would have been different if the sale had been completed in a bankruptcy proceeding, and was evidenced by an order entered under Section 363(f) of the Bankruptcy Code authorizing the sale of the assets "free and clear of all liens, claims and encumbrances" and specifically providing (as do most bankruptcy court orders in such contexts) that the buyer would not be deemed a successor of the seller, and have no liability for successor liability claims. While Teed does not answer this question, and suggests a tension between the competing policies addressed in federal labor law and federal bankruptcy law, at least one case (cited in the *Teed* opinion) tips this balance in favor of bankruptcy law, concluding that a sale under Section 363 of the Bankruptcy Code can be free of liability for employment discrimination and sex discrimination claims. See *In re TransWorld Airlines, Inc.* 322 F. 3d 283 (3rd Cir. 2003). However, in the Sixth Circuit—which includes Michigan and Tennessee—at least one decided case suggests a possible different result. See, for example, *In re Wolverine Radio Co*. 930 F.2d 1132 (6th Cir. 1991), a case in which the Sixth Circuit Court of Appeals allowed the Michigan Employment Security Commission to apply a chapter 11 debtor's "experience rating" to a party that had bought the debtor's assets "free and clear" in a sale under section 363 of the Bankruptcy Code, noting, as part of its rationale that what was at stake was a "comprehensive federal-state system providing for the security of unemployed workers"—a policy concern not unlike that identified by the Court in *Teed*.

A similar unanswered question flows from the failure of the *Teed* opinion to indicate whether the underlying non-bankruptcy court sale transaction had been approved by a Wisconsin state court, or had been the subject of a state court order of any kind. What are a lender, buyer, and seller to do in the face of this decision when liquidation is imminent, and the parties wish to avoid bankruptcy? Based on the Seventh Circuit's analysis should we now conclude that in a non-bankruptcy court sale of assets in which the tension between competing federal statutes is absent (i.e. a receivership sale, an article 9 sale transaction under the UCC, or a sale under an assignment for the benefit of creditors) the result is that existing claims of the kind described in *Teed* are now another "cost of liquidation" for a lender to bear in an insolvency context? Should we also conclude that employees have been handed a new seat at the table in a wind down situation? Does an asset buyer with knowledge of a pending FLSA claim or other labor related claim have any alternative but to reduce its proposed purchase price for assets by the amount of the potential liability? Teed suggests careful attention to these questions will be necessary in insolvency related sale transactions.

While the insolvency interplay may be yet to fully evolve, the "buyer beware" implications of the Seventh Circuit's holding in *Teed* are clear – when acquiring a company's assets, whether in an insolvency context or otherwise, perform appropriate due diligence to uncover potential violations of federal labor and employment statutes, and be sure to consider how to structure the purchase terms and price accordingly, notwithstanding disclaimers of liability.

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