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Doctrine of Successor Liability:

7th Circuit Expands Federal Standard to FLSA Claim Context

This week we delve into the doctrine of successor liability by way of the recent Seventh Circuit decision *Teed v. Thomas & Betts Power Solutions, L.L.C.*, in which the court of appeals held that the federal common law standard and not state law standards applies in Fair Labor Standards Act (FLSA) cases. The opinion acts both as a meaningful development in FLSA case law but also a very instructive opinion on the doctrine of successor liability in general.

Before we jump into the case, a side note to the opinion is that it was a consolidated opinion for two extremely similar cases that were on appeal. As the opinion was authored by Judge Richard Posner, this quirk of consolidating two cases allowed the judge to add a line that amused your author. The judge wrote, "for simplicity we'll pretend that they are just one suit and that there is just one appeal." Perhaps, it is the caffeine coursing through my veins to keep me going after IU's extremely late sweet sixteen defeat or the excitement that nears as I prepare to complete this post and dash off to watch the NCAA Midwest Regional Semifinals, but Judge Posner beginning an opinion with "we'll pretend" brings a smile to my face. A man known for his legal scholarship and often accused of flippant disregard for the seriousness of some opinions beginning a case with a small phrase reminiscent of child's bedtime story amuses me. But, I digress.

Let us advance to the substance of the opinion.

The case arose when a group of employees of JT Packard & Associates filed suit under the Fair Labor Standards Act (FLSA) seeking compensation for unpaid overtime. After the case was filed, the plaintiffs sought to substitute Thomas & Betts Power Solutions, LLC for JT Packard & Associates. The basis for this attempted substitution is that the parent company of Thomas & Betts had purchased the assets of Packard and placed them into the Thomas & Betts subsidiary. Thomas & Betts resisted this substitution. Nevertheless, the trial judge permitted it to happen and the resulting $500,000 judgment along with costs and attorney fees was against Thomas & Betts and not Packard.

The reason that the trial judge allowed Thomas & Betts to be substituted for Packard was the application of the doctrine of successor liability. In understanding this doctrine you must first realize that "[w]hen a company is sold in an asset sale as opposed to a stock sale, the buyer acquires the company's assets but not necessarily its liabilities[.]" The difference between a stock sale and asset sale may sound complicated, and certainly there are aspects of it that are. However, on the fundamental level it is quite simple. The stock sale of a company is the actual sale of the company itself as each share of stock represents an ownership interest in the company. The asset sale is a sale of only the actual property that is owned by the company. An example to illustrate the point is that a stock sale would be like selling your entire car to someone. An assets sale, on the other hand, would be more like selling the car for parts. The specific strategy and reasons why a company would utilize a stock sale versus an asset sale would be better addressed in a semester long course taught by my old corporate law professor Antony Page. Since we do not have that much time, let it suffice that we know the difference and not worry about the reasoning.

The determination of whether the liabilities flow from the company to the buyer of its assets is determined by the doctrine of successor liability. "Most states limit such liability, with exceptions . . . to sales in which a buyer (the successor) expressly or implicitly assumes the seller's liabilities." One such state that applies this rule is Wisconsin. However, the federal law approach to successor liability is quite different. The "federal common law standard of successor liability . . . is more favorable to plaintiffs[.]" Specifically, the fact that an entity purchasing the assets disclaims successor liability has no impact on application of the doctrine.

The reason I made sure to note that Wisconsin law differs from the federal law is because this case was filed in a Wisconsin federal court. Since Thomas & Betts disclaimed successor liability when it purchased the assets of Packard, were Wisconsin law to apply, there would be no successor liability – plain and simple.

Thus, a major issue in the case was the determination of whether the federal standard or the Wisconsin standard applied.

The court concluded that the federal standard applied. In support of this decision the court looked to why a federal standard was created in other contexts.

> The idea behind having a distinct federal standard applicable to federal labor and employment statutes is that these statutes are intended either to foster labor peace, as in the National Labor Relations Act, or to protect workers' rights, as in Title VII, and that in either type of case the imposition of successor liability will often be necessary to achieve the statutory goals because the workers will often be unable to head off a corporate sale by their employer aimed at extinguishing the employer's liability to them. This logic extends to suits to enforce the Fair Labor Standards Act. "The FLSA was passed to protect workers' standards of living through the regulation of working conditions. 29 U.S.C. § 202. That fundamental purpose is as fully deserving of protection as the labor peace, anti-discrimination, and worker security policies underlying the NLRA, Title VII, 42 U.S.C. § 1981, ERISA, and MPPAA." *Steinbach v. Hubbard*, 51 F.3d 843, 845 (9th Cir. 1995). In the absence of successor liability, a violator of the Act 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 (for such an assumption would reduce the purchase price by imposing a cost on the buyer) and then dissolving. And although it can be argued that imposing successor liability in such a case impedes the operation of the market in companies by increasing the cost to the buyer of a company that may have violated the FLSA, it's not a strong argument. The successor will have been compensated for bearing the liabilities by paying less for the assets it's buying; it will have paid less because the net value of the assets will have been diminished by the associated liabilities.

Since the court determined that the federal standard applied, the next step of the analysis was whether the trial court properly applied the federal standard. To determine whether successor liability attaches to the assets under the federal standard, a court must consider the following factors and balance them to determine application.

> (1) Whether the successor had notice of the pending lawsuit[.]
>
> (2) Whether the predecessor . . . would have been able to provide the

> relief sought in the lawsuit before the sale. . . .
>
> (3) Whether the predecessor could have provided relief after the sale . . . The predecessor's inability to provide relief favors successor liability, as without it the plaintiffs' claim is worthless.
>
> (4) Whether the successor can provide the relief sought in the suit . . . without which successor liability is a phantom (this is a "goes without saying" condition, not usually mentioned).
>
> (5) Whether there is continuity between the operations and work force of the predecessor and the successor . . . which favors successor liability on the theory that nothing really has changed.

After balancing these factors, the court concluded that there was "no good reason to reject successor liability in this case[.]" The court also went on to state that application of successor liability is "the default rule in suits to enforce federal labor or employment laws. (For remember that the successor's disclaimer of liability is not a good reason in such a case.)"

This decision not only provides a terrific analysis of the federal standard for applying the doctrine of successor liability, but it also provides a road map for expanding the federal standard to any claim based upon a federal labor or employment statue. Moreover, it stands as the first circuit court opinion to have expanded the federal standard into the FLSA context.

Join us again next time for further discussion of developments in the law.

<u>Sources</u>

- *Teed v. Thomas & Betts Power Solutions, L.L.C.*, ___ F.3d ___, Nos. 12-2440, 12-3029 (7th Cir. Mar. 26, 2013).
- 29 U.S.C. chapter 8 – Fair Labor Standards Act.

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