

April 11, 2013

Buyer Beware: Seventh Circuit Upholds Application of the Federal Common Law Standard of Successor Liability in an Asset Sale

One of the benefits to structuring an acquisition as an asset deal is that the buyer has the ability to choose the liabilities that it will assume and the liabilities that will remain with the seller, including contingent liabilities. After closing, any assumed liabilities become the obligations of the buyer (as the seller's successor), but the liabilities that the buyer did not assume remain the obligations of the seller. Most state laws limit successor liability in asset deals to those sales where the buyer "expressly or implicitly assumes the seller's liabilities."^[1] A recent Seventh Circuit ruling, however, has raised doubt about a buyer's ability to leave certain liabilities behind with the seller. The case is a reminder that, in certain situations, a buyer may be liable under federal common law for a successor liability claim even though it would not be liable for such claim under applicable state law. The case is particularly concerning because the buyer had expressly excluded the seller liabilities in question in the purchase agreement.

Teed v. Thomas & Betts Power Solutions, L.L.C.

In *Teed v. Thomas & Betts Power Solutions, L.L.C.* ("**Teed**"), the United States Court of Appeals for the Seventh Circuit (the "**Seventh Circuit**"), in an opinion authored by the influential Judge Richard A. Posner, held that the federal common law standard of successor liability, which is much more favorable to plaintiffs than the state law standard, controls in suits brought under the nation's leading wage law, the Fair Labor Standards Act (the "**FLSA**").^[2] *Teed* involved JT Packard & Associates (the "**Company**") whose assets were held in receivership and sold at an auction to the highest bidder (the "**Buyer**").^[3] The purchase agreement provided that the Buyer was acquiring the assets "free and clear of all Liabilities" and further excluded any liabilities that the Company may have had relating to employment claims for overtime pay under the FLSA.^[4] Notwithstanding what seemed to be clear language, the United States District Court for the Western District of Wisconsin (the "**District Court**") found the Buyer liable for the Company's FLSA liabilities by applying the federal common law standard of successor liability rather than Wisconsin state law, which would likely have precluded successor liability because of the Buyer's express disclaimers. The Seventh Circuit affirmed the District Court's decision, reasoning that "successor liability is appropriate in suits to enforce federal labor or employment laws—even when the successor disclaimed liability when it acquired the assets in question—unless there are good reasons to withhold such liability."^[5] In fact, the Seventh Circuit went on to state that even an express "disclaimer of successor liability is not a defense" when the liability is based on a violation of federal labor or employment laws.^[6] In reaching such conclusion, the Seventh Circuit utilized the following five-factor test to determine whether the Buyer was liable under the federal common law standard of successor liability:

April 11, 2013

- 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;
- 4) Whether the successor can provide the relief sought in the suit; and
- 5) Whether there is continuity between the operations and work force of the predecessor and the successor.^[7]

Practice Considerations

While future buyers may wish to argue that the Seventh Circuit's decision is limited to FLSA cases, the court's repeated use of the phrase "federal labor or employment laws" suggests otherwise.^[8] Whether the Seventh Circuit's ruling will be reviewed or even appealed remains to be seen. Even if *Teed* is reversed or if other courts refuse to apply it, the Seventh Circuit's analysis is a reminder of the importance of a thorough due diligence analysis so buyers know what they are buying and understand the impact of both the assumed and excluded liabilities. While successor liability has always loomed as a state law possibility in an asset sale context, buyers of assets must be mindful that *Teed* arguably increases the likelihood of successor liability in the context of certain federal labor and employment liabilities, particularly to the extent those liabilities were known to the buyer prior to closing. Accordingly, buyers who are aware of any current, alleged, or potential federal labor or employment claims should seek protections from such liabilities in the form of a purchase price reduction or indemnification from the seller because, as demonstrated in *Teed*, merely disclaiming those liabilities is not enough if the federal common law standard is applied.

[1] *Teed v. Thomas & Betts Power Solutions, L.L.C.*, Nos. 12-2440, 12-3029, 2013 WL 1197861, at *1 (7th Cir. Mar. 26, 2013).

[2] *Id.*

[3] It should be noted that the *Teed* case is actually an appeal of two related suits for overtime pay under the FLSA, but the Seventh Circuit's opinion treats the two suits as one suit for purposes of the appeal. *Id.*

[4] *Id.* at *2.

[5] *Id.* at *3.

[6] *Id.* at *1.

[7] *Id.* at *2-3.

[8] See *id.* at *3, *6.

April 11, 2013

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