Employer Successor Liability in Asset Sales: Exclusion Provisions Are No Shield
Assessing Exposure by Navigating the Courts' Balancing Test, Privity and Notice Requirements

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Successor Liability in Labor & Employment Law Claims
Balancing Test and Nine Factors

In determining whether the imposition of successor liability is appropriate, courts should consider:

1. the interests of the (putative successor) defendant employer;
2. the interests of the plaintiff employee; and
3. the goals of federal policy in light of the particular facts of a case and the particular legal obligation at issue.

Balancing Test and Nine Factors

In helping to ascertain the above three prong balancing approach, courts should also consider:

1. Whether new employer had notice of charge or claim before acquisition of business;
2. The ability of the predecessor to provide relief;
3. Whether there has been substantial continuity of the same business operations;
4. Whether new employer uses the same plant;
5. Whether new employer uses substantially the same workforce;
6. Whether new employer uses substantially the same supervisory personnel;
7. Whether the same jobs exist under substantially similar working conditions;
8. Whether new employer uses substantially the same machinery, equipment, and production methods; and
9. Whether new employer produces or offers substantially the same product or service.

Privity Requirement

Some courts have explicitly or implicitly indicated that there should be a separate and distinct factor considered in addition to the nine MacMillan factors when analyzing the propriety of imposing liability on a successor; namely, whether privity exists between the predecessor and successor.
Privity Requirement (Continued)

I. Cases that suggest that privity must always be shown as a condition precedent to imposing successor liability.

*Whitmore v. O’Connor Management, Inc.*, 156 F.3d 796, 799 (8th Cir. 1998).

Plaintiff could show no sale of a business between the predecessor and successor. Instead, the successor entity took over the management of a food court at a shopping mall where the plaintiff had worked for the predecessor … also no notice.

*Domínguez v. Hotel, Motel, Restaurant & Miscell. Bartenders Union*, 674 F.2d 732, 733 (8th Cir. 1982).

Eighth Circuit refrained from imposing successor liability where the successor had purchased the business at a public foreclosure sale … also no notice.
Privity Requirement (Continued)

*Coffman v. Chugach Support Services, Inc.*, 411 F.3d 1231, 1237-1238 (11th Cir. 2005).

Eleventh Circuit stated unequivocally that the plaintiff must show “a merger or transfer of assets” between a predecessor and potential successor before successor liability could even conceivably be imposed -- at least in USERRA cases.
Privity Requirement (Continued)

Continued efficacy of *Coffman* is in question because it was decided before the effective date of the U.S. Department of Labor’s issuance of USERRA regulations which specifically address successor liability and which at least one district court has found eliminates any need to establish privity as a prerequisite to imposing successor liability.

Therefore, the foregoing cases stand for the proposition that companies acquiring a business and/or its employees from a predecessor without ever entering into negotiation for those assets (through, for example, competitive bidding for a service contract as in Whitmore and Coffman) or entering into some manner of contractual privity to obtain the assets may be able to avoid a finding of successor liability.
Privity Requirement (Continued)

II. The Sixth Circuit’s *Cobb* ruling indicates that privity is not always a condition precedent to imposing successor liability.

In mid-2006, the Sixth Circuit had occasion to revisit its seminal *MacMillan* holding and address successor liability issues in the context of a FMLA claim including the issue of whether a showing of privity between two employers is always a condition precedent to imposing successor liability under the FMLA and other labor and employment law claims. *Cobb v. Contract Transport, Inc.*, 452 F.3d 543, 551 (6th Cir. 2006).

Sixth Circuit found that the defendant was a successor in interest, and stated significantly: “[W]e decline to hold...that a merger or transfer of assets is always a precondition to successor liability.” *Id.*
While privity was not a required condition precedent in the FMLA case before the Court it stated it could be relevant to other types of claims such as Title VII actions under appropriate circumstances. *Id.* at 555-556. Such circumstances may arise when a court is addressing whether imposing successor liability is equitable in the context of liability for past discrimination or unfair labor practices of a predecessor because the value of the predecessor’s assets is presumed to have increased from the illegal conduct of the predecessor which would benefit a successor. The successor, assuming it has notice of the past activity, would then be able to negotiate a lower purchase price or indemnity clause to protect itself from a potential plaintiff’s future claim. *Id.*
Privity Requirement (Continued)

*Cobb* leaves for further consideration the potential privity-related issues of (1) government employment environments where there is rarely a “sale” or other form of “privity” in the traditional private employer sense but perhaps an “acquisition” in instances of elected officials “acquiring” existing staff thereby establishing sufficient continuity to impose successor liability;
Privity Requirement (Continued)

see Jolliffee v. Mitchell, 971 F. Supp. 1039, 1041-1043 (W.D. Va. 1997) (Deputy filed FMLA claim against successor sheriff and court ruled that due to the “substantial continuity” of the employment relationship between the predecessor and successor sheriffs and the deputy, the successor sheriff was a successor in interest for purposes of FMLA liability assuming deputy could prove eligibility for FMLA leave such as having suffered a serious health condition, et al.) see also Briggs v. Waters, 2006 WL 2861619 *4 (E.D. Va. 2006) citing United States v. Gregory, 871 F.2d 1239, 1246 (4th Cir. 1989) and King v. McMillan, 2006 WL 2126279 *2 (W.D. Va. 2006) (Title VII cases in governmental setting), and
Privity Requirement (Continued)

(2) the impact of bankruptcy proceedings as discussed later in this presentation. Practitioners should consider these open questions since each factual situation and the equities involved therein will impact a court’s successor liability analysis.
Notice

Some courts view the “notice” factor as being a threshold matter before considering the balancing test and other sub-factors discussed earlier. The Sixth Circuit followed its seminal *MacMillan* decision with two opinions that modified and restricted the scope of applicability of the successor liability factors enunciated in that case. Specifically, the Sixth Circuit reviewed and affirmed a trial court’s decision to refrain from applying the *MacMillan* factors in a class action alleging race discrimination under Title VII that was brought against a potential successor.
The Sixth approved of the trial court’s findings that there was “…no evidence in the record that charges of employment discrimination had been filed against [the predecessor employer] Viking Freight Company…and that there was likewise no evidence that…claims of employment discrimination, if any, against Viking were known to [the successor] Spector at the time it acquired Viking.” Id. The Sixth indicated that such findings “remove this case from the rationale of MacMillan…and under these circumstances, the District Court did not err in refusing to hold [the successor] Spector liable for any unlawful discrimination which may have been practiced by [the predecessor] Viking.” Id.
Notice (Continued)

The Sixth Circuit then reaffirmed its holding in Wiggins in the context of a Title VII sexual harassment and gender discrimination claim. Rabidue v. Osceola Refining Company, a Division of Texas-American Petrochemicals, Inc., 805 F.2d 611, 616 (6th Cir. 1986) overruled on other grounds Harris v. Forklift Systems, Inc., 510 U.S. 17 (1993). In Rabidue, the Sixth stated that the Wiggins decision stands for the proposition that the MacMillan balancing test is appropriate “with the caveat that upon a factual finding that (1) charges of discrimination had not been filed with the EEOC at or before the time of acquisition, and (2) the successor had no notice of contingent charges of discrimination at or before the time of acquisition, the case [is] removed from the rationale of MacMillan and successor liability would not attach, thus relieving the trial court from applying the balancing test mandated by MacMillan.”
In effect, the *Wiggins-Rabidue* cases removed the first prong of the nine *MacMillan* factors (“1. Whether new employer had notice of charge or claim before acquisition of business”) from the balancing test and made that factor an initial hurdle that a claimant must clear before moving on to the balancing of the remaining factors.
Notice (Continued)

Who has the burden of proof as to the notice issue and does the notice need to be “direct” or is “indirect” or “inferred” notice sufficient?
Notice (Continued)

The Sixth Circuit, in the context of a labor relations case, stated that “there is support for the principle that the successor has the burden of proving the lack of any knowledge of a predecessor’s unfair labor practices.” *NLRB v. South Harlan Coal, Inc.*, 844 F.2d 380, 384 (6th Cir. 1988). Moreover, a finding that the successor had “indirect” knowledge of the predecessor’s unfair labor practices is sufficient to justify the imposition of successor liability. *Id.* at 385. The Sixth Circuit cited to the U.S. Supreme Court case of *Golden State Bottling Company, Inc. v. National Labor Relations Board*, 414 U.S. 168 (1973) and explained that based upon the principles articulated in that opinion “knowledge of unfair labor practice litigation need not be actual, but may be inferred from the circumstances.” *Id.*
Notice (Continued)

The Sixth continued: “To hold otherwise would be to permit successors in operations to evade too easily the strong congressional policy in favor of providing remedies for employees harmed by a predecessor’s unfair labor practices. Such evasion cannot succeed simply by denying any actual knowledge of unfair labor practices charges [where there exists] a strong circumstantial evidence basis from which knowledge could reasonably be inferred.” *Id.* at 386.
Bankruptcy

In *Chicago Truck Drivers, Helpers and Warehouse Workers Union (Independent) Pension Fund v. Tasemkin*, 59 F.3d 48 (7th Cir. 1995), the putative predecessor employer Tasemkin Furniture Company, Inc. (“Old Tasemkin”) filed for Chapter 7 bankruptcy protection in an Illinois federal bankruptcy court. *Id.* at 49. However, before filing for bankruptcy, Old Tasemkin had failed to contribute over $300,000.00 to its employees’ pension fund. The employee’s pension fund ("Fund") became aware of the bankruptcy proceeding and attempted but failed to recover on its claim during the bankruptcy proceeding. *Id.*
Bankruptcy (Continued)

Meanwhile, Old Tasemkin entered into a debt compromise agreement with its secured lender and subsequently sold the business assets to another company named Tasemkin, Inc. ("New Tasemkin") which sale was approved by the bankruptcy court. *Id.* The Fund then brought its employee pension claim against New Tasemkin under the successor liability doctrine. *Id.*
Bankruptcy (Continued)

The Seventh Circuit began by articulating the now-familiar standard for successor liability in employment claims which is that a successor may be held liable for claims arising during a predecessor’s control of a particular business if (1) the successor had notice (either actual or inferred under the circumstances) of the employment-related claim before acquisition and (2) there was substantial continuity in the operation of the business before and after the sale. Id. quoting EEOC v. G-K-G, Inc., 39 F.3d 740, 748 (7th Cir. 1994).
Bankruptcy (Continued)

The Court then addressed whether an intervening bankruptcy or other court approved sale of assets is a bar to application of the doctrine. In deciding that such intervening proceedings do not bar the doctrine, the Seventh Circuit rejected the district trial court’s holding that it would “not allow the court-created doctrine of successor liability to preempt the congressionally enacted priority scheme of the Bankruptcy Code.” *Id.* at 50.
The Seventh Circuit noted that the argument against application of the doctrine applied equally to companies “nearing the brink of bankruptcy”:

“The potential for chilling does not vary as a function of a company’s precise degree of distress, and there is no reason to accord purchasers of formally bankrupt entities some special measure of insulation from [successor] liability that is unavailable to ailing but not yet defunct entities. (Of course, it is neither certain nor clear that the chilling effect need give us pause; purchasers can demand a lower price to account for pending liabilities of which they are aware, and under federal successorship principles will not be held responsible for liabilities of which they had no notice.)” Id. at 51.
The Court then rejected the idea that the successorship doctrine frustrates the Bankruptcy Code by allowing some unsecured creditors (such as employees) to leapfrog over others. *Id.* at 51. The Seventh Circuit concluded:

“What the imposition of successor liability would accomplish, and what the district court objected to, would be a second opportunity for a creditor to recover on liabilities after coming away from the bankruptcy proceeding empty-handed. But a second chance is precisely the point of successor liability, and it is not clear why an intervening bankruptcy proceeding, in particular, should have a *per se* preclusive effect on the creditor’s chances.” *Id.*
Other Asset Sales

A company’s insolvency and its impact upon successor liability analysis were also addressed in *Brzozowski v. Correctional Physician Services, Inc.*, 360 F.3d 173 (3rd Cir. 2004). In this case, the plaintiff was employed by Correctional Services, Inc. (putative predecessor - “Correctional”) which supplied medical services to prisoners in several states. *Id.* at 175. The plaintiff filed a charge with the EEOC alleging gender discrimination under Title VII against Correctional. *Id.*
Unbeknownst to the plaintiff, Correctional had agreed to sell its assets to Prison Health Services (putative successor - “Prison”). *Id.* The agreement contained a clause expressly disclaiming Prison from any liability for certain pending lawsuits and EEOC claims. *Id.* The plaintiff later learned of the asset sale during its lawsuit against Correctional and moved to add Prison as an additional defendant under the theory of successor liability. *Id.* A Pennsylvania federal district court denied the motion and the plaintiff appealed. *Id.*
Other Asset Sales (Continued)

The Third Circuit reversed the district court and held that the plaintiff should be permitted to proceed with its case against Prison utilizing the successor liability doctrine for labor and employment law claims. \textit{Id.} at 182. With respect to employment cases, “the doctrine of successor liability applies where the assets of the defendant-employer are transferred to another entity.” \textit{Id.} quoting \textit{Rego v. ARC Water Treatment Co. of Pennsylvania}, 181 F.3d 396, 401 (3\textsuperscript{rd} Cir. 1999).
Other Asset Sales (Continued)

This is especially true where the plaintiff has “no knowledge of the asset sale and no opportunity to protect her claim.” *Id.* at 178. The fact that a putative successor does not take appropriate steps to insulate itself from liability does not make application of the remedial doctrine unfair where the successor has means at its disposal to anticipate such a situation and offset expected costs associated with a plaintiff’s potential claim. *Id.* “[T]he mere substitution of a [financially] responsible defendant for an insolvent one is not a basis for denying successor liability.” *Id.* at 179.
Other Asset Sales (Continued)

More recently, the Third Circuit remanded an employment case to a trial court that had failed to apply the successorship doctrine where a putative successor had purchased the assets of a financially struggling predecessor. In *Einhorn v. M.L. Ruberton Construction Company*, 632 F.3d 89 (3rd Cir. 2011) the Third Circuit concluded:

“In sum, we hold that a purchaser of assets may be liable for a seller's delinquent ERISA fund contributions to vindicate important federal statutory policy where the buyer had notice of the liability prior to the sale and there exists sufficient evidence of continuity of operations between the buyer and seller. The inquiry should be effectuated on a case by case basis balancing the equities presently before the court.” *Id.* at 99.
Other Asset Sales (Continued)

For a cogent explanation of the fundamental difference between a claim or debt that may be dischargeable in bankruptcy and a junior security interest/lien that may be retired in a UCC disposition of collateral, see *Ed Peters Jewelry Co., Inc. v. C&J Jewelry Co., Inc.*, 124 F.3d 252 (1st Cir. 1997).
Interference with Bankruptcy Process

Attempts to influence Bankruptcy Court supervised bidding process sanctioned in *In re: Pan American*.

Practitioners should make careful note of an opinion arising from the Southern District of Florida that assessed a one million dollar ($1,000,000.00) sanction against the National Labor Relations Board (NLRB) in a case where the NLRB had (1) filed a pre-bankruptcy petition Proof of Claim against a financially troubled not-for-profit hospital for back-pay restitution on behalf of a group unionized employees and then after the hospital had filed for bankruptcy protection, (2) filed a Notice of Pendency of Unfair Labor Practice Charges (“Notice”) in the case and then served it on all parties including a cache of entities that had expressed interest in engaging in the Bankruptcy Court approved bidding process to acquire the hospital. *In re: Pan American Hospital Corporation*, 364 B.R. 832, 834 (S.D. Fla. 2007). The Notice warned potential purchasers of potential NLRA successor liability for previous violations of the failing hospital entity. *Id.*
Bankruptcy Interference (Continued)

The Bankruptcy Court found the NLRB to be in civil contempt and in violation of 11 U.S.C. § 362 of the Bankruptcy Code (relating to automatic stays) for filing and serving the post-petition Notice. *Id.* at 839. The court held that the NLRB Notice was served for an “improper purpose” and was intended to chill the 11 U.S.C. § 363 bidding process by inferring that potential successor liability existed and should be considered by bidders while bidding for the failing hospital. *Id.* at 837.
Bankruptcy Interference (Continued)

This case should give counsel pause to consider the possible sanctions that may result from merely asserting or attempting to impute successor liability to potential successors within the context of an active bankruptcy action. While an aggrieved employee could certainly file a pre-petition Proof of Claim for any remedy available under law for a perceived or proven violation of labor and employment law statutes, it would be very risky to circulate any type of post-bankruptcy petition notice seeking to impute successor liability to potential successors for fear that such action may be viewed as an attempt to directly or indirectly influence a Bankruptcy Court supervised bidding process.
Bankruptcy Interference (Continued)

Such employees would be better served by waiting until the bankruptcy process is completed and then ascertaining the identity of the purchaser and applying the principles gleaned from the opinions discussed earlier where some courts have found it appropriate to impose successor liability on a purchaser even though it acquired a business through a bankruptcy proceeding.
CRITICAL QUESTIONS:

• What statute is implicated?

• Does putative successor have any independent knowledge or responsibility?

• Did putative successor learn about potential liability during acquisition?
EMPLOYER DEFENSES/
SUGGESTIONS FOR COUNSEL:

• Focus on equity

• Emphasize impossibility of knowing

• Anticipate by Contract (Indemnity)

• Anticipate in due diligence
Alternatives to Protect Against Successor Liability

• Identifying the issues
• Pricing the deal
• Indemnification
• Insurance
• Bankruptcy Purchase (363 Sale)
Identifying the Issues

• On issues where successor liability possible:
  – Carefully diligence the issues
    • Asset purchases traditionally involve less diligence than stock purchases
    • However, use stock purchase-type diligence for key issues
  – Consider possible extensions of the successor liability doctrine
    • For example, single employer pension plans
  – Have specific exclusions from liability assumption in purchase agreement
  – Get strong reps and warranties
    • Stock purchase-like on these issues
Pricing the Deal

• Diligence also key here
  – Need to know the issues to appropriately price the deal

• Since risk of successor liability is often unknown, can be a real challenge to reach agreement on price adjustment
  – Consider purchase price “holdback” until statute of limitations runs
Indemnification

• Purchase agreements usually provide indemnification for breaches of reps and warranties and/or for imposition of excluded liabilities

• One key issue – is the seller likely to be able to make good on an indemnification promise?
  – Often sellers dissolve after they wind up operations
  – Consider escrow
Insurance

- Seller’s employment claims insurance may not cover successor liability imposed on buyer
- Reps and warranties insurance
  - We have been seeing this much more often in the past few years
  - Carves out “known” exposures – intended to protect against undiscovered risks
  - Can be expensive – often 2-4% of policy limit, typically with significant deductible
- Legal contingency/successor liability insurance
  - Typically covers specific issues identified in diligence
  - Cost varies based on insurance company’s assessment of risk; 4-10% of policy limit is fairly common
Bankruptcy

• Section 363 sale
  – Allows “free and clear” sale of assets to a buyer if:
    • Applicable nonbankruptcy law permits sale of the property free and clear of any interest of the third party;
      – One key issue is what is “property”
      – Courts also generally allow sold assets to be free and clear of all “claims”, which the Bankruptcy Code defines to include any “right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured”
    • The entity holding the [security or other] interest consents;
    • Such interest is a lien and the price at which such property is sold is greater than the aggregate value of all liens on the property;
    • Such interest is in bona fide dispute; or
    • Such entity could be compelled in a proceeding to accept a money satisfaction of its interest
Section 363 Sale Process

• Seller markets assets; selects best bidder to be “stalking horse”
• Bid procedures established to maximize price in auction of assets
• Auction typically 3-4 weeks after bankruptcy court approves bidding procedures
• Highest bidder wins, subject to approval of bankruptcy court
• Sale hearing at court; creditors can object, and judge is required to consider their interests
  – Court order usually has very broad release of claims against the buyer and the seller
• Proper process should shield buyer from successor liability claims
Section 363 Successor Liability – Courts Express Concerns

• In *Morgan Olson L.L.C. v. Frederico (In re Grumman Olson Indus. Inc.)*, 467 B.R. 694 (S.D.N.Y. 2012), the court held that a party was not barred from asserting successor liability claims against the purchaser in a section 363 sale, where the claims at issue arose out of the debtor’s conduct prior to the bankruptcy filing but the claim did not arise until after the bankruptcy (a truck accident based on an allegedly defective product manufactured before the bankruptcy). The court found that the creditors had not received adequate notice of their potential claims in the bankruptcy at issue (because they did not know it existed at the time of the bankruptcy), and taking away their right to seek redress under state law successor liability when they did not have notice or an opportunity to participate in the proceedings would deprive them of due process.
  — Court said risk should be reflected in purchase price
  — Of course, no real indemnification possibility here, as no one to pay it and escrows are uncommon in the bankruptcy process

• Thus, even a bankruptcy purchase is not without successor liability risk