EMPLOYMENT LAWSCENE ALERT: WAGE AND HOUR LIABILITY—THE HIDDEN DANGER IN ASSET ACQUISITIONS

One of the critical keys to a successful asset acquisition is recognizing potential liabilities and negotiating around those liabilities through a well-drafted asset purchase agreement ("APA"). However, certain liabilities that may attach to the buyer following the sale may not be apparent from the seller's balance sheet or from a typical due diligence review—making the risk a hidden liability. One such potential hidden liability in an asset acquisition is the seller's past wage and hour violations under the federal Fair Labor Standards Act ("FLSA"). Even when the potential liability is identified by the buyer and the parties have negotiated contractual terms in the APA for the buyer not to assume such liability, the buyer may still have exposure for such wage claims when it is deemed a successor under federal common law.

Wage and hour claims under the FLSA can result in significant liability to an employer. Most FLSA claims are brought as a collective action (similar to a class action) on behalf of all similarly situated employees which can result in penalties up to double back wages for up to three years for willful violations plus the opportunity for the recovery of attorney's fees. This can oftentimes lead to hundreds of thousands of dollars in liability and even millions of dollars if the collective class is large enough and the violation involves significant underpayment of lawfully required wages. Typical claims under the FLSA include: (i) misclassification of employees as exempt; (ii) failing to pay employees for hours worked such as for travel time, donning and doffing, meals and rest periods; (iii) failure to properly calculate an employee's "regular rate" of pay in the calculation of overtime; and (iv) improperly classifying workers as independent contractors rather than as employees.

Many business people operate under the general assumption that when a company is sold in an asset sale, as opposed to a stock sale, the buyer acquires the company's assets "free and clear" of the seller's liabilities unless expressly or implicitly assumed by the buyer. However, many federal circuit courts have recognized that when liability is based on a violation of a federal statute involving labor relations or employment, then application of successor liability under federal common law is appropriate in suits to enforce federal labor or employment laws, like the FLSA, to prohibit employers who violated those laws from avoiding liability by selling, or otherwise disposing of, their assets and dissolving. For example, we previously addressed in this blog (click here for the post) the Seventh Circuit's decision in *Teed v. Thomas and Betts Power Solutions, L.L.C.* where the Seventh Circuit imposed successor liability upon the buyer in an asset acquisition for the seller's FLSA violations despite language in the APA that expressly disclaimed such liability by the buyer.

Because a buyer could be held liable as a successor for the seller's past wage and hour violations, it is incumbent upon the buyer to perform a thorough due diligence of the seller's compliance with wage and hour laws. If potential wage and hour compliance issues are detected, then the buyer can take necessary steps to protect itself by: (i) drafting appropriate representations and warranties regarding the seller's compliance with labor and employment laws; (ii) shifting the potential obligation back to the seller through a carefully drafted indemnification provision that properly defines "losses" to include all potential liabilities under the FLSA; (iii) either negotiating a reduced basket (a threshold amount of losses or damages the buyer must incur before it is entitled to indemnification from the seller) or excepting any FLSA liability imposed on the seller from the basket; (iv) negotiating an increased escrow fund to cover any potential indemnification obligation created from any past wage and hour liabilities that may be imposed on the buyer as a successor; and (v) negotiating a purchase price adjustment.

Having an experienced law firm with both transactional and employment attorneys on your side who can recognize and address a buyer's potential exposure to FLSA liability can make the difference between a successful acquisition or an acquisition where the buyer is saddled with a liability it never saw coming. Click here to meet your OCHD&L business law team.

BEWARE POTENTIAL EMPLOYMENT SUCCESSOR LIABILITY IN ASSET TRANSACTIONS

With Labor Day in the rearview mirror and the fall M&A deal season now upon us it is important to remember that, while most liabilities can be extinguished in an Asset Purchase Transaction, there are a few liabilities that cannot. This post will focus on one such liability – Federal Employment Liability.

Last spring, the Seventh Circuit, in *Teed v. Thomas and Betts Power Solutions, L.L.C.,* held that certain federal employment liabilities (e.g. ongoing Fair Labor Standards Act (FLSA) litigation) may flow from the seller through the asset purchase to the buyer despite language to the contrary in the purchase agreement.

In *Teed*, the seller was in receivership and embroiled in various FLSA litigation stemming from pre-sale activity. The buyer negotiated a clause in the asset purchase agreement absolving it of liability in this pending litigation and the state court approved the sale of the assets "free and clear of all liens, claims, encumbrances, and other interests of any kind."

After the acquisition, the plaintiffs moved to substitute the seller for the buyer in their

ongoing FLSA cases. The Seventh Circuit determined that because a federal law was at issue, federal common law applied. The federal common law regarding successor liability is not as limited as most state's successor liability laws and, in *Teed*, the court held that the seller was liable under the doctrine of successor liability.

Successor liability is a complicated doctrine, particularly when federal laws are involved or the parties to a transaction are from more than one state. Not only do the successor liability laws vary from state to state, the Federal Circuits all have their own interpretations of it as well. Therefore, it is important to perform thorough due diligence of a target company and hire transactional attorneys who have employment law experience and are able to evaluate whether or not the liabilities can be contracted around or have the potential to attach to the buyer after the transaction is complete so that the proper indemnifications, escrow, or holdbacks can be negotiated into the purchase agreement.

As always, if you have any questions on this topic or employment law in general, please do not hesitate to contact us.