

# One Minute Memo®



## Third Circuit Extends Reach of Potential FLSA Successor Liability

By Andrew Lucano, Marjorie R. Culver and Scott Rabe

Earlier this month, the Third Circuit issued an important ruling in *Thompson v. Real Estate Mortgage Network*, No. 12-3823 (3d Cir. Apr. 3, 2014), joining the Seventh and Ninth Circuits in holding that the federal common law standard should be applied when determining whether a successor entity may be liable for federal wage and hour violations under the Fair Labor Standards Act (“FLSA”) allegedly committed by its predecessor. The import of the ruling is that it now will likely be easier for plaintiffs to assert FLSA claims against a current employer and to hold the current employer liable for violations by its predecessor.

The plaintiff in *Thompson* was hired in June 2009 by defendant Security Atlantic Mortgage Company (“Security Atlantic”). The plaintiff alleged that, in response to an investigation into Security Atlantic, *Thompson* and many of her colleagues were asked by their supervisors to complete new job applications to work for defendant Real Estate Mortgage Network (“REM”), and her employment was subsequently transferred to REM, and she was put on the REM payroll. Security Atlantic subsequently went out of business.

Plaintiff brought FLSA claims on behalf of herself and a collective of employees, alleging, among other things, that REM was liable for FLSA overtime violations committed by Security Atlantic on a theory of successor liability. Defendants moved to dismiss Plaintiff’s complaint, which the District Court granted for failure to state a claim.

The Third Circuit reversed the District Court’s decision, and held, among other things, that the appropriate standard to apply for purposes of determining successor liability under the FLSA is the more lenient federal common law standard as opposed to New Jersey law.

Absent fraud or an express agreement to assume liabilities, most jurisdictions, including New Jersey, will impose successor liability to FLSA claims only where there is a substantial continuity of operations between the predecessor and successor. By ruling that the federal common law applies, the Third Circuit applied “a lower bar to relief than most state jurisprudence” finding that a successor may be found liable as necessary “to protect important employment-related policies.” The Third Circuit explained that courts only need to consider the following factors to assess successor liability under the federal common law standard: (1) continuity of operations and workforce of the successor and predecessor; (2) notice to the successor of its predecessor’s legal obligations; and (3) ability of the predecessor to provide adequate relief directly. While it remains to be seen how this ruling will be interpreted and applied going forward, it is possible that successor liability for FLSA claims may now be found in circumstances where a successor entity simply had knowledge of its predecessor’s FLSA violations or where a predecessor entity is judgment proof.

This decision has major implications for buyers involved in certain acquisitions, such as asset purchases, where buyers customarily rely on the general rule that, unless expressly assumed, successors are generally not responsible for the liabilities of their predecessors. In light of this and similar decisions in the Seventh and Ninth Circuits, buyers will need to be vigilant in their due diligence concerning potential underlying FLSA liability, and make sure that the value of the transaction accounts for the potential transfer of such liability to buyer in connection with the transaction. This is all the more important where there is the possibility that the seller may have insufficient assets, or may otherwise be defunct following the closing of a transaction.

The case also appears to represent a continuation of a trend towards a more relaxed standard for successor liability for FLSA claims generally. As noted above, the Seventh and Ninth Circuits have already adopted the federal common law standard, and it would not be surprising to see other Circuits join suit.

We will be sure to keep you apprised of developments in this area.

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