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Asset Purchases in the 3rd Circuit: Einhorn Precedent and Successor Liability

In a recent 3rd Circuit decision,[1] the court held that an asset purchaser may be liable for a seller's delinquent employee benefit fund contributions where (1) the purchaser had notice of the liability prior to the sale and (2) there exists sufficient continuity of operations between the purchaser and the seller. This ruling should put purchasers on notice that careful due diligence regarding employee benefit matters is required in connection with any asset purchase.

History

In October 2005, M.L. Ruberton Construction Co. ("Ruberton"), a general construction company, purchased the assets of Statewide HiWay Safety, Inc. ("Statewide"), a highway construction company, for $1.6 million. An audit of Statewide's payroll records conducted earlier that year indicated that the company was delinquent by almost $600,000, including liquidated damages in its contributions to two employee benefit funds affiliated with a local Teamsters union (the "Funds"). During the asset purchase negotiations, the delinquency was discussed among the principals but never addressed in the transaction documents.

Prior to closing and in order to settle a legal action by the union, Statewide promised to pay the delinquent contributions and Ruberton agreed to hire union employees. Following the closing, Statewide defaulted on its obligations.

As a result, plaintiff, on behalf of the Funds, sued Ruberton on the basis of successor liability. The District Court of New Jersey granted summary judgment to Ruberton, applying the traditional common law rule that liabilities are not transferred when a company sells its assets. Under the common law rule, the District Court held that Ruberton was not a successor-in-interest to Statewide.

3rd Circuit Decision

The 3rd Circuit reversed the District Court's decision and held that an asset purchaser may be held liable for a seller's delinquent employee fund contributions when the purchaser had notice of the liability prior to the sale and there exists sufficient evidence of continuity of business operations

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For more information, please contact any of the individuals listed below:

Scott Warren Goodman NJ, NY
sgoodman@daypitney.com
(973) 966 8226

Ronald H. Janis NY, NJ
rjanis@daypitney.com
(212) 297 5813
(973) 966 8263

Frank E. Lawatsch, Jr. NY, NJ
flawatsch@daypitney.com
(212) 297 5830

Michael T. Rave NJ
mrave@daypitney.com
(973) 966 8123

Randy K. Rutherford NJ, NY
rrutherford@daypitney.com
(973) 966 8240

Megan K. Tlusty NJ, NY
mtlusty@daypitney.com
(973) 966 8312

between purchaser and seller. The court justified its expanded view of successor liability under the employment-related policies set forth in ERISA.

The court also cited the U.S. Supreme Court's decision in *Golden State Bottling Co. v. NLRB,*[2] in which the Supreme Court held that the purchaser of a business could be held liable for remedying an employee's unlawful discharge when the purchaser had notice of the discharge and continued, without interruption or substantial change, the seller's business operations. As the opinion discusses, a central policy goal underlying ERISA is to protect plan participants and beneficiaries against delinquent contributors. In *Golden State,* the Supreme Court emphasizes the importance of protecting employees who would otherwise not have a remedy against a defunct employer after the sale of that employer's business.[3] Such a policy judgment altered the District Court's balance of equities, leading to an expanded view of successor liability. Absent the imposition of successor liability on Ruberton, beneficiaries of the Funds would have no remedy, contravening the congressional policy regarding ERISA funds. The court reasoned that because successor liability requires notice, a purchaser may be in the best position to remedy an ERISA violation. Once a potential purchaser is aware of an ERISA fund delinquency of a seller, the purchaser can use that potential liability as a bargaining chip when negotiating terms of a purchase agreement.

Although there is no dispute that Ruberton did have notice of the delinquency, the 3rd Circuit Court remanded on the issue of whether there was substantial continuity of the seller's business after the asset purchase, identifying several relevant factors:

- whether the purchaser used the same workforce;
- whether the purchaser used the same equipment and location;
- whether the purchaser completed the seller's work orders; and
- whether the seller and purchaser served the same customers.

Conclusion

As a result of the decision, Ruberton is now exposed to nearly $1 million in potential liability to the Funds. The 3rd Circuit panel pointed out that the expanded theory of successor liability has also been applied in other employment-related contexts in the 3rd Circuit, as well as in the 1st, 2nd, 7th and 9th Circuits. A "federal common law successorship doctrine imposing liability upon successors beyond the confines of the common law rule when necessary to protect important employment-related policies" has been developing.[4]

Asset purchasers (regardless of where located) should carefully conduct due diligence regarding any and all ERISA- and employment-related matters. When potential liability for any employee-related benefit is discovered, it is imperative that the purchaser take action to address that liability. The purchaser should not assume that the liability will remain with the seller, regardless of whether the liability is specifically excluded in the purchase agreement. This is particularly true in cases where the seller is selling all or substantially all its assets, or the seller is in financial distress. Ways that the purchaser could limit its liability include establishing an

escrow in the amount of the liability and/or a specific indemnity clause covering the liability (assuming that the purchaser is satisfied that the seller and/or the owners have sufficient assets to cover the liability). If the purchaser is unable to mitigate its exposure, a reduction in the purchase price or a termination of negotiations may be required.

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[1] *Einhorn v. M.L. Ruberton Constr. Co.,* No. 09-4204, 2011 U.S. App. LEXIS 1171 (3rd Cir., Jan. 21, 2011).

[2] 414 U.S. 168 (1973).

[3] *Id.* at 181.

[4] *Einhorn,* 2011 U.S. App. LEXIS 1171 at *11

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