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Andrew P. Pickering

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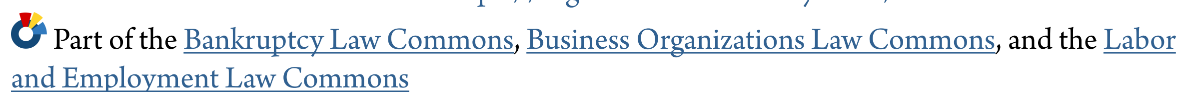
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Steinbach v. Hubbard: Somebody Call an Ambulance! The Fair Labor Standards Act and the Successor Liability Doctrine Have Been Seriously Injured!*

I. INTRODUCTION

Ordinarily, when one company buys the assets of another, the purchaser buys free and clear of the seller's liabilities.[1] One exception to this rule is the federal common law doctrine of successor liability.[2] This doctrine extends the liability of a predecessor entity to its successor where there is a substantial continuity between the operations of the two.[3] Courts have applied the doctrine to extend liability under various provisions of remedial legislation on the grounds that the statutes' underlying policies warranted placing liability on successors to the original offending employers.[4]

The issue of whether successor liability attaches under the Fair Labor Standards Act[5] ("FLSA") was recently addressed by the Ninth Circuit in *Steinbach v. Hubbard*.[6] There, the court

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1. 10 WILLIAM M. FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 4880 (perm. ed. rev. vol. 1993).

2. *See* Chicago Truck Drivers, Helpers & Warehouse Workers Union (Indep.) Pension Fund v. Tasemkin, Inc., 59 F.3d 48, 49 (7th Cir. 1995). The three other exceptions arise when (1) the buyer agrees to assume the seller's liabilities, (2) the transaction amounted to a de facto merger of the two companies, or (3) the transfer was made in bad faith to avoid creditors. 10 FLETCHER, *supra* note 1, § 4880.

3. *See, e.g.*, John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543, 551 (1964).

4. *E.g.*, *id.* (National Labor Relations Act); Upholsterers' Int'l Union Pension Fund v. Artistic Furniture, 920 F.2d 1323 (7th Cir. 1990) (Multiemployer Pension Plan Amendments Act); Criswell v. Delta Air Lines, 868 F.2d 1093 (9th Cir.) (Age Discrimination in Employment Act), *cert. denied*, 489 U.S. 1066 (1989); Trustees for Alaska Laborers-Constr. Indus. Health & Sec. Fund v. Ferrell, 812 F.2d 512 (9th Cir. 1987) (Employee Retirement Income Security Act); Musikiwamba v. ESSI, Inc., 760 F.2d 740 (7th Cir. 1985) (42 U.S.C. § 1981 (1994)); Bates v. Pacific Maritime Ass'n, 744 F.2d 705 (9th Cir. 1984) (Title VII of the Civil Rights Act of 1964).

5. 29 U.S.C. §§ 201-219 (1994).

6. 51 F.3d 843 (9th Cir. 1995). The court noted that it was addressing an issue

ruled that successor liability generally exists under the FLSA, but that it did not attach under the facts presented.[7]

This Note analyzes whether the Ninth Circuit's decision correctly interpreted the successor liability doctrine and whether the decision furthered the aims of the FLSA. Part II examines the history of the FLSA. Part III describes the factual situation in *Steinbach* and the reasoning of the Ninth Circuit panel. Part IV analyzes the test that the court applied in determining if successor liability attached and scrutinizes the court's concerns about imposing successor liability. Part V concludes that the *Steinbach* decision undermines the legitimate policies underlying both the successor liability doctrine and the FLSA.

II. BACKGROUND

A. *The Fair Labor Standards Act*

The Fair Labor Standards Act of 1938 ("FLSA")[8] was created to better the conditions of the American worker.[9] In enacting the FLSA, Congress noted that "labor conditions detrimental to the maintenance of the minimum standard of living necessary for health, efficiency, and general well-being of workers" was having a detrimental effect on interstate commerce.[10] As a result, Congress passed the FLSA to "correct and as rapidly as practicable

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of first impression. *See id.* at 844. However, there are several district court decisions, most of them unpublished, that passed on the question of successor liability under the FLSA. *See* Brock v. LaGrange Equip. Co., 28 Wage & Hour Cas. (BNA) 780 (D. Neb. 1987); Usery v. Broadway Inn, Inc., 23 Wage & Hour Cas. (BNA) 1077 (W.D. Mo. 1978); Durkin v. Hunnicutt, 76 Lab. Cas. (CCH) ¶ 33,219 (S.D. W. Va. 1975); *see also* Carlton v. Interfaith Medical Ctr., 612 F. Supp. 118, 121 n.2 (E.D.N.Y. 1985) (noting that successor liability may be applied to cases involving the Equal Pay Act, a component of the FLSA).

7. *Steinbach*, 51 F.3d at 848.

8. Ch. 676, 52 Stat. 1060 (codified as amended at 29 U.S.C. §§ 201-219).

9. For a more detailed analysis of the FLSA's history and enforcement schemes, see 1 MARK A. ROTHSTEIN ET AL., EMPLOYMENT LAW §§ 4.1-.10 (1994); Clyde Summers, *Effective Remedies for Employment Rights: Preliminary Guidelines and Proposals*, 141 U. PA. L. REV. 457, 491-500 (1992) (reviewing the remedies for various violations of employment laws, including the FLSA); Stephen G. Wood & Mary Anne Q. Wood, *The Fair Labor Standards Act: Recommendations to Improve Compliance*, 1983 UTAH L. REV. 529; *see also* Lora Jo Foo et al., *Worker Protection Compromised: The Fair Labor Standards Act Meets the Bankruptcy Code*, 2 ASIAN PAC. AM. L.J. 38 (1994) (discussing the interplay between the FLSA and the Bankruptcy Code in the context of the "hot goods" provision of the FLSA).

10. Fair Labor Standards Act § 2(a).

to eliminate [those] conditions . . . without substantially curtailing employment or earning power."[11]

Two of the FLSA's main purposes were to establish a minimum wage[12] and to mandate overtime compensation.[13] These provisions may be enforced by the Secretary of Labor or by private plaintiffs.[14] Private plaintiffs may sue for back wages, liquidated damages in an amount equal to back wages owed, and reasonable attorneys' fees.[15] However, certain remedies are only within the province of the Secretary of Labor.[16]

B. Successor Liability

1. In general

The concept of successor liability was first introduced in the workplace by the Supreme Court in *John Wiley & Sons, Inc. v. Livingston*.[17] There, the Court considered successor liability in the context of the National Labor Relations (Wagner) Act ("NLRA").[18] The Court concluded that a successor must bargain with a union that its predecessor had recognized and also arbitrate with that union to the extent that the successor was contractually bound to do so.[19] The Court's holding was premised upon national labor-relations policies that balanced the rights of employers with the "protection [of] employees from a sudden change in the employment relationship."[20]

Subsequent decisions more clearly defined the extent to which successors may be liable in the labor-relations setting. More recently, in *Golden State Bottling Co. v. NLRB*,[21] the Court

11. *Id.* § 2(b).
12. 29 U.S.C. § 206 (1994).
13. *Id.* § 207.
14. *Id.* § 216(b), (c).
15. *Id.* § 216(b).
16. These are injunctive relief against the employer to enjoin future violations, *id.* § 217, and referral to the Department of Justice for criminal prosecution of willful violations, *id.* § 216(a).
17. 376 U.S. 543 (1964).
18. Ch. 372, 49 Stat. 449 (1935). *Wiley* actually dealt with the Labor Management Relations (Taft-Hartley) Act of 1947, ch. 120, 61 Stat. 136 (codified as amended at 29 U.S.C. §§ 141-187 (1994)), which amended and expanded upon the NLRA, but the *Steinbach* court referred to the Act in question as the NLRA. For the sake of clarity, this Note will refer to the Act as the NLRA.
19. *Wiley*, 376 U.S. at 550-51.
20. *Id.* at 549.
21. 414 U.S. 168 (1973).

set forth a two-prong balancing test for determining successor liability. In view of the federal policy in favor of avoiding labor disputes, preserving an employee's NLRA rights, and providing injured employees with a remedy, the Court held that an employer could be held liable as a successor when it (1) was a bona fide successor (i.e., when there was a substantial continuity of business operations from the previous entity to its successor) and (2) had notice of a pending unfair labor practice suit.[22]

Federal circuit courts of appeals have expanded the scope of the successor liability doctrine to include other contexts.[23] Because of this expansion, the notice prong has been modified to require that the successor company have "notice of the charge or pending lawsuit prior to acquiring the business or assets of the predecessor."[24] In addition, a third prong has been added which considers the extent to which a predecessor is able to provide adequate relief.[25]

2. *Prior FLSA cases*

Before the Ninth Circuit decided *Steinbach*, several district courts had determined that successor liability could attach under the FLSA. In one case, a corporation created to replace a partnership which was previously enjoined from violating the FLSA was found to be a successor.[26] Another court found a corporation liable as a successor when, after a bank repossessed the predecessor's assets for failure to pay on a note, the former executives of the predecessor purchased those assets and formed a new corporation in the same line of business with essentially the same workforce.[27] Two other district courts also decided, without deliberation, that the successor liability doctrine applied in the FLSA

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22. *Id.* at 171-72.

23. *See* cases cited *supra* note 4.

24. Musikiwamba v. ESSI, Inc., 760 F.2d 740, 750 (7th Cir. 1985).

25. Criswell v. Delta Air Lines, 868 F.2d 1093, 1094 (9th Cir.), *cert. denied*, 489 U.S. 1066 (1989). The Sixth Circuit provided a nine-factor successor liability test in EEOC v. MacMillan Bloedel Containers, Inc., 503 F.2d 1086, 1094 (6th Cir. 1974), but most of the factors are a part of the "substantial continuity" prong of the *Golden State Bottling* test. Wheeler v. Snyder Buick, Inc., 794 F.2d 1228, 1236 n.7 (7th Cir. 1986).

26. Durkin v. Hunnicutt, 76 Lab. Cas. (CCH) ¶ 33,219 (S.D. W. Va. 1975).

27. Brock v. LaGrange Equip. Co., 28 Wage & Hour Cas. (BNA) 780 (D. Neb. 1987).

context.[28] Against this background, the Ninth Circuit decided *Steinbach v. Hubbard*.[29]

III. *STEINBACH V. HUBBARD*

A. *The Facts*

Steven and Sheila Hubbard ("the individual Hubbards") ran Hubbard Ambulance Services, Inc. ("Hubbard"), a company providing non-emergency ambulance services. In 1987, Hubbard and the individual Hubbards filed for bankruptcy, though Hubbard continued to provide services.[30] In June 1991, the twelve plaintiffs, all former or current employees of Hubbard,[31] filed suit against Hubbard and the individual Hubbards, alleging violations of the FLSA's minimum wage and overtime provisions.[32] Later in the summer of 1991, Care Ambulance Service ("Care") began negotiating with Hubbard over a sale of Hubbard's assets to Care. At one meeting, Hubbard informed two vice presidents of Care of the pending FLSA suit, while also giving the opinion that the suit was meritless.[33]

Hubbard and Care reached an agreement whereby Care would lease Hubbard's assets for one year at $600 per month and employ Steven Hubbard.[34] Care also agreed to buy Hubbard, if the bankruptcy court approved the sale.[35] When the arrangement took effect on October 31, 1991, the ambulance service took on the name of "Hubbard/Care," retaining virtually the same offices, employees, and equipment as Hubbard.[36] Care even made a down payment on its agreement to purchase Hubbard.[37] How-

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28. Carlton v. Interfaith Medical Ctr., 612 F. Supp. 118, 121 n.2 (E.D.N.Y. 1985); Usery v. Broadway Inn, Inc., 23 Wage & Hour Cas. (BNA) 1077, 1078 (W.D. Mo. 1978).

29. 51 F.3d 843 (9th Cir. 1995).

30. *Id.* at 844. The *Steinbach* court did not indicate whether Hubbard was undergoing Chapter 11 (reorganization) or Chapter 7 (liquidation) bankruptcy.

31. *See infra* note 36; *see also infra* note 56.

32. *Steinbach*, 51 F.3d at 844.

33. *Id.*

34. *Id.*

35. *Id.*

36. Hubbard/Care used the same office, retained the operations manager and nine other employees, leased a vehicle from Hubbard Ambulance, and used the same medical equipment. *Id.* at 845. However, only one of the plaintiffs in the action was still working for Hubbard Ambulance at the time of the agreement and was subsequently employed by the "Hubbard/Care" entity. *Id.*

37. *Id.*

ever, the bankruptcy court never approved the sale, and Care terminated its lease with Hubbard in February 1992.[38]

The plaintiffs added Care as a defendant on the theory of successor liability in March 1992.[39] Care moved for summary judgment, and the district court granted the motion.[40] An interlocutory appeal to the Ninth Circuit Court of Appeals followed.[41] The court of appeals affirmed, holding that Care was not liable as a successor to Hubbard.[42]

B. *The Court's Reasoning*

The Ninth Circuit reviewed the history of the successor liability doctrine, including both Supreme Court decisions and extensions of the doctrine by the federal circuit courts of appeals. The court noted that the FLSA's "fundamental purpose" of "protect[ing] workers' standards of living through the regulation of working conditions" was just as deserving of protection as the policies underlying other employment statutes.[43] Further, the court held that the rationale for applying the doctrine to other employment statutes justified application of the doctrine in the FLSA context.[44]

In applying the three-prong test, the court found that the first prong—bona fide successorship—was not met because a permanent transfer of assets between Hubbard and Care never took place.[45] With regard to the notice prong, the court noted that while Care "technically . . . had notice of the existing lawsuits," Hubbard's situation in bankruptcy did not allow for any negotiation for a lower price to allow Care to "protect [itself] against liability."[46] Thus, lack of fairness in the absence of such protection caused the notice prong to fail.

In considering the "adequate relief" prong, the Ninth Circuit cited *Musikiwamba v. ESSI, Inc.*[47] for the proposition that when

38. *Id.*
39. *Id.*
40. *Id.*
41. *Id.*
42. *Id.* at 848.
43. *Id.* at 845.
44. *Steinbach*, 51 F.3d at 847.
45. *See supra* text accompanying notes 34-38.
46. *Id.* at 847.
47. 760 F.2d 740 (7th Cir. 1985).

the predecessor can provide no relief, the public's "substantial interest in the free transfer of capital" should prevail.[48] It is in the interests of the seller, the buyer, and the employees, claimed the court, to allow distressed companies to "find[] suitors" by shopping around for a buyer without exposing the potential buyer to successor liability.[49] Thus, because the public's interest would best be served by allowing the free transfer of capital without imposing successor liability on Care, this prong was not met.[50]

Finally, the Ninth Circuit cited "fairness concerns" in favor of not applying successor liability.[51] The disproportionality of the potential $100,000 in FLSA damages to the $600 per month paid for the three- to four-month duration of the lease and a concern for the potential "windfall" to the plaintiffs caused the court to conclude that successor liability should not be imposed on Care.[52]

IV. ANALYSIS

This Note contends that the *Steinbach* court's decision was erroneous for three reasons. First, the court misapplied the successor liability test; its application of all three prongs was inconsistent with court of appeals precedent. Second, the court misconstrued what impact imposing successor liability would have on the employees of companies in Hubbard's situation. The court believed that employees would be better off if the doctrine were applied sparingly. In fact, the opposite is true. Third, the court misinterpreted the basic policies underlying the FLSA. The court's interpretation of the FLSA undermines the effectiveness of the FLSA.

A. *Applying the Successor Liability Test*

1. *Bona fide successor*

The Ninth Circuit held that Care was not a bona fide successor. Bona fide successorship is found where there has been a "substantial continuity of identity in the business enterprise"

48. *Steinbach*, 51 F.3d at 846.
49. *Id.* at 846-47.
50. *Id.* at 847.
51. *Id.*
52. *Id.*

from the previous entity to its successor.[53] Here, the transfer of assets by Care was not permanent but by a temporary lease, and "[n]o agreement for a permanent transfer [of assets] was ever reached."[54] In all of the previous successor liability cases upon which the plaintiffs relied, only the sale of assets had been implicated, not a lease.[55] Because the transfer was not permanent, the court was not inclined to find that Care bought Hubbard's liability.[56]

Despite the fact that the acquisition was only temporary,[57] imposing liability on an employer such as Care is necessary in order to deter a manipulation of lease status to avoid successor liability. The court's holding may extend to leases a qualified immunity from successor liability in FLSA cases.[58] The holding may then encourage corporations to "lease" all future acquisitions to avoid being held liable for FLSA violations as a successor, leaving uncompensated employees without any kind of remedy. Employer noncompliance with the FLSA is already a serious problem.[59] Noncompliance will not be ameliorated, and indeed may worsen, if corporations can "lease" the employees of a failing

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53. John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543, 551 (1964).

54. *Steinbach*, 51 F.3d at 846.

55. *Id.*

56. Another concern which the panel did not mention but may have weighed into the analysis was the composition of Hubbard/Care's workforce compared to the plaintiffs in the lawsuit. Only one of the plaintiffs in the action was still employed by Hubbard when the lease was executed. *Id.* at 845. The other plaintiffs' attempt to make Care a successor may have been seen as an opportunistic attempt to find a "deep pocket." However, keeping all of the plaintiffs out of court does nothing to preserve the rights of the plaintiff who remained with Hubbard/Care. The court ought to have at least considered that employee's rights before making any such evaluation.

57. If Care's acquisition of Hubbard's assets had been permanent, there is little question that Care would have been a bona fide successor. The continuity required to be held a bona fide successor may be shown when the successor uses the same methods of production, employs substantially the same workforce and supervisory personnel in the same jobs in substantially similar working conditions, and produces the same product. *See* Fall River Dyeing & Finishing Corp. v. NLRB, 482 U.S. 27, 43 (1987). In this case, the business was run out of the same office and used the same equipment, managers, and employees as Hubbard. *Steinbach*, 51 F.3d at 845. The name was even coopted as "Hubbard/Care" ostensibly to assure customers that it was the same operation. *Id.* This level of continuity would be enough to assure that Care would have been found a bona fide successor had it purchased Hubbard's assets.

58. *See id.* at 848 n.1 ("Faced with a longer-term commercial lease, we might conceivably have reached a different conclusion. . . . We adopt no per se rule that all leases create only temporary transfers. Each case must be examined on its facts.")

59. *See* Wood & Wood, *supra* note 9, at 561 ("Noncompliance with the FLSA . . . is a serious problem.").

company for a short time without exposing themselves to successor liability and thereby deprive the employees of any sort of remedy for unpaid wages.[60] For these reasons, the Ninth Circuit ought to have found Care a bona fide successor to Hubbard.[61]

2. Notice of the claims

The *Steinbach* court found that Care did not have notice of the plaintiffs' claims, despite the fact that the individual Hubbards told Care executives about them. The court characterized this disclosure as "technical[] . . . notice."[62] The court argued that, because of the bankruptcy, "Care was in little better position to protect itself" than the plaintiffs because of its inability to negotiate a lower price or an indemnity clause. Since "the principle [sic] reason for the notice requirement is to . . . guarantee[] that a successor had an opportunity to protect against liability by negotiating a lower price or an indemnity clause," fairness required that the notice prong fail.[63]

The court missed the point—Care did, in fact, have "notice of the . . . pending lawsuit prior to acquiring the business or assets of" Hubbard.[64] Hubbard told Care of the suit by the plaintiffs in the course of negotiations.[65] There are no other special policy concerns in the test. By attempting to recharacterize the actual notice as "technical notice,"[66] the court appears to spare

60. *Cf.* Foo et al., *supra* note 9, at 38-40 (discussing problems bankruptcy presents in the context of FLSA "hot goods" provision).

61. It may be argued that one of the earlier FLSA cases, Usery v. Broadway Inn, Inc., 23 Wage & Hour Cas. (BNA) 1077 (W.D. Mo. 1978), supports the holding that Care was not a bona fide successor. However, the facts of that case are clearly distinguishable. In *Broadway Inn*, the court refused to grant summary judgment on the issue of whether a bank that had bought the Broadway Inn at a foreclosure sale was a successor to the Inn's FLSA violations or not, since the bank had sold the Inn after a year to another entity and no longer had an ownership interest. *Id.* at 1078. It is true that in *Steinbach*, Care had only "temporary" control or ownership like the bank in *Broadway Inn*. However, the issue in *Broadway Inn* was whether the bank should be found a successor because someone else now owned the inn. In *Steinbach*, there was no "subsequent owner" who assumed liability for Hubbard Ambulance from Care. The temporary ownership issue from *Broadway Inn* is no defense for Care in this case.

62. *Steinbach*, 51 F.3d at 847.

63. *Id.*

64. Musikiwamba v. ESSI, Inc., 760 F.2d 740, 750 (7th Cir. 1985).

65. *Steinbach*, 51 F.3d at 844.

66. Even a lack of "technical notice" has been held insufficient to absolve a successor of liability. *See* Slack v. Havens, 522 F.2d 1091, 1092, 1095 (9th Cir. 1975) (finding notice in a Title VII action in which the successor corporation was "not

Care from the consequences of such actual notice—that "[a] successor with notice of an existing unfair labor practice charge against the predecessor can be held accountable for remedying these past wrongs."[67]

The court also appeared to have assumed some facts which were not present with regard to the negotiations between Hubbard and Care. The opinion was silent as to whether Care and Hubbard discussed an indemnity clause or considered a "discount" in the anticipated sale price to offset the cost of the FLSA lawsuit. There is merely an assertion that "because of the pending bankruptcy, there was little room for negotiation of protection,"[68] without support from the law or the facts.[69] Thus, the court caught itself in a logical bind: It seems to have presumed that a purchaser such as Care would not reasonably proceed in its purchase of Hubbard without such a provision, yet the court saw fit to protect Care from the possibility that it was "lacking in foresight" to do so. The court should have found that Care had notice sufficient to meet this prong of the test.

3. *Ability of the predecessor to pay*

The *Steinbach* court held that the third prong was also not met in this case. Citing *Musikiwamba v. ESSI, Inc.*[70] to support

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mentioned in the [plaintiffs'] complaint to the [Equal Employment Opportunity Commission], . . . dissolved before [the] suit [was] commenced, [and was] not properly joined in the district court proceedings"; an "absence of technical notice" was not fatal since the successor had a "full and fair opportunity" to defend itself, and "was not prejudiced in any way by a failure to [receive] antecedent notice of the EEOC proceedings").

67. NLRB v. Jarm Enters., 785 F.2d 195, 202 (7th Cir. 1986) (NLRA). The Seventh Circuit went on to say that "[t]he basis for this principle is not focused on the conduct of the successor but rather the need to prevent mere changes in the title to the business from frustrating the national labor policy of remedying unfair labor practices." *Id.*

68. *Steinbach*, 51 F.3d at 847.

69. There is no basis for the court's assertion in the Bankruptcy Code, *see* 11 U.S.C. § 363(b)(1) (1994) (requiring all sales of assets not in the ordinary course of business be approved by the bankruptcy court), and other courts have held to the contrary, *see, e.g.*, Chicago Truck Drivers, Helpers & Warehouse Workers Union (Indep.) Pension Fund v. Tasemkin, Inc. 59 F.3d 48, 50-51 (7th Cir. 1995) ("Of course, it is neither certain nor clear that . . . [the "chilling effect" of successor liability in bankruptcy] 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.").

70. 760 F.2d 740 (7th Cir. 1985).

the proposition that "[i]mposing liability on a successor when a predecessor could have provided no relief whatsoever is likely to severely inhibit the reorganization or transfer of assets of a failing business,"[71] the court found that because "Hubbard might not have had the resources to recompense the plaintiffs prior to the transfer," the situation "further tip[ped] the equities towards Care."[72] Because Hubbard could not pay the claims itself, the court argued, this portion of the successor liability test failed.

The court misinterpreted this third prong. The court defined "the extent to which the predecessor is able to provide adequate relief directly"[73] as meaning that if the predecessor cannot pay, then successor liability should not attach. The *Musikiwamba* court itself, however, clearly stated that "it would be grossly unfair, except in the most exceptional circumstances, to impose successor liability when the predecessor is fully capable of providing relief . . . ."[74] In other words, the successor should be absolved of liability when the predecessor was able to provide relief prior to the acquisition.

In this case, Hubbard filed for bankruptcy before the FLSA lawsuit was commenced.[75] It was unable to provide relief to the plaintiffs prior to the agreement with Care. Thus, it would not be "grossly unfair" to place the burden of furnishing that relief on the party capable of doing so—Care.

In sum, the Ninth Circuit reached the wrong result in finding that Care did not meet any of the three prongs of the successor liability test. It misconstrued the law governing each factor and misapplied the facts of the case.[76] The court's result, how

71. *Id.* at 751.

72. *Steinbach*, 51 F.3d at 847.

73. *Id.* at 846.

74. *Musikiwamba*, 760 F.2d at 750; *see also* Wheeler v. Snyder Buick, Inc., 794 F.2d 1228, 1236 (7th Cir. 1986) (holding the successor not liable when the predecessor was substantially capable of providing relief before the sale of its assets to the successor and the successor was without timely notice); Perma Vinyl Corp., 164 N.L.R.B. 968, 969 (1967) ("[T]he successor who has taken over control of the business . . . is generally in the best position to remedy [the] unfair labor practices most effectively."), *enforced sub nom.* United States Pipe & Foundry Co. v. NLRB, 398 F.2d 544 (5th Cir. 1968).

75. *See Steinbach*, 51 F.3d at 844 (noting that Hubbard filed its bankruptcy petition in 1987, while the FLSA suit was not filed until June 1991).

76. The court may have also been concerned with the validity of the plaintiffs' minimum wage and overtime claims. This fact may be inferred from the court's conspicuous adoption of the following quotation from *Musikiwamba*: "[A]n injured employee should [not] be made better off [by a change in the business]. . . . A company

ever, was also affected by faulty interpretations of the relevant worker protection policies, both in the specific context of bankruptcy, and the more general context of the basic policies underlying the FLSA.

B. *Successor Liability and the Employees of the Bankrupt Predecessor*

In holding that Care was not a bona fide successor, the Ninth Circuit spoke of the policy of protecting the employment status of workers whose company is failing.[77] The court reasoned that if potential successor companies are subject to liability for attempting to salvage a failing company, they will not be interested in keeping the failing company alive and its workers employed. On the other hand, if such successors may "test the waters" to see if they can resuscitate the failing company, the workers' jobs may be more secure. The court, therefore, believed that the best way to protect workers and their continued employment was not to impose successor liability on corporations in Care's position.[78]

The court's analysis fails to take into account the concept of unjust enrichment. If a company such as Care is permitted to try out the failing entity and decide not to purchase it, the testing company has gained the use of the employees of the ailing company and the benefits of any FLSA violations without having to pay for them.[79] In addition, the realities of bankruptcy dictate

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on the verge of bankruptcy may find itself deluged with meretricious claims . . . as employees see the prospect of a deep-pocket to provide relief." 760 F.2d at 750-51. These statements arguably show some hostility by the court towards the plaintiffs' claims.

If this was a concern, the Ninth Circuit should not even have glanced at the merits of the underlying FLSA claim. The court itself confessed that "[w]hether [Hubbard] in fact did [violate the FLSA] is not at issue in this appeal." *Steinbach*, 51 F.3d at 844. Indeed, the court's glance would have tainted the result. Justice Brennan voiced similar concerns in Warth v. Seldin, 422 U.S. 490 (1975):

> While the Court gives lip service to the principle, oft repeated in recent years, that "standing in no way depends on the merits of the plaintiff's contention that particular conduct is illegal," in fact the opinion . . . can be explained only by an indefensible hostility to the claim on the merits.

Id. at 520 (Brennan, J., dissenting) (footnote and internal citation omitted).

77. *Steinbach*, 51 F.3d at 847.

78. *Id.* at 847.

79. *See* EEOC v. MacMillan Bloedel Containers, Inc., 503 F.2d 1086, 1092 (6th Cir. 1974) ("It is to be emphasized that the equities of the matter favor successor

that employees of a bankrupt company, such as Hubbard, will probably not be paid.[80] The FLSA was designed to prevent unjust enrichment, not promote it. Congress found that interstate commerce and the national economy were burdened by workers not being paid the wages due them.[81] The national interest in preventing this sort of burden should be at least as important in the calculus of determining liability as the nation's interest in the free flow of capital.

The Seventh Circuit has ably responded to the *Steinbach* court's fears about "[d]istressed companies like Hubbard" not having "an easy time finding suitors"[82] in *Chicago Truck Drivers, Helpers & Warehouse Workers Union (Independent) Pension Fund v. Tasemkin, Inc.*[83] There, the predecessor company had incurred substantial liability for delinquent pension fund payments under the Employee Retirement Income Security Act and had gone into Chapter 7 bankruptcy.[84] The pension fund unsuccessfully attempted to recover its claim on behalf of its beneficiaries. The predecessor then transferred its interest in a debt compromise agreement with its secured lender to a successor company with virtually the same identity, leaving the bankruptcy

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liability because it is the successor who has benefited from the discriminatory employment practices of its predecessor."); Perma Vinyl Corp., 164 N.L.R.B. 968, 969 (1967) ("The imposition of . . . [successor liability] upon even the bona fide purchaser does not work an unfair hardship upon him. When he substituted himself in the place of the perpetrator of the unfair labor practices, he became the beneficiary of the unremedied unfair labor practices."), *enforced sub nom.* United States Pipe & Foundry Co. v. NLRB, 398 F.2d 544 (5th Cir. 1968). *But see* Claiborne Barksdale, *Successor Liability Under the National Labor Relations Act and Title VII*, 54 TEX. L. REV. 707, 716 n.55, 730 (1976) (arguing that successors do not automatically benefit from the illegal practices of the predecessor unless the successor commits the same practices, and that "*MacMillan Bloedel* inappropriately emphasizes a merely hypothetical benefit" without any sort of supporting analysis).

80. *See* Foo et al., *supra* note 9, at 40-41 (noting that employees due back wages under the FLSA are unsecured creditors and in all likelihood will never be paid). If there are still assets after secured creditors are paid, unpaid employees do stand a chance of being paid, since they have a high priority among unsecured creditors. *See* 11 U.S.C. § 507(a) (1994); 3 ROY BABITT ET AL., COLLIER ON BANKRUPTCY ¶ 507.04 (15th ed. 1995).

81. *See* Fair Labor Standards Act § 2(a).

82. *Steinbach*, 51 F.3d at 847.

83. 59 F.3d 48 (7th Cir. 1995). *Chicago Truck Drivers* was concerned with successor liability under the Multiemployer Pension Plan Amendments Act, but its reasoning is equally applicable here.

84. *Id.* at 49.

estate and all remaining creditors with nothing.[85] The pension fund then sued the successor company under a theory of successor liability.[86]

In holding that the successor company was liable, the Seventh Circuit noted *Steinbach*'s concern that "[f]ear of successor liability . . . would 'chill' sales in bankruptcy and as a result harm employees of the failed concern who might have retained jobs with the successor business."[87] The *Chicago Truck Drivers* court, however, countered the scenario presented by the *Steinbach* court:

> 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 the purchasers of formally bankrupt entities some special measure of insulation from 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.)[88]

Thus, the Ninth Circuit's concerns about the "chilling effect" of successor liability are not universally recognized.

The *Steinbach* court's uneasiness is further undermined by one of the primary purposes of bankruptcy: "[T]o obtain for the Nation the fruits of American enterprise."[89] As one commentator has argued, "[o]ne way to ensure that the fruits of American enterprise are enjoyed is to ensure that American laborers are paid their rightful wages. Thus, the reorganization policy [of Chapter 11 under the Bankruptcy Code] practically mandates that the rights of workers to their wages be accorded the utmost priority."[90] The portion of capital in the economy derived from workers' wages is surely as deserving of protection as that of corporate America.

85. *Id.*
86. *Id.*
87. *Id.* at 50.
88. *Id.* at 50-51.
89. MARTIN J. BIENENSTOCK, BANKRUPTCY REORGANIZATION 1 (1987).
90. Foo et al., *supra* note 9, at 41 n.27.

Thus, the *Steinbach* court mistakenly assumed that not imposing successor liability would help the employees of a bankrupt company in the long run, even if making successors liable would be the only way to insure that employees of failing companies get paid. The feared "chilling effect" of successor liability is not certain, and bankruptcy ought to protect all of the "fruits of American enterprise." The court's analysis was similarly flawed when it considered the basic policies behind tbe FLSA.

C. The Policies Behind the FLSA

In addition to interpreting the worker protection policies in the bankruptcy context, the Ninth Circuit also examined the purposes and policies underlying the FLSA in its decision not to impose successor liability on Care. Noting that successor liability had been introduced "in order to vindicate important statutory policies favoring employee protection,"[91] the court reasoned that "the policies underlying the FLSA can best be effectuated by seeing to it that violations are remedied *in as many cases as possible*,"[92] although not necessarily in all of them.

In so reasoning, the court slighted the purposes and policies of the FLSA in favor of protecting business entities. When Congress passed the FLSA, it intended the FLSA to eliminate "labor conditions detrimental to the maintenance of the minimum standard of living necessary for health, efficiency, and general wellbeing of workers" without excessively harming the employer.[93] Moreover, the Supreme Court has admonished the courts to ensure these worthy policies by not being miserly in their interpretation of the FLSA:

> [The] provisions . . . of the Fair Labor Standards Act are remedial and humanitarian in purpose. We are not here dealing with mere chattels or articles of trade but with the rights of those who toil, of those who sacrifice a full measure of their freedom and talents to the use and profit of others. Those are the rights that Congress has specially legislated to protect. Such a statute must not be interpreted or applied in a narrow, grudging manner.[94]

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91. Steinbach v. Hubbard, 51 F.3d 843, 845 (9th Cir. 1995).
92. *Id.* at 846 (emphasis added).
93. *See* Fair Labor Standards Act § 2.
94. Tennessee Coal, Iron & R.R. v. Muscoda Local No. 123, 321 U.S. 590, 597

The Supreme Court has also held that exemptions from FLSA coverage are to be construed narrowly against the employer.[95] Thus, the policies underlying the FLSA indicate that protecting employees' wage rights by broadly applying the FLSA's coverage is appropriate.

The *Steinbach* court's reasoning arguably made the employees' FLSA interests subservient to the employer's interests in protecting the "free transfer of capital."[96] The reason that the doctrine of successor liability was originally imposed, however, was to vindicate important national interests in avoiding labor unrest and "protect[ing] . . . employees from a sudden change in the employment relationship."[97] Because "successor liability is [to be] liberally imposed"[98] and imposition of FLSA liability will not substantially damage an employer, the policies underlying the FLSA lend support to applying successor liability to Care and corporations in a similar position and to avoid applying such coverage "in a narrow, grudging manner."[99]

Furthermore, imposing liability on employers such as Care is imperative in order to deter repeated violations of the FLSA. Current enforcement procedures are less than adequate for deterring FLSA violations by employers.[100] Few violations are dis

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(1944); *cf.* Wheeler v. Snyder Buick, Inc., 794 F.2d 1228, 1237 (7th Cir. 1986) ("[V]indication of the Congressional purpose to diminish substantially, if not to eliminate, discrimination in employment [under Title VII] justified not only the importation of the common law concept of successor liability, but liberalization of that concept in favor of victims of discrimination in employment.").

95. Arnold v. Ben Kanowsky, Inc., 361 U.S. 388, 392 (1960) ("We have held that . . . [exemptions from coverage under the FLSA] are to be narrowly construed against the employers seeking to assert them and their application limited to those establishments plainly and unmistakably within their terms and spirit." (citing Mitchell v. Kentucky Fin. Co., 359 U.S. 290, 294 (1959))); *see also* Fennell v. TLB Plastics Corp., No. 84 CIV.8775(LLS), 1989 WL 88717 at *2 (S.D.N.Y. July 28, 1989) ("Successor liability is liberally imposed." (citing Fall River Dyeing & Finishing Corp. v. NLRB, 482 U.S. 27 (1987))).

96. *Steinbach*, 51 F.3d at 847.

97. John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543, 549 (1964).

98. *Fennell*, No. 84 CIV.8775(LLS), 1989 WL 88717 at *2 (citing Fall River Dyeing & Finishing Corp. v. NLRB, 482 U.S. 27 (1987)).

99. Tennessee Coal, Iron & R.R. v. Muscoda Local No. 123, 321 U.S. 590, 597 (1944).

100. *See* Summers, *supra* note 9, at 499 ("Individual suits . . . do not in fact provide an adequate remedy or a substantial deterrence."); Wood & Wood, *supra* note 9, at 561 ("Noncompliance with the FLSA . . . is a serious problem."). For several excellent recommendations for sorely-needed changes to the FLSA that will further

covered,[101] settlements and damages awarded are generally inadequate,[102] and "[i]n practical terms, individual suits border on irrelevancy."[103] The epidemic of violations cannot be slowed if a company such as Care may avoid liability for unpaid wages by "leasing" the employees of an ailing company for a short time and availing itself of their labor. This is no less true where the failing company is bankrupt, or nearly so.[104] This is no way to vindicate the basic policies and purposes of the FLSA.[105]

To summarize, the Ninth Circuit misconstrued the policies that underlie the FLSA in *Steinbach*. These policies favor more vigorous protection of employees' wage rights than the court recognized. Deterring violations of the FLSA should be acknowledged as a valid concern in determining successor liability.

V. CONCLUSION

In deciding *Steinbach*, the Ninth Circuit has seriously harmed the doctrine of successor liability. By establishing that

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deter violations, see *id.* at 561-70.

101. *See* Summers, *supra* note 9, at 492 ("It is estimated that the Department of Labor discovers only one-fifth of all underpayments.").

102. *Id.* at 493-94 ("Inadequate settlements [between the Department of Labor and offending employers] are [frequently] accepted . . . . [C]ases often are settled for a portion of the wages due or are abandoned entirely." (footnotes omitted)); *id.* at 497 ("[I]ndividual claims are customarily small. The average minimum pay claim is less than $200 and the average overtime claim is less than $400. . . . [T]he claims are often not sufficiently large to lead an employee to bring suit . . . .").

103. *Id.* at 499.

104. For a commentary on the hardships that bankruptcy can work on employees, see Foo et al., *supra* note 9, at 38-40.

105. The court may have also been concerned about the size of any potential damage award that would have been imposed on Care had it been found a successor. The court mentioned that the potential liability for Care was over $100,000. Steinbach v. Hubbard, 51 F.3d 843, 847 (9th Cir. 1995). But statistics governing recovery of FLSA damages suggest that Care probably would not have been hurt in any significant way. *See supra* notes 100-03 and accompanying text. For example, assuming that (1) the figures quoted in note 102, *supra*, are correct, (2) each of the 12 *Steinbach* plaintiffs had both an overtime claim and a minimum pay claim, *see* 51 F.3d at 844, and (3) each plaintiff had an "average claim," then Care's liability would have been about $14,400 (12 plaintiffs x ($200 minimum pay claim + $400 overtime claim) x 2 (liquidated damages equal to the amount of regular damages) = $14,400)—a far cry from the $100,000 figure the court produced. (However, this figure does not take into account any potential award of attorneys' fees under 29 U.S.C. § 206(b).) Thus, any fear of an "aquatic massacre" resulting from a successor entity in the circumstances of this case being held liable under the FLSA for "dipping its toe in the water [to] explor[e] the acquisition of [an ailing company]" is not supported by reality. *Steinbach*, 51 F.3d at 848.

leases may not be a permanent enough form of transfer to trigger successor liability, that form of "acquisition" may become the norm. Indeed, leasing may enable successor companies to easily avoid paying for the mistakes of its predecessor. The notice prong of the successor liability test has also been weakened under *Steinbach*. A court need not consider whether the parties have in fact negotiated the possibility of a lower price or an indemnity clause. Instead, the court may simply assume that no such provision was possible if the company was bankrupt and relegate any actual or "technical" notice to oblivion.

The *Steinbach* decision also has dangerous repercussions for the FLSA. Business considerations now may take precedence over important national policies. Economic efficiency should not be permitted to endanger the aims of the nation and its workers merely because a court may disagree with those aims. To proceed otherwise places employees' rights in peril.

Andrew P. Pickering