

# Paradigm

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# Third Circuit Upholds FLSA Claims Against Successor Entity

In *Thompson v. Real Estate Mortgage Network*, 2014 U.S. App. LEXIS 6150 (3d Cir. April 3, 2014), the Third Circuit Court of Appeals, in a precedential decision, joined the U.S. Courts of Appeals for the Seventh and Ninth Circuits and applied the federal common law standard to evaluate whether the plaintiff sufficiently pleaded a Fair Labor Standards Act (FLSA) successor liability claim against the company that purchased her now defunct employer. Applying this standard, the Third Circuit upheld plaintiff's FLSA claims against the successor entity.

## Background

Patricia Thompson, a New Jersey resident, was hired as a mortgage underwriter by defendant Security Atlantic Mortgage Company ("Security Atlantic"). Shortly thereafter, however, she was assigned to a training class led by a representative for a different mortgage company, defendant Real Estate Mortgage Network (REMN). That employee "represented

that REMN was a sister company of Security Atlantic." In February 2010, allegedly in response to an investigation being conducted by the U.S. Department of Housing and Urban Development (HUD) into Security Atlantic's mortgage practices, Thompson and many of her colleagues were asked by supervisors to fill out new job applications to work for REMN. Thompson completed the application as requested. From roughly that date forward, Thompson's paychecks were issued by REMN. Defendants characterized Security Atlantic, which is no longer in business, as "defunct." Despite Thompson's transfer to REMN, virtually no change occurred in on-site operations. Thompson and her colleagues continued to do the same work at the same location. Thompson's pay rate and direct supervisors remained the same. Thompson alleges that no employees were laid off during this transition, although some of her colleagues continued to receive paychecks from Security Atlantic.

Thompson quit in August 2010, not long after Security Atlantic's Executive

Vice President told her that the company did not pay overtime to underwriters. She filed a lawsuit claiming that throughout her tenure with Security Atlantic and REMN, employees were treated as salaried workers exempt from overtime pay and were required to work more than 40 hours per week, including nights and weekends. In addition, Thompson sought to hold REMN liable for Security Atlantic's own statutory violations under theories of joint liability and successor liability.

## State vs. Federal Law

One issue addressed by the Third Circuit in evaluating whether Thompson sufficiently plead her claims against either defendant was whether REMN, as an alleged successor to Security Atlantic, could be held liable for any wage-and-hour violations committed by its predecessor. In determining that issue of first impression, the Third Circuit examined whether the New Jersey state law test for successor liability applied



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or the less burdensome federal common law approach.

The parties disputed which law governed Thompson's FLSA successor liability claims. Thompson argued that, as to her FLSA claim, the court apply a federal common law standard for successor liability that has slowly gained traction in the field of labor and employment disputes over the years. The federal common law standard requires consideration of the following factors in determining whether successor liability should be imposed: "continuity of operations and work force" from the predecessor to the successor, the successor's notice of the predecessor's legal obligation, and the ability of the predecessor to provide the relief sought. By contrast, under New Jersey law, successor companies are considered legally distinct from their predecessors and do not assume any debts or obligations of the prior entity, except where: (1) the purchasing corporation expressly or impliedly agreed to assume such debts and liabilities; (2) the transaction amounts to a consolidation or merger of the seller and purchaser; (3) the purchasing corporation is merely a continuation of the selling

corporation, or (4) the transaction is entered into fraudulently in order to escape responsibility for such debts and liabilities. The court agreed with Thompson that the federal law applied but found that an issue remained as to whether Thompson's allegations satisfy the federal common law standard in the case at hand.

### **Successor Liability**

Considering the federal standard factors, the court found the allegations were enough to surmount a motion to dismiss under the federal standard. The court held that the first factor was satisfied finding that there was sufficient continuity in the operations and work force when REMN took over Security Atlantic, since essentially all aspects of employment remained the same. Second, while the complaint did not clearly allege facts that show that REMN had knowledge of Security Atlantic's FLSA violations before the transfer, the plaintiff alleged that Security Atlantic's payroll and scheduling was controlled by her supervisors who later became officers of REMN, and after the transfer, the same practices and operations continued under the same management. As to the third factor, the predecessor's "ability . . . to provide

adequate relief directly," defendants have represented that Security Atlantic is now "defunct," which the court interpreted to mean that it is likely incapable of satisfying any award of damages to plaintiff. In total, the Third Circuit found these allegations were enough to surmount a motion to dismiss under the federal standard.

The court also reinstated Thompson's claims under the New Jersey Wage and Hour Law, finding that her allegations satisfied the more restrictive state law standard as well.

### **Implications**

The trend continues for federal courts to embrace a broad view in evaluating the question of whether federal FLSA liability may be imposed upon a successor company. Employers taking on workers through corporate acquisitions or who are faced with acquiring employees from related corporate entities should consider the potential FLSA ramifications. As more federal courts find companies liable under common law successor liability principles for FLSA violations, companies should require strict review of potential successor companies' wage and hour practices for all potential mergers and acquisitions. **P**

