

Buyer Beware: Tenth Circuit Issues Decision Emphasizing Critical Need for Employment Diligence

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A [recent decision](#) from the Tenth Circuit Court of Appeals highlights some of the pitfalls of entering into commercial transactions without conducting thorough employment diligence – even in the asset purchase context.

In 2009, buyer (Roark-Whitten) purchased a hotel. Following the transaction, several employees of the hotel alleged management had discriminated against them. The Equal Employment Opportunity Commission (“EEOC”) filed a complaint against Roark-Whitten, alleging Title VII violations. During the pendency of the EEOC’s complaint, Roark-Whitten sold the hotel to another entity, Jai Hanuman, LLC, which subsequently sold the hotel to another entity, SGI, LLC. For each transaction, the EEOC amended its complaint to name the new owner. Jai Hanuman and SGI moved to dismiss the complaint, arguing they were not liable for any discriminatory conduct as successors. The district court agreed and dismissed the complaint as against them.

On appeal, the Tenth Circuit Court of Appeals reversed, holding SGI could be liable as a successor for liability stemming from the discrimination claims. The EEOC argued the Jai Hanuman-SGI purchase agreement contained language providing that SGI had thirty (30) days to investigate the hotel’s liabilities. The Tenth Circuit agreed, reasoning because the purchase agreement afforded a due diligence period, SGI should have conducted “reasonable and adequate” investigation during its diligence. The Tenth Circuit reasoned that such diligence would have uncovered the lawsuit and its accompanying liabilities. Thus, SGI had constructive notice of the lawsuit and is a successor concerning these liabilities.

The Tenth Circuit’s ruling is a cautionary tale to buyers. Employment-law successor liability is a risk in asset transactions even when purchase agreements contain protective language. While “retained liabilities” and indemnification language may allow a buyer to recover successor liability damages from a seller, such language does not necessarily insulate a buyer from liability prescribed by law.

There are several laws that impose successor liability regardless of the purchase agreement language or whatever ancillary agreements may exist. And, any indemnities are sometimes of no use in the event the seller no longer operates and/or there is no money in escrow to cover such damages. The Tenth Circuit's decision emphasizes the need for buyers, regardless of whether the transaction is an asset or a stock deal, to thoroughly diligence potential employment liabilities.

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