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What's New in Novation?

Discharging Deferred Compensation Obligations Upon Sale of a Business

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This article looks at how the seller of a business might ensure that it rid itself entirely of deferred compensation obligations assumed by the buyer.

The seller can best assure it relinquishes its obligations by obtaining employees' express consent to discharge the seller when the obligations are assumed by the buyer. Assuming this is impossible or impractical, however, the seller can try show that transferred employees gave their implied assent to a discharge of the seller's obligation.

For example, the seller may argue that employees gave their implied consent assent if they accept service with the buyer, with notice that the buyer has assumed the obligation and the seller relinquished them. There is some evidence that this is a good argument under ERISA. But there is almost no ERISA law on point. A look at analogous state law raises only more questions, as state law has developed along two paths. Implied assent will be found more readily under one than

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the other. At this point, it is unclear which path the ERISA law might take. The prudent seller should at the least notify transferred employees that buyer has assumed their obligations, and seller relinquished them. The effectiveness of this notification is not assured. But absent employees' express assent, and until the law develops, it may be as good as the seller can get.

The employer who sells a business may well think it has quit itself of the deferred compensation obligations assumed by the buyer during the deal. We here explore whether this is so—and if so, when.

We discuss this issue in terms of a hypothetical employer (Seller) who plans to sell an ongoing business to Buyer. As part of the deal, Buyer agrees to assume Seller's obligations to pay accrued, vested deferred compensation under an unfunded top hat plan for executives who accept continued employment with Buyer. Some time after the deal, the Buyer becomes insolvent and is unable to pay the vested deferred obligations it assumed. Can the executives transferred to Buyer successfully demand payment from Seller of the obligations that Buyer promised to assume? Standard principles of contract law say that they might.

Under the theories of delegation and assignment, when the obligor in a contract assigns his obligation to a third party, the original obligor retains the obligation, as a surety or guarantor. The original obligor is relieved of the obligation only if the obligee agrees to release the original obligor and substitute the second in his place, in a "novation." A novation is a new contract, and thus must be supported by consideration, be definite, and have the mutual assent of all parties.[1]

If these principles strictly apply, Seller may be on the hook for the deferred compensation obligations assumed by Buyer, should Buyer be unable to pay, unless Seller can show that the executives assented to release Seller from its obligation.

In this article we explore whether and how Seller might discharge itself for good of its vested deferred compensation obligations to employees transferred to Buyer upon the sale of a business. Our organizing scheme is a practical rather than a theoretical one. We look at the question from the point of view of a seller already engaged in sales negotiation. Thus, the issue arises after the deferred compensation document has been drafted executed, obligations thereunder have accrued and vested, but before the deal is final. This is thus organized as a "what do we do now" kind of analysis, rather than a best-of-all-possible worlds analysis.

Our very simple hypothetical is designed to keep the question as narrow as possible. It involves only executive compensation obligation covered by the contract provisions of Title I of ERISA, but not its fiduciary obligations. It ignores excess plans, which are not subject to Title I and are thus subject to state law alone. It ignores the transfer of obli-

gations under a qualified defined benefit plan, subject to the funding rules of the Code and ERISA, and the rules of ERISA Title IV. We also assume that the sale is made in good faith to Buyer who is thought by Seller on the basis of objective evidence to be as creditworthy as Seller at the time of sale.

IS THERE AN ERISA DOCTRINE OF NOVATION?

Our opening question is whether there is an ERISA theory of delegation and novation applicable to the transfer of deferred compensation obligations. The tentative answer is that there seems to be one, although in protean form. A handful of ERISA cases have invoked this theory, although very few have ultimately disposed of any issues under it. Moreover, federal courts looking for more guidance will find some precedent in state case law governing the transfer of deferred compensation obligations upon the sale of a business. In short, the case law is surprisingly sparse under both ERISA and its possible sources in state law, but in both cases seems to point to a yes answer.

ERISA Novation Cases

A few ERISA cases have relied on the theories of delegation and novation to determine whether, upon the sale of a business, the seller remained liable as a guarantor for the vested obligations assumed by buyer.

For example, *United Steelworkers of America Local 2116, v. Cyclops Corp*. 653 F.Supp 574 (S.D. Ohio 1987), *aff'd in part, vacated in part*, 860 F.2d 189 (6th Cir. 1989), involved the seller's transfer of pension obligations pursuant to the sale of a division. Under general contract principles of delegation and novation (which it did not identify more specifically), the district court held that the buyer's assumption of the pension obligations did not relieve the seller of these obligations, because employees did not assent to a novation discharging the seller from its duty. Having set up a common law contract theory, however, the court went on to hold that the seller's obligation was discharged in full by its funding the transferred obligation to the extent required by Code Section 414(l).

Howe v. Varity Corp., 1989 US Dist Lexis 17521 (SD Iowa, 1989), *aff'd on other grounds*, 36 F3d 746 (1994), *aff'd* 516 U.S. 489 (1996), involved the sale of a business to a financially weak buyer, along with the transfer of benefit obligations for both retired employees and those who continued service with the buyer. The district court applied contract law principles to conclude that the seller remained liable to provide benefits for those plaintiffs that accepted employment from the buyer. Under Restatement (Second) of Contracts 381 (1981), the court

held that "… the predecessor's delegation of performance of employee benefit promises to a successor does not bar a claim against the predecessor in the absence of a valid asset by the obligee." Further holding that any assent in this instance was void because obtained fraudulently by the seller's misrepresentations, the court concluded the seller remained liable. [1989 US Dist Lexis 17521, Fn 26.]

Divining an ERISA theory of delegation and novation is made difficult by the tiny number of cases that have addressed it. The difficulty is increased because, even in those cases where the theory is initially applied, its development is stopped by other infirmities of the clam, such as ripeness or the obligation's failure to vest.

For example, development of the *Cyclops* novation theory (and its 414(l) twist) was halted by the Sixth Circuit, which held that the issue was not ripe for adjudication until after default by the buyer. 860 F.2d 189, 196. Following *Cyclops*, the District Court for the District of Columbia also halted a potential novation-and-delegation case under ripeness principles. *Systems Council EM-3 v. AT&T Cor*p., 972 F.Supp. 21 (D.D.C. 1997) (plaintiffs' claim that seller remains secondarily liable for retiree medical benefit obligations assumed by buyer, not ripe for adjudication until buyer refuses payment), *aff'd* 159 F.3d 1376 (DC Cir. 1998).

The *Varity* novation theory was overruled by the Eighth Circuit on the grounds that the benefits in question never vested. Since under straight contract principles the seller could have terminated its obligations at any time, the Eighth Circuit concluded that its retained obligation was similarly nonbinding.[2]

As an aside, we would note that, despite being overruled by the Eight Circuit's vesting theory, the novation theory set forth by the *Varity* district court had an odd final act. As to a small group of retirees who had retired before the sale and never accepted employment with the buyer, the Eighth Circuit held that the seller retained liability for retiree benefit obligations, because of the retirees' failure to assent to a novation with the buyer. 36 F3d 746, 756 (1994), *aff'd on other issues,* 516 U.S. 489 (1996).

This holding is puzzling on its face, as under the Eighth Circuit's reasoning, these benefits too, were terminable at any time by the seller, and never vested, even as to retirees. One can only speculate that, for this small group of individuals, the *Varity* court could find no other avenue of recovery in a case it found egregious, and applied a theory that was otherwise untenable. This piece of *Varity* may be seen as a result-oriented oddity, confined to the facts of that case. The Supreme Court declined to rule on this aspect of the *Varity* opinion, holding that the parties had not sufficiently raised it.

The Sixth Circuit expressly read this aspect of *Varity* as confined to

the "egregious" facts of that case. In *Sengpiel v. B.F. Goodrich Co.*, 156 F.3d 660 (6th Cir. 1998), the Sixth Circuit disagreed with *Varity* on this point, and held that the seller of a business did not remain liable for the nonvested benefits of transferred employees, whether or not they assented to release the seller. The seller did not need participants' consent to transfer obligations, reasoned the court, if it did not need their consent to terminate or amend them.

In short, there is some reason to believe the federal courts will apply theories of delegation and novation under ERISA to the transfer of deferred obligations pursuant to the sale of a business. But the paucity of the case law—and in the case of *Varity*, its oddity—makes its outline difficult to define.

State Law Cases

In fashioning a federal common law of novation under ERISA, the federal courts might also look to how similar questions are decided under state law. They will find that a handful of state law cases address the question of whether, if the seller of a business transfers vested deferred compensation obligations pursuant to the deal, and buyer fails to perform, the seller remains secondarily liable. Those courts that have addressed this issue have tended to apply principles of state contract law, and under these laws have tended to conclude that, absent evidence of employees' actual assent to discharge the seller, there is no novation and the seller remains secondarily liable should buyer fail to perform.

For example, in a case involving the transfer of vested severance pay obligations pursuant to the sale of a business, the Fourth Circuit applied South Carolina contract law to hold that the seller remained primary liable to pay under its own severance policy should the buyer fail to do so when due and owing. [*Livernois v. Warner Lambert Co., Inc.*, 732 F.2d 1148 (4th Cir. 1983).] In a case also involving the transfer of vested severance pay obligations, the Maryland Court of Appeals applied Maryland contract law to hold that the seller's obligation as guarantor had not been discharged by employees' assent to novation with buyer. [*Dahl v. Brunswick Corporation* 277 MD 471, 356 A.2d 221 (1976).] The Supreme Court of Connecticut held that under the contract law of that state, the question of whether employees agreed to novation with a successor employer after sale of business was a triable issue of fact for a jury. The court explained, "Novation requires proof that the one in the position of creditor in this case, the plaintiffs had accepted a new debtor in the place of the defendant to which they would look for fulfillment of the severance pay obligation owing to them." [*Mace v. Conde Nast Publications, Inc.,* 155 Conn. 680, 237 A.2d 360, 361 3634 (1967). *Cf e.g., Clark, Ex'x v. General Cleaning Co.*, 345

Mass 62, 185 NE2d 749 (1962) (applies Massachusetts contract law to determine whether employee assented to discharge of seller's contract obligation upon sale of business).]

ERISA Common Law of Novation: Where Will it Reside?

We have seen there is some evidence of a nascent doctrine of ERISA novation governing the transfer of vested deferred compensation obligations. It can be found in the handful of federal cases that have addressed the question under ERISA. And support for its further development can be found in the few cases that address the transfer of deferred compensation obligations under state law.

But both federal and state case law is so sparse that the outlines of this embryonic ERISA doctrine—if any—are almost impossible to define. And applying it to any one situation is further hindered by the problem that besets any effort to predict the development of the federal common law of ERISA: In any particular case, where will the court decide to look for this federal common law?

In some questions, the federal courts appear to look at ERISA common law as a uniformly applicable law, derivable from all state laws in much the same way as a restatement or other hornbook law. But in others they do not.

For example, consider the ERISA statute of limitations for ERISA actions other than fiduciary breach. In the absence of statutory provision, the courts have fashioned a federal common law statute of limitations. But only a handful of cases have fashioned an exclusive ERISA one. [*See e.g, Meagher v. IAM Pension Plan,* 856 F.2d 1418 (9th Cir. 1988), cert. denied 490 U.S. 1039 (1989).)] Instead, the vast majority of the courts have decided to adopt the most analogous state law in the area where the case is brought. [*Meade v. Pension Appeals and Review Committee*, 966 F.2d 190 (6th Cir. 1992).] We have discussed this—and other puzzles arising from the notion of the federal common law of ERISA in another article.[3]

In the area of novation and delegation, it is not yet clear which avenue the courts will take, and opinions go both ways. For example, *Armbruster v. K-H corp.*, 206 F.Supp.2d 870 (E.D. Mich), involved retiree medical benefits. Because the contract stated that it was be construed under the laws of the state of New York, the *Armbruster* court applied New York contract principles to determine whether retirees assented to substitution of buyer for seller as obligor of retiree medical benefits. In *Varity v. Howe*, by contrast, both the district court and the Eighth Circuit applied the hornbook law of Restatements (Second) of Contracts, to come up with a universal federal common law theory.

For the remainder of this article, we assume a blended or hornbook

ERISA law of novation and delegation. This is purely a necessary convenience in the absence of an actual case where actual state law might have to be considered. The employer and its advisors, of course, would want to consider whether state law should be the guide—and if so, of which state.

APPLYING ERISA: SOME EDUCATED GUESSES

We have seen that the sparse case law indicates that principles of novation and delegation may well apply to transfers of deferred compensation obligations. These principles will apply under the federal common law of ERISA, but where the court will find such law is at this point still a guess.

Given very little guidance, our hypothetical Seller still has to figure out how it can be discharged of its deferred compensation obligations upon the sale of the business. To return to basic principles, the Seller is discharged only if employees assent to a novation with the Buyer. The novation itself must in itself be a valid contract. Thus it must be supported by consideration, it must be determinable and the employee/creditors must assent. [*Trane Co., Div. of American Standard, Inc. v. Whitehurst-Lassen Construction Co*, 881 F.2d 996 (1st Cir. 1989).]

We ignore the problem of definiteness, assuming it can be handled in the agreements.

The issue of consideration is also reasonably easily dealt with, for somewhat more complex reasons. As the deferred compensation is vested and earned, its payment to employees is mere satisfaction of an already-existing duty. Its payment cannot in itself be additional consideration. This would be true whether it were paid by Seller or its delegee, Buyer. But in the novation context, the substitution by the new obligor for the old is in itself consideration. [*Swords Co. v. Hogland*, 278 Ill. App. 611 (Ct Appeals Ill Second Dist. 1935). *Rose Acre Farms, Inc. v. Cone*, 492 N.E.2d 61 (1986) (In discussing whether there had been consideration to support novation as to an accrued vested bonus, held that there was, as "the only thing which validated the substituted bonus and extinguished the old one is that by extinguishing the old debt, it constitutes consideration for the new obligation.")]

But of course whether this substitution of obligors has been effected is the very issue in question. This chicken-and-egg problem is typically solved by looking *first* at whether the obligee assents to the substitution of the new obligor for the old. If the obligee assents, there is a substitution of obligors, and adequate consideration is thereby provided. [*See, e.g., Rose Acre Farms, Inc. v. Cone*, 492 N.E.2d 61 (1986).]

Thus, the practical stumbling block to establishing a novation is ensuring the employees' assent. This assent may be express or implied.

But the assent must specifically discharge Seller. Without assent to the discharge, the employees' assent to the assumption of the obligations by the Buyer is merely acceptance of an additional obligor, with Seller retained as surety.

THE PROBLEM OF ASSENT

Employee's assent to discharge Seller may be express, or implied. Express assent may of course be impossible or impractical to obtain. In this case, Seller will have to rely on implied assent, inferred from employees conduct after sale. We walk through all possible avenues of assent.

Express Assent in the Original Agreement

The first place to look for employees' assent is in the deferred compensation agreement itself, to see if employees empowered Seller to substitute another obligor for itself. This kind of up-front assent is valid. "Assent to a novation may be expressed by a contractor at the time the contract is made, empowering the obligor to substitute another for himself." [Corbin on Contracts § 866, FN 39. *See e.g., Fay v. BAT Holdings*, 646 F. Supp. 946 (1986); *See also Baum v. National Finance Company*, 108 Col 107 (1941) (buyer of apartment heater not bound to pay balance due when purchase agreement stated that upon sale of apartment, any unpaid balance due "shall follow the property and become due from new owner or purchaser" and the apartment was sold).]

For example, from Seller's point of view, a desirable contract provision might say something like this:

The Employee agrees that if she accepts a transfer to another employer (Buyer) pursuant to a disposition of the Company's business assets, the Company will be released from its accrued liabilities to under the agreement, provided that Buyer assumes the liabilities.

Express Assent in a "Successors and Assigns" Clause?

The deferred compensation agreement will probably lack this helpful clause. And in our hypothetical (involving the imminent transfer of vested accrued obligations) it is too late too add one.

Can employees' express assent be read in other parts of the deferred compensation agreement, however? For example, it is not unusual for the a plan to state something like: "Benefits under this plan will be provided by the Company, and its successors or assigns." Is the inclusion of "successors and assigns" sufficient to show employees' express assent

to a substitution of Buyer for Seller's obligation? The answer is mixed at best.

There is some authority for this position cases dealing with a covenant not to compete, signed between an employee on the one hand, and his or her employer and its "successors and assigns." Courts in these cases have found that, when the employer sells its business, and the employee continues to work for the buyer, the employee has assented to assignment of the covenant to the seller, based on the "successors and assigns" language, and the employee's continued performance of services. [*See National Linen Service Corporation v. Glower*, 179 Ga. 136 (1934), *Orkin Exterminating Company v. Burnett*, 259 Iowa 1218 (1966), *Supplies for Industry v. Christensen*, 135 Ariz. 107 (1983); *but see Seligman & Latz v. Noonan*, 201 Misc. 96 (1951), *Avenue Z Wet Wash Laundry Co. v. Yarmush*, 129 Misc. 427 (1927).]

The applicability of these cases may be subject to doubt, however. First, they apply to the employee's assent to assignment of the benefits of a contract, not to the discharge of its obligations. Second, they arguably reside in the tradition of employee assent to "unilateral" employment contracts. In such cases, employees' assent to a change in the terms of a contract is typically found in the employees' continued performance of services with the knowledge of the modified contract terms. In contrast with standard contract theory, the employees' actual assent is not required to be shown. We return to the question of employee assent to changes in an contract in more detail below.

Should the court instead use standard principles of contract law to judge the whether assent may be found in the "successors and assigns" language of the agreement, it may look for a more robust proof of assent. And under hornbook contract law, the "successors and assigns" language may fail to show that the employee gave his or her up-front assent to novation with a new obligor. According to Corbin, "[This language] should seldom, if ever, be held to mean that a party is intended to have power to substitute another party as obligor in place of himself, that is, to assign his duty." [Corbin on Contracts Sec 871 and n. 81.]

Express Assent upon Transfer

Seller and Buyer may be able to agree upon a mechanism by which transferred employees give their assent to discharge Seller from its transferred obligations. For example, they may agree that Buyer will make employees' assent to release Seller a condition for accruing additional benefits under Buyer's deferred compensation plan.

This of course depends on Buyer's agreement and cooperation. Its viability is entirely subject to the relative bargaining strength of the parties, and is beyond the scope of this article.

Implied Assent by Providing Services to Buyer

As we have seen, although Seller might prefer employees' express assent to a discharge, it may be unable to get it. In this case, Seller will have to look for evidence of employees' implied assent to discharge Seller from its obligation.

One possible piece of evidence for such implied assent is employees' acceptance of employment from Buyer. Can Seller argue that employees who provide services to Buyer, with knowledge of Buyers' assumption of the obligations, have impliedly assented to discharge by Seller?

ERISA Cases—Little Guidance

Only two ERISA cases seem to touch on the issue of employee's assent to a novation. Of these, only one gets to the question of whether employees' continued services after a sale shows their assent to a novation. It can read in the affirmative—but it is not entirely clear.

United Steelworkers of America v. Textron, Inc., 8 EBC 1309 (D. Mass. 1986), *aff'd on other issues*, 836 F.2d 6 (1st Cir. 1987) involved retiree medical and other retiree benefits. After the sale of a division, these obligations were assumed by the buyer. After the buyer became insolvent, transferred retirees and employees asked the district court to issue a temporary injunction to the seller, under the theory that the seller had not been discharged from its obligation merely by buyer's assumption.

The court granted the injunction as to some individuals, but refused as to employees who were entitled to retire before the sale, but chose to work for its successor. The court held that there was sufficient evidence for the seller's argument that these employees had assented to a novation releasing seller from its obligations. The court reasoned that "they stayed on as active employees of [buyer] and may have 'thrown in their lot' with [buyer]." In addition, the court noted that, as active employees after the sale, they were represented by the union in negotiations with the buyer.

It is unclear whether the court located employees' assent in the performance of services, or their union representation. Thus, the case arguably supports the argument that employees' implied assent to a novation under ERISA may be inferred from their agreement to perform services with the buyer (when, of course, they also had the chance to accept obligations from the seller). But it may also be read more narrowly to apply only to employees covered by a collective bargaining agreement.

The question of assent is touched on but left unanswered in *Howe*

v.Varity Corp., 1989 US Dist Lexis 17521 (SD Iowa 1989), *aff'd on other grounds*, 36 F3d 746 (1994), *aff'd* 516 U.S. 489 (1996). As we noted above, the district court held that the seller of a business was not relieved of transferred benefit obligations absent "valid assent" by the employees. As the court found that no valid assent was possible because of the seller's misrepresentations, it did not have to address the question of how valid assent to discharge would be shown.

State Law Cases—Two Strands

We have seen that the *Textron* case offers some equivocal support for the argument that employee's performance of services with Buyer constitutes assent to discharge Seller of its obligations. The case is unclear, however, and no other case seems to address the issue squarely under ERISA.

What about analogous state law? Is there support in state law for the development of an ERISA argument that employees' continued employment with Buyer shows their assent to a discharge of Seller from its obligations?

The answer is somewhat indeterminate, because state contract law has two strands from which the federal courts could draw—and each reaches a somewhat different result. Thus, the answer may depend on whether the federal courts look to the "unilateral employment contract" line of cases and their relatively weaker requirements of assent, or standard contract cases and their stronger one.

Unilateral Employment Contract Cases

Under one significant strand of state case law governing employee compensation, it can be argued that employees' agreement to perform services for Buyer shows their assent to discharge Seller from its obligations, provided that they are notified of Buyer's assumption of the obligations.

While evolving, it is the law in many jurisdictions that the employer has a unilateral right to alter an employment contract. Under this theory, a prospective change in employment terms is an offer of a modification of a unilateral contract. The employee's continuing to work is acceptance of the offer, provided that (in some jurisdictions) he or she has notice of the changed terms. [*Dahl v. Brunswick Corporation* 277 MD 471,486 356 A.2d 221, 230 (1976).] This doctrine is applied most frequently to "employment at will" or "employee handbook" cases. These typically involve employees' challenge to the employer's right to rescind a purported promise-of-continued-employment agreement in the employee handbook. State courts generally uphold the employer's right to unilateral modification, but vary in the specificity of notice

required to be given to the employees. [*See, e.g.,* discussion in *Fleming v. Borden, Inc.* 314 S.C. 452, 450 S.E.2d 589, 594-95(1994).]

The theory of continued-services-as-assent has also been applied to find employees' assent to changes in the compensation or conditions attached to a previously existing contract. For example, it has been found that an employee's continued provision of services is sufficient consideration for the modification of an at-will employment contract to require the enforcement of a covenant not to compete, when the covenant was added after his initial entry into the employment contract. [*Mattison v. Johnston*, 152 Ariz, 109, 112-13, 730 P.2d 286, 289-90 (1986).]

It may be seen that these cases have lesser standards of consideration and mutual assent than do standard principles of contract law. For example, if employees have a contract right to continued employment (via their handbook), their continuing to render services pursuant to this right is arguably not consideration, absent their assent to modification of the contract. And performance of services, in the absence of affirmative intent to agree to a contract modification, would not in the ordinary contract sense be "assent"—even if the services were performed in full knowledge of the contract's modified terms. [*See, e.g.*, *Fleming v. Borden, Inc.* 314 S.C. 452, 450 S.E.2d 589, 594-95(1994) (expressly rejecting requirement for affirmative employee assent that would be applicable under bilateral contract theory). *See also* discussion in Blumrosen, Blumrosen, Carmingani and Daly, Downsizing: Employee Rights or Employer Prerogative?2 Empl Rts. & Employ. Ply. J. 1 (1988).]

Thus, under these cases, Seller can argue that employees who accepted Buyer's offer of employment and continued to work for Buyer, with the knowledge of Buyer's assumption of the obligation, have assented to discharge of Seller and novation with Buyer.

Standard Contract Cases

Applying standard contract principles found outside of the employment context, however, a different answer may be reached.

Generally, a creditor's mere knowledge of the assumption by a second obligor is not enough to effect a novation. There must in addition be evidence that the creditor actually assented and agreed to release the first obligor. [*Security Ben. Life Ins. Co. v. Federal Deposit Ins. Corp.*, 804 F. Supp. 217 (D Kan 1992).]

In looking for evidence of assent, the burden of proof is on the obligor to show that the creditor in fact assented to release him. In practice, this means that the courts do not accept the obligee' conduct as proof of his assent to a novation and release of the original obligor, of that conduct is consistent with his or her mere assent to the third party as

delegee. Thus, something in addition to mere course of course of dealing is required to show that the obligee assented to a novation with a new obligor. [*See, e.g., Burnett v. West Madison State Bank*, 375 Ill. 402; 31 N.E.2d 776 (1940) (rejecting argument that depositor had assented to substitute new bank for old bank as obligor, as "the facts alleged are consistent with the idea that he might have intended to look to both banks for payment"); *Phillips & Arnold, Inc. v. Frederick J. Borgsmiller, Inc.,* 123 Ill. App. 3d 95 123 Ill. App. 3d 95; 462 N.E.2d 924(1984) (mere fact that contractor continued work on installation contract, even he learned that seller sold all assets and obligations of business to buyer, is not evidence that he assented to novation with buyer); *Shank v. William R. Hague, Inc.*, 192 F.3d 675 (7th Cir. 1999) (under Wisconsin law, course of conduct not evidence of implied assent to novation when contract did not preclude delegation, and obligee's agreement to accept 3d party obligor was consistent with mere delegation); *Simmons Nat'l Bank v. Dalton,* 232 Ark. *359*, 337 S.W.2d 667 (1960) (Bank's attempt to collect money from second obligor, without attempting also to collect from first obligor, did not show implied asset to a novation, absent express intent to release first obligor); *Wenner v. Marsh USA, Inc.,* 2002 Ohio 2176 (2002) (no assent to novation shown by independent contractor who provided risk management services to transferee of contract, even after he knew that contract and its obligations had been transferred, and accepted money payment from the transfer).]

Thus, under the higher standards of mutual assent applicable under standard contract theory, it might not be enough to show that employees continued to provide services to Buyer, even if it could be shown they had been notified of Buyer's assumption of the obligation from Seller.

Implied Assent by Providing Services to Buyer After Notification of Seller's Repudiation

Is the Seller's case for employees' implied assent strengthened if it notifies former employees not only of Buyer's assumption of the obligations, but also of Seller's own repudiation of them? This notice might say, for example:

> As of the Sale Date, for all employees who continue services for Buyer, obligations shall be assumed by Buyer. Seller will no longer be responsible for payment of these obligations.

We could find no authority on point, under state law or ERISA, so what follows is our best inferences from analogous cases. Under this tentative analysis, it would seem that the answer is not much changed

by the added specificity of the notice. While the Seller undoubtedly has a better case, whether it is good enough may depend upon which strand of contract law a court looks to in defining a theory of ERISA assent.

Under the "unilateral employment contract" strand of law, this kind of notification would probably strengthen Seller's case. Employees who accept employment with Buyer provided services with full notice of Buyer's assumption and Seller's repudiation of the obligations. Under the unilateral contract way of thinking, this is evidence of their assent to modified contract via substitution of obligors. The substitution of obligors (thus assented to) is consideration for the new agreement. As we have seen, the *Textron* District court showed some (albeit very unclear) signs of thinking this way in the ERISA context.

Under more standard contract principles, the answer is less clear. Seller's strongest hope is that, by expressly repudiating, it can push events to fit under the doctrine of "novation after repudiation." Under this theory, a novation may arise that discharges an obligor's duties where the obligee, with knowledge of a repudiation by the obligor, accepts any performance from the assignee without reserving his rights against the assignor. [*See Honeycutt v. Billingsley*, 992 S.W.2d 570, 579-80 (Tex. App. 1999); Restatement (Second) of Contracts § 329 (1981).]

"Performance" of course is in this case actual payment of the deferred obligation. Under this doctrine, then, any transferred employees whose obligations go into pay status and accept payment from Buyer, with knowledge of Seller's anticipatory breach, without expressing a reservation of rights against Seller, might be said to have assented to a novation, and released Seller from its obligation. [*See Rose Acre Farms, Inc. v. Cone*, 492 N.E.2d 61 (1986) (Employee who had performed all conditions necessary to earn bonus, but accepted payment of a smaller without complaint, assented to a novation, and the employer was discharged of its obligation to pay the larger bonus).]

Under straight contract law, however, the doctrine of novation after repudiation may offer minimum comfort to Seller. First, it would seem to apply only to employees who go into pay status *before* the Buyer's inability to pay the obligation. Thus, the extent of Seller's full liability remains open and contingent.

Second, it is not clear that, even with respect to this limited class of transferred employees, the doctrine will relieve Seller of its retained obligation to pay. This is in part because Seller's attempted repudiation involves repudiation of a unilateral contract to pay money. (That is, the employees have done everything necessary to earn the compensation' the only act left under the agreement is Seller's payment). In many jurisdictions, courts refuse to recognize repudiation in such contracts until the debtor refuses payment after the obligation becomes due and

owing. Under this principle, Seller cannot not repudiate until after Buyer is insolvent and employees actually present demands for payment to Seller.

That is, as arguably Seller has not "repudiated," employees who perform service for Buyer have no knowledge of actual repudiation or even anticipatory repudiation. By accepting payment from Buyer, they have assented to nothing—even if they accept with full knowledge of Seller's avowed discharge of its own obligation. As they have assented to no change in obligors, they are receiving only what was due to them under a pre-existing obligation, and no consideration supports the novation

Support for the skepticism expressed in the above paragraph is found in cases holding that a creditor's acceptance of a check for less than the amount owed does not discharge the debtor' obligation to pay the rest. This is so "even though the check had been in enclosed in a letter stating that it was tender in fully satisfaction of the debt else to be returned, or if words of similar import had been written on the check." [*Bryan, Keefe & Co. v. Howell*, 92 Fla. 295, 109 So. 593 (1926).] This is because payor's payment of a previously existing debt is not valid consideration, and no novation could be founded on it. [*Id*.]

Predicting an ERISA Standard of Implied Assent

We have seen that employees' agreement to provide services for Buyer may arguably be assent to release Seller from its obligation, particularly if they are notified of Buyer's assumption of the obligation, and Seller's relinquishment. We have also seen that this argument is significantly stronger under the standards of assent typical of unilateral employment contract cases, rather than standard contract law.

Which standard of assent would the Federal courts apply to find evidence of an ERISA novation?

The answer is unclear. The ERISA decision of the *Textron* district court points to the lesser standard used in employment contexts. Recall that the court held that, after the sale of a division, employees who accepted employment with the buyer may have assented to a novation releasing the seller from transferred obligations. In the court's word's, they "stayed on as active employees of [buyer] and may have 'thrown in their lot' with [buyer]." [*United Steelworkers of America v. Textron, Inc.,* 8 EBC 1309 (D. Mass 1987), *aff'd on other issues*, 836 F2d 6 (1st Cir. Mass 1987).]

There is not much state case law on the question of assent to transferred deferred compensation obligations. But what little there is tends to apply the stricter standards of general contract law.

For example, in *Dahl v. Brunswick Corporation,* 277 MD 471, 356 A.2d 221 (1976) Maryland court of appeals held that the seller's obliga-

tion for vested severance pay was not discharged as to employees transferred pursuant to the sale of a business, even though assumed by the buyer, absent evidence of their actual assent to substitution. The Connecticut case *Mace v. Conde Nast* also involved the question of whether transferred employees agreed to a novation discharging the seller severance pay obligations assumed by the buyer upon the sale of a business. The Supreme Court of Connecticut held this was a triable issue of fact for a jury, stating "novation requires proof that the one in the position of creditor in this case, the plaintiffs had accepted a new debtor in the place of the defendant to which they would look for fulfillment of the severance pay obligation owing to them." [*Mace v. Conde Nast Publications, Inc.,* 155 Conn. 680, 237 A.2d 360, 361 3634 (1967) *Cf. Clark, Ex'x v. General Cleaning Co*., 345 Mass 62, 185 NE2d 749 (1962) (when incident to the sale of a business, the buyer assumed the contract of a transferred employee, but paid the transferred employee less than the contract rate, the fact that the employee worked for the buyer two weeks at the lower salary did not show his assent to a novation).]

In short, this is very hard to call. State case law goes both ways—although there is some evidence that, at least when assumption of a deferred compensation obligation is involved, courts will use the stricter standard of general contract law. A single ERISA case points to the less strict standard of unilateral employment contract law—but is unclear at best.

CONCLUSION

We have discussed ways in which the seller of a business might ensure that it rid itself entirely of deferred compensation obligations assumed by the buyer. While it is not entirely clear that contract principles of delegation and novation apply to these ERISA obligations, the prudent seller will assume they do and try to plan around them.

The seller can best assure it relinquishes its obligations by obtaining employees' express consent to discharge it when the obligations are assumed by the buyer. Assuming this is impossible or impractical, however, the seller can still try show that transferred employees gave their implied assent to the discharge.

For example, the seller may argue that employees gave their implied consent to discharge seller of its obligation if they accepted service with the buyer, with notice that the buyer has assumed the obligation and the seller relinquished them.

There is some evidence that this is a good argument under ERISA. But there is almost not ERISA law on point. Analogous state law has developed along two paths—one applicable to so-called unilateral

employment contracts, and one to standard contracts. Implied assent will be found more readily under the former than the latter. At this point, it is unclear which path the ERISA law might take. The prudent seller should at the least notify transferred employees that buyer has assumed their obligations, and seller relinquished them. The effectiveness of this notification is not assured. But absent employees' express assent, and until the law develops, it may be as good as the seller can get.

NOTES

1. See, e.g., Corbin on Contracts secs. 866, 1297; Annotations at 61 A.L.R.2d 755.

2. However, the seller retained liability under another theory: as an equitable remedy under ERISA § 502(a)(3) for its fiduciary breach in lying to employees in connection with their transfer to a financially impaired buyer.

3. Barker and O'Brien, The ERISA Common Law and the Limits of Reticulation, 14 BLJ 2.

4. See Corbin on Contracts sec 963, Farnsworth, *Contracts* sec 8.20 (1982)

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