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The Limits of Business Limited Liability: Entity Veil Piercing and Successor Liability Doctrines

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THE LIMITS OF BUSINESS LIMITED LIABILITY: ENTITY VEIL PIERCING AND SUCCESSOR LIABILITY DOCTRINES

John H. Matheson†

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I. INTRODUCTION

The quest for limited liability in business enterprises and transactions has been a driving force in the development of business organization law for centuries. The historical development of corporations and limited partnerships evidences this primary goal. The recent development of the modern forms of limited liability partnerships and limited liability companies proves that this quest continues unabated. In addition, parties to significant business transfer transactions have long sought by construct and contract to apportion and limit their respective legal responsibilities and liabilities.

Counterbalancing this inexorable trend toward limited liability has been the penchant of common law jurisprudence to define its limits. Common law theories of piercing the corporate veil and successor liability, among others, have been developed and expanded by the courts as equitable restraints on the strength of business limited liability protections, making these protections more akin to presumptions than unassailable principles.

If, as the famous aphorism goes, “hard cases make bad law,”

then hard business cases provide a recipe for Hungarian goulash.

So it is with the entrée recently served up by the Minnesota courts in a series of substantive trial court determinations and three reported appellate decisions, culminating in the Minnesota Supreme Court’s recent en banc report of Johns v. Harborage I, Ltd.

Here’s how the recipe goes. Start with one business enterprise, Gators Bar and Grill (“Gators”) located in the Mall of America shopping center. Chop that business into three legally distinct parts, all with intertwined relationships: a limited partnership that leases the business premises, holds the liquor license, and owns the operation’s physical assets; a second limited partnership that provides management services to the business; and a corporation that supplies employees to the business. Add one sexual harassment victim with a valid but unsatisfied judgment against the corporate piece of the business. Separately arrange a transfer of
the assets of the first limited partnership, not found to be liable on
the harassment verdict, to a distinct, unrelated corporation, from
which satisfaction of the harassment judgment ultimately is sought.
Cover with a combination of both federal and state common and
statutory law. Combine all ingredients together and sprinkle
liberally with equitable considerations. The result is, as with many
other culinary creations, at least interesting. Whether or not one
finds it appealing or appetizing is, as in all matters of this kind,
dependant on one’s personal (legal) tastes.

This article seeks to make sense of the recipe and the ultimate
concoction that is Johns v. Harborage I, Ltd. (collectively “Johns”).
The legal substance of the case involves the use by business parties
of devices to limit their liabilities. Part II describes the
development of limited liability entities (“LLEs”), and the use of
limited liability transactions, such as those employed by the
defendants in Johns, as well as exceptions to the applicable
presumptions of limited liability. Part III parses the facts and
history of the multiple Johns decisions. Part IV explains and
explores the rulings in Johns in light of the legal and equitable
principles surrounding the evolution of business limited liability
and its exceptions.

II. LIMITED LIABILITY ENTITIES AND TRANSACTIONS AND THEIR LIMITS

Businesses and their owners regularly seek to limit the scope of
their liabilities. After all, the less liabilities a business has to pay or
assume, the greater the potential for profit for the owners in the
operation of the business. There are two distinct ways in which
these business liabilities may be limited. First, entrepreneurs may
take advantage of various state laws to create some form of limited
liability entity under which the business will operate. These
entities, such as traditional corporations and the newer limited
liability companies, have a legal existence separate from the owner
of the business and presumptively shield the owner from personal
obligation for the business debts. In the business context, this
might be referred to as “entity-based limited liability.”

4. Id.
5. See infra Part II.
6. See infra Part III.
7. See infra Part IV.
Second, when two businesses engage in a transaction, such as a purchase and sale of business assets, they may seek contractually or structurally to limit the obligations of the transferee business for the obligations of the transferor. This method of limiting transactional liability attempts to have the price paid by the transferee for the acquired assets reflect only the obligations explicitly assumed. In the business context, structuring transactions so as to identify and minimize assumed and potential liability can be referred to as "transaction-based limited liability." Both of these methods of business liability limitation were employed in *Johns* and both were challenged by the plaintiff.

A. The Development and Limits of Limited Liability Entities

Much of the history of the development of business organization law relates to attempts to create the perfect legal vehicle for business purposes. Until the early to mid-1800s, legislation in both England and the U.S. imposed strict limits on an owner’s ability to incorporate and to receive the benefits of limited liability. Incorporation typically required a special act of Parliament or a state legislature. State legislatures enacting general corporation statutes usually imposed substantial limitations on corporations, including minimum paid-in capital requirements, limited permissible purposes, and limited duration. As corporations began to dominate the economic landscape, however, legislatures removed nearly all of the original limitations on the ability of corporations to organize and operate.

Following the Industrial Revolution, the development of capital markets depended on limited liability protection. Capital-intensive businesses required substantial expenditures beyond the means of the typical entrepreneur, necessitating the infusion of outside investment. Providing limited liability to those who

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8. *See* Kenneth K. Luce, *Trends in Modern Corporation Legislation*, 50 MICH. L. REV. 1291, 1293 (1952) (describing how "corporate charters were difficult and expensive to obtain, the fruit of special privilege"); *see also* Morton J. Horwitz, Santa Clara Revisited: The Development of Corporate Theory, 88 W. VA. L. REV. 173, 208 (1986) ("It is not usually appreciated that truly limited shareholder liability was far from the norm in America even as late as 1900.").


11. *See* id. at 26-32.
12. *See generally* HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW 1836-
contributed capital encouraged investment because people could invest without risking their full personal net worth. Although investors may be willing to risk their entire net worth in businesses they operate themselves, they are not willing—absent limited liability—to invest in businesses that they do not operate or closely oversee. Limited liability enabled venture capitalists and casual investors to invest in diverse enterprises without incurring the excessive costs necessary to monitor each enterprise closely. More broadly, this grant of limited liability to investors advanced national economic policies by encouraging a broader base of participants in business investment.

Corporate law, while securing this limited liability, provides that corporate power must be exercised according to certain mandatory rules that "govern defined issues in a manner that cannot be varied by corporate actors." Most importantly, all corporations presumptively must have a board of directors that acts as the central governance group. Ownership is legally separate from control. The owners/shareholders elect a board of directors


14. See Henry Hansmann & Reinier Kraakman, Toward Unlimited Shareholder Liability for Corporate Torts, 100 YALE L.J. 1879, 1879 (1991) (observing that limited liability "creates incentives for excessive risk-taking by permitting corporations to avoid the full costs of their activities"); David W. Leebron, Limited Liability, Tort Victims, and Creditors, 91 COLUM. L. REV. 1565, 1566 (1991) (describing "the traditional corporate and economic justifications for limited liability" as "the need to encourage investment in productive, albeit risky, activities").

15. Melvin Avon Eisenberg, The Structure of Corporation Law, 89 COLUM. L. REV. 1461, 1461 (1989) (footnote omitted) (concerning "the legal rules that directly concern the internal organization of the corporation and the conduct of corporate actors"); see Jeffrey N. Gordon, The Mandatory Structure of Corporate Law, 89 COLUM. L. REV. 1549, 1553-54 n.16 (1989) (enumerating Delaware's mandatory rules). But cf. Roberta Romano, Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws, 89 COLUM. L. REV. 1599, 1599-602, 1616 (1989) (contesting Professor Gordon in part and arguing that although many "mandatory" rules may be avoided, some may be desirable "when externalities are present").

16. See, e.g., DEL. CODE ANN. tit. 8, § 141(a) (2001) (stating that a board of directors is required unless otherwise provided in certificate of incorporation); MODEL BUS. CORP. ACT § 8.01 (1999) (establishing that board of directors is required unless all shareholders agree to nontraditional form of governance); MODEL BUS. CORP. ACT § 8.03 (1999) (stating number and election of directors required).
that makes business policy and manages the corporate enterprise, resulting in a representative, as opposed to democratic, governance structure. Beyond choosing the directors and acting on certain extraordinary matters, corporate ownership and involvement in business decisions and transactions is presumptively passive.\footnote{17 See, e.g., Del. Code Ann. tit. 8, § 141(a) (2001); Model Bus. Corp. Act § 8.01(b) (1999) (establishing that business and affairs of corporations shall be managed by or under direction of board of directors). Corporate law requires shareholders to elect the board of directors through regularly scheduled annual elections. See, e.g., Del. Code Ann. tit. 8, § 211(b) (2001) ("[A]n annual meeting of stockholders shall be held for the election of directors on a date and at a time designated by or in the manner provided in the bylaws."); Model Bus. Corp. Act § 7.01(a) (1999) ("A corporation shall hold a meeting of shareholders annually at a time stated in or fixed in accordance with the bylaws."). To provide accountability, perpetual directorships are often banned. See Easterbrook & Fischel, supra note 13, at 3 (noting that "states almost uniformly forbid perpetual directorships").}

The development of the corporate entity was parallel to the development of the limited partnership.\footnote{18 The main downside with the use of the corporate form has been its unattractive tax treatment. A corporation is subject to double taxation: it is taxed once as an entity, and its shareholders are taxed on distributions of dividends, which are treated as ordinary income. See I.R.C. § 301-381 (2002) (imposing a double tax on corporations).} Situated as a hybrid between the classic general partnership and the corporation, a limited partnership has at least one general partner, who, like all partners in a regular general partnership, must have unlimited personal liability. The rest of the partners can be limited partners who, like their corporate shareholder counterparts, do not have personal liability for the debts of the enterprise. In essence, the premise for allowing corporate limited liability is continued in the limited partnership. Limited partners, like shareholders in the corporation, have no management rights and no personal liability. They trade their involvement in management for the security of limited liability. General partners, on the other

\footnote{17 See, e.g., Del. Code Ann. tit. 8, § 141(a) (2001); Model Bus. Corp. Act § 8.01(b) (1999) (establishing that business and affairs of corporations shall be managed by or under direction of board of directors). Corporate law requires shareholders to elect the board of directors through regularly scheduled annual elections. See, e.g., Del. Code Ann. tit. 8, § 211(b) (2001) ("[A]n annual meeting of stockholders shall be held for the election of directors on a date and at a time designated by or in the manner provided in the bylaws."); Model Bus. Corp. Act § 7.01(a) (1999) ("A corporation shall hold a meeting of shareholders annually at a time stated in or fixed in accordance with the bylaws."). To provide accountability, perpetual directorships are often banned. See Easterbrook & Fischel, supra note 13, at 3 (noting that "states almost uniformly forbid perpetual directorships").}

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\footnote{19 Several of the entities involved in Johns were limited partnerships. Johns III, 664 N.W.2d 291, 293 (Minn. 2003). New York ushered in the first limited partnership statute in 1822 and soon other jurisdictions began adopting this business form. Louisiana is the exception. See R. Kurt Wilke, Note, Limited Partnership Control: A Reexamination of Creditor Reliance, 60 Ind. L.J. 515, 516-18 (1985). In 1916, the Commissioners on Uniform State Laws drafted the Uniform Limited Partnership Act, which was subsequently enacted by nearly every state. Id. In 1976, the Commissioners on Uniform State Laws approved a Revised Uniform Limited Partnership Act, which most jurisdictions adopted. Id. at 524-28, n.60. A new revised Act has recently been promulgated and has been adopted by many states, including Minnesota in 2004. 2004 Minn. Laws ch. 199 (codified as amended at Minn. Stat. Ann. §§ 323A.1-01-323A.12-03 (West 2003)).}
hand, like directors and officers of a corporation, have management authority but also some level of personal liability.

All in all, however, the standard limited partnership was only a partial solution in the search for the perfect form of business organization. While limited partners in limited partnerships could enjoy the security of limited liability, a general partner still remained subject to unlimited liability. In addition, the traditional connection between management authority and personal liability continued.

As the next and much more recent development of business organization law, the limited liability company (“LLC”) represented a significant step in the breakdown of the trade-off of investor passivity for limited liability. Causing a minor business revolution over the past several decades, the LLC was created out of whole cloth. The LLC represented a new hybrid to the business entity montage. Unlike a limited partnership in which a general partner has personal liability to third parties for the recourse debts of the business, all owners of an LLC enjoy limited liability—no owner bears personal responsibility for LLC debts.

In addition, most LLC codes derive from a partnership organizational framework, with presumptive management by the
owners/members.\textsuperscript{23} The common link in each of the LLC statutes is either presumptive or optional management by the owners. The concept of separating management authority from ownership is gone. No longer is managerial passivity the price that must be paid for limited liability.

Finally, the development of the “limited liability partnership” or “registered limited liability partnership” (jointly “LLP”) as the newest form of LLE highlights the breakdown of the final barriers between passive investors and active managers. An LLP is first and foremost a general partnership wherein the partners both own and manage the business. Like the general partnership, there is no separation between the partners’ roles as investors and as managers. Almost as an aside, LLP statutes usually contain a one-paragraph provision restricting the limited liability of a LLP’s owners if appropriate documentation is filed with the state.\textsuperscript{24}

In sum, today the traditional purposes for limited liability, those of promoting passive investment and encouraging capital development, have broadened. Legislatures’ purposes have expanded from merely encouraging and protecting passive investors to simply and actively promoting business. The limited liability of corporate and limited partnerships promotes investment and capital development, while new LLE forms, such as the limited liability company and limited liability partnership, expect owner involvement in running the business. This combination of active management and presumptive limited liability that typifies the modern closely held business organization is well represented by the entities employed by the initial defendants in the \textit{Johns} matter.

\textbf{B. Traditional Piercing and Enterprise Entity Limits of Limited Liability}

Despite the proliferation of limited liability business entity forms, American law governing business limited liability has had a

\textsuperscript{23} See Gazur & Goff, \textit{supra} note 21 (assessing the LLC form); Robert R. Keatinge et al., \textit{The Limited Liability Company: A Study of the Emerging Entity, 47 Bus. Law.} 375 (1992) (comparing LLCs to other business organization forms and analyzing state LLC statutes).

\textsuperscript{24} See, e.g., Minn. Stat. §§ 323A.3-06(c), 323A.10-01 (2002). By combining limited liability for general partners with the well-established partnership law foundation, LLP legislation produced renewed interest in the partnership form. The LLP is a solution for participants seeking a partnership structure with active control but limited liability. Any thought of having to forgo active involvement in the business in order to obtain the protection of limited liability has been eliminated.
contentious history. In the 1800s, Thomas Cooper described limited liability as a “mode of swindling, quite common and honourable in these United States” and “a fraud on the honest and confiding part of the public.”

Yet, early in the twentieth century, President Butler of Columbia University acclaimed business limited liability as “the greatest single discovery of modern times” and that “even steam and electricity are far less important than the limited liability corporation, and they would be reduced to comparative impotence without it.”

The decisions of the courts have reflected the ambivalence that pervades the policy of allowing business LLEs. Use of the corporate or other limited liability form for the operation of a business presumptively shields the personal assets of the owners/shareholders from the claims of the business’s creditors. A court may be asked to ignore this liability shield when a voluntary or involuntary creditor finds the corporation unable to pay its debts. The creditor would then like the court to disregard or “pierce” the statutory limited liability shield so that the debts of the business might be satisfied out of the owners/shareholders’ assets, personal or otherwise. Absent a judicial decision to “pierce the veil” in this manner, the limited liability created by the applicable corporate statute stays intact and the creditor must shoulder the loss.

Therefore, the most typical way in which courts reflect the policy ambivalence over limited liability is by “piercing the veil” of the LLE to hold the owners of a business personally liable for the business debts. This is the classic form of “piercing” and operates vertically to hold the owner liable for the debts of the business.


28. To provide guidance on when the owner of a limited liability entity will lose the benefit of limited liability, the place to start should be with the courts’ experiences over the years dealing with this issue in the corporate context. This is not as helpful as one might think; the “tests” used by courts to determine whether to pierce the limited liability veil are universally recognized as unhelpful. See, e.g., Phillip I. Blumberg, The Law of Corporate Groups: Procedural Problems in
An alternative form of LLE veil piercing is of a horizontal nature, typically involving brother/sister or sibling corporations. As will be explored in more detail later, this is the nature of the piercing analysis employed by the courts in *Johns*. Sometimes a single business enterprise is set up using separate and multiple limited liability entities, operating on the same level and having the same owners and/or managers. The claim of horizontal piercing asks the court to ignore the separate legal existences of the sibling corporations and pierce their veil so that the assets of all related entities are available to satisfy creditor claims. The theory is that the separate entities are simply parts of one unified business enterprise and that the legal analysis should reflect that operational reality.

*The Law of Parent and Subsidiary Corporations* 8 (1983) (suggesting that court decisions are "irreconcilable and not entirely comprehensible"); *Robert Charles Clark, Corporate Law* 72 (1986) ("[T]he courts usually forgo any sustained attempt at a remedial theory or even a coherent exposition of the basis of liability, although descriptive summaries are occasionally attempted."); *Easterbrook & Fischel, supra* note 13, at 54-55 ("[T]ests used by courts—whether a corporation has a 'separate mind of its own,' whether it is a 'mere instrumentality,' and so forth—are singularly unhelpful."). The courts employ at least three conclusive "tests":

1. the "agency" test under which the plaintiffs must establish that the parent exercised a significant degree of control over the subsidiary's decisionmaking;
2. the "alter ego" test which is founded in equity and permits the court to pierce the corporate veil when the court must prevent fraud, illegality or injustice, or when recognition of the corporate entity would defeat public policy or shield someone from liability from a crime;
3. the "instrumentality" test under which the plaintiff must establish that the parent exercises extensive control over the acts of the subsidiary giving rise to the claim of wrongdoing; and
4. the "integrated enterprise" test under which the court considers (a) interrelation of operations, (b) centralized control of labor relations, (c) common management, and (d) common ownership or financial control. *Richard v. Bell Atl. Corp.*, 946 F. Supp. 54, 61 (D.D.C. 1996) (citations omitted). Application of these tests often consists largely of lists that the courts recite with little analysis or justification. Some courts list as many as nineteen factors. See, e.g., *Laya v. Erin Homes, Inc.*, 352 S.E.2d 93, 98-99 (W. Va. 1986) (listing 19 factors). A sample list from one court recites "insufficient capitalization for purposes of corporate undertaking, failure to observe corporate formalities, nonpayment of dividends, insolvency of debtor corporation at time of transaction in question, siphoning of funds by dominant shareholder, nonfunctioning of other officers and directors, absence of corporate records, and existence of corporation as merely a façade for individual dealings." *Minnesota Power v. Armco, Inc.*, 937 F.2d 1363, 1367 (8th Cir. 1991). According to that court, an unspecified number of these factors, combined with an element of "injustice or fundamental unfairness," would justify disregarding the corporation and holding the owners liable. *Id.*
The classic cases of this nature involve the taxicab industry. In *Walkovszky v. Carlton*, for example, a businessman, Carlton, owned a taxicab business that he set up by creating ten separate corporations, each of which owned two cabs and had one driver. As simplified, the structure of this business is set out in Figure 1.

**Figure 1: Entities Comprising Taxicab Business**

The plaintiff, Walkovszky, was severely injured when struck by a taxicab owned by Seon Cab Corp. ("Seon"), but Seon’s assets were insufficient to satisfy the judgment. At that point plaintiff had two ways to argue for piercing the corporate veil: traditional vertical piercing to hold Carlton personally liable as Seon’s owner, or horizontal piercing between the separate cab companies so as to aggregate their assets and increase the pool of assets available for satisfaction of the judgment.

As to the traditional vertical piercing claim against Carlton individually, the court in *Walkovszky* concluded that the complaint was deficient because it was “barren of any ‘sufficiently particular(ized) statements’ . . . that the defendant Carlton and his associates are actually doing business in their individual capacities, shuttling their personal funds in and out of the corporations ‘without regard to formality and to suit their immediate convenience.’” However, the court concluded that the plaintiff might succeed on a horizontal piercing claim. Walkovszky alleged that “[a]lthough seemingly independent of one another, these corporations are alleged to be ‘operated . . . as a single entity, unit and enterprise’ with regard to financing, supplies, repairs,

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31. *Id.* at 420 (internal citations omitted).
employees and garaging, and all are named as defendant.”32 Thus, the separate existence of the ten business entities operating as individual taxicab companies under common ownership might be “pierced” and their assets aggregated into one judicially reformed legal entity for purposes of liability. As the Court analyzed the situation it clearly distinguished vertical from horizontal piercing:

In the case before us, the plaintiff has explicitly alleged that none of the corporations “had a separate existence of their own” and, as indicated above, all are named as defendants. However, it is one thing to assert that a corporation is a fragment of a larger corporate combine which actually conducts the business. It is quite another to claim that the corporation is a “dummy” for its individual stockholders who are in reality carrying on the business in their personal capacities for purely personal rather than corporate ends. Either circumstance would justify treating the corporation as an agent and piercing the corporate veil to reach the principal but a different result would follow in each case. In the first, only a larger corporate entity would be held financially responsible while, in the other, the stockholder would be personally liable. Either the stockholder is conducting the business in his individual capacity or he is not. If he is, he will be liable; if he is not, then, it does not matter—insofar as his personal liability is concerned—that the enterprise is actually being carried on by a larger “enterprise entity.”

This theory of horizontal piercing is sometimes referred to as the “enterprise entity” or “enterprise liability” theory of judicial veil piercing and entity reformation. The label comes from a famous article by Adolph Berle, where he posits that:

[a]nother illustration of judicial erection of a new entity occurs in situations where the corporate personality (as embodied in its charter, books and so forth) does not correspond to the actual enterprise, but merely to a fragment of it. The result is to construct a new aggregate of assets and liabilities. The decisions disregard the paper corporate personalities and base the results on the assets of the enterprise.34

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32. Id. at 416.
33. Id. at 418-19 (citations omitted).
C. Transactional Limitation of Liability: Asset Transfers

The concept of transactionally limiting business liability is initially very straightforward. Indeed, it is a concept that we all use and rely upon on a daily basis. For example, if I own an automobile and you want to buy it from me, all we have to do is agree on price and any other relevant terms and then I will give you the keys to the car and you will pay me for it. The result is a transfer of assets for valid consideration.

Assume that in addition to having an automobile for sale, I also have an outstanding balance on an unsecured loan from a financial institution that I took out to finance the original purchase of the car. If you buy my automobile from me, are you responsible for the loan as well? Of course not—unless you agree to be.

A similar analysis applies to transfers of assets between businesses. If one business owns real property or personal property, or has intangible property rights, such as intellectual property, franchise, or contract rights, those assets are presumptively transferable to another business entity without the transferee incurring any obligations not voluntarily assumed as part of the transaction. The analysis becomes slightly more complicated when, instead of a discrete asset being transferred between businesses, one business basically wants to acquire the total operations of another company. This is what businesspersons and lawyers refer to as the stuff of “mergers and acquisitions,” or M&A, for short.

As a starting point, there are various ways in which one business can acquire another. One common method is for the business to be acquired, often referred to as the “target,” to merge into the acquiring business (or a subsidiary). A merger occurs when two or more business entities combine to produce a single entity (the “surviving” entity) pursuant to a merger plan.35 If one business decides to acquire another company through direct absorption, a “two-party” merger takes place. The acquiring entity

35. Mergers can be direct or indirect, depending upon the presence of a subsidiary. When a corporation is merged directly into the acquiring corporation, only the acquiring corporation survives the merger. With "triangular" mergers, a corporation merges with a newly formed subsidiary of the acquiring corporation and the surviving corporation becomes a subsidiary of the acquiring corporation. A transaction constitutes a "merger" regardless of whether the corporation surviving the merger is a previously existing operating corporation or is a new corporation formed solely for the purpose of surviving the merger.
(A) gives the existing owners of the target company (T) cash, stock or other property in order to purchase the target business. The transaction looks like Figure 2.

**Figure 2: Merger of Two Business Entities**

![Diagram](T=A

T = TARGET ENTITY
A = ACQUIRING ENTITY

S = SURVIVING ENTITY RESULTING FROM T AND A MERGER

When a merger becomes effective, a number of significant changes occur simultaneously. Primarily, only the surviving entity continues in existence, eliminating the separate existence of the constituent organizations. The two businesses literally and legally become one. As a result, the surviving entity has all of the privileges, powers, property, rights, and other interests of each of the constituent entities. More significantly for the current discussion, the surviving entity becomes liable for all liabilities and obligations of all constituent organizations, and claims or proceedings against a constituent company may be pursued against the surviving entity. Therefore, quite literally, the assets and liabilities of the constituent organizations become merged into and the responsibility of the surviving entity. To continue with our

36. With respect to mergers of Minnesota corporations, see, for example, Minnesota Statutes section 302A.641, subdivisions 2(a) and 2(c) (2002).

37. As to Minnesota corporations, see, for example Minnesota Statutes section 302A.641, subdivision 2(c) (2002).
automobile and loan sales transaction analogy posited earlier, in a
merger, the surviving entity gets both the car and the loan.

Given that a merger necessarily results in acquisition of all of
the liabilities as well as the assets of the target entity, businesses
seeking to make acquisitions sometimes seek an alternative
transactional structure that allows selectivity with respect to the
liabilities assumed. This alternative structure is the asset transfer.
In an asset transfer, the two constituent organizations exchange
operational assets for cash or other consideration, but do not
merge and do not become a single entity. Each business starts as a
separate entity and each business survives as a distinct entity with its
own separate existence after the asset transfer. An asset transfer
between two businesses looks like Figure 3.

**Figure 3: Asset Transfer Between Business Entities**

![Figure 3 Diagram](image-url)

Legally, the distinction between a merger and an asset transfer
is monumental. With the former, the acquiring entity has no
choice in selecting among the target’s assets and liabilities. The
acquirer succeeds to the amalgam of the two original entities. With
the latter, however, the acquiring entity can selectively choose
which assets and which, if any, liabilities it wants to acquire. Quite
literally, the acquiring entity can take the car without acquiring any
obligation for the loan. Moreover, even if liabilities will be assumed
as part of an asset transfer transaction, the specific obligations
assumed can be separately identified and priced. That is, the
consideration paid for the acquired assets (and possibly liabilities)
will reflect the basket of items acquired. Therefore, at least from the liability minimization perspective, an asset acquisition is a much more favorable transactional acquisition structure than a merger.

D. Successor Liability as a Basis for Expanding Transactional Liability

The basic legal rule of liability in an asset transfer is that a purchaser or other transferee of business assets from another business entity is not responsible for the debts and obligations of the transferring entity. For example, the Minnesota Business Corporation Act (“MBCA”) expressly provides that a transferee of substantially all of the assets of a Minnesota corporation is liable for the debts, obligations, and liabilities of the transferor only to the extent contractually assumed by the transferee or otherwise provided in the MBCA or by other Minnesota Statutes. 38

This legislative directive has generally been followed by Minnesota courts. For example, in product liability cases decided since section 302A.661, subdivision 4, was enacted, courts have found no successor liability in part because of the Minnesota legislation and in part because prior Minnesota case law also limited such liability. In Niccum v. Hydra Tool Corp., 39 the court, in

39. 438 N.W.2d 96, 99 (Minn. 1989). One of the exceptions to successor liability noted by the Niccum court is the doctrine of de facto merger. Id. at 98. Minnesota jurisprudence on de facto merger is still developing. According to the Minnesota Federal District Court, the Minnesota Court of Appeals has applied a multi-factor analysis to determine whether a de facto merger occurred:
(1) Whether there is a continuation of the enterprise of the seller corporation, so that there is a continuity of management, personnel, physical location, assets and general business operation.
(2) Whether there is a continuity of shareholders which results from the purchasing corporation paying for the acquiring asset with shares of its own stock, this stock ultimately coming to be held by the shareholders of the corporation so that they become a constituent part of the purchasing corporation.
(3) Whether the seller corporation ceases its ordinary business operations, liquidates and dissolves as soon as legally and practically possible.
(4) Whether the purchasing corporation assumed the obligation of the seller ordinarily necessary for the continuation of normal business operations of the seller corporation.

Gamradt v. Fed. Labs., Inc., No. 02CV816MR/RL, 2003 WL 22143729, at *3 (D. Minn. Sept. 2, 2003) (citations omitted). The Federal District Court adopted the Minnesota Court of Appeals’ analysis of de facto merger and predicted that the Minnesota Supreme Court, given the opportunity, would adopt it as well. Id. at *4; see Fine v. Schwinn Cycling Fitness, Inc., No. C3-00-1079, 2000 Minn. App. LEXIS

http://open.wmitchell.edu/wmlr/vol31/iss2/3
affirming summary judgment in favor of a transferee corporation, noted that section 302A.661, subdivision 4, indicates the Minnesota legislature’s intent to limit any extension of successor liability. In Everest v. American Transportation Corp., an Arkansas corporation purchased assets from another Arkansas corporation and continued to manufacture the same products as the transferor at the same plant with many of the same employees that the transferor had used. In a suit relating to a death allegedly resulting from the negligent design and manufacture of the product by the corporation’s transferor, the U.S. District Court for Minnesota granted summary judgment to the transferee on grounds that Minnesota does not impose liability on a transferee even if it engages in essentially the same manufacturing operations as the transferor.

Despite this general rule, state courts have traditionally applied four exceptions to the presumption of non-liability of transferees. These exceptions are:

Generally where one corporation sells or otherwise transfers all of its assets to another corporation, the latter is not liable for debts and liabilities of the transferor, except: (1) where the purchaser expressly or impliedly agrees to assume such debts; (2) where the transaction amounts to a consolidation or merger of the corporation; (3) where the purchasing corporation is merely a continuation of the selling corporation; and (4) where the transaction is entered into fraudulently in order to escape liability for such debts.

In addition, both the statute itself and the Reporter’s Notes establish that the statute does not override transferee liability under federal and state statutes. As discussed in detail below, it is the

41. Id. at 207-08.
43. Minnesota Statutes section 302A.661, subdivision 4, states that the transferee is liable for the transferor’s obligations to the extent provided in other Minnesota statutes. The Reporter’s Notes to § 302A.661, subd. 4, recite that
interplay of this federal and state liability in the asset transfer context that is an important aspect of the *Johns* decisions in the Minnesota appellate courts.

III. *JOHNS V. HARBORAGE I, LTD.*

A. The Facts and Preliminary Decisions

In 1993, Lori Johns worked as a server at Gators Bar and Restaurant at the Mall of America. Ms. Johns was sexually harassed by a coworker while working there in February of 1993. One month later, Ms. Johns resigned from her position at Gators, and on January 14, 1994, she filed unlawful discrimination charges with the Equal Employment Opportunity Commission ("EEOC"). In June 1995, the EEOC issued Ms. Johns a right-to-sue notice. On September 15, 1995, she filed a sexual harassment suit against Gators in Minnesota District Court under both Title VII of the Federal Civil Rights Act and section 363.01 of the Minnesota Human Rights Act ("MHRA").

At the time of the sexual harassment in 1993, Gators was operated by three legal entities. FPM, Ltd. ("FPM") was a Texas limited partnership formed in May 1992, that leased the Gators premises from the Mall of America Company, held the liquor license, and owned all the furniture, fixtures, equipment and inventory. Harborage I, Ltd. ("Harborage I") was a Texas limited
partnership formed in December 1991, that provided management services to Gators (and at least seven other bars) as a general contractor. Harborage, Inc. was a Texas corporation incorporated in 1986 that provided employees for Gators and issued paychecks to Gators’ employees as a subcontractor. All three businesses shared the same offices in Dallas, Texas and all three shared ties to both Charles W. Greener and Joyce O. McReynolds.

Ms. Johns originally brought her employment discrimination suit against Harborage, Inc., the company that issued the checks for her work. Harborage, Inc. initially admitted to being Johns’s employer. In July 1996, defense counsel requested that Johns amend her complaint to list Harborage I as her employer. Johns made this change. Then in October 1996, defense counsel advised Johns that Harborage, Inc. was actually her employer at the time of her harassment, so the parties stipulated to a change in the complaint again. One month later, Harborage, Inc. filed for

54. Greener Aff. ¶ 4.
55. Johns III, 664 N.W.2d at 293.
57. Greener Aff. ¶ 10.
58. Johns III, 664 N.W.2d at 293.
59. Id.
60. Greener Aff. ¶ 10.
61. Johns III, 664 N.W.2d at 293. The Charles W. Greener Trust was the sole shareholder of Main Event, Inc. (“Main Event”) which in turn, held thirty-nine percent of FPM and one hundred percent of Harborage, Inc., outright. William J. Morris Aff. of 2/20/97, Ex. F at 11 (Intoxicating Liquor or Wine License Application). Through Harborage, Inc., Main Event also held 99% of FPM. Johns I, 585 N.W.2d at 860. McReynolds held the positions of President, Vice-President, Secretary, Treasurer and sole Director in: (1) Harborage, Inc., (2) Harborage Services, Inc. (the general partner in FPM), (3) FPM I, Inc. (the general partner in FPM), and (4) Main Event, Inc. Johns I, 585 N.W.2d at 859. When FPM was formed, Leon Carroll signed as President of both Harborage I and Harborage Services, Inc. (“Harborage Services”). Id. However in 1995, when Harborage, Inc. transferred its interest as a limited partner in FPM to AFSC Services I, Ltd., McReynolds signed as the President of Harborage, Inc. and Harborage Services.
63. Id.
bankruptcy protection. Ms. Johns then filed a motion to amend her complaint to name Harborage I and FPM as defendants, which the district court granted.

On September 8, 1997, following a bench trial, the district court concluded that Harborage, Inc. and Harborage I was a simple integrated enterprise, each of which could be considered Ms. Johns’s employer for purposes of her lawsuit, and that they had submitted Ms. Johns to a hostile work environment based on her sex. The district court awarded damages, including punitive damages and attorney fees, to Ms. Johns against Harborage I. The district court however, dismissed all claims against FPM stating only that: “Defendant FPM, Ltd., while sharing some common ownership, was only the lessee and holder of the liquor license at Gators, but not involved in management or labor relations to a degree sufficient to be considered plaintiff’s employer.”

Before the district court judgments were entered, Jillian’s entered into an asset purchase agreement (“APA”) with FPM, Ltd. and other entities, to purchase the assets of Gators and two other bars at the Mall of America. In May 1998 the APA closed. The APA did not specifically mention the lawsuit with Johns. Harborage I was not a party to the APA, but $3.7 million of the purchase price went to pay management fees that would have been payable to Harborage I up until shortly before the transaction. Johns v. Harborage, Inc., No. PI 95-17129 at 4 (Minn. Dist. Ct. Sept. 30, 2000) (district court memorandum). FPM I, Inc. received $352,491 of those management fees. Hennessy Aff., Ex. 2 at 1.
Agreement ("TSA") with Harborage I so that Harborage I would continue to provide administrative and labor services to Gators until certain employees could be transferred to Jillian’s payroll. Jillian’s commenced operating Gators without substantial change. It retained the same name, location, supervisors, managers, employees, uniforms, pay, benefit, décor, menu, furniture, and equipment.

In February 1998, Harborage I appealed the district court ruling. In November 1998, the court of appeals affirmed the district court ruling, except as to punitive damages, and later awarded Ms. Johns appellate attorney fees. In March of 1999, while attempting to collect on her judgment, Ms. Johns discovered that Harborage I could not satisfy any of the judgment because its assets had been liquidated. As a result, Ms. Johns moved to add Jillian’s as a defendant to her complaint on the theory of successor liability. On September 30, 2000, the district court granted Ms. Johns’s motion to add Jillian’s as a defendant.

Ms. Johns then moved for summary judgment against Jillian’s as a successor to the defendants already found liable in the action. Jillian’s filed a cross motion for summary judgment, objecting to the procedure by which it was made a party to the action and denying succession of Harborage I. The district court granted Ms. Johns’s motion for summary judgment on the grounds that: (1)
“the effect, if not the intent,” of the APA was to block collection of a valid judgment; (2) Jillian’s was aware of the “vital role” Harborage I played in the operation of Gators; (3) the same management personnel remained following Jillian’s purchase; and (4) Jillian’s knew well its potential liability. The district court ordered the judgments amended to add Jillian’s as a judgment debtor. The court of appeals reversed, finding that Jillian’s was not a successor of Harborage I.

B. The Supreme Court Opinion

In an en banc decision, the Minnesota Supreme Court reversed the court of appeals rulings and held that the classification of Jillian’s as Harborage I’s successor was correct. As stated by the majority, the issue at the heart of the case was “whether Jillian’s can be considered a successor employer for purposes of enforcing the judgment obtained against Harborage I.”

Significantly, the court held that under Minnesota corporate law, Jillian’s was not liable to Ms. Johns. When Ms. Johns sought to enforce the judgment against Harborage I, she was unable to collect because the employer’s assets had been liquidated, and Ms. Johns then sought a judgment against Jillian’s. The supreme court held that purchasers of corporate assets are liable only to the extent provided for by contract, and, therefore, Jillian’s did not have successor corporation liability under Minnesota’s corporate law. Because Jillian’s had only agreed to assume certain specified liabilities (which did not include discrimination claims) under the APA and TSA, the court ruled that, under Minnesota Statutes section 302A.661, subdivision 4, Jillian’s was not liable for the judgment as a successor to the former Gators entities.

The Minnesota Supreme Court ruled, however, that the protection against transferee liability under Minnesota Statutes section 302A.661, subdivision 4, does not apply to successor liability

84. Johns II, 645 N.W.2d at 764.
85. Id. at 767.
86. Johns III, 664 N.W.2d at 764 (Gilbert, J., dissenting).
87. Id. at 296.
88. Id. at 297.
89. Id. at 293-94.
90. Id. at 297.
91. Id.
applicable to Title VII claims. The court rejected Jillian’s argument that federal successor liability could not extend beyond state successor liability, recognizing that federal successor liability is federal common law, independent from state law. Acknowledging, however, that the U.S. Supreme Court has not ruled on the issue of whether successor liability applies to Title VII cases, the court noted that the federal circuits uniformly apply successor liability to Title VII cases and concluded that this application is proper in light of the nature and goal of Title VII.

After justifying its application of federal successor liability to the *Johns* case, the court analyzed the particular facts of *Johns* under the two pronged inquiry it outlined: whether there existed continuity of the business and whether Jillian’s as a successor had notice of the underlying claims by Ms. Johns. The court concluded that the undisputed facts showed a substantial continuity of business operations. In examining the continuity of business operations, the Minnesota Supreme Court considered the entire Gators restaurant as the business. The court argued that even though the owners of Gators were free to “unbundle the business into as many legal entities as they choose, the policies that underlie Title VII cannot be avoided by attempting to confine the ‘employer’ function to a limited entity that has no purpose independent of the business as a whole.” Under the federal doctrine, the court did not focus on the formalities of the APA or TSA; rather it focused on the fact that the buyer basically continued the business with no change in management, location, or other attributes. Noting that the location and people remained the same, the court ruled that, as a matter of law, the continuity of the business had been established.

92. *Id.* at 299.
93. *Id.* at 298.
94. *See id.* The court cites other cases extending federal successor employer liability to Title VII cases. *See* EEOC v. G-K-G, Inc., 39 F.3d 740, 747-48 (7th Cir. 1994); EEOC v. Vucitech, 842 F.2d 956, 945 (7th Cir. 1988); *In re* Nat’l Airlines, Inc., 700 F.2d 695, 698 (11th Cir. 1983); Dominguez v. Hotel, Motel, Rest. & Misc. Bartenders Union Local # 64, 674 F.2d 732, 733 (8th Cir. 1982); Trujillo v. Longhorn Mfg. Co. Inc., 694 F.2d 221, 224-25 (10th Cir. 1982); Slack v. Havens, 522 F.2d 1091, 1094-95 (9th Cir. 1975).
95. *See Johns III*, 664 N.W.2d at 299-300.
96. *Id.* at 299.
97. *Id.*
98. *Id.*
99. *Id.*
With regard to the notice requirement, the court noted that Jillian’s did not contend that it lacked notice of the judgment against Harborage I.\(^{100}\) In fact, Jillian’s hired employees who were involved in the litigation with Ms. Johns, including Harborage I’s human resources director, who was an active member of the litigation.\(^{101}\) Based on this, the court ruled that Jillian’s was aware of the judgment for Ms. Johns and had the opportunity to take that judgment into account when bargaining for Gators.\(^{102}\) The court ruled that Jillian’s had the proper notice required for successor liability to attach.\(^{103}\) As a result, Johns III met both prongs of the federal test the Minnesota Supreme Court outlined and the court added Jillian’s to the judgment.\(^{104}\)

The dissent took issue with the majority’s successor liability analysis.\(^{105}\) The dissent argued Jillian’s was not a successor to the defendant, Harborage I.\(^{106}\) While the dissent admitted that the U.S. Supreme Court does not distinguish between mergers, consolidations, and asset transfers in applying federal successor liability, the dissent argued that all of the case law applying the doctrine involves at least one of those three types of transfers.\(^{107}\) The dissent asserted that since Harborage I and Jillian’s were not involved in any of those types of transfers, they did not have a predecessor to successor relationship.\(^{108}\) The dissent further argued that by naming Jillian’s a successor, the district court and the Minnesota Supreme Court were essentially overturning the previous district court ruling that held that FPM was not liable to

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\(^{100}\) Id.

\(^{101}\) Id. at 299-300.

\(^{102}\) Id. at 300.

\(^{103}\) Id. Because a judgment had already been entered in the case, the requirement for filing an EEOC claim was clearly met. Johns had to file the EEOC claim before she could bring a suit against Harborage I. Id. at 295-96.

\(^{104}\) Id. at 300.

\(^{105}\) The dissent agreed with only three propositions the majority set forth. First, Justice Gilbert agreed that Minnesota corporate law did not make Jillian’s liable as a successor. Id. Second, he agreed that federal successor liability did not distinguish between the types of asset transfers when examining successor liability. Id. Third, he agreed that federal successor liability applied to labor law issues. Id. at 300-03. The dissent took issue with the procedure used to join Jillian’s as a defendant in the case. Id. at 303. This comment focuses solely on the federal successor liability issue; hence, it will not discuss or address the dissent’s arguments on the procedure used to join Jillian’s.

\(^{106}\) See id. at 301-02 (Gilbert, J., dissenting).

\(^{107}\) Id.

\(^{108}\) Id.
Ms. Johns. \textsuperscript{109} Finally, according to the dissent, the majority had imposed a dramatic new risk on those who would acquire the assets of an ongoing business that will result in an unwieldy increase in buyers’ due diligence investigations attempting to protect against that risk. \textsuperscript{110}

IV. UNDERSTANDING THE LIMITS OF LIMITED LIABILITY IN \textit{JOHNS}

The rulings by the Minnesota Supreme Court in \textit{Johns III} implicate both entity-based limited liability and transaction-based limited liability. Jillian’s could not be held liable to Ms. Johns unless Jillian’s was found to have some connection with the entity that was John’s employer at the time of the unlawful discrimination, that is, Harborage, Inc. This determination requires an analysis of entity-based limited liability and its enterprise entity exception. In addition, even if some relationship existed between Jillian’s and Ms. Johns’s former employer, Jillian’s must be found to be the employer’s successor. This second determination requires an analysis of transaction-based limited liability and its successorship limitations. Only by exploring these two pieces separately can the conclusions in \textit{Johns III} be understood and considered for their ultimate merits.

Consider the quandary of the Minnesota courts as the \textit{Johns} case progressed. Remember that the Gators business originally was separated into discrete pieces, as illustrated by Figure 4.

\textsuperscript{109} \textit{Id.} at 301-02. The dissent argued that by finding successor liability, the court was denying the separate legal existence of the various entities created to operate Gators. \textit{Id.} at 301. According to the dissent, the majority created a new rule that as long as the owners of various entities benefited from a transaction, those entities could be considered as one entity. \textit{Id.}

\textsuperscript{110} \textit{Id.} at 300. After arguing that the method of transfer did not support the application of federal successor liability, the dissent further argued that the remedy sought by Johns did not support the application of the doctrine either. \textit{Id.} at 302. The dissent made the point that the federal successor employer doctrine is an equitable doctrine and cases where courts employed it involved at least some equitable relief. \textit{Id.} In the present case, the dissent argued that there were no equitable principles involved because Johns only sought monetary damages. \textit{See id.} The dissent claimed that neither equitable nor legal principles supported a finding of successor liability in \textit{Johns} and as a result, the Court should not have named Jillian’s as a successor liable to Johns. \textit{Id.}
Initially, the district court was faced with a valid discrimination lawsuit against one of those pieces, Harborage, Inc., which had been identified as Ms. John’s employer.\(^{111}\) On the eve of trial, Harborage, Inc. filed for bankruptcy protection.\(^{112}\) To deal with this conundrum, the district court determined that Harborage, Inc. and Harborage I, Ltd. were so interrelated in the labor relations aspect of the Gators business that they could both be treated as Ms. John’s “employer” for purposes of liability under Title VII.\(^{113}\) At the same time, the district court determined that FPM, Ltd. was not sufficiently interrelated so as to be considered Ms. John’s employer.\(^{114}\) These initial determinations by the district court were based on Title VII federal law concepts of who is an “employer.”\(^{115}\)

Believing that it had supplied Ms. John with a viable remedy through its use of the joint employer or integrated employer doctrine under Title VII, the district court entered judgment for Ms. John against both Harborage, Inc. and Harborage I, Ltd., but not against FPM, Ltd.\(^{116}\) But that was not the end of the saga. When Ms. John attempted to collect on her judgment, she discovered that Harborage I could not satisfy her judgment because

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\(^{112}\) Id.

\(^{113}\) John III, 664 N.W.2d at 293.

\(^{114}\) Id.

\(^{115}\) Id. There is and was a substantial jurisprudence under Title VII allowing more than one entity to be treated as the employer if there is a sharing of employment related functions. See, e.g., Stephen F. Befort, Labor Law and the Double-Breasted Employer: A Critique of the Single Employer and Alter Ego Doctrines and a Proposed Reformulation, 1987 Wis. L. Rev. 67 (1987); Mark Crandley, The Failure of the Integrated Enterprise Test: Why Courts Need to Find New Answers to the Multiple-Employer Puzzle in Federal Discrimination Cases, 75 IND. L.J. 1041 (2000); Gina M. Delahunt, Pointing Fingers—Will the Real Employer Please Stand Up! When is an Entity an Employer in a Sexual Harassment Claim?, 7 J. SMALL & EMERGING BUS. L. 501 (2003). The district court did not rely on common law horizontal veil piercing to bring in Harborage I and exonerate FPM.

its assets had been liquidated.\textsuperscript{117} Despite the best efforts of Ms.
Johns, her attorneys, and the district court, Ms. Johns was still left
without a viable defendant to satisfy her judgment.

Ms. Johns moved to add Jillian’s as a defendant to her
complaint on the theory of successor liability.\textsuperscript{118} The district court
granted Ms. Johns’s motion and ultimately found Jillian’s
responsible.\textsuperscript{119}

\textbf{A. Analysis of the Entity Piercing Determination}

Before Ms. Johns could successfully get to Jillian’s assets,
however, she somehow had to connect Jillian’s to Harborage, Inc.
or Harborage I, the entities determined to be Ms. Johns’s joint or
integrated “employer.” That is, she had two separate hurdles
to cross to get a remedy against Jillian’s. First, Ms. Johns had to
convince the courts to create a link among all of the original Gators
entities, including FPM. Second, Ms. Johns needed the courts to
find that Jillian’s was the successor of that redefined amalgam.

The problem for Ms. Johns and the courts was that Jillian’s
connection with the original employer, Harborage, Inc., was non-
existent. Jillian’s connection with Harborage I was by way of the
TSA, whereby Harborage I simply agreed to provide administrative
and labor services to Gators until certain employees could be
transferred to Jillian’s payroll.\textsuperscript{120} Jillian’s connection with FPM was
by way of the asset purchase agreement. Figure 5 illustrates the
separate relationships of Jillian’s with Harborage I and with FPM,
the remaining solvent entities that had been the original Gators
operation.

\textsuperscript{117} Johns III, 664 N.W.2d at 293.
\textsuperscript{118} Johns II, 645 N.W.2d at 763. Harborage I did not oppose the motion to
amend the complaint to include Jillian’s as a defendant. \textit{Id.}
\textsuperscript{119} Johns III, 664 N.W.2d at 294; Johns v. Harborage, Inc., No. 95-17129, at 3-4
added Jillian’s as a defendant on the grounds that: (1) Jillian’s knew well its
potential liability, (2) the effect, if not the intent, of the APA was to block
collection of a valid judgment, (3) Jillian’s was aware of the vital role Harborage I
played in the operation of Gators, (4) Harborage I had other ties to the Sellers,
and (5) Harborage I’s principals (Greener and McReynolds) benefited
substantially from the sale while avoiding valid judgment debt. Johns v.
memorandum).
\textsuperscript{120} Johns II, 645 N.W.2d at 763.
Under traditional successor liability principles, the asset purchase agreement between Jillian’s and FPM provided the most substantial basis for some connection between Jillian’s and the three entities originally involved in the Gators operation. That is, common law courts had sometimes found successor liability in the asset transfer context despite an attempt by the parties to limit the transferee’s liability.  

The problem in *Johns* was that FPM previously had been absolved from liability, at least to the extent of not being considered to be Ms. Johns’s “employer” under the Title VII joint or integrated employer doctrine. The courts needed some way to combine the operations of Harborage I and FPM. Despite the finding by the district court that FPM was not Ms. Johns’s employer for Title VII purposes, the supreme court did find a basis for tying Harborage I and FPM together as one entity. The theory applied was the common law enterprise entity theory of horizontal piercing in the entity-based limited liability context. The supreme court refused to view Harborage I and FPM as separate entities. According to the supreme court, they were functionally both pieces of the same business operation, that is, Gators Bar and Grill. That is, no matter who the *employer* was, the *business* as a on-going concern necessitated inclusion of all the pieces, including FPM. “Although Greene [sic] and McReynolds were free to unbundle the business into as many legal entities as they choose, the policies that underlie Title VII cannot be avoided by attempting to confine the ‘employer’ function to a limited entity that has no purpose independent of the business as a whole. Greene [sic] and McReynolds were only able to operate Gators by joining the efforts of all of the related entities.”

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121. See supra text accompanying notes 38-43.
122. *Johns III*, 664 N.W.2d at 299.
123. *Id*.
124. *Id* (emphasis added).
According to the supreme court, Harborage, Inc., Harborage I, and FPM while ostensibly separate legal entities, were functionally one business operation.\textsuperscript{125} The legal framework had to be reconstructed to fit the practical and operational reality. The language from Adolph Berle’s famous 1947 article on horizontal piercing fits precisely:

Another illustration of judicial erection of a new entity occurs in situations where the corporate personality (as embodied in its charter, books and so forth) does not correspond to the actual enterprise, but merely to a fragment of it. The result is to construct a new aggregate of assets and liabilities . . . . The decisions disregard the paper corporate personalities and base the results on the assets of the enterprise.\textsuperscript{126}

Therefore, according to the supreme court, the appropriate way to view the Gators pre-Jillian’s organizational structure is illustrated by Figure 6.

\textbf{Figure 6: The Horizontally Combined Entities Comprising Gators Restaurant}

\begin{center}
\begin{tikzpicture}
  \draw[fill=blue!20] (0,0) rectangle (2,1);
  \node at (1,0.5) {Harborage, Inc.};
  \draw[fill=blue!20] (2,0) rectangle (4,1);
  \node at (3,0.5) {Harborage I, Ltd.};
  \draw[fill=blue!20] (4,0) rectangle (6,1);
  \node at (5,0.5) {FPM, Ltd.};
  \node at (1,1.5) {McReynolds and Greener};
\end{tikzpicture}
\end{center}

Just like the historic situations involving taxicab companies, the separate existences of the three entities that originally comprised Gators were horizontally pierced to become one legally reformed business entity.

Justice Gilbert’s dissent took the majority to task on the issue of horizontally combining the separate entities that comprised Gators.\textsuperscript{127} According to Justice Gilbert:

The foundation for the majority opinion made at the district court is full of fault lines that should not be

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\textsuperscript{125} Id.
\textsuperscript{126} Adolf A. Berle, Jr., The Theory of Enterprise Entity, 47 Colum. L. Rev. 343, 348 (1947).
\textsuperscript{127} Johns III, 664 N.W.2d at 300-03 (Gilbert, J., dissenting).
expanded upon by this court.

\ldots

This reasoning is problematic for a number of reasons. It ignores the separate, valid and legal existence of the various entities. Moreover, this rationale is used to pierce the separate independent veil of each entity because “the principals benefited” from the sale. A new legal theory has been created in Minnesota, which appears to abolish the distinction between separate legal entities as long as the principals of the various entities benefited from the transaction. Again, the majority fails to cite to authority for this major new proposition. 128

Justice Gilbert seems to be right in part. Johns III does appear to be the first time the Minnesota Supreme Court has adopted, albeit inartfully, the enterprise entity theory of horizontal veil piercing among business entities. In response, however, the supreme court majority might have said that this theory is not so novel, but rather is the well-worn enterprise entity or horizontal piercing theory of corporate law, and that the authority for this not so new and not so major proposition comes from Adolph Berle and the taxicab cases.

In any event, Minnesota now has support for horizontal veil piercing from its highest court. As Justice Gilbert aptly summarized the supreme court majority’s enterprise entity horizontal piercing analysis:

[this] legal theory ignores the fact that these separate companies were long in existence and were not set up to defraud the appellant or anyone else. Appellant was only hired by, worked for, and harmed in the employment context by Harborage I. Now, long after the appellant has left the employment and lost in the first go-around in court against FPM, the district court has successfully bundled up all of these separate business entities to make each one liable for the debts of the others. 129

The legal entity had been reformed to reflect the practical

128. Id. at 301.
129. Id. at 301-02. Justice Gilbert knew what this meant for Jillian’s: “By concluding that Jillian’s is liable to the appellant as a successor-employer, the district court ignored the fact that FPM was only the seller of these assets and had been previously absolved of any responsibility by this same district court and now 3 years after the initial decision, attributes liability to ‘the Jillian defendants.’” Id. at 302.
reality of the business enterprise.

B. State and Federal Successor Liability—One Step Forward and One Step Back

The next step to ultimately holding Jillian’s liable to Ms. Johns was to determine if Jillian’s was a successor to the combined Gators entities, Haborage, Inc., Harborage I, and FPM. The supreme court’s analysis on this point consists of two parts: first, successor liability under state law, that is, the MBCA, and second, successor liability under federal Title VII employment discrimination law. Each of these parts deserves separate consideration.

1. The Rationalization of Minnesota Successor Liability Law

Maybe the most significant aspect of the Johns III decision in the supreme court was its clarification and narrowing of successor liability under Minnesota corporate law. As discussed above, the presumption is that, in a transfer of business assets context, the transferee is not liable for the transferor’s obligations except to the extent explicitly assumed. Historically, the courts had created four common law exceptions to this presumption, such as where there was an implied assumption of debts, a de facto merger, a mere continuation of the transferring enterprise, or the transaction was entered into fraudulently.

In 1981, when the then-new MBCA was adopted, the legislature tried to significantly restrict the application of common law successor liability under Minnesota law. Minnesota Statutes section 302A.661, subdivision 4, provides simply that “[t]he transferee is liable for the debts, obligations, and liabilities of the transferor only to the extent provided in the contract or agreement between the transferee and the transferor or to the extent provided by this chapter or other statutes of this state.” Therefore, the intent was to presumptively limit transferee liability to those liabilities voluntarily assumed in the asset transfer contract itself. The only stated exception was for statutory law, that is, “to the extent provided by this chapter or other statutes of this state.” No room was left for
application of the four common law (as opposed to statutory) exceptions that had previously been applied by the courts.\textsuperscript{135}

This intent to effectively limit transferee liabilities to those explicitly assumed and those legislatively mandated, thereby eliminating the common law jurisprudence in this area (and the four common law exceptions), is echoed in several places. The report to the Minnesota legislature prepared by the Advisory Task Force, the drafting body for the MBCA, states that section 302A.661 “reflects current law with respect to sales of assets except that subdivisions 3 and 4 are new. They permit . . . the restriction of successor liability to liabilities imposed by the agreement of transfer [and] by other statutes, such as Article 6 of the U.C.C.”\textsuperscript{136} Similarly, the Reporter’s Notes to section 302A.661, included at the time of the adoption of the MBCA, provide that “[s]ubdivision 4 of this section is aimed at limiting civil liabilities of transferees assumed by transferees to those agreed to between the parties or imposed by law, even if the transferee is operating the corporation in exactly the same manner as it was operated by the transferor.”\textsuperscript{137} Nevertheless, despite this apparently clear legislative intent to restrict state successor liability, the Minnesota Court of Appeals and the Minnesota federal courts continued to apply the four common law exceptions to transferee non-liability even after adoption of the MBCA.\textsuperscript{138}

\textsuperscript{135} J.F. Anderson Lumber Co. v. Myers, 296 Minn. 33, 37-38, 206 N.W.2d 365, 368-69 (1973) (citing 15 WILLIAM MEADE FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 7122 (perm. ed. 1992 & Supp. 2004)). The J.F. Anderson court stated that the judicially imposed exception for a “continuation of the selling corporation” did not apply solely because a purchaser carries on the same business of the seller but instead applies primarily to reorganizations of a corporation under federal or state statutes. \textit{Id}.


Johns afforded the Minnesota Supreme Court an opportunity to address the question of the continued vitality of the four common law exceptions to non-liability of transferees directly. Remember, as visualized by the supreme court, the relationship between Jillian’s and the horizontally combined Gators entities looked like Figure 7.

Figure 7: Jillian’s Relationship with the Combined (Solvent) Gators Entities

The issue of successor liability law, what the majority of the Minnesota Supreme Court called the "heart of the case," was whether Jillian’s would be liable as a transferee of these combined entities under successor liability law. As a matter of Minnesota successor liability law, both the majority and dissent agreed in their restrictive interpretation of Minnesota law and the rejection of the four common law exceptions to transferee non-liability. The majority held:

Minnesota successor-corporation law, as codified by

plaintiff on issue of whether transfer of assets constituted a de facto merger resulting in liability of transferee as a de facto successor corporation). No other recent case has been found in which a Minnesota court suggested that an assets sale that would not otherwise result in transferee liability might be classified as a de facto merger creating such liability under the facts presented in the case. In New York Life, substantially all of the transferor’s assets were transferred to its sister corporation, and the transferor then liquidated its remaining assets and ceased doing business. Id. The court determined that section 302A.661, subdivision 4, was inapplicable because the provision was enacted after the transfer of assets occurred. Id.

139. In Niccum v. Hydra Tool Corp., 438 N.W.2d 96, 99, 101 (Minn. 1989), the Minnesota Supreme Court, while citing J.F. Anderson, affirmed summary judgment in favor of a transferee corporation, noting that Minnesota Statutes section 302A.661, subdivision 4, indicates the Minnesota legislature’s intent to limit any extension of successor liability.

140. Johns III, 664 N.W.2d 291, 296 (Minn. 2003).
statute, provides that “The transferee is liable for the debts, obligations and liabilities of the transferor only to the extent provided in the contract . . . .” Minn. Stat. § 302A.661, subd. 4 (2002); see also J.F. Anderson Lumber Co. v. Myers, 296 Minn. 33, 40-41, 206 N.W.2d 365, 370 (1973) (holding that when one corporation transfers its assets to another, the receiving corporation is not responsible for debts of transferor unless it agrees to assume these debts). Jillian’s did not have successor-corporation liability under Minnesota’s corporate law because Jillian’s carefully defined the liabilities it would assume, and debts such as Johns’ judgments were not among them.\footnote{141}

There are several monumental aspects of this short section of the Minnesota Supreme Court’s majority opinion in \textit{Johns III}. Note first that the majority stated the rule of Minnesota successor liability just as it had been intended by the legislature when it adopted section 302A.661 of the MBCA in 1981; that is, that the transferee’s liabilities are defined by the contract between the transferor and the transferee.\footnote{142} The court did not even qualify its statement by quoting the explicit exception in section 302A.661 for state \textit{statutory} law, although clearly that exception could have applicability in the right situation. Second, when the court made reference to its pre-MBCA decision in \textit{J.F. Anderson Lumber Co. v. Myers},\footnote{143} which had stated not only the general rule on non-liability for transferees, but also the four common law exceptions, the supreme court majority in \textit{Johns III} clarified the holding of that case.\footnote{144} The Minnesota Supreme Court majority in \textit{Johns III} cites \textit{J.F. Anderson} for the “holding that when one corporation transfers its assets to another, the receiving corporation is not responsible for debts of transferor unless it agrees to assume these debts.”\footnote{145} Period. No mention of any common law exceptions to that rule of non-liability is made, even though the “mere continuation” exception arguably could have been applied on the \textit{Johns} facts.\footnote{146} Third, when summarizing its holding as to Jillian’s non-liability under Minnesota successor liability law, the supreme court majority focused solely on the

\footnote{141}{Id. at 297.}
\footnote{142}{Id.}
\footnote{143}{296 Minn. 33, 40-41, 206 N.W.2d 365, 370 (1973).}
\footnote{144}{\textit{Johns III}, 664 N.W.2d at 297.}
\footnote{145}{Id.}
\footnote{146}{This is clear because the Court found that “substantial continuity” between Jillian’s and its predecessors was demonstrated for purposes of Title VII federal successor liability. \textit{Id.} at 299.}
parties’ agreement, stating that “Jillian’s did not have successor-corporation liability under Minnesota’s corporate law because Jillian’s carefully defined the liabilities it would assume, and debts such as Johns’ judgments were not among them.”

On this fundamental point of Minnesota corporate law, the supreme court majority and the dissent found agreement. As the dissent summarizes: “The majority correctly points out that Jillian’s did not have successor corporate liability under Minnesota corporate law. All of the companies here were properly registered to do business and they carefully defined the liabilities and debts they wanted to assume and appellant’s debts were not among those.”

It therefore is fair to conclude that a unanimous Minnesota Supreme Court has conclusively determined that the concept of successor liability under Minnesota law is fundamentally a function of the agreement between the parties. Parties to an asset transfer transaction can define their own allocation of liabilities, which will not only bind those parties, but also third parties, such as Ms. Johns, as well as the Minnesota courts. Moreover, absent a finding of state or federal statutory law imposing greater obligations, a review of the agreement between the parties is determinative of this allocation.

These conclusions are a tremendous benefit for parties negotiating asset transfer transactions involving Minnesota businesses. The parties can negotiate their asset transfer contracts confident that their contractual liability allocations are determinative absent statutory law, such as federal environmental law or, as in the Johns matter, federal Title VII law, to the contrary. More important, parties to asset transfer transactions should be able to avoid costly and substantial litigation with third parties about the potential applicability of the four common law exceptions to transferee non-liability that pre-dated adoption of the MBCA. On the basis of both the majority and the dissent in Johns, trial courts should summarily dispose of claims to apply these common law exceptions.

2. Federal Successor Liability Law under Title VII

The issue of Jillian’s potential successor liability under federal

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147. Id. at 297.
148. Id. at 300.
Title VII law remained. As the majority of the supreme court analyzed the issue, its finding of no liability under Minnesota law and its clarification of successor liability in Minnesota was important but not dispositive. “In addition to successor-corporation liability under Minnesota corporate law, a separate and broader concept of successor-employer liability has been recognized in federal decisions under Title VII. Because Title VII provides an alternate basis for the judgments in this case, the federal doctrine of successor-employer liability must be considered.”

The U.S. Supreme Court first established successor employer liability in *John Wiley & Sons, Inc. v. Livingston*. In that case, the issue was what effect a merger of two companies had on a union bargaining agreement. The successor employer refused to bargain with or recognize the union, and it refused to honor the bargaining agreement the union held with the predecessor employer. The Court stated that in cases involving federal labor policy, federal law controls. National labor policy requires certain protections for workers and those protections may limit the owner’s freedom to sell his or her company. National labor policy requires a balancing of employer and employee interests. Considering that the Court ruled that the successor was required to arbitrate with the union under the bargaining agreement. The successor was not required to renew the agreement, but it did need to arbitrate with the union so that a settlement could be reached for all of the back pay and benefits that the successor had denied.

149. *Johns III*, 664 N.W.2d at 297. This conclusion is also consistent with the MBCA itself. As the Reporter’s Notes to Section 302A.661 provide, “of course, federal statutes may preempt this statute in certain areas of liability.” REPORTER’S NOTES—1981 TO SECTION 302A.661 OF THE MBCA, at 298, 2003-04 Special Pamphlet, 298 (2003), reported in *WEST’S MINNESOTA CORPORATION, LIMITED LIABILITY COMPANY, AND PARTNERSHIP LAWS* (2004-05).
151.  *Id.* at 545.
152.  *Id.*
153.  *Id.* at 548. The Court stated that state law may be used to aid in the development of appropriate principles or their application to the particular facts of a case, but ultimately, the law is federal and it supersedes any state laws. *Id.*
154.  *Id.* at 549.
155.  *Id.*
156.  *Id.* at 548. While ordinary contract law would not hold a successor liable for something that it had not bargained for, collective bargaining agreements are not normal contracts. See *id.* at 549.
the union members since the merger.\footnote{157} In its analysis of the case, the Court set out a two part test for determining whether a successor has a duty to arbitrate with the union.\footnote{158} First, there must be a substantial continuity of identity between the business before and after the merger or change in ownership.\footnote{159} Second, the successor must have notice of the employees’ claims so that the successor might consider them when bargaining with the predecessor.\footnote{160}

Later cases affirmed the holding in \textit{John Wiley \& Sons, Inc.}\footnote{161} The federal circuits expanded the test in \textit{John Wiley \& Sons, Inc.} beyond NLRA cases into Title VII actions.\footnote{162} The landmark case applying successor employer liability to Title VII cases was \textit{EEOC v. MacMillan Bloedel Containers, Inc.}\footnote{163} In that case, the court found that the similarities between the NLRA and Title VII warranted applying the same successor employer liability rule to both types of cases.\footnote{164} Examining the breadth of successor liability in the labor context, the court set out nine factors to consider in a Title VII successor case.\footnote{165} Since \textit{MacMillan}, other federal courts have

\begin{footnotes}
\footnote{157}{\textit{Id.}}\footnote{158}{\textit{Id.} at 551.}\footnote{159}{\textit{Id.}}\footnote{160}{\textit{Id.}}\footnote{161}{See \textit{EEOC v. MacMillan Bloedel Containers, Inc.}, 503 F.2d 1086, 1089 (6th Cir. 1974); \textit{Johns III}, 664 N.W.2d 291, 297 (Minn. 2003); see also Marc A. Tenenbaum, \textit{Fall River: The NLRB’s Expansive Successorship Doctrine}, 50 Ohio St. L.J. 181, 182-85 (1989) (discussing the history of federal successor doctrine).}\footnote{162}{See \textit{MacMillan}, 503 F.2d at 1094. Later cases followed the precedent set in \textit{MacMillan}. See Kevin W. Brown, Annotation, \textit{Liability under Title VII of Civil Rights Act of 1964 (42 U.S.C.A. §§ 2000e et seq.) of Employer, As Successor Employer, For Discriminatory Employment Practices of Predecessor}, 67 A.L.R. Fed. 806 (1984).}\footnote{163}{503 F.2d 1086 (1974).}\footnote{164}{\textit{Id.} at 1090 (stating “[w]e are of the view that the considerations set forth by the Supreme Court in these three cases as justifying a successor doctrine to remedy unfair labor practices are applicable equally to remedy unfair employment practices in violation of Title VII”).}\footnote{165}{\textit{Id.} at 1094. The nine factors set out by the court were: 1) whether the successor company had notice of the charge, 2) the ability of the predecessor to provide relief, 3) whether there has been a substantial continuity of business operations, 4) whether the new employer uses the same plant, 5) whether he uses the same or substantially the same work force, 6) whether he uses the same or substantially the same supervisory personnel, 7) whether the same jobs exist under substantially the same working conditions, 8) whether he uses the same machinery, equipment and methods of production and 9) whether he produces the same product.}\footnote{Id. (citing Howard Johnson Co. v. Detroit Local Joint Executive Bd., Hotel \& Rest. Employees \& Bartenders Int’l Union, 417 U.S. 249, 256-58 (1974); Golden State...}
interpreted the MacMillan test so that the last seven factors actually form the first part of the two part test: substantial continuity of business operations. The second part of the test is notice of the claim.

The Minnesota Supreme Court analyzed the particular facts of Johns III under this two pronged test. For the majority of the supreme court, much of the groundwork for a finding of successor Title VII liability in Johns III had been accomplished by its horizontal piercing and combination of the three entities that comprised Gators before Jillian’s entered the picture. In examining the continuity of business operations, the Minnesota Supreme Court considered the entire Gators restaurant as the business. The court argued that even though the owners of Gators were free to “unbundle the business into as many legal entities as they choose, the policies that underlie Title VII cannot be avoided by attempting to confine the ‘employer’ function to a limited entity


167. Under Title VII, the notice factor requires that the injured employee have filed a claim with the EEOC prior to the transfer of company assets. See Rabidue v. Osceola Refining Co., 805 F.2d 611, 616 (6th Cir. 1986) (citing Wiggins v. Spector Freight Sys., Inc., 583 F.2d 882, 886 (6th Cir. 1978) (holding that the successor employer could not be held liable because the plaintiff had not filed a claim with the EEOC prior to the company acquisition). So, the Title VII notice requirement has two components for the employee to show successor employer liability: actual notice to the successor of the claim, and the filing of an EEOC claim prior to the transfer.


169. Id. at 299. It is also important to note that under federal successor liability, the method of transfer is not determinative of whether a successor has liability. Golden State Bottling Co., Inc. v. N.L.R.B., 414 U.S. 168, 182 n.5 (1973). The Supreme Court reasoned that the policies underlying the labor law doctrine of successorship allowed for a broader application of liability. Id. So while some states may limit successor liability based on the type of transfer conducted, federal doctrine does not distinguish between mergers, consolidations, and purchases of assets as long as the three pronged test for successor liability is satisfied. Id.; Chi. Truck Drivers, Helpers, and Warehouse Workers Union (Indep.) Pension Fund v. Tasemkin, Inc., 59 F.3d 48, 49 (7th Cir. 1995).
that has no purpose independent of the business as a whole.\textsuperscript{170} Noting that the employees, managers, location, name of the restaurant, and menu all remained the same, the court ruled that as a matter of law, a substantial continuity of business operations was shown.\textsuperscript{171}

As to the notice requirement, Jillian’s did not contend that it lacked notice of the judgment against Harborage I.\textsuperscript{172} Jillian’s hired the employees who were involved in the litigation with Johns, including Harborage I’s human resources director.\textsuperscript{173} The court concluded that Jillian’s was aware of the judgment for Ms. Johns and had the opportunity to take that judgment into account when bargaining for Gators.\textsuperscript{174} The court ruled that Jillian’s had the proper notice required for successor liability to attach.\textsuperscript{175}

The Minnesota Supreme Court’s finding of federal successor liability under Title VII piggy-backed on its finding of horizontal piercing among the three original Gators entities. Once combined, Jillian’s was involved in an asset transfer with them and the fact that FPM had been initially found not to be an “employer” did not prevent its being found to be a part of the enterprise entity that constituted Gators and to which Jillian’s succeeded.

As the supreme court viewed the transactions between Jillian’s and the combined entity, “[b]y the combination of the APA and TSA, Jillian’s acquired control of all of the related entities.”\textsuperscript{176} As to Jillian’s claim that it should only be tied to FPM through the APA, the supreme court responded that “[a]lthough we do not fully understand the district court’s decision not to enter judgment against FPM, we do not regard this as fatal to successor-employer liability because . . . the judgment against Harborage I implicates the entire business of Gators, to which Jillian’s succeeded.”\textsuperscript{177}

\textsuperscript{170} Johns III, 664 N.W.2d at 299.
\textsuperscript{171} Id.
\textsuperscript{172} Id.
\textsuperscript{173} Id. at 300.
\textsuperscript{174} Id.
\textsuperscript{175} Id. Because a judgment had already been entered in the case, the requirement for filing an EEOC claim was clearly met. Johns had to file the EEOC claim before she could bring a suit against Harborage I.
\textsuperscript{176} Id. at 299.
\textsuperscript{177} Id. (emphasis added).
V. CONCLUSION

*Johns v. Harborage I, Ltd.* is a complex amalgam of facts and legal issues. It provided the Minnesota Supreme Court with the opportunity to address several significant legal issues. The result of that analysis provides some guidance for entrepreneurs and their counsel with respect to the limits of limited liability in the entity and transactional settings. First, as to entity based limited liability, the court accepted the concept of horizontal veil piercing in order to legally reform a series of related entities to reflect their operational business enterprise reality. Second, as to transactional based limited liability, the Minnesota Supreme Court clarified Minnesota successor liability law by limiting successor liability to only those obligations explicitly assumed by the parties and those imposed by state or federal statutory law. As a matter of state successor liability law, application of the previously employed four common law exceptions is gone. This is consistent with the Minnesota legislature’s intent in adopting the MBCA. Finally, in its least remarkable action, the Minnesota Supreme Court applied federal Title VII successor liability law in a manner consistent with its application by the federal courts in other employment discrimination cases.