NO. A12-1654

State of Minnesota
In Court of Appeals

Continental Hydraulics, Inc.,

Relator,

v.

Minnesota Department of Employment
and Economic Development,

Respondent.

RELATOR'S REPLY BRIEF

Gary A. Van Cleve (#156310)
Rob A. Stefonowicz (#297161)
LARKIN HOFFMAN DALY &
LINDGREN, LTD.
1500 Wells Fargo Plaza
7900 Xerxes Avenue South
Minneapolis, MN 55431-1194
(952) 835-3800

Attorneys for Relator

Lee B. Nelson (#77999)
Amy R. Lawler (#388362)
Minnesota Department of Employment
and Economic Development
First National Bank Building
332 Minnesota Street, Suite E200
St. Paul, MN 55101-1351
(651) 259-7117

Attorney for Respondent

2013 – BACHMAN LEGAL PRINTING – FAX (612) 337-8053 – PHONE (612) 339-9518 or 1-800-715-3582

TABLE OF CONTENTS

TABLE OF AUTHORITIES ii

INTRODUCTION 1

ARGUMENT 2

I. THE TRANSFER OF THE EXPERIENCE RATING HISTORY FROM CMI TO CHI PURSUANT TO MINN. STAT. § 268.051, SUBD. 4(B)(2) IS LEGALLY IMPROPER AND FACTUALLY UNSUPPORTED. 2

A. The Language, "there is substantially common management or control," was Enacted in Minnesota to Comply with the SUTA Dumping Prevention Act of 2004. 2

1. The SUTA Act Does Not Apply to Arm's Length Market Transactions Between Wholly Independent and Unrelated Entities. 3

2. The "Detailed Explanation of Section 303(k) [the SUTA Act]" Further Confirms that the Transaction Between CHI and CMI Should Not Have Resulted in the Transfer of Experience History Rating. 6

3. Other States that have Adopted Provisions to Ward off SUTA Dumping Require the Existence of Common Management or Control between the Predecessor and Successor Companies in Order to Enforce the Transfer of an Experience Rating. 10

II. THE PENALTY ASSESSED TO CHI IS UNWARRANTED AND SHOULD BE CANCELLED AND RESCINDED. 10

CONCLUSION 13

TABLE OF AUTHORITIES

Statutes

Minn. Stat. § 268.051, subd. 4(b)(2) 2, 7

Minn. Stat. § 268.051, subd. 4(d) 10, 11

Minn. Stat. § 268.184, subd. 1 a(a) 12

Minn. Stat. § 645.08 (1) 6

Minn. Stat. § 645.16 (1), (2), and (3) 8

Minn. Stat. § 645.17 (2) 5

Minn. Stat. § 645.22 10

Mo. Code Regs. Ann. Tit. 8, § 10-4.190(1)(B) 10

SUTA Act, 42 U.S.C. § 503 (k)(1) 3, 4

SUTA Dumping Prevention Act of 2004, Pub. L. No. 108-295, § 2, 118 Stat. 1090, 1090 4

Tex. Lab. Code Ann. § 204.081(2) 10

Other Authorities

2005 Minn. Laws ch. 112 5

The American Heritage Dictionary 693 (2d College ed. 1985) 5

Rules

Fla. Admin. Code Ann. R. 60BB-2.031(3)(d) 10

INTRODUCTION

Relator Continental Hydraulics, Inc. ("CHI") has been wrongfully burdened with an unemployment tax rate based on the "experience rating history" of Continental Machines, Inc. ("CMI"), a company with whom CHI does not now, nor has it ever, shared "substantially common management or control." Respondent Minnesota Department of Employment and Economic Development ("DEED") has disregarded and ignored: (1) the letter and intent of the law, failing to recognize and acknowledge the plain meaning of the word "common" in the key phrase "there is substantially common management or control between the predecessor and successor"; (2) the guidance and "Detailed Explanation" of the law as provided by the U.S. Department of Labor that supports and confirms the arguments advocated by CHI; and (3) other states' interpretations of this federally-mandated law that are consistent with the arguments advocated by CHI.

The undisputed record reflects that CMI sold the hydraulics portion of its business to the highest bidder, Duplomatic Oleodinamica ("Duplomatic"), an Italian company, in an arm's length market transaction. Duplomatic formed CHI in connection with this asset purchase. CMI and CHI are wholly unrelated entities. CHI is independently owned, managed and controlled solely by Duplomatic. There simply is *no* common ownership, management or control between CMI and CHI, and accordingly, the experience rating history transferred to CHI, and penalty imposed on CHI, are legally and factually unsupported and improper.

ARGUMENT

I. THE TRANSFER OF THE EXPERIENCE RATING HISTORY FROM CMI TO CHI PURSUANT TO MINN. STAT. § 268.051, SUBD. 4(B)(2) IS LEGALLY IMPROPER AND FACTUALLY UNSUPPORTED.

A. The Language, "there is substantially common management or control," was Enacted in Minnesota to Comply with the SUTA Dumping Prevention Act of 2004.

DEED asserts in its brief that the "key phrase" in this dispute is the language "substantially common management or control between the predecessor and successor." *DEED Brief at 8.* Except for DEED's omission of the key words "there is" which precede the above-quoted phrase, CHI agrees, as this is the language that DEED relies on (incorrectly) for its transfer of experience rating history from CMI to CHI, and it is further the language cited in the decision (the "Decision") of the Unemployment Law Judge ("ULJ") now on appeal. AA22-23, 49. This "key phrase" is the language found in Minn. Stat. § 268.051, subd. 4(b)(2), which reads in pertinent part as follows:

> (b) A portion of the experience rating history of the predecessor employer is transferred to the successor employer when:
>
> (1) a taxpaying employer acquires a portion, but less than all, of the organization, trade or business, or workforce of another taxpaying employer; and
>
> (2) there is 25 percent or more common ownership *or there is substantially common management or control between the predecessor and successor*, the successor employer acquires, as of the date of acquisition, the experience rating history attributable to the portion it acquired, and the predecessor employer retains the experience rating history attributable to the portion that is has retained. * * *

Minn. Stat. 268.051, subd. 4(b) (emphasis added).

The language "or there is substantially common management or control" was added to Subdivision 4(b)(2) in 2005 to comply with the SUTA Dumping Prevention Act of 2004 (the "SUTA Act") – a fact that DEED does not deny. Prior to 2004, state and federal law required a transfer of UI experience rating history if there is "25 percent or more common ownership." The SUTA Act required states to add language to address an identified loophole in the anti-SUTA dumping law, specifically, a form of SUTA dumping that occurs when an existing company creates a new company with new ownership (in name only – typically owned by a spouse or child), transfers all or part of its trade or business (including its work force) to this new shell company, while in reality operating and controlling both entities. DEED acknowledges the genesis and history of this added language, indicating that "Relator's brief is partially accurate in its explanation of what the federal SUTA Act, 42 U.S.C. § 503 (k)(1) did, in that Minnesota did broaden its statutory succession definition to include not just common ownership, but also common management and control." *DEED Brief at 10.* While conceding this undisputed legislative history, DEED continues to advance an argument that is inconsistent with both the letter of the law and its history and intent.

1. <u>The SUTA Act Does Not Apply to Arm's Length Market Transactions Between Wholly Independent and Unrelated Entities.</u>

DEED confirms and acknowledges in its brief that the language at issue – "there is substantially common management or control" – was enacted in Minnesota to comply with the SUTA Act. *DEED Brief at 10.* DEED's interpretation and application of this language, however, wholly ignores and disregards the language of the SUTA Act itself.

DEED argues that there need not be any point in time at which the two entities at issue in this matter, CMI and CHI, shared "substantially common management or control." *Id. at 9*. The SUTA Act expressly provides that there must be commonality in ownership, management or control "at the time of the transfer" of the workforce. *See* SUTA Dumping Prevention Act of 2004, Pub. L. No. 108-295, § 2, 118 Stat. 1090, 1090.

The SUTA Act, which amended the language of the 42 U.S.C. § 503(k)(1), reads as follows:

> For purposes of subsection (a), the unemployment compensation law of a State must provide –
>
> > (A) that if an employer transfers its business to another employer, and *both employers are (at the time of transfer) under substantially common ownership, management, or control*, then the unemployment experience attributable to the transferred business shall also be transferred to (and combined with the unemployment experience attributable to) the employer to whom such business is so transferred,
>
> * * *

Id. (emphasis added). Accordingly, under the SUTA Act, when one entity, Company A, transfers its business to another entity, Company B, and *at the time of the transfer, both* Company A and Company B are under "substantially common ownership, management or control," the employment history attributable to Company A shall be transferred to Company B. *Id.* This most definitely does not describe the circumstances involved in the arm's length transaction between CMI and CHI. CMI and CHI have never been under common management or control.

DEED argues that CHI's position – that there must some point in time where the two entities share "substantially common management or control" – has no basis in law and is "befuddling" and "strange." *DEED Brief at 9.* CHI's position is neither befuddling nor strange, but rather is an accurate recitation of the law as found in the SUTA Act itself and the language of Minn. Stat. 268.051, subd. 4(b)(2), which was specifically adopted to comply with the SUTA Act. *See* 2005 Minn. Laws ch. 112 (stating the law was "[a]n act relating to unemployment insurance; conforming various provisions to federal requirements"). What is befuddling and strange is DEED's steadfast reading-out of the language which makes clear its application. Subdivision 4(b)(2) requires that "*there is* substantially *common* management or control" between the entities. The language "there is" requires a present state. Common management or control means "[b]elonging equally to two or more; shared by all alike; joint." *The American Heritage Dictionary* 693 (2d College ed. 1985). Here, the two entities, CMI and CHI, did not share common management or control at any point in time. The individuals who manage and control CHI, Roberto Maddalon (president and chairman of CHI, and also the CEO of Duplomatic) and Dale Horihan (CHI's CEO), do not manage or control CMI and have no existing relationship with CMI. Accordingly, the ULJ Decision upholding the transfer of experience history rating from CMI to CHI based on Subdivision 4(b)(2) is legally and factually unsupported.

DEED's failure to give meaning to the word "common" violates the fundamental rule of statutory interpretation requiring that meaning be given to *all* statutory language. Minn. Stat. § 645.17 (2) ("the legislature intends the entire statute to be effective and

certain."). DEED's ignoring of the phrase "there is" which precedes "substantially common management or control" abrogates the canon of construction that "words and phrases are construed according to the rules of grammar . . . ." Minn. Stat. § 645.08 (1).

2. The "Detailed Explanation of Section 303(k) [the SUTA Act]" Further Confirms that the Transaction Between CHI and CMI Should Not Have Resulted in the Transfer of Experience History Rating.

DEED's brief references and relies on a document titled a "Detailed Explanation of Section 303(k)," which was prepared by the U.S. Department of Labor to assist states in adopting laws to conform with the federal requirements of the SUTA Act. *See DEED Brief at 12-13.* The Detailed Explanation is also cited in and appended to CHI's initial brief. *See AA4-AA12.* This guidance document consists of questions, answers and examples. *Id.* The information set forth in the Detailed Explanation further confirms that an arm's length transaction between two independent and unrelated entities does not trigger the transfer of experience rating history under the state amendments. *Id.*

The question and response to "Question 4" of the Detailed Explanation provides an example "of when experience must be transferred under the amendments." *See* AA5. The example describes Corporation A, an existing entity with the state's maximum unemployment compensation (UC) contribution rate. *Id.* Corporation A establishes "a shell corporation that is treated as a separate employer for UC purposes," *Id.* This shell corporation qualifies for the state's minimum UC contribution rate. *Id.* Corporation A then transfers all or some of its workforce to the shell corporation. *Id.* Absent the amendments to the SUTA Act, "even though Corporation A *controls the shell and its*

operations, it escapes" the higher contribution rate on the "transferred workforce" and instead pays the lower rate of a newly-created entity. *Id.* (emphasis added). The answer to Question 4 then indicates that "[u]nder the amendments, if the workforce is transferred to a shell, then the unemployment experience attributable to the transferred workforce must also be transferred to the shell." *Id.*

This example, which is wholly dissimilar to the arm's length market transaction between CMI and CHI, confirms the necessity that "common control" be shared between Corporation A and the newly-created company to trigger transfer of the rating. In other words, there must be overlapping shared common management or control. The SUTA Act amendments, as reflected in Minn. Stat. § 268.051, subd. 4(b)(2), likewise provide that the transfer of experience rating history occurs when "*there is* substantially common management or control between the predecessor and successor." (emphasis added). The amendments do not provide for a transfer of experience rating history when Corporation A sells a portion of its business assets in an arm's length market transaction to Corporation B, an unrelated and wholly independent entity.

CHI was neither acquired nor created by CMI, and CHI is not a shell of CMI. CMI sold for value in a market transaction the hydraulics portion of its business to a wholly unrelated third-party, a European-based company, Duplomatic, which formed a wholly-owned domestic company, CHI, to take the assets and operate a hydraulics business in the United States. There was not a "transfer of workforce" from Corporation A to a shell, as described in the U.S. Department of Labor example. CHI, a wholly independent and unrelated employer, hired those employees who were discharged from

CMI when CMI's hydraulics business ceased to exist. Corporation A, in the example, "controls and operates the shell" following the transfer of workforce which, under the amendments, triggers the transfer of the associated experience history to the shell. CMI does not now, nor has it ever, owned, controlled, managed or operated CHI. DEED disregards not only the letter of the law, but also the intent clearly articulated in the SUTA Act and the Detailed Explanation of the SUTA Act. The SUTA Act was enacted to prevent this previously unlegislated form of SUTA dumping – dumping between commonly managed and controlled companies. DEED admits, however, in its brief that it has never contended that CHI engaged in SUTA dumping – yet continues to insist that the statute nevertheless applies. *DEED Brief at 16.* The proper meaning of the Minnesota statute must be determined by considering "the occasion and necessity for the law"; "the circumstances under which it was enacted"; and the "mischief to be remedied." Minn. Stat. § 645.16 (1), (2), and (3). The SUTA Act and the Detailed Explanation provide guidance on all these considerations and lead to the conclusion that companies that are not commonly managed or controlled companies, such as the wholly-separate CMI and CHI, are not the intended target of the mandate for transfer of the experience rating.

As referenced above, DEED itself cites to and relies on the Detailed Explanation of the SUTA Act in its brief. *See DEED Brief at 12-13.* Specifically, DEED references "Question 6" – "How does a state determine if there is 'substantially' common ownership, management, or control of two employers?" *DEED Brief at 12; AA5.* The response provides that the "state would consider the extent of commonality or similarity

of: ownership; any familial relationships; principals or corporate officers; organizational structure; day-to-day operations; assets and liability; and stated business purposes." *AA5.* CMI and CHI manifest none of these commonalities or similarities. CHI and CMI are wholly unrelated and separate companies. They do not possess common ownership or any familial relationships. The principals or corporate officers are not common to one another and their organizational structures are wholly separate. The day-to-day operations of the two companies are not common and they do not share or have common assets, liabilities or a stated business purpose. The former CMI employees now working for CHI were terminated from CMI before beginning their respective roles with CHI. Indeed, the ULJ recognized the wholly-separate nature of CMI's and CHI's management and control in the Decision by conceding that "[CMI's] Wilkie had final say in all significant investment and strategic decisions" while CHI's Maddalon "has the final in such decision[s]." AA21.

DEED argues that two employees of CMI, Heist and Horihan, provided "input" to different management groups at CMI in their prior respective positions as vice president/treasurer, and general manager,[1] but nothing in the statute supports the transfer of an experience rating based on "input" to management. The statutory requirement is whether "there is substantially common management or control between the predecessor and successor."

---

[1] Heist testified that Horihan's position responsibilities at CMI consisted of "mostly sales and marketing." T. 15.

3. Other States that have Adopted Provisions to Ward off SUTA Dumping Require the Existence of Common Management or Control between the Predecessor and Successor Companies in Order to Enforce the Transfer of an Experience Rating.

Canons of statutory construction direct that where laws are uniform with other states, this state's laws "shall be interpreted and construed to effect their general purpose to make uniform the laws of those states which enact them." Minn. Stat. § 645.22. As CHI argued in its initial brief, the States of Texas, Missouri and Florida all enforce a "common management" and "common control" requirement that looks to whether the predecessor company exercises concurrent or continuing management authority over the successor. Tex. Lab. Code Ann. § 204.081(2); Mo. Code Regs. Ann. Tit. 8, § 10-4.190(1)(B); Fla. Admin. Code Ann. R. 60BB-2.031(3)(d). The undisputed and utter absence of this essential element in the facts here mandates that, in conformity with uniformity of states' laws principles, Minnesota's law be applied consistent with these principles.

DEED's interpretation of the statute, and the ULJ's capitulation to that interpretation, which is contrary to the letter and intent of the law, would be a terrible result for Minnesota workers because it will lead to experienced employees losing their jobs or being denied employment whenever a part of a business or company is acquired for fear that DEED would penalize the acquiring company.

II. THE PENALTY ASSESSED TO CHI IS UNWARRANTED AND SHOULD BE CANCELLED AND RESCINDED.

DEED assessed an $18,201 penalty against CHI for an alleged violation of Minn. Stat. § 268.051, subd. 4(d), which provides that "Each successor employer *that is subject*

to paragraph (a) or (b) must notify the commissioner of the acquisition by electronic transmission, in a format prescribed by the commissioner, within 30 calendar days of the date of acquisition. Minn. Stat. § 268.051, subd. 4(d) (emphasis added). As addressed in CHI's opening brief, this provision does not apply to CHI because it is not an "employer subject to paragraphs (a) or (b)." The reference to "paragraph (a) or (b)" in Subdivision 4 (d) pertains to an employer that is subject to an experience rating transfer because "(a)" there is 25 percent or more common ownership or "(b)" there is 25 percent or more common ownership or there is substantially common management or control between the predecessor and successor. Neither paragraph (a) nor paragraph (b) applies to CHI for the reasons presented in this appeal. Accordingly, CHI should not be penalized for failing to provide information based on a statutory provision that does not apply to the transaction at issue.

DEED, seeking to justify the significant penalty it imposed on CHI, claims that it was unaware of the transaction until December 2011,[2] and that it "has no way of knowing when one company buys another, unless that company informs DEED of the purchase." *DEED Brief at 16.* The record clearly reflects and confirms, however, that CHI, within a week or so of the acquisition, completed online DEED forms. T. 21. DEED acknowledges the same by letter to CHI dated August 5, 2011 – "You recently registered a business entity with our Department indicating that you had either acquired all or part

---

[2] DEED alleges in its brief that CHI went online on December 19, 2011, to fill out a DEED questionnaire (Ex. 6). *DEED Brief at 16, 18; see also* Decision at AA24. CHI disputes and denies that it completed this questionnaire or provided the information reflected on this questionnaire. T. 13-14.

of a business or had a change of legal entity." Ex. 5. Upon receipt of DEED's August 5, 2011 letter, CHI (its CFO Heist) contacted DEED at the phone number listed on its letter and spoke to a DEED representative. T-21-22. Heist discussed the matter with DEED and recalls specifically asking DEED "what I needed to do here." T. 24. Heist then went "online and added everything that [he] could." T. 24. CHI does not recall receiving a subsequent letter from DEED dated November 10, 2011 (Ex. 4), and accordingly, did not respond. T. 24. To CHI's knowledge, it had responded to DEED's inquiry and provided all necessary information concerning the transaction.

Even though the record shows that CHI met its reporting obligation, to the extent that it could be said that there was a failure to provide required information, Minnesota law provides a statutory exemption from penalty on account of ignorance or inadvertence. *See* Minn. Stat. § 268.184, subd. 1 a(a). Pursuant to Minn. Stat. § 268.184, subd. 1 a(a), a "penalty under this paragraph *must be canceled* if the commissioner determines that the failure occurred because of *ignorance or inadvertence*." Here, CHI did not consider itself to be a "successor," so it was ignorant of any further reporting obligations. CHI responded to DEED's August 5, 2011 letter and provided all information it believed was required, but it did not receive the November 2011 letter to which no CHI response was made, which bespeaks of "inadvertence." The penalty, under law, "must be cancelled" if failure to provide information occurred because of either "ignorance or inadvertence." The ULJ's refusal to cancel the penalty should be reversed.

CONCLUSION

DEED's transfer of CMI's experience rating history to CHI is legally and factually unsupported. DEED has ignored and disregarded the letter and intent of the law. Accordingly, CHI respectfully requests that this Court reverse the Decision, vacate the experience rating transfer and penalty imposed, and remand this matter for recalculation of CHI's UI tax rate.

Dated: 1/15/2013

Gary A. Van Cleve (156310)
Rob A. Stefonowicz (297161)
Larkin Hoffman Daly & Lindgren Ltd.
1500 Wells Fargo Plaza
7900 Xerxes Avenue South
Minneapolis, Minnesota 55431-1194
(952) 835-3800

Attorneys for Relator

1439746.2