

*a few things you should know about...*

## Employment Law Issues in M&A Deals

This edition of *A Few Things You Should Know* discusses potential employment law issues that have the potential to affect M&A deals. In equity acquisitions (including mergers), the target company's legacy employment-related obligations and liabilities will survive the closing—and in some merger structures, become the obligations and liabilities of the buyer. Even if the deal is structured as a sale of assets, it is possible for the buyer to be held liable for employment-related claims as a successor employer if there is substantial continuity between the buyer and seller entities. As a result, it is vital to conduct a thorough investigation of the target company's employment policies and practices and pending employment claims prior to the acquisition in order to avoid potentially serious legal and financial consequences in the future.

- **HUMAN RESOURCES POLICIES**

Many startup companies lack the resources to invest heavily in employment law compliance. As a result, it is not uncommon to find companies looking to be purchased with human resources policies that are not in compliance with current law. For example, the City of Seattle recently passed comprehensive local ordinances governing paid sick and safe time and company scheduling practices that come with substantial recordkeeping requirements and stiff financial penalties for violators. Prior to acquisition, buyers should carefully review human resources policies and procedures and employment records belonging to the target company to assess potential noncompliance with the law that could lead to liability down the road.

- **ACCRUED PAID TIME OFF**

The target company's policies regarding vacation and other paid time off should be reviewed to determine whether there is an obligation to pay out any accrued but unused paid time off to employees upon separation from employment. Note that this paying out also may be required under state law. The paid time off balances of the target company's current employees should be requested to determine the potential liability and whether balances can be transferred to the buyer or may need to be paid out.

- **EMPLOYMENT AGREEMENTS**

Employment agreements entered into between the target company and its employees should be reviewed. Specifically, buyers should pay close attention to clauses that alter at-will employment status or provide for severance payments to employees or acceleration of unvested compensation or equity upon a change in control of the Company (i.e., "golden parachute" clauses). Noncompetition and other restrictive covenants, especially for key employees, should be reviewed for enforceability. Proprietary information and invention assignment agreements should be reviewed and potentially be put in place for employees with roles in developing intellectual property.

- **EXISTING CLAIMS BY EMPLOYEES**

Existing legal claims that have been asserted against the target company by the company's employees should be reviewed. This includes not only those cases involved in active litigation, but also cases in which employees (or former employees) have filed charges with the Equal Employment Opportunity Commission ("EEOC") or the federal Department of Labor, or other federal, state or local agencies, or have sent a demand letter threatening to sue. The target company's workers' compensation claim history and any health and safety complaints also should be reviewed.

- **OTHER POTENTIAL CLAIMS**

In addition to reviewing active claims against the target company, it is a good idea to investigate whether there are any *potential* claims lurking out there as well. Buyers should check to see if any employees were terminated from the target company in the last three years, paying particular attention to employees who were terminated in the last 300 days, which is the deadline by which employees must file a charge of discrimination with the EEOC in most states. The buyer may want additional information regarding the circumstances under which an employee was terminated (and whether or not a waiver of claims was obtained as part of a separation agreement) in order to estimate potential future liability. A high rate of employee separations also could be a sign of other issues within the organization that the buyer may want to investigate.

- **EXEMPT VS. NON-EXEMPT EMPLOYEES**

Due diligence generally should include obtaining a list of all employees, their compensation level, and their status as exempt or nonexempt employees for overtime purposes in order to ensure compliance with the Fair Labor Standards Act and state law. This analysis recently became more complicated after a federal district court in Texas issued a nationwide injunction on November 22, 2016 enjoining the Department of Labor's new rule, which would have increased the salary-basis test for the exemption for "white collar" employees to \$47,476 per year, leaving the state of the law in flux for now.

- **EMPLOYEES VS. INDEPENDENT CONTRACTORS**

It is important to obtain and review a list of all of workers classified as independent contractors by the target company to ensure that the each worker is properly classified. The misclassification of employees as independent contractors is a pervasive problem and can result in liability for unpaid taxes, wages and employee benefits.

- **NON-EXEMPT TIME-TRACKING SYSTEMS**

If the target company employs non-exempt workers (including both hourly and salaried non-exempt), the buyer may want to review the time-tracking system in place to ensure compliance with state and federal wage and hour laws. A systematic failure to properly enforce employees' hours and/or breaks and meal times could result in potential class-action liability down the road. Buyers also may want the target company's non-exempt employee pay practices reviewed (e.g., policies for payment of travel time, time-rounding practices, and inclusion of non-discretionary bonuses in the regular rate for overtime purposes) to determine potential liability for unpaid wages.

- **COLLECTIVE BARGAINING AGREEMENTS AND GRIEVANCES**

Although the prevalence of unions has declined over the years, if the target company is unionized, it will be important to collect and review all collective bargaining agreements that are in force. Although the buyer may not be bound by the existing collective bargaining agreement in an asset sale, it may still be required to bargain with the existing unions in good faith if it rehires the employees of the company that was sold. It is also important to review past and pending grievances to understand what disputes may exist between the union(s) and the company.

- **EMPLOYEE RECORDS AND STATUS**

Form I-9s and work authorization status for employees should be reviewed for compliance. Buyers may want to request documentation relating to current employee performance problems to help assess the workforce and inform employment decisions. Buyers also may want information regarding employees on a leave of absence, including their anticipated date of return.

- **FAMILY RELATIONSHIPS AND POTENTIAL CONFLICTS OF INTEREST**

It is not uncommon for startup entrepreneurs to hire friends and relatives to work for the company. Disclosure of any family relationships among employees or directors may be requested in due diligence to determine potential conflicts of interest and appropriate employee reporting structures.

- **WARN ACT OBLIGATIONS**

Large mergers or acquisitions involving plant closures and/or mass layoffs may trigger notification requirements under the Worker Adjustment and Retraining Notification (WARN) Act. The WARN Act requires covered employers to provide employees with notice of certain plant closures and/or mass layoffs at least 60 days in advance. Failure to provide notice can result in liability to *each* impacted employee for back pay and benefits for the period of violation, up to 60 days. Note that some states, such as California, require advance notice in situations that may not trigger the federal WARN Act.

- **EMPLOYEE COMPENSATION AND BENEFIT PLANS**

Any comprehensive due diligence should entail a detailed review of the target company's benefit plans as well as any commission and/or other incentive pay and bonus plans.

## CONTACT

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