

Big Ideas: Q&A with Brian Nugent



Brian Nugent represents employers throughout the United States in labor and employment matters, as well as corporate formation, contracts, unemployment taxation, and M&A. His focus includes advising human capital and human resources outsourcing companies such as professional employer organizations (PEOs) and temporary staffing companies, that frequently retain him to assist with all of their legal and regulatory needs, including forming the legal entities, licensing in more than 40 states, client service agreements, employee handbooks, workers' compensation insurance, benefits and general employment matters. He is also frequently retained to represent buyers and sellers in transactions in the employment outsourcing industries, and has been retained on a number of occasions to assist buyer's counsel with the particular due diligence issues in these industries.

Currently working at Akerman LLP, Brian is a member of the NAPEO legal advisory committee and a member of the National Staffing Association.

DSP: Hi Brian, thanks for sharing your perspectives with our DSP readers. You have a long and successful law career with a focus on human capital business models, and in particular PEO and staffing providers. What's the genesis of your focus and what do you enjoy most about working in these areas of human capital?

BN: Early on in my career (mid 90s) I wanted to work as a litigator and was practicing in Tallahassee, FL. While doing commercial litigation work, a close friend of mine from undergraduate school (FSU) became the CFO of a company called Outsource International, Inc., which was a temporary staffing firm. At this time, the PEO industry was in its infancy and was still referred to as "employee leasing". This was also around when Florida passed its first licensing statute in the PEO industry. As a young, aggressive lawyer looking to build a book of business I was intrigued by companies that could disrupt traditional employment models. So, when asked if I was interested in doing legal work for Outsource International, I said yes – even though I knew practically nothing about temporary staffing or alternative employment business models. About three years later my friend became the CEO.

I joined Outsource International as their Chief Legal Officer ("CLO") less than a year before the company went public. I moved to Deerfield Beach, Florida and aided in a very large roll up strategy (25 acquisitions) of staffing firms. During this period, and after Outsource International went public, the company decided to form a PEO as a wholly owned subsidiary named Synadyne. Interestingly, Synadyne retained Fred Davidson who also wrote the initial code of the PEO technology provider PrismHR. Synadyne was effectively the incubator for what is PrismHR today, which is the PEO payroll software that today is the predominant operating system used in the PEO industry. Before I left Outsource International in 2000, I led the team that sold that subsidiary. I really enjoyed my experience as the CLO because I learned about all of the business issues the company was facing as a member of the executive team.

In 2000, I went on to be the CLO for Advantech Solutions, which was a pure-play PEO with approximately 22,000 WSEs. The senior management alongside me was truly second to none and I gained a very deep operational understanding of the PEO industry, which to this day gives me a unique perspective in my legal advisory role. During this period, I also became very involved with the National Association of Professional Employer ("NAPEO"), and I developed a national reputation for providing legal advice to the PEO and staffing industries as well as operational advice to such companies.

After about 3.5 years at Advantech, I decided to start my own law firm to focus on alternative employment business models / industries, which included PEO and temporary staffing. In this role, I prided myself on approaching all legal situations from a business / operational perspective to understand the value proposition of each company, which tremendously helped in building my practice. A key part of my early success in launching my law practice was securing three engagements where the companies (one temporary staffing and one PEO) retained me as their outsourced General Counsel and I operated as if I was "down the hall", available to respond to all legal and business issues that arose.

I was and still am seeking new opportunities and with the operational approach I take, even as outside counsel, I believe I have built a very differentiated practice.

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DSP: As you mentioned, I think many of our readers know this but PEOs are a co-employment model and some of our readers may remember this space being referred to as “employee leasing”. You’ve been one of the top legal advisors in the PEO industry for a long time. Give our readers a brief lesson of how you have seen the PEO model evolve over time.

BN: Think about this – in 1996 I was sitting at the first ever legal advisory meeting for NAPEO in Colorado Springs where the actual term “co-employment” was coined. The term “employee leasing” no longer accurately described the actual co-employer relationship, and the term “joint employment” was not an accurate description of the relationship either. In this arrangement, there isn’t a joint responsibility for employment, but rather an allocation of responsibilities between the PEO and its client. Thus, the advent of the term “co-employment” to describe a true PEO arrangement.

It was also important to distinguish PEO, or co-employment, from temporary staffing. In fact, the American Staffing Association was, and still is, steadfast in making it clear in PEO licensing statutes, that a temporary staffing business is not the same as a PEO and is exempt from licensing. The key distinction is that in staffing, the primary role of the staffing company is to supply employees to a client in order to supplement the client's existing workforce (sometimes a “temp-to-perm” arrangement). A PEO, on the other hand, does not actually supply employees to its clients. It “joins at the hip” with an employer and its existing workforce, and then allocates employer responsibilities to manage that workforce with the client. The client continues to manage and control their workforce and the PEO provides discreet services to assist the client in managing that workforce in a co-employer arrangement. In the early days many times the primary sales driver was a lower workers’ compensation insurance. This meant that PEOs were targeting blue and gray collar businesses to save them money on workers’ compensation because as a PEO you can aggregate a lot more payroll and get discounts based on that payroll. At the time, the target client size for PEOs an average of 10-20 employees, maybe 30, and that is still applicable today.

Outside of the insurance plans, there was often only “lip service” given to the HR services a PEO delivers but this has been the largest evolution within PEOs, particularly as technology has evolved to manage a larger amount of employees throughout the entire employee lifecycle from open enrollment to terminations. Today, a PEO needs to be able to manage multi-state operations, remote employees, workers’ compensation, unemployment claims, workplace misconduct, and claims, all benefits, etc. from one platform that is as no-touch as possible.

To be clear, today the stickiness of clients can still be driven by lower workers’ compensation rates, and at times more favorable health insurance rates, but a bigger driver now is the ability of the client to outsource its non-core functions to a “one-stop-shop” portal for all administration and management which includes more robust HR offerings. Vendor management and efficiency, which frees up management to focus on revenue generating and client facing activities, is a very big deal.

DSP: What are some of the top legal issues today that PEO providers need to understand?

BN: Fundamentally, this depends on the maturity of the PEO. In the initial stages, the PEO must make sure that all processes are implemented including having the right client service agreements, secured banking relationships, setting up workers’ compensation, being able to provide a basic level of HR, etc.

As a PEO evolves and gets big enough to have a master health plan, for example, there is a much longer list of items to check off such as complying with ERISA laws and not just state insurance laws. Then, being a multi-state employer you need to be well-versed in every state because a PEO grows as each client expands into new states and hires new employees. For example, an Oklahoma-based PEO client may suddenly expand and hire employees in New York and California and the PEO must be prepared to handle such an expansion and guide the client on new compliance issues, including state specific licenses, updated contracts, updated certificates of insurance, verifying that insurances are available in those states, complying with leave and wage-based laws peculiar to those states, etc. The compliance checklist expands exponentially as a PEO grows and you must make sure you have the right internal and / or external expertise. Having the right consultants can allow a PEO to set up 401(k) and formulate health plans properly. If you have an insurance agency that shares common ownership with the PEO, you must understand the rules around receiving commissions on group benefit plans sponsored by the PEO. Remember, every state has its own regulations / obligations. Importantly, your IT system has to be able to handle this scale of payroll and offerings. Finally, the company’s cybersecurity must be buttoned up. Many argue that PEO providers are just as much data companies as they are human capital companies - so protecting that data is critical.

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DSP: The PEO industry landscape is very bifurcated. There are many small or regionally-focused PEOs with under 10,000 WSEs and then a few very large providers such as ADP's TotalSource, Paychex Oasis, Insperty, TriNet, etc. This dynamic, combined with a lot of private equity capital to invest, leads to a lot of consolidation. You've advised many of the leading PEOs driving that M&A activity on both the buy-side and sell-side.

Here's a two-part question: i) what is the biggest thing a PEO should do to ready itself for a sale process, and ii) what are the most prominent PEO-specific issues that tend to surface in selling a PEO?

BN: What's unique about my background is that when I started my career in the PEO industry I was focused more on operations rather than M&A. Even as the in-house lawyer, we would use outside counsel for M&A advice but it provided me with "on-the-job" training on how to execute transactions, and being in-house counsel, I saw the transactions from both an operational and legal perspective. When I started my own firm, there was not just an opportunity but a need for focused M&A advisory in this industry. For someone who has been in-house and understands operations like employment and compliance, it has enabled me to experience first-hand the business issues that PEOs could face in a sale process. This allows me to provide M&A legal advice with the business issues at the forefront.

For a PEO owner to be ready for a sale process they must simply being prepared for what is going to be the intensity of the overall diligence process. There are nuances for PEOs which I just mentioned in terms of the complexity of the regulations that PEOs must follow and track as they are constantly changing. Notable issues to be aware of are how each state impacts licensing requirements, client service agreements, employment laws, insurance issuance laws, and ensuring cybersecurity and cyber insurance is very buttoned up. In my experience, only the larger firms have a handle on all these issues – and even then it can still be "messy" in the due diligence phase.

Another issue is what I previously mentioned about PEOs owning or having shared control over agencies. When establishing these agencies, their sole purpose is to provide workers' compensation insurance to clients. Remember, most PEOs cannot attract a healthcare provider to write a "master" health plan that would be sponsored by the PEO. Therefore, the PEO is forced to arrange healthcare and benefits through policies sponsored by each client but administered by the PEO, which is much less efficient. That being said, even small PEOs can usually secure a master workers' compensation insurance policy. Thus, the commonly owned agency can legally (subject to some state insurance laws) collect commissions on premiums paid on the PEO master worker's compensation policy, and from client health plans that the agency is the broker of record for. As a PEO grows, it usually wants to convert its healthcare offerings to a plan sponsored by the PEO, which is where rules change as to the ability of the agency to collect commissions on such a plan. Under ERISA, which governs health plans, commissions paid to a commonly owned agency are likely "prohibited transactions" and can create serious liabilities for the PEO plan sponsor if not handled properly. This issue can be fixed but it should be done as soon as possible because every buyer will want to explore such commission payments.

DSP: Brian, you are in a unique position to share some insight between the relationships of PEO and payroll providers relative to the newer industry development of the global employer of record model which is attracting a lot of attention these days.

BN: Well first, as an attorney, allow me to bring some definitional clarity around these business models. A PEO involves a co-employment relationship, is defined in approximately 40 states, and requires licensing in those states. PEOs are technically the "employer of record" but embrace a co-employer relationship with its client. On the other hand, an EOR is not defined and is primarily derived from a form of employment relationship that grew out of temporary staffing outside the United States. I am not aware of any statutory definition of EOR. That being said, it is a term that I am seeing much more lately, and the arrangement deployed under that acronym differs from company to company. The "devil is in the details" between a PEO and EOR – in some operations, companies advertised as an EOR are in reality a PEO while others may not be.

Pure payroll providers deliver services without being the "employer of record" – they provide the services under each client's Federal Employer Identification Number ("FEIN"), which is a less efficient model albeit usually less expensive. What's been interesting to me is seeing the cross-selling opportunities between traditional payroll companies, such as ADP and Paychex, with their respective PEO divisions, TotalSource and Oasis. These companies have done a great job using the core payroll offering as a feeder to upsell the PEO model. This is a very natural step and way to capture more client spend. Conversely, there are some contradictions – I don't see as many PEO providers intentionally providing traditional ASO services unless, for example, the PEO's insurance plan doesn't cover the industry of a potential client.

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Today, while the PEO offering is fundamentally more compelling than payroll-only providers, in my view, advances in technology have made the payroll-only offering much more efficient to deliver. For example, consider all of the very efficient ways to deliver self-service functionality for the SMB payroll market. In this way, the newer technology-focused platforms have a big advantage over the older payroll platforms. As we add to the business model equation the global EOR model, the question still remains of what *actually* are they – are they global payroll providers or global "long-term staffing companies" now entering the U.S. market from overseas? We're seeing the emergence of both models but more frequently a global PEO-like model with few providers attempting to build a true global payroll engine. That's very hard and a more future state objective.

Outside of the U.S., an EOR must comply with many local laws applicable to employers. Beyond being the FEIN employer of employees at client companies, there is not a clear uniform definition. In many countries, an EOR is treated as a temporary staffing company. In the U.S., an EOR cannot take the position of being an extension of temporary staffing because as an assignment becomes long term, it may meet the statutory definition of a PEO which would trigger licensing requirements in most states. When you begin to peel back the offerings that EORs provide, they follow the traditional co-employment model of having the employer (the company's client) direct an employee's day-to-day activities and set their wages but the EOR will provide the benefits and HR-related services such as compliance which begins to sound very similar to a PEO model.

As of today, in the U.S., there is not a standard definition of what an EOR is and how it is different than a PEO. It will be interesting to see how this gray line is discussed and solved. From an M&A advisory perspective, this means EOR operators must understand that they may be subject to all of the regulatory and compliance complexities that a PEO faces and, if so, should ensure they are meeting the requirements. That's the lawyer in me speaking, of course.

Time will tell how this all shakes out.

DSP: Let's end on a personal note. Brian, you've had a great and successful career. What are you most proud of?

BN: I am most proud of creating and building my practice to this level. Early on in my career, I had opportunities and resources but I needed to be fearless to say yes to opportunities, even if I did not know much about it, and learn quickly -- most of the time it was on my own nickel and time. Looking back, to have the courage to go in-house was both frightening and exciting. All of my experiences and now being at Akerman gives me lots of satisfaction professionally – I am able to work with outstanding clients and businesses I thoroughly enjoy while still taking on very rewarding pro bono work. In my personal life, I am very thankful to be in a position where I still remain very active in the lives of all of my children.

Brian, as a “closer look” give the DSP readers a few Personal Fun Facts about yourself...

Birthplace & Where You Grew Up:

I was born in Newark, New Jersey but moved down to Miami, Florida when I was about 5 and grew up there

First Job:

I had a summer job at the Department of Parks and Recreation for the city of Hialeah, Florida

Memorable Vacation Spot:

I took my entire family back to Athlone, Ireland (I'm 100% Irish) where my grandparents grew up – I took them back to my family's house, met many first cousins, and my kids actually went back there to work during the summers

Favorite Restaurant:

The Albion Inn on the Mendocino Coast of California

Musician or Artist You Like:

Jimmy Buffet!

Favorite Sports Team & Why:

Go Seminoles! I've lived in Colorado for 18 years and I still have season tickets

Last Book You Read:

“The 2% Way” by Myron Rolle – a true and inspirational story for sure

Little Known Fact:

I was the intramural champion in Olympic competitive badminton at FSU

My Golden Rule:

Integrity is only tested when the tide is low and always, always, always act with integrity when nobody is looking

Thanks Brian!