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Top 10 Labor & Employment Issues in M&A Transactions

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Your business is buying (or selling) a company – now what? Due diligence is an essential part of a successful merger or acquisition, and there are countless labor and employment issues that may come up during this process. Should due diligence reveal that the target company is not in compliance with a certain law, the parties will have to analyze the risks associated with the transaction as a result of non-compliance. Is it too costly to come into compliance now? Are the risks of litigation or government action material? Here are the top 10 labor and employment issues in M&A transactions that businesses should keep in mind during the due diligence process:

1. Misclassification of Workers

Assessment of worker misclassification is commonly at the top of the issues list for labor and employment diligence. There are two main types of misclassification: (i) misclassification of employees as exempt from overtime and minimum wage requirements under the Fair Labor Standards Act (FLSA) and state law; and (ii) misclassification of employees as independent contractors. With respect to the first, employees must meet the salary level, salary basis, and duties tests under both the FLSA and applicable state law to be properly treated as exempt. As to the second, there are a variety of tests for independent contractor status at the both the federal and state level for purposes of wage and

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hour, immigration, tax, unemployment compensation, workers' compensation, benefits, and other areas of compliance. Either misclassification mistake can result in exposure to material liability, including unpaid wages and benefits, unpaid taxes, penalties, liquidated damages, attorney's fees, and costs. Further, such liability can go back up to three years under the FLSA, or even longer under certain state wage and hour laws (like New York, which is six years), and for similar periods under other applicable federal and state enactments. In addition, there is also a need to ensure that joint employer liability for wages, benefits, and other matters for temporary/leased employees is adequately addressed in the governing contracts. For all these reasons, misclassification is a major issue that should be vetted heavily in due diligence.

2. Failure to Include Non-Discretionary Bonuses When Calculating Overtime

Some employers offer employees bonuses based on achieving individual or company-wide metrics. Whether such bonuses are lawfully considered discretionary is important. Further, non-discretionary bonuses must be included in calculating the regular rate of pay for overtime compensation to non-exempt employees. Many employers do not realize that the Department of Labor (DOL) has a very narrow view of what constitutes a discretionary bonus. If an employee knows about the bonus and how to earn it, the DOL says it is not discretionary and must be included in calculating the overtime rate. To qualify as truly discretionary in the eyes of the DOL, all three of these criteria must be met:

- The employer has the sole discretion, until at or near the end of the period that corresponds to the bonus, to determine whether to pay the bonus;
- The employer has the sole discretion, until at or near the end of the period that corresponds to the bonus, to determine the amount of the bonus; and

- The bonus payment is not made according to any prior contract, agreement, or promise causing an employee to expect such payments regularly.

For example, if the employer gave employees annual bonuses based on productivity or attendance or days without safety incidents, those were not discretionary and should have been included in the overtime rate. Where employers have failed to include non-discretionary bonuses in calculating the overtime rate, they have failed to pay overtime properly, creating exposure. In such circumstances, the parties to the transaction will need to agree on both valuation of, and approach to, this exposure. Furthermore, failing to pay an employee a non-discretionary bonus can result in a lawsuit.

3. Successorship Under Union Contracts

Does the company being purchased have a unionized workforce? When a company purchases the assets of a unionized employer, with certain caveats, the asset purchaser is deemed a "successor" if a majority of its employees formerly worked for the unionized employer. If the purchaser is deemed to be a successor, it must recognize and bargain with the union that represented the seller's employees. Companies considering the purchase of a unionized business must analyze the added burden of a union contract. For example, the purchasing company may be bound by bargained-for policies established by an existing collective bargaining agreement that the purchasing company otherwise would never agree to – and previously had refused to existing employees such as a certain number of paid days off of work.

4. Overtime and Break Pay Issues

Compensation for overtime, on-call time, and meal and rest breaks are common pay issues that can result in significant litigation costs or government action. These issues may be covered not only by the FLSA, but often by state and local law. Such issues can be difficult for employers to manage, and they are therefore ripe for non-compliance.

5. Immigration

There are a host of immigration issues that arise in employment. One common issue is failing to properly determine whether employees are authorized to work in the country where they will be performing services. A purchaser should consider whether the target company has timely and properly completed Form I-9s for current and former employees and complied with E-Verify when required by federal or state law. The rules surrounding I-9s are complicated and timing is critical. Common errors include accepting unacceptable documents, accepting fraudulent documents, not recording the document title, issuing authority and expiration date or not recording it correctly, failing to timely sign and date each section, not retaining copies of I-9 documents or purging them too early, failing to track expiration dates and re-verify when needed.

If the target company employs foreign nationals working under visas, the purchaser must plan ahead. For example, nonimmigrant visas that are tied to a specific petitioning employer, such as H-1B and L-1 in particular, can be impacted during a corporate M&A transaction. For H-1B employees, the employer may need to notify U.S. Citizenship and Immigration Service through the filing of an amended H-1B petition depending on the circumstances of the M&A deal. L-1 employees may no longer qualify for L-1 status if the M&A transaction eliminates the qualifying relationship between the U.S. employer and the qualifying foreign employer abroad. These are just some examples and not an exhaustive list.

6. Employee Background Checks

The federal Fair Credit Reporting Act (FCRA) set the rules under which employers generally may obtain and use background check on a potential employee from a third-party source. Employers are required to take certain steps at three different stages: before requesting a background check; before taking adverse action based on one; and after taking adverse action. In addition to the federal law, many states also have their own background check statutes. Failure to comply with the FRCA or state background check law, such as by failing to comply with notice, disclosure, and authorization requirements, can result in costly legal action. In fact, the last several years has seen an explosion of class actions alleging FCRA violations, many of which have resulted in multi-million dollar settlements such as a $9 million settlement in California, an $11.5 million settlement in Georgia, and a $22.45 million settlement in Virginia just this year.

7. Affordable Care Act (ACA) Compliance

The ACA requires employers with fifty or more full-time employees (or the equivalent in part-time employees) to offer affordable minimum value health insurance to full-time employees (those working 30 or more hours per week), or else pay specific ACA-imposed penalties. The ACA also requires employers to annually file proof of ACA compliance with the IRS. Some states also have enacted laws that require annual reporting. An employer that has failed to comply with all provisions of the ACA, and has failed to respond to any penalty notices, will be required to pay significant fees.

8. Golden Parachute Payments

Employers at times provide certain financial benefits to key executives, referred to as golden parachute payments, in the event of a change in control as a result of a merger or takeover. Purchasing companies will have to navigate any federal or state tax consequences of the golden parachute payments in the event of a purchase. For instance, unless subject to an exception under IRS Code Section 280G, such payments may not be deductible by the corporation and are subject to an excise tax on the individual.

9. WARN Act (and State Mini-WARN Acts)

Employers with one hundred or more employees (not counting employees who have worked less than six months in the last twelve months and not counting employees who work an average of less than twenty hours per week) conducting layoffs or plant closings must assess whether the Worker Adjustment and Retraining Notification (WARN) Act applies. Many states have also adopted mini-WARN Acts which apply to smaller employers or to layoffs affecting fewer employees than the federal WARN Act threshold. Each has its own notification procedure. Employers who have engaged in layoffs or plant closings in the past should assess whether they were required to follow WARN (or mini-WARN law) requirements, and, if so, whether they complied with those requirements.

10. OSHA

Violations of the Occupational Safety and Health Administration (OSHA) regulations are always important to keep an eye out for during due diligence, but especially now. Although the world may have "moved on" from the COVID-19 pandemic, OSHA continues to vigorously enforce its Guidance on Mitigating and Preventing the Spread of COVID-19 in the Workplace. OSHA's General Duty Clause provides that, in addition to compliance with hazard-specific standards, each employer shall furnish to employees employment and a place of employment which are free from recognized hazards that are causing or are likely to cause death or serious physical harm. OSHA considers it is a violation of the General Duty Clause for a company to fail to have a written COVID-19 policy that is distributed to employees. In addition, it is important to request OSHA 300, 300A, and 301 Forms, as well as materials with respect to any OSHA inspections, corrective actions, settlements, and citations while conducting due diligence. Depending on the type of company, diligence with respect to respiratory protection and hearing conservation programs may also be necessary.

For further assistance on M&A transactions, information regarding your Company's obligations or risks in transactions, and guidance regarding labor and employment due diligence, contact your Akerman labor and employment attorney. Akerman has a team of dedicated Labor & Employment lawyers with significant experience handling these issues for clients.
