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Diligent Diligence

10 EMPLOYMENT STEPS THAT WILL HELP IN CORPORATE TRANSACTIONS

By Geoffrey D. DeBoskey

It used to be that an employment lawyer's primary role in connection with a corporate transaction was simply to pass along the most recent employment agreement template. That was back in the good old days when a company's most significant employment concern was ensuring that the sales manager did not begin weekly meetings with a dirty limerick.

Now in-house attorneys and human resource directors lie awake at night worrying about meal periods, overtime exemptions and employee pay stubs. The wage/hour class action boom that began about five years ago has created a significant potential source of corporate liability. As a result, employment-related due diligence can now be as important as the due diligence connected to accounting and intellectual property matters.

Employment lawyers generally provide three services when it comes to corporate transactions: (1) conduct due diligence on the employment practices of the target company; (2) ensure that the transaction documents (e.g., purchase agreements, executive employment agreements, etc.) do not create employment law liability; and (3) provide advice on the best way to fix unlawful employment practices. Although just about every corporate transaction presents at least one unique issue, there are also many common traps. However, an article titled "132 Common Corporate Employment Traps" almost certainly would not make it past the editor's desk. Therefore, I'll limit myself to a more manageable 10.

1. WARN Act

The federal Worker Adjustment and Retraining Act and its California equivalent mandate that an employer provide notice to employees 60 days before engaging in certain layoffs, terminations and plant closures. A sale or merger does not trigger the WARN Act in and of itself. However, a WARN Act issue may arise if the acquiring company only chooses to take on some of the employees or forces employees to interview for positions with the company. Moreover, if the acquiring company plans to engage in layoffs or plant closings, it needs to be familiar with its obligations under the WARN Act.

2. Overtime classification

Practically every industry has been hit by class actions involving overtime pay. The first wave of lawsuits came against retail stores that classified their department or store managers pursuant to the executive exemption. Class actions are now challenging the application of virtually every overtime exemption. No business or industry is immune. It is very important that an acquiring company examine the exemption status of the target company's employees and determine whether employees might be misclassified.

3. Meal periods and rest periods

Plaintiffs' lawyers have plagued employers with a wave of class actions alleging that employees were not properly provided with meal periods or authorized and permitted to take rest periods. A lack of compliance in this area can create substantial liability. Several years ago, I was pleased to learn a company that was being purchased by one of our clients had a written meal-period policy. That is, until I saw that the policy provided for a 20-minute onsite meal period. This policy would only be good news to a plaintiff's lawyer hoping to upgrade his or her yacht. It is very important that an acquiring company review meal-break and rest-period policies, plan for any potential liability and quickly implement proper policies and procedures. A change in ownership is an excellent time to implement proactive meal-break and rest-period compliance procedures because employees expect that new owners will bring with them new policies and procedures.

4. Collective bargaining agreements

A corporate lawyer recently told me the story of a company that only learned the business it had just bought was unionized when, several days after the closing, the shop steward introduced himself to the new owners. Surprise! It is important to determine whether any employees are unionized or if there has been any recent union activity. If employees are unionized and are subject to a collective

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Geoffrey D. DeBoskey, an associate in the Los Angeles office of Sheppard Mullin Richter & Hampton, practices in the firm's labor and employment group.

bargaining agreement, the acquiring company should review the agreement to ensure that it is comfortable with any restrictions contained in that agreement. The acquiring company may be able to structure the deal to avoid assuming the collective bargaining agreement. Additionally, the target company may have obligations to negotiate with the union over the effects of the sale.

5. Pay stub requirements

California law mandates that an employee's pay stub should contain nine specific pieces of information, including the total number of hours worked by the employee, all deductions and the precise legal name and address of the employer. Employees frequently file lawsuits alleging hypertechnical violations of the pay stub rule. For instance, California law requires that pay stubs contain the "inclusive dates of the period for which the employee is paid." Several companies are currently facing lawsuits alleging that their pay stubs are not compliant with the law because the stubs included only an entry for "pay period ending" on a specific date. Therefore, it is important to ensure that the target company's pay stubs fully comply with the law.

The acquiring company should also plan to make any changes to the pay stubs that are necessitated by the transaction. For instance, the "name and address of the legal entity that is the employer" often changes in connection with a corporate transaction, and the company must modify the pay stubs accordingly.

6. Executive employment agreements

Acquiring companies frequently want to enter into employment agreements with the target corporation's key employees. Unfortunately, many companies will simply pull up a prior employment agreement and make changes to that document without having it reviewed by an employment attorney. Laws and best practices change over time and modifications to one part of an agreement can make other parts of an agreement problematic. Disability clauses are the most common culprit because companies often try to create disability termination provisions that are not compliant with disability and leave laws.

It is also important to review existing employment agreements. For instance, many executive employment agreements contain "change of control" provisions that the executive can activate if the company merges or is acquired. Such provisions often provide that, upon the occurrence of a covered event, an executive can resign and receive the same benefits that he or she would have received if the company had terminated the executive without cause. Executives are sometimes willing to waive their right to claim that a transaction constitutes a change in control as part of a new employment agreement with the purchaser.

7. Accrued vacation

Taxation and employment law considerations are relevant to the decision of whether to transfer or pay out vacation time that has been accrued by the target company's employees. It is important for attorneys to discuss this issue with their clients at a relatively early stage in the transaction.

8. Non-competition clauses

Corporate lawyers at my firm regularly ask me to explain to other out-of-state corporate lawyers why I deleted a non-competition clause from an executive employment agreement. California has one of the strictest prohibitions against non-competition agreements in the nation. Although companies can protect trade secrets, non-competition agreements are generally invalid. One exception, provided that certain conditions are met, permits a company to obtain a reasonable and narrowly tailored non-competition clause against a person who is selling his or her ownership interest in a business. However, that exception is very narrow. The California court of appeal, in Strategix Ltd. v. Infocrossing West Inc., 142 Cal.App.4th 1068, held last year that a purchaser can only require a seller to agree not to solicit the customers of the business he or she sold. Courts may refuse to enforce any aspects of an overly aggressive non-competition or non-solicitation clause even if parts of the agreement are compliant with the law. It is important, therefore, to review all non-competition and non-solicitation agreements to ensure that they comply with the strict rules governing these agreements.

9. Independent contractor relationships

I was once asked to conduct employment due diligence because the company being purchased by our client had classified every one of its workers as independent contractors. This despite the fact that the company provided the equipment, the people in question worked only for the company and the workers were covered by the company's health benefits plan. Had our corporate attorney not spotted the issue and involved employment counsel, the client would have inherited a very difficult situation. Instead, we seamlessly reclassified the workers when we closed the acquisition.

10. Record retention

Too often, acquiring companies do not retain employment records that pre-date the corporate transaction. Occasionally, the new owners do not even know where such records are stored. One client spent weeks searching for old time cards, only to ultimately discover that they were sitting in a box in the previous owner's garage. Both California and federal law require companies to keep certain wage-and-hour records for specified periods of time. The acquiring company may choose to retain I-9 employment verification forms prepared by the seller rather than have all the existing employees execute new forms. In addition, companies often need wage-and-hour records to defend against lawsuits. Therefore, it is essential that acquiring companies locate and retain prior employment records.

Due diligence in employment matters often reveals a number of unlawful practices. However, it is far better to discover such problems before rather than after the transaction closes. The good news is that a corporate changing of the guard often provides an excellent opportunity to clean up problematic practices because employees expect that a new company will implement new policies. An employment law attorney can help companies strategically structure the documents and corporate transition in a manner that reduces the potential for liability. ❖

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