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# Labor and Employment Issues Triggered by Mergers and Acquisitions in the U.S.

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# Introduction



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## Purpose of Due Diligence

- Discover problems! Uncover obstacles/deal breakers to completing a transaction, learn about the seller's business, and confirm that representations and warranties about the acquired business are accurate
- Failure by buyer to conduct adequate diligence can raise significant problems post-closing
- Board of Directors will want to show to its stockholders that it met its fiduciary duties



## How a Diligence Review is Conducted

- Due Diligence Request List sent to seller
- Compiled information is organized and provided in data room or virtual data room
- Buyer reviews diligence material; diligence team can include in-house lawyers, HR professionals, outside counsel, accountants and others; individuals with particular expertise should review specialized areas
- Buyer's counsel and diligence team prepare a diligence report documenting what was reviewed, issues discovered, and proposed resolution of such issues prior to closing



## Particular Employment/Labor Issues

- Employment and incentive compensation arrangements: change in control provisions/ assignment/consent provisions; how will compensation arrangements integrate into buyer's business; perks; do any employees of seller own shares in seller?
- Employee v. independent contractor status
- Citizenship and work status issues
- Vacation/disability/sick pay/severance policies; review of company policies/handbooks/manuals on employee matters



## Particular Employment/Labor Issues

- Workers compensation policies, procedures and claims, and pending or concluded proceedings
- Governmental charges by any labor agencies or employee grievances or complaints, including wage and hour, discrimination and employee benefits
- Turnover of personnel/stability issues
- Personnel records regarding pattern of bias/discrimination



## Particular Employment/Labor Issues

- Any labor union issues; strikes, lock-outs or slowdowns; any claims filed with NLRB
- Non-disclosure agreements, assignment of IP rights, non-competition and protection of intellectual property/confidential information
- Deferred compensation - Section 409A tax issues
- Employee Benefit matters: ERISA issues, unfunded or underfunded issues, IRS, Department of Labor or Pension Benefit Guaranty Corporation inquiries, audits, reviews or investigations



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## Union Issues

- Stock Purchase
- Asset Purchase
- Successorship clauses
- Duty to Bargain



## The WARN Act

- Federal WARN Act requires that covered employers provide advance notice before undertaking a mass layoff or plant closing
- Many states have adopted “mini-” WARN acts, some of which impose requirements significantly different from those in the federal act
- WARN measures employment actions that occur at an employer’s “single site of employment” – generally, a single office, plant, or facility



## Plant Closings and Mass Layoffs

- Mass Layoff: An action that results in an employment loss of at least 33% of the workforce at a single site of employment during any 30-day period, affecting at least 50 employees. If 500 employees are affected, the one-third requirement does not apply.
- Plant Closing: A temporary or permanent shutdown of a single site of employment or one or more facilities or operating units within a single site of employment that results in an employment loss during any 30-day period for 50 or more employees.



## WARN and Corporate Transactions

- Stock Deals: No special considerations, as employees continue to be employed by the same employer
- Asset Sales: WARN specifically provides that employees' termination of employment incident to an asset sale does not constitute a loss of employment for WARN purposes: "Notwithstanding any other provision of this chapter, any person who is an employee of the seller (other than a part-time employee) as of the effective date of the sale shall be considered an employee of the purchaser immediately after the effective date of the sale." 29 U.S.C. § 2102(b)(1).



## Corporate Transactions – Planning for RIFS

- Purchasers and sellers must both consider early in the transaction process the extent to which the seller's employees will become employed by the purchaser
- Where no or few employees will experience an employment loss, the WARN Act is not likely to be implicated
- Where significant employee terminations will occur, the parties must carefully consider when the terminations will occur, what notice will be required, and what, if any, exceptions, may be available to avoid or limit liability
- Be sure to consider requirements of state WARN laws



## Existing Employment Contracts

### From the Seller's Perspective:

- Are severance obligations potentially triggered by “good reason” or other employee termination provisions?
- In an asset sale, will your former executives have the ability to compete against the remaining portions of your business?
- Do the agreements have clear and enforceable assignment provisions?
- Is there a need to amend/replace contracts in anticipation of the transaction?



## Existing Employment Contracts

### From the Buyer's Perspective:

- Can you and should you try to shed unwanted contracts? Collective bargaining agreements?
- Anticipating departures, are you protected from competition through existing agreements?
- If not, can you negotiate protection in advance of the deal?
- Regardless, prepare for likely competition from departing employees (or soon to be departing employees)



## New Agreements

### Before the Deal:

- Can you ensure business continuity up to the time of the deal once the transaction becomes “public” within the seller’s operations through pre-transaction agreements?
- Can you encourage the seller to implement additional or enforceable non-competition agreements before the deal becomes “public” within the seller’s organization?
- Is the buyer willing to “pay” for stay-on agreements or the seller’s implementation of pre-deal restrictive covenant agreements?



## New Agreements

### **Sale of Business Restrictive Covenants:**

- Do not include them in any post-deal employment agreements
- Tie them to specific terms of the purchase agreement
- Research whether you should tie the covenants to a specific portion of the deal proceeds
- Utilize forfeiture provisions in addition to injunctive relief



## New Agreements

### **Other Restrictive Covenants Executed at the Time of Transaction:**

- Critical that your analysis is jurisdiction specific (one size does not fit all)
- A thorough evaluation of choice of law, exclusive jurisdiction and potentially arbitration provisions is critical
- Inclusion of discretionary language within “cause” definitions



## New Agreements

### Other Restrictive Covenants Executed at the Time of Transaction:

- Inclusion of fiduciary language in “duties” clauses to assist in dealing with duty of loyalty disputes
- Do not overreach with restrictive covenants to mirror sale of business covenants (depending on your jurisdiction)
  - Is additional consideration required?
  - Is enforcement tied to the reason for separation?



## Common Employee Benefits Issues – Introduction

- Due diligence and representations usually include at least:
  - Identification and review of employee benefit plans
  - ERISA and IRC compliance
  - Pending or threatened claims
  - Qualified plan matters
  - Special consideration to defined benefit and multiemployer plans
  - COBRA compliance



## Common Employee Benefits Issues – Introduction

cont'd.

- Retiree health
- Transaction-related compensation
- Post-closing ability to modify benefits
- Stock/merger – more representations
- Asset – typically more limited representations if Buyer not assuming plans



## Common Employee Benefits Issues – Cautions

- Controlled group rules – complex
  - For many benefits purposes, all trades or businesses under common control and corporations within the same “controlled group” are treated as single employer
  - Generally connected, directly or indirectly, by 80% common ownership
  - Also affiliated service groups in some cases
- Defined benefit plans, multiemployer plans, retiree health



## Common Employee Benefits Issues – 401(k) Plan Transition

Typical buyer position in asset deal:

- Require seller to retain its 401(k) plan and fully vest transitioning employees
- Employees incur a severance from employment with seller and can elect a distribution and/or rollover of 401(k) plan account (assuming seller's plan allows distributions promptly at termination of employment)
- Troubleshooting: participant loans



## **Common Employee Benefits Issues – 401(k) Plan Transition**

Seller Scenario #1 in asset deal:

- Seller keeps its 401(k) plan for employees of retained business
- Sale may trigger a “partial termination” requiring full vesting
- If not a partial termination, vesting still may be an important morale issue for buyer
- Troubleshooting: participant loans



## Common Employee Benefits Issues – 401(k) Plan Transition

### Seller Scenario #2 in asset deal:

- Seller requests that buyer assume seller's 401(k) plan
- Buyer:
  - Buyer with existing business may already have its own 401(k) plan
  - Limited ability to terminate assumed plan post-closing if buyer has existing plan
  - Maintaining as a separate plan can be burdensome
  - Merger of 401(k) plan with problems could taint buyer's 401(k) plan and protected benefits could complicate recordkeeping
  - Due diligence is critical



## Common Employee Benefits Issues – COBRA Responsibility

General Rules – If purchase agreement is silent, “default” rules in regulations apply

- Stock or Asset Sale – If seller or any member of its controlled group continues a health plan after the sale, seller (or the related company) has COBRA responsibility
- Asset Sale – If neither seller nor related company has a group health plan after closing and buyer continues the business operations associated with the purchased assets without interruption or substantial change, buyer is a “successor employer” and responsible for COBRA coverage



## Common Employee Benefits Issues – COBRA Responsibility

- *Caution* – If buyer is not a successor employer (e.g., seller or related company continues a health plan), COBRA qualifying event occurs for terminating employees, even if hired by buyer and offered coverage under buyer's plan
- Stock Sale – If neither seller nor related company has a group health plan after closing, buyer is responsible for COBRA coverage



## **Common Employee Benefits Issues – COBRA Responsibility**

Parties are free to contractually negotiate allocation of COBRA responsibility

- If contractually obligated party breaches, responsibility reverts to party obligated under COBRA regulations



## Common Employee Benefits Issues

- Golden parachute payments/excise tax
- Post-closing promises
  - Service credit
  - Comparable benefits
- Flexible Spending Accounts



## Immigration-Related Issues

In this global market economy, the probability that an M&A will involve foreign personnel in one or both sides of the transaction is high.

- Foreign executives and technicians that come into the U.S. to address an M&A need to be aware of U.S. immigration law.
- Most M&A's involve temporary transfer of executive and technical personnel to the U.S. before the closing of the deal (due diligence) and afterwards (for start-up).



## Immigration-Related Issues

These two different steps within an M&A have different immigration consequences under U.S. immigration law

- Foreign personnel engaged in a due diligence can enter the U.S. under a B-1 visa, which they usually already possess.
- B-1 visas allow for entry into the U.S. for purposes of business. Entry is allowed for up to 90 days per visit.
- Personnel from 23 specific countries do not need a visa to enter the U.S. for business (“VWP countries”).



## Immigration-Related Issues

After the closing of the transaction, all foreign executive and technical who will work in the U.S. (even part time) need a work visa

- There are multiple visas available for personnel involved in an M&A. Which one is correct depends on cost, timeframe, Nationality and expertise of the individual.
- Visas available include E-1, E-2, H-1B, L-1A, L-1B, NAFTA and (rarely) O visas.
- Visas for executives are usually granted much more easily than visas for technical personnel



## Immigration-Related Issues

Changes in ownership may have a significant impact on the foreign workers that are already working in the U.S. at the time of the M&A

- Changes in ownership usually disqualify E and L visa holders from working for the surviving entity
- On the contrary, H-1B visas are “portable” – and getting USCIS approval to work for the surviving entity is generally not an issue
- Likewise, NAFTA workers just need to renew their visa under the surviving entity, which is a relatively straightforward process



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