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Dodging US employment law violations during international mergers and acquisitions

By Thomas Stromberg and Javier Garcia

Thomas Stromberg (tstromberg@perkinscoie.com) is partner in Perkins Coie's Mergers & Acquisitions practice group, and **Javier Garcia** (jgarcia@perkinscoie.com) is partner in Perkins Coie's Labor & Employment practice group, both based in Los Angeles, California, USA.

Every buyer of a US business needs to think about how it will operate the business after an acquisition and how to avoid existing and future liabilities resulting from operations. Some operational challenges are evident, while others are not as obvious. One challenge that our non-US clients spend time and resources overcoming is complying with applicable employment laws and regulations while maintaining a productive and effective workforce. US employment laws vary from state to state and are often very different from the laws of the countries in which non-US buyers operate. This challenge needs to be identified and managed when executing the acquisition of a US business or a business that maintains a workforce in the United States.

Employment landmines in US companies

The US employment law landscape is always evolving. Many states, such as California, adopt and implement new employment laws and regulations every year. Any non-US buyer of, or investor in, a US business needs to (i) understand at the time of purchase and thereafter the applicable employment laws and regulations and have a plan for managing its workforce in compliance with those laws and regulations, and (ii) have procedures in place that will keep the acquired business's management informed of applicable changes in employment laws and regulations and allow them to modify employment policies and procedures. In addition, when a non-US buyer is executing a purchase of a US business, it is important to understand the extent to which the target company is in compliance with applicable employment laws and regulations and what liabilities the target company has incurred as a result of failing to be in compliance. Failing to understand existing liabilities or be in compliance with applicable employment laws or regulations could lead to significant litigation, resulting in fines, litigation fees, settlement costs, or court judgments.

The following are key employment policies, procedures, and practices that should be evaluated in each diligence review of a target company.

Hiring/discharge practices

Limiting employment liability starts with having policies and procedures in place at the hiring stage. These policies and procedures should include well-drafted offer letters that lay out the terms and conditions of employment and establish the at-will employment relationship or, alternatively, an employment agreement when appropriate, among other terms of employment. Companies should also have policies and procedures for terminating the employment relationship, including the proper notices and procedures. For example, California has specific forms that are required to be issued at discharge, and employees should be issued all wages due on the last day of employment. Companies should also consider severance agreements at the time of discharge where feasible and prudent.

Intellectual property protections

An extremely important employment practice for companies to undertake is to protect intellectual property by having employees sign proprietary information and inventions assignment agreements. These agreements should contain confidentiality provisions, or the company should have separate stand-alone confidentiality agreements. Having these agreements in place is critical to protecting intellectual property, as it precludes employees from claiming they personally invented and own company intellectual property, or using the intellectual property to benefit a subsequent employer or company.

To the extent necessary, a company should take steps to protect confidential proprietary information in the employment context by (i) limiting access to such information to only employees who need the information and (ii) implementing security measures to protect the confidentiality of the information (e.g., password-protected systems).

Worker classification

Proper worker classification as either employees or independent contractors is a significant legal issue in California. California implemented AB 5 on January 1, 2020, which establishes (with some exceptions) a presumption that all workers in California are employees and places the burden on the hiring company to prove that workers are, in fact, independent contractors if a dispute arises.[1] AB 5 also adopts a three-part test to determine whether a worker is properly classified as an independent contractor. Each company operating in California should understand the three-part test and audit its relationship with service providers from time to time.

Employment policies

A well-run company should also have employment policies and procedures in place to not only protect employees, but also protect the company from liability. This includes antidiscrimination policies, employee complaint and investigation processes, and meal and rest break policies, just to name a few. These policies allow employees to bring liability-creating issues and problems to a company's attention and give the company the opportunity to address and/or correct problems. Having proper meal and rest break policies and procedures is also extremely important, as the failure to do so could lead to a class action lawsuit that could potentially put a company out of business and create individual liability for company executives.

Arbitration agreements

Another prudent consideration relates to arbitration agreements. Although the law on arbitration agreements continues to evolve, a properly drafted arbitration agreement can potentially save a company thousands of dollars in litigation by avoiding the potential for large class actions and the risk associated with going to court and facing a potential "runaway jury."

Union activity

Union activity, including existing collective bargaining agreements or campaigns to unionize workers, is a critical factor to consider in buying or investing in a US business. The presence of a union could add another layer of complexity to operating a business in the US.