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Employee Issues Can Loom Large in Sale-of-Business Transactions

Four Potentially Costly Issues to Avoid

■ By Terry Allen and Stacy Marsh - Gibson Dunn's Orange County office

Many business owners are surprised at the scrutiny given by potential buyers of their business to employee matters. The scrutiny cannot be dismissed as purely irrational. Employers failing to comply with state or federal employment laws and regulations can face substantial liabilities and disruption to their operations, risks that buyers will carefully evaluate. Business owners may also find that poorly conceived or overly burdensome employee compensation arrangements suppress enterprise value when the business is for sale.

Discussed below are four employee-related issues with outsized potential to harm the value and marketability of businesses plagued by them. Many of these potential minefields stem from fairly complex laws, so it makes sense to navigate them with the help of an experienced employment law attorney.

Classify With Care

Federal and state wage and hour laws provide that employees not satisfying certain exemptions must be paid overtime and given meal and rest breaks at specified intervals. Common exemptions include those for executive, administrative and professional employees. Employers are often surprised at how narrowly the exemptions are applied. The professional exemption, for example, only encompasses employees who engage in a specified recognized profession (including law, engineering, teaching and accounting, among others) or in a "learned or artistic profession." The exemption in each case is subject to additional requirements, including that the employee regularly use "discretion and independent judgment" in his or her work. Employers who misclassify employees as exempt from overtime or violate other wage and hour practices may be liable for back wages, penalties, interest, attorneys' fees and costs and, in some cases, punitive damages.

Periodic audits of employee classifications may help. Particular attention should be given to classification decisions that affect a large number of similarly-situated employees. Scrutiny should also be given to overtime calculations and payments, meal and rest breaks, final pay check practices, reporting time pay, vacation policies, bonus calculations, expense reimbursement and payroll deductions, other areas frequently the subject of litigation.

Don't Get Tied Down

Employers that provide generous employment agreements may find these agreements are paid for in lost sale value. Terms a buyer may disfavor include the guarantee of employment for a specified period (including terms limiting the employer's termination rights to circumstances constituting "cause"), the provision of a lucrative severance package upon termination or a change of control, and the guarantee of certain perquisites.

Another area where maintaining flexibility is paramount is in the design of equity compensation programs (e.g., stock options). Equity compensation plans should not require a buyer to assume or continue outstanding awards following a transaction, as this requirement may not be practicable or consistent with the buyer's intentions. But by the same token, these plans should not preclude the assumption or continuation of outstanding awards. Some buyers will want the flexibility to continue awards and maintain existing vesting provisions as a retention incentive for employees after the transaction.

Pay on the Merits

The Lilly Ledbetter Act of 2009 is expected to increase the prevalence of claims asserting that differences in employee compensation are improperly based on gender, race, age or disability by making these claims easier for employees to bring. The Ledbetter Act provides that a violation occurs at the time an individual is affected by an allegedly discriminatory compensation decision or practice, including each time compensation or benefits are paid. Compensation decisions made five, 10 or even 20 years ago can be the basis for a lawsuit, so long as a claim is filed with the federal Equal Employment Opportunity Commission within 180 days from the date of the last paycheck reflecting a discriminatory pay disparity.

Employers can mitigate the risks of pay disparity claims. Steps to be taken include documenting the basis for compensation decisions and retaining all documentation on a long-term basis, tying compensation decisions to non-subjective factors to the extent possible, conducting periodic reviews of employee compensation to ensure consistency in pay decisions, and subjecting proposed compensation to human resources review, particularly where individual managers make compensation decisions and where salaries result from individual negotiations.

Reduce the Risk in Reductions

Employers undertaking workforce reductions in the current weak economy can expect buyer scrutiny in a future sale. Layoffs often trigger individual and class action lawsuits asserting discrimination, retaliation or similar claims based on a characteristic that is protected by law (such as age (defined as over 40), race, gender, disability or whistle blowing activities).

Layoffs should be based on documented, consistently-applied guidelines. Because job performance is often a key factor in layoff selection, employers should have performance review procedures in place, provide candid reviews, and document performance problems on an on-going basis. A risk analysis should be conducted with counsel following preliminary layoff selections to identify any individual high risk decisions or adverse impact on a protected class.

A workforce reduction may also implicate certain requirements under federal and state Worker Adjustment And Retraining Notification (WARN) Acts. Both the federal and California WARN Acts require 60 days' advance written notice to affected employees and state and local officials in the event of a plant or operations closing or a mass layoff, as defined under the statutes. Qualifying employment actions that do not comply with WARN requirements may result in class action claims and subject employers to liability for wages, penalties and attorneys' fees.

Mr. Allen is a corporate transactions partner and Ms. Marsh is a labor and employment associate in the Orange County office of Gibson, Dunn & Crutcher LLP.

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