This practice note describes labor and employment-related considerations that arise in the context of corporate mergers and acquisitions. Specifically, this note aims to equip a buyer with an eye to discover, manage, and prevent potential liabilities resulting from a target company’s labor and employment practices during a merger or acquisition. It offers practical guidance on how to conduct due diligence in every aspect of a corporate transaction where employment-related issues might arise.

This practice note addresses the following key issues:

1. Overview of an Employment Lawyer’s Role in an M&A Transaction
2. Preliminary Considerations – Stock versus Asset Deals
3. Conducting Due Diligence – Key Issues
4. After the Sale – Terminating Seller’s Employees

For more information on labor and employment considerations in business transactions, including sample forms and checklists, see Due Diligence in Business Transactions (LJP) §§ 11.02–11.08, Due Diligence Request List (Executive Compensation and Employee Benefits), Due Diligence Checklist (Employment Agreements), Due Diligence Checklist (Employment Agreements), Due Diligence Checklist (Retirement and Retiree Benefit Plans), Due Diligence Checklist (Incentive Plans), and Due Diligence Checklist (Award Agreements).

Overview of an Employment Lawyer’s Role in an M&A Transaction

A buyer-side employment lawyer can have a significant impact on a business transaction by spotting employment-related liabilities in the target company that might otherwise have gone unnoticed. An employment lawyer’s findings can substantially change the terms of an agreement, affect the purchase price, or, in some instances, prevent a deal from occurring at all. On the other hand, if the employment lawyer does not perform his or her duty adequately, substantial problems may develop after the deal closes that could have been prevented, leading to a serious case of buyer’s remorse.

Given the critical nature of the role, an employment lawyer working on a corporate transaction must pay meticulous attention to detail. Employment issues can arise in all different aspects of a transaction, so counsel need a sharp eye to dutifully represent the purchaser’s interests. As described below, an employment lawyer must carefully examine a wide range of issues, from potential lawsuits, to wage and hour liability, to immigration concerns.
Preliminary Considerations – Stock versus Asset Deals

At the outset of any labor and employment due diligence, it is important to understand the nature of the deal, as it will affect the scope of your review. In a stock purchase, the seller transfers its ownership of the target company’s stock to the buyer, and the buyer becomes the controlling or sole shareholder of the target. In a merger structure, the buyer either absorbs the target company by direct merger, or the target becomes a wholly owned subsidiary of the buyer. In either a stock purchase or a merger structure, all employees of the target may be transferred at closing, more or less automatically, to the buyer. By stepping into the shoes of the seller, the buyer may assume all of the target’s assets and liabilities with respect to the target’s employees; therefore, attorneys should conduct a comprehensive review of the entire company and its employment-related issues.

In an asset purchase, on the other hand, the buyer acquires some or all of a business’s assets; the liabilities that the buyer inherits vary according to which assets it acquires and the applicable state law. Thus, the labor and employment attorney’s role in such a deal is more targeted, focusing specifically on how to integrate employees from the purchased asset into their new company. Unlike stock purchases, employees generally do not transfer automatically in an asset purchase, meaning the buyer must expressly assume employment agreements and restrictive covenants with the acquired personnel; any anti-assignment or change-in-control clauses in the acquired employees’ employment contracts could require specific negotiation. In either deal type, be sure to inspect the terms of the transaction, including the indemnification clauses, which determine who assumes liability in the event of employment lawsuits and other post-closing complications.

If your position allows you to influence the way the deal is structured, consider the various benefits and drawbacks of each deal type from an employment perspective. For instance, a stock acquisition:

- Offers a more efficient and seamless transition than an asset deal by transferring employees automatically
- Doesn’t require the seller and buyer to enter into express assignments for the transfer of restrictive covenants and employment agreements – and –
- Avoids meritless but costly employee claims alleging breach of severance pay agreements and mass termination notification laws that arise as a result of terminating and rehiring employees in an asset deal (see After the Sale – Terminating Seller’s Employees – “Legal Considerations”)

An asset acquisition:

- Allows the buyer to pick and choose its employment-related assets and liabilities through negotiations with the seller
- Doesn’t require the buyer to automatically inherit the terms of unfavorable existing employment agreements and restrictive covenants – and –
- Depending on the state law, may be the only available structure for acquiring another company’s assets

For more information on acquisition structures, see Asset Purchase, Stock Purchase, and Merger Structures: Benefits and Drawbacks.

Conducting Due Diligence – Key Issues

Deal teams call upon labor and employment attorneys to conduct due diligence prior to an acquisition for two primary reasons: (1) to identify potential liabilities of the target company that could affect the terms of the deal or purchase price, and (2) to uncover obstacles to integrating the employment operations of the two merging companies and their workforces. Consider the issues below when conducting your due diligence.

For more information on conducting due diligence regarding labor and employment matters, including guidance on developing a due diligence plan, forming a diligence team, and reporting your results, see Due Diligence Requests Checklist (Business Transaction) (Labor and Employment). See also Due Diligence in Business Transactions (LJP) § 11.01 et seq. For an annotated form to request relevant labor and employment information during the due diligence process, see Due Diligence Request List (Labor and Employment). See also Due Diligence in Business Transactions (LJP) §§ 11.09–11.12.

For an overview of due diligence in business transactions generally and related resources, see Due Diligence for Securities Offerings Resource Kit.

Employment Claims from Employees and Government Agencies

When conducting diligence, it is essential to review all relevant former, pending, and prospective claims against the employer. Be sure to obtain summaries of all types of claims, including agency audits and citations, administrative investigations and proceedings by federal, state, and local agencies (including the Equal Employment Opportunity Commission (EEOC) and the Department of Labor (DOL)), administrative charges by employees, enforcements actions, demand letters, and formal lawsuits.
To begin, review resolved claims and litigation going back a certain period of time (e.g., filed within the prior five years). While these claims do not pose an ongoing threat of liability, they can demonstrate a history of employment law noncompliance that you’ll need to rectify when the target company’s employees join your client’s workforce. Be sure to also review documents concerning the resolution of past claims, including settlement agreements, consent decrees, and judgments.

Next, examine any pending employment claims against the target company to determine which, if any, could become severe or otherwise have high risk. Pending claims against a company may appear insignificant during a corporate transaction, but they can evolve into multimillion-dollar lawsuits.

Compare the facts and legal landscape for each pending case. If the allegations in one case could apply to a wide variety of employees who haven’t yet brought litigation (e.g., employees unlawfully denied meal periods or misclassified as exempt), beware. A favorable ruling for the employee in the primary case could mean a favorable ruling for other employees in the future or a high-value class action lawsuit, depending on the number of employees involved.

Along with past and present litigation, you should evaluate the risk of future litigation. Inspect each demand letter the target company has received to determine if the issues the letter raises appear problematic. If so, conduct an investigation to decide if the issues have merit.

**Joint Employment**

If the target company has relationships with staffing agencies, employee leasing companies, or contractors employing their own staffs, investigate whether the company jointly employs its workers with another organization. Often overlooked, joint employment arrangements may confer additional responsibilities on the purchaser, such as bargaining with the joint employer’s union. They may also increase the value of the target company’s liabilities vis-à-vis tax, workers’ compensation, and unemployment insurance obligations. To assess joint employment liability, review applicable agreements between the potentially joint employers, investigate the degree of control each company exercises over the employees, and identify any indemnity agreements that allocate liabilities between the companies. For more information on joint employer issues, see Joint Employment Relationships: Best Practices and Risks.

**Employment Agreements**

You should evaluate existing employment contracts and offer letters to determine whether they must or should be honored following your business transaction, as well as how they may impact your transaction. Some employment agreements, particularly executive employment agreements, include a “change in control” provision that dictates what should occur in the event of a business transaction. A change in control provision could award employees compensation or other benefits.

For more information on conducting due diligence on executive employment agreements, see Due Diligence Checklist (Employment Agreements).

**Wage and Hour Liability**

Disputes over wages and hours can become a huge source of liability for the buyer. The target company’s policies and procedures must comply with both the Fair Labor Standards Act (FLSA), 29 U.S.C. § 201 et seq., which prescribes wage and hour requirements at the federal level, and state and local laws, which often impose higher standards to protect employees. Violations of the FLSA can result in a fine of all unpaid overtime, an equal amount in liquidated damages, and attorney’s fees and costs. See Perez v. Palermo Seafood, Inc., 548 F. Supp. 2d 1340, 1348–51 (2008). State laws confer additional penalties. In California, for example, aggrieved employees may seek additional penalties for wage and hour violations under the Private Attorneys General Act (PAGA), Cal. Labor Code § 2698, et seq. For information on wage and hour laws in your jurisdiction, see Wage and Hour State Practice Notes Chart.

Accordingly, to assess the risk that your client will face wage and hour liability from the transaction, carefully investigate the seller’s payroll practices. Try to determine, for example, whether the company provides the statutorily required number of meal and rest breaks, correctly calculates and pays overtime wages, and includes mandatory information on paystubs. Be sure to note the overall size of the workforce in determining the scope of potential liability. Companies with large headcounts face more potential liability from wage and hour class actions than smaller employers.

Finally, research whether the successor doctrine, which holds the purchaser liable for the unlawful acts of its predecessor, applies to putative FLSA claims. See, e.g., Steinbach v. Hubbard, 51 F.3d 843, 848 (9th Cir. 1995) (holding that successorship liability exists as to FLSA claims when certain conditions are met). If not, the buyer may be shielded from FLSA claims arising out of the employee’s previous employment.

**Misclassification of Workers**

Workers can be misclassified in one of two common ways: as an independent contractor (as opposed to an employee) and as an exempt employee (as opposed to a nonexempt employee). If employees are misclassified as independent contractors, or nonexempt employees are misclassified as exempt, liability can accumulate quickly in the form of meal and rest break violations, failure to pay overtime, failure to maintain and provide accurate wage statements, failure to provide final wages upon separation of employment, and other wage and hour claims.

To conduct your misclassification audit, first obtain the target company’s employee data, job descriptions, classifications, sal-
aries, paystubs, timekeeping records, wage and hour policies, and independent contractor agreements. With this information in hand, assess the seller’s workforce (as well as the target company’s method for classifying employees, to the extent it is not privileged) to ensure that workers are properly classified and do not pose a risk of a class action wage and hour lawsuit. In so doing, ensure that you apply the appropriate tests for classifying workers for the relevant jurisdiction(s) to determine whether the employees are correctly classified. Be sure to evaluate the statutes of limitations and penalties for wage and hour violations, as well, to assess the scope of the potential liability.

Buyers should pay special attention to sellers who recently reclassified their workforce or who reclassify their workforce as a result of the transaction, since this may indicate the employees were previously misclassified. That said, employers may simply reclassify employees to comply with developments in the law. For example, in 2018, the California Supreme Court changed the test for determining whether a worker should be classified as an independent contractor as opposed to an employee, which in turn caused many companies to evaluate whether their independent contractors should be reclassified under the new requirements. See Dynamex Operations West, Inc. v. Superior Court, 4 Cal. 5th 903, 964 (2018).

For more information on analyzing employee exemption status, see Wage and Hour—FLSA Requirements and Exemptions. For more information on exemptions under state law, see the practice notes in the “Exempt vs. Non-exempt” column of Wage and Hour State Practice Notes Chart. For more information on determining whether an individual is an independent contractor or employee, see Independent Contractor Tests and Risks of Worker Misclassification and Independent Contractor Red Flag Checklist. For information on independent contractor classifications under state laws, see Independent Contractors State Practice Notes Chart.

**Vacation and Sick Pay**

You should also examine the policies regarding vacation and paid time off during a merger and acquisition. Vacation time is not required in the United States, but when paid vacation or other time off is provided and an employee has been terminated before he or she has taken the vested time, the employer may be obligated to pay wages at the final rate of pay for the unused time, depending on the jurisdiction. It is important to be aware of how each jurisdiction treats different employee benefits. For example, vacation time in California is protected and paid out as wages upon termination of employment, but paid sick leave is not. See Cal. Lab. Code §§ 227.3, 246(g)(1). Determine compliance by examining the seller’s policies regarding vacation days, personal days, sick days, paid time off, and terminations.

For information on vacation and PTO requirements in your jurisdiction, see Paid Vacation and PTO State Law Survey and the “Pay Timing, Frequency, Methods, and Deductions” column of Wage and Hour State Practice Notes Chart. For information on paid sick leave requirements, see Paid Sick Leave State and Local Law Survey (Private Employers) and the “Family, Medical, Sick, Pregnancy, and Military Leave” column of Attendance, Leaves, and Disabilities State Practice Notes Chart.

**Restrictive Covenants**

Restrictive covenants generally come in the form of non-competition, non-solicitation, or non-disclosure agreements, often contained as provisions within an employment agreement. As a representative for the buyer, you should determine whether the selling company has any restrictive covenants in place with any of its current or former employees and whether they are sufficient to protect your client’s assets and proprietary information. If not, consider the costs of entering into new restrictive covenant agreements—supported by the necessary consideration—with the incoming employees. On the other hand, assess the risk that these employees would compete with your client’s business if you do not execute new covenants, particularly if the buyer decides to downsize in conjunction with the acquisition.

If the buyer intends to adopt the restrictive covenants of its incoming employees, scrutinize each restrictive covenant to make sure it has adequate consideration and is enforceable within your jurisdiction(s), as many states differ in their approach. For example, while non-compete agreements are generally unenforceable in California, they may be enforceable when made in conjunction with the sale of a business. Cal. Bus. & Prof. Code §§ 16600, 16601 (allowing non-competes in connection with the sale of a business’s goodwill).

For more information on drafting and reviewing restrictive covenants, see the practice notes in the Restrictive Covenants subtask. For more information regarding restrictive covenants under state law, see Non-competes and Trade Secret Protection State Practice Notes Chart.

**Anti-discrimination Policies**

Assess the target company’s anti-discrimination, anti-harassment, and anti-retaliation policies and procedures to ensure it maintains robust protections against workplace discrimination and harassment and has not exposed the buyer to future discrimination lawsuits. In addition, you should research the law in your jurisdiction to see if the buyer has liability under the successor doctrine for the unlawful acts of its predecessor. Many federal and state anti-discrimination laws hold the purchaser liable for the target company’s discrimination. See, e.g., Rojas v. TK Communs., 87 F.3d 745, 750 (5th Cir. 1996) (Title VII); EEOC v. Rockwell Int’l Corp., 36 F. Supp. 2d 1056, 1057 (N.D. Ill. 1999) (ADA); Criswell v. Delta Airlines, Inc., 868 F.2d 1093, 1096 (9th Cir. 1988) (ADEA). If you fail to uncover any discrimi-
Unionized Workforces

An employer taking over a unionized workforce must address unique additional considerations, such as whether it is bound by the collective bargaining agreement between the target company and the union and whether the buyer has an obligation to bargain with the target company employees’ union. For guidance on these issues, see Collective Bargaining Obligations: When Must a Changed Employing Entity Bargain with an Existing Union?

Workplace Safety

The Occupational Safety and Health Act (OSHA) and corresponding state laws govern workplace safety. Make sure that the target company’s employees have been trained on safety and that their training programs satisfied the standards set forth in OSHA, as well as any other applicable regulations.

You should also evaluate past and present workers’ compensation claims to determine (1) whether the seller’s employees repeatedly experience any type of workplace injuries, (2) whether any illness and prevention program is adequate to prevent and address workplace injuries, and (3) whether poor safety practices create undue risk to employees and for future litigation. In addition, you should review the adequacy of your client’s insurance coverage to protect against large health and safety claims. (This may be more or less important depending on the nature of the selling company’s business or operations—for example, a construction company or chemicals manufacturer may have more frequent or more severe workplace injuries than an office supply store.)

For more information on health and safety requirements generally, see the practice notes in the Workplace Safety and Health task. For more information on state health and safety requirements, see Occupational Safety and Health Plan State Law Survey. For more information on state workers’ compensation requirements, see Workers’ Compensation State Practice Notes Chart.

Immigration Considerations

If any parties to the transaction employ foreign personnel, you need to be mindful of recent immigration issues and regulations to adequately protect your client’s workers. Foreign workers may be impacted by a corporate transaction in numerous ways. Changes in ownership can disqualify certain visa holders from working for the new ownership. Workers might need to renew their visas or obtain a different type of visa to work for the new company. And workers who are in the process of applying for permanent residency may be affected by the transaction.

To protect foreign workers and prevent the loss of key personnel, it is important to be aware of the different restrictions and allowances of each visa. Evaluate the number and type of foreign workers and whether they are working under appropriate visas. If they would like to continue working in the United States, ensure that their work visas remain valid after the transaction.

Finally, take note of any workers whose application for permanent residency may be affected by the transaction and make sure they know where they stand. If you can anticipate these problems before they take effect, giving notice to the affected employees will likely help.

If your client is acquiring a business in an industry in which it is common to employ undocumented workers (such as agricul-
It is important to verify the employees’ work authorizations (i.e., I-9s and supporting documentation). Failure to adhere to federal immigration laws can spell significant civil and criminal penalties. For more information on I-9 compliance, see I-9 Policies and Best Practices for I-9 Compliance.

If you lack expertise in this area of law, it is important to consult with immigration counsel—especially in light of today’s rapidly changing immigration landscape. For more information on immigration law consideration in business transactions (including sample forms and checklists), see Immigration Law Considerations in Business Transactions and Due Diligence in Business Transactions (LJP §§ 11A.01–11A.07).

After the Sale – Terminating Seller’s Employees

Another key aspect of representing the buyer in a corporate transaction is consulting on the transition of employees from the target company to their new employer once the deal has closed. To benefit from the efficiencies gained from merging the two companies, most purchasers will lay off redundant or underperforming employees. Thus, your role as employment counsel is (1) to provide information that helps the buyer decide which employees to terminate and which to retain and (2) to advise the employer on how to comply with applicable laws when terminating employees who are no longer desired.

Even though this section concerns issues after the transaction is complete, you should evaluate these considerations as early in the deal process as possible to avoid unanticipated headaches.

Determining Who to Keep and Who to Terminate

Deciding who to terminate following a merger or acquisition requires employers to navigate a veritable minefield of legal perils. Review the guidance below when advising an employer at this stage of the deal process.

Utilizing Performance Management Documents

When determining which employees to transfer over to the buyer and which to terminate, a reasonable place to start is with the target company’s performance management documents. Consider requesting and analyzing the target company’s performance reviews, disciplinary records, performance improvement plans, and performance management policies to identify underperformers before making any final decisions on whom to discharge.

However, while performance management documents can be informative, risks abound when seeking and relying on employee performance evaluations for personnel decisions. First off, if the target company’s evaluations reflect unlawful discrimination, then terminations based on such tainted assessment would be equally unlawful. Therefore, avoid relying exclusively on performance evaluations when deciding which employees to terminate. Bolster the employer’s justifications for its terminations by interviewing supervisors at the target company about their subordinates’ work or by observing employee performance over a period of time after the merger or acquisition so the employer has an independent basis for its assessment.

Second, the buyer may run afoul of employee privacy laws. In some states, a target company exposes itself defamation lawsuits when it releases employee evaluations to the buyer without the employee’s consent. Many states also restrict or prohibit third-party access to personnel files, which contain the performance management documents. As such, carefully research the privacy laws in your jurisdiction before seeking these documents. For more information on state employee privacy rights, see Employee Privacy State Practice Notes Chart.

Avoiding Discrimination Claims

As with all reductions in force (RIFs), employers must be careful that their selection process does not disparately impact a protected class without a legitimate, nondiscriminatory justification. For instance, an employer who decides to terminate employees with higher compensation in an effort to minimize costs may expose itself to an age discrimination lawsuit if the highest paid employees also happen to be over 40, as is often the case. In such cases, it is imperative that the employer have evidence supporting the fact that it was motivated by a legitimate, nondiscriminatory reason. Thus, document the employer’s selection process carefully. For additional guidance on avoiding disparate impact claims when conducting RIFs, see Disparate Impact Analysis: Key Steps and Tests.

Terminating Employees – Legal Considerations

Finally, the buyer must comply with all statutory and contractual obligations surrounding employee terminations and RIFs. The key considerations for this stage of the transaction are laid out below.

Severance Provisions

Inspect the severance provisions in the existing employee contracts. While the FLSA does not require severance pay, employers must comply with employment contracts that provide for severance.

Courts have generally held that employers do not owe severance to employees who are terminated and rehired by the buyer as part of the corporate transaction (as in an asset acquisition). See, e.g., Bradwell v. GAF Corp., 954 F.2d 798 (2d Cir. 1992). Nevertheless, to avoid the headache and expense of litigation over severance pay following business deals, ensure that the transferred employees’ severance provisions clearly provide an exception for the sale of the business or its assets. For addition-
Additionally, remember that the buyer will owe contractually mandated severance to the employees the buyer chooses to separate once the deal is complete. Inform the buyer of any costly severance provisions, as they may affect the employer’s liability assessment.

**WARN Considerations**

The Worker Adjustment and Retraining Notification (WARN) Act, 29 U.S.C. § 2101 et seq., requires employers to provide 60 days’ notice to workers who will be separated from employment in a mass layoff or a plant closing. Buyers should review RIFs closely to evaluate whether they trigger WARN notice requirements. For more information on WARN Act requirements, see [Reductions in Force and WARN Compliance](#).

Many states have developed their own versions of the WARN Act, which often use similar terms as the federal WARN Act but may have different definitions or requirements. To determine whether the relevant jurisdictions have their own state versions of the WARN Act, see the “Mass Layoff and Plant Closing Laws” column of [Investigations, Discipline, and Terminations State Practice Notes Chart](#).

Penalties for a WARN Act violation can include up to 60 days of back pay for each employee, lost benefits, civil penalties, and attorney’s fees. Accordingly, you should be diligent in determining whether the WARN Act (and any state-specific mini-WARN acts, if applicable) apply in your corporate transaction and complying with their mandates.

Parties to a corporate transaction should note that WARN Act requirements generally do not apply with respect to employees of the seller who are merely transferred to the buyer. 29 U.S.C. § 2101(b)(1). For instance, in [Patterson v. O’Neal](#), the Northern District of California held:

As stated by the Department of Labor (DOL), WARN notice is only required where the employees, in fact, experience a covered employment loss, and no such notice is required where employees are only technically terminated in the course of transferring from the seller’s employ to the buyer’s. As several courts have recognized, this provision was crafted by Congress specifically to prevent employees of a sold business from bringing suit when they have not suffered an actual loss of employment.


However, this does not mean that WARN will never apply in a corporate transaction. For example, the WARN Act still requires a party to give notice when it is downsizing as a result of the transaction or other business reasons.

The party responsible for providing the notice depends on when the layoff occurs. The seller is responsible for providing WARN notice up until the date of the sale; after the effective date of the sale, the purchaser is responsible for providing notice. 29 U.S.C. § 2101(b)(1); see also [Burnsides v. MJ Optical, Inc.](#), 128 F.3d 700, 702 (8th Cir. 1997).

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