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Turnaround Advisers Must Beware Calif. Labor Landscape

By **Karl Block**

Law360, New York (July 6, 2017, 5:09 PM EDT) --
A fair day's pay — it sounds like a good thing for a new law to promise, doesn't it?

Karl Block

In fact, California's A Fair Day's Pay Act, signed into law by Gov. Jerry Brown in October 2015, was intended to ensure that employees were protected from "wage theft" by enlarging the universe of potential parties that could be held responsible for wage and hour violations. In reality, however, the legislation, which took effect Jan. 1, 2016, could have a detrimental effect on companies and, by extension, employees, due in part to its wide-ranging potential impact on the turnaround market and acquisitions — from transactions and management agreements to funding and other issues related to the restructuring of businesses in, or with operating entities in, California. This law is a different law than the Federal Fair Labor Standards Act, which is beyond the scope of this article.

Expanded Liability, Increased Labor Commissioner Authority

On its face, the Fair Day's Pay Act simply expands liability for wage and hour violations and enhances the labor commissioner's enforcement authority to impose civil penalties against any employer or other person acting on an employer's behalf for failure to pay wages, the denial of meal/rest breaks, and the failure to reimburse for employee business expenses, among other claims. The definition of wages is broad under California law and includes not only monetary compensation for an employee's work, but also overtime pay, bonuses, vacation and severance pay, as well as employee benefits (employer payments to insurance plans, unemployment compensation payments and contributions to profit sharing plans, for example).

Before passage of the act, liability could not be imposed on individual directors, officers or managing agents of an employer simply by virtue of their corporate position. The amendments codified and expanded the definition of an employer or other person acting on behalf of an employer to include "a natural person who is an owner, director, officer, or managing agent of the employer."

The law also limits the ability of a newly formed business or successor company to avoid its obligations to pay outstanding wage and hour claims by closing or restructuring, as the act applies to any new business or successor entity that is found to be similar in operation or ownership, engaged in the same work, under similar working conditions, or with the same supervisors. It also applies to any new entity that conducts "substantially the same production process or operations, produces substantially the

same products or offers substantially the same services [or] has substantially the same body of customers.”

California’s labor commissioner also gained increased enforcement authority under the new legislation. The act allows the commissioner to hold hearings “to recover civil penalties against any employer or other person acting on behalf of an employer” for wage and hour violations. Most notably, it also gives the commissioner the ability to use remedies available to judgment creditors, including placing liens, levying bank accounts or other business assets, or prohibiting a company or successor entity deemed to be substantially similar from conducting business until a surety bond is posted.

The Impact on Turnaround Efforts and Acquisitions

The expansion of liability to "a natural person who is an owner, director, officer, or managing agent of the employer” could easily be interpreted to include turnaround executives, managers and others brought in to help failing or distressed entities. Especially broad is the definition of “managing agents” as those exercising substantial and independent authority and judgment in corporate decision-making, as set forth in statute and interpreted by the California courts.

In addition to potential personal liability exposure of turnaround executives, managers and others acting on behalf of an employer, these provisions could have a significant impact on other aspects of restructurings, including recapitalizations, restructures of debt and trade debt, and new financings.

Further, the effect of the enhanced authority of the labor commissioner could lead to stark, and possibly expensive, repercussions, potentially jeopardizing transactions. Indeed, the commissioner may have the ability to not only assess successor liability on the acquirer in a transaction, the commissioner may be able to assess liability on management of the successor entity.

What’s the risk, really? It’s hard to know. It will be some time before these and other potential issues with the new law make their way to court and are ruled upon — if ever — which leaves the direct impact the act may have on the turnaround market and acquisitions up in the air. Perhaps more to the point for those who might be caught in the act’s net, even appropriate due diligence might not mitigate your risk. It’s not uncommon for companies (particularly those in financial distress) to have incomplete or inaccurate employment records, so even proper review of company records might not uncover the risk until it’s too late.

The corporate turnaround and restructuring industry plays a vital role in our economy — saving assets, jobs and organizations — as do distressed acquisitions. In working with businesses in California, turnaround advisers and acquirers should be sure to monitor developments on the act, and speak with local counsel about the state’s unique wage and hour landscape.

Karl E. Block is a partner at Loeb & Loeb LLP in the firm's Los Angeles office.

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