# COVID-19: EMPLOYMENT ISSUES IN HEALTH CARE MERGERS AND ACQUISITIONS IN THE ERA OF COVID-19

Date: 31 August 2020

**U.S. Health Care and Labor, Employment, and Workplace Safety Alert**

By: Spencer Hamer, Brian Graham, Rikki A. Sapolich-Krol, Erinn L. Rigney, Ali U. Nardali, Ali U. Nardali

Mergers and acquisitions in the healthcare industry have been on the upswing in recent years, and even with the impact of the COVID-19 pandemic, and the layoffs, furloughs, and financial losses that have followed in its wake, the market remains surprisingly active. Hospitals and health systems announced 14 transactions during the second quarter of 2020—not significantly lower than the 19 transactions reported in Q2 of 2020.[1]

While due diligence of employment law matters is always critical in a merger or acquisition, it is a complex task in healthcare industry transactions.

The COVID-19 pandemic requires a further level of analysis in healthcare industry employment issues, underscoring the importance of this critical aspect of the M&A process.

The following is an overview of key employment law-related considerations for healthcare transactions in the COVID-19 era.

## EXEMPT STATUS

Buyers must evaluate whether employees have been classified properly under the relevant federal and state wage and hour laws. For example, nurses can be classified as exempt professionals under federal law, but not under California law. In addition, while mid-levels such as physician assistants and nurse practitioners can potentially be classified as exempt, licensed practical nurses are typically non-exempt. In addition, in January 2020, the federal minimum salary required for exempt status was raised from US$23,660 to US$35,568 and many states have higher requirements. Given the complexities that can arise with healthcare professionals, classifications must be reviewed in detail by the buyer, or justified by the seller, ideally with job descriptions tailored with specificity to the controlling authority.

## INDEPENDENT CONTRACTORS

Historically, it has been common within the healthcare industry for physicians and mid-levels to be employed on a contractor basis, often performing the same duties as other workers classified as employees. While the risk that physicians will bring a claim for misclassification is arguably low, IRS and state rulings have found, in certain circumstances, that physicians were in fact misclassified as contractors, and litigation over classification of mid-levels is common, both on an individual and on a class/collective action basis. In addition, certain states, most recently, California, have adopted a stringent “ABC”[2] test for contractor classification, under which any work performed within the usual course of the hiring entity's business renders the relationship that of

©2005-2024 K&L Gates LLP. All Rights Reserved.

employer/employee. California's law provides a carve-out for physicians, but in jurisdictions where the ABC test applies, contractor status for other employees will likely be subject to challenge.

## EMPLOYMENT AGREEMENTS

Employment agreements commonly have key provisions, such as change of control bonuses, options, equity interests, and similar clauses, which can impact the value of the target. In addition, buyers will want assurance that key executives, sales employees, and others will not leave and compete; thus the existence and scope of non-competition and non-solicitation clauses must be scrutinized. California has historically refused to enforce non-compete agreements, with certain exceptions, and some states, such as Colorado and Florida, have enacted limits on physician non-competes. Employment agreements must also be reviewed for assignability, choice of law/venue, cause/good reason termination standards, responsibility for nose and tail malpractice insurance, and other key provisions.

## IMMIGRATION

Buyers should evaluate whether completed and correct Form I-9s are on file for each active employee, and all recently terminated employees. Are I-9s stored electronically, and if so, is that storage system compliant with federal regulations? Have the I-9s been subject to an audit or investigation by DOL or ICE? Buyers can usually choose to retain the existing I-9s, or have all employees complete new ones. If the existing I-9s are retained, any errors transfer to the buyer. If new I-9s are completed, they must be done within three business days. Buyers should assess existing I-9s to determine which path to take, and targets should take appropriate action to address any outstanding issues. Due diligence must also examine whether any employees have an employment-based immigration status, such as H-1B, J-1, O-1, or TN. Some employment-based visa classifications are easily transferred to the new entity, whereas others require filing and approval of a new petition. Similar concerns apply to employees seeking lawful permanent resident status—some processes are easily transferred, and others can be disrupted by a merger or acquisition. Before taking action to address immigration matters, however, consult with counsel, as self-audits and remedies can raise additional legal issues.

## LABOR RELATIONS

Does a union represent all or part of the target's employees? Alternatively, has any union organizing taken place in the recent past? If a union exists, the collective bargaining agreement must be reviewed, and negotiations with the union will likely be necessary if terms or conditions of employment will be impacted by the deal. The buyer should also evaluate how the bargaining units have been structured—are they limited to nurses, for example, or do microunits exist? In addition, the degree to which any labor unrest exists, such as unfair labor practice charges, should be evaluated.

## BENEFIT PLANS AND EXECUTIVE COMPENSATION COMPLIANCE

Buyers should conduct due diligence on retirement and other broad-based benefit plans to confirm that benefits to furloughed and laid-off employees were provided in accordance with the relevant plans' terms and applicable laws. Whether furloughed employees are permitted to continue participation in health plans without COBRA elections will depend on the terms of the relevant plan and underlying insurance policies. Buyers should also perform due diligence on retirement and other broad-based benefit plans to confirm that any changes (for

©2005-2024 K&L Gates LLP. All Rights Reserved.

example, a reduction in employer matching contributions) were implemented in accordance with the relevant plan's terms and applicable laws. For target companies that have implemented salary or other compensation reductions or modifications due to cash-flow or other concerns, buyers should confirm that the reductions were structured in compliance with the deferred compensation rules of the tax code. For target companies that have implemented changes to their incentive compensation arrangements (for example stock option repricings or modified goals/payments in annual bonus plans), buyers should confirm that such changes were implemented in accordance with relevant tax and securities laws, and that related accounting charges were reflected in the target company's financial statements. Absence-of-changes covenants in purchase agreements should be crafted to require disclosure of any such changes, and special attention should be given to interim-operating covenants to ensure that buyers retain consent rights to any “make-whole” payments and/or further pandemic-related changes between signing and closing.

## FAMILIES FIRST CORONAVIRUS RESPONSE ACT

Whether the target is up to date on recent changes to the Families First Coronavirus Response Act (FFCRA) is a new aspect of due diligence with particular relevance to the healthcare industry. Under FFCRA, government employers as well as private employers with fewer than 500 employees are required to provide paid sick leave, and expanded family and medical leave, to eligible employees. Though there are limited exemptions for employers of health care providers and emergency responders, a recent court decision may limit a health care entity's ability to take advantage of those exclusions. On August 3, a New York federal district court vacated four specific provisions of FFCRA regulations, including the “work-availability” requirement; the expansive definition of “health care provider”; the provisions relating to employer consent for intermittent leave; and the documentation requirements as a precondition to taking leave. Though there is some uncertainty as to the impact of the ruling, in the interim, buyers should evaluate healthcare targets for coverage under FFCRA. Further, buyers should assess whether a target has administered FFCRA leave in compliance with all applicable regulations, as violations can lead to potential enforcement actions, as well as private lawsuits for unpaid wages and liquidated damages.

## ANTI-DISCRIMINATION/ANTI-HARASSMENT

Several large verdicts rendered for sexual harassment in hospitals and other healthcare settings in recent years have made analysis of the culture of the target company a critical part of due diligence. The target should have detailed anti-discrimination and anti-harassment policies in its employee handbook, with an acknowledgment of receipt of the handbook in the file for all employees. In addition, sellers should be prepared to show that they have conducted anti-harassment training, ideally for all employees, but at a minimum for managers (except in states such as California and New York, where training for all employees is mandatory). Analysis must also be done of whether a history of lawsuits, audits, or investigations suggests a culture of non-compliance. The target should be prepared to show, with appropriate documentation, that if it has experienced instances of inappropriate conduct, prompt and appropriate remedial action was taken.

## WORKPLACE SAFETY

Workplace safety compliance is always a critical part of due diligence for any industry, but since the onset of COVID-19, the legal risks associated with safety issues have increased. Employers are already being sued for allegedly failing to protect their employees from COVID-19, and while these claims are arguably preempted by

©2005-2024 K&L Gates LLP. All Rights Reserved.

workers' compensation laws, they will almost certainly continue to be filed. In addition, numerous whistleblower claims have been filed against healthcare industry employers over failure to take appropriate steps to address COVID-19-related safety issues, and media coverage of employees subjected to allegedly unsafe environments has been extensive. Thus, buyers should pay extra attention to OSHA compliance, reportable incidents, illness and injury prevention plans, and COVID-19 policies and preparedness.

### WARN ACT

According to the American Hospital Association, despite billions of dollars in federal relief for the healthcare industry, U.S. hospitals are expected to lose over US$323 billion as a result of the COVID-19 pandemic, largely due to a lower patient volume after canceling elective procedures. In response, healthcare employers have attempted to cut costs by implementing furloughs and layoffs, with nearly 270 hospitals and health systems having implemented furloughs or layoffs in 2020. Under the Worker Adjustment and Retraining Notification (WARN) Act, subject to certain exceptions, employers with 100 or more employees must give at least 60 days notice to workers in the event of a mass layoff lasting more than six months or a plant closing. In April, the Department of Labor issued guidance regarding COVID-19, confirming that COVID-19-related layoffs will not be granted any special exemption under the WARN Act. In addition to WARN, state “mini-WARN” acts must also be examined. For example, employers engaging in mass layoffs or plant closings as defined under California's mini-WARN act were given a limited reprieve from the state law's notice requirements, provided that they provide notice as soon as reasonably possible.

K&L Gates's team of health care employment lawyers is available to answer any questions regarding these matters.

## FOOTNOTES

[1] KaufmanHall: Healthcare Mergers & Acquisitions Activity Report: Q2 2020

[2] Under the ABC test, unless the employer can satisfy all three of the following conditions, the worker is an employee not a contractor:

- The worker is free from the control and direction of the hiring entity (contractually and in reality);
- The worker performs work that is outside the usual course of the employer's business; **and**
- The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.

©2005-2024 K&L Gates LLP. All Rights Reserved.

## KEY CONTACTS

**SPENCER HAMER**
PARTNER

ORANGE COUNTY, PALO ALTO
+1.949.623.3553
SPENCER.HAMER@KLGATES.COM

**BRIAN GRAHAM**
PARTNER

AUSTIN
+1.512.482.6828
BRIAN.GRAHAM@KLGATES.COM

**RIKKI A. SAPOLICH-KROL**
PARTNER

SAN FRANCISCO
+1.415.882.8027
RIKKI.SAPOLICH@KLGATES.COM

**ERINN L. RIGNEY**
PARTNER

CHICAGO
+1.312.807.4407
ERINN.RIGNEY@KLGATES.COM

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.

©2005-2024 K&L Gates LLP. All Rights Reserved.