M & A Lawyers Beware: Immigration Risks Lurk in Your Next Deal

By Angelo A. Paparelli and Ted J. Chiappari [*]

As the U.S. dollar swoons in value against major foreign currencies, the price of gold rises to historic heights. Long term U.S. interest rates dip and short term rates hover near zero. At the same time, U.S. corporate profits and cash accumulations ascend to their highest levels in 40 years. All of these conditions foretell a sharp upswing in merger and acquisition activity. Bargains are there for the taking. Indeed, a new M & A rush to acquire has already begun, with the value in acquisition activity increasing by 8.7% for the first six months of 2010 over the previous half year.

Against this backdrop, the Obama Administration, through the Department of Homeland Security, continues its drive to increase worksite enforcement of the immigration laws. Employers remain in the crosshairs of a DHS unit known, chillingly, as ICE (Immigration and Customs Enforcement). Meantime, Congress stalemates over comprehensive immigration reform, and the public perceives (and available data confirm) that the employment of unauthorized workers remains rampant across the country.

To be sure, the failings of worksite enforcement may not be so much the result of widespread and willful flouting by employers of the immigration laws. It may instead be caused primarily by a broken statutory system that delegates to employers the duty to verify employment eligibility in an environment rife with identity theft, the proliferation of fraudulent documents, and antidiscrimination laws that punish firms that probe too deeply into the verification process. Still, whether the gaping cracks in the immigration edifice are attributable to design flaws in statutes and regulations or to lawbreaking employers, the immigration-compliance risks inherent in M & A transactions remain.

Until recently, immigration-related due diligence in M & A deals has been considered only fleetingly (if at all) before buyer and seller sign the purchase agreement. During the Bush Administration, immigration-compliance surprises, discovered typically after the closing, were mainly seen as unpleasant and inexpensive droppings to be tidied up and shoveled away by the surviving entity. Today, however, a resounding drumbeat of ICE press releases announces the indictments, arrests and convictions of employers and company officials for immigration worksite violations. Understandably, the mind-set of buyers has changed. Potential immigration concerns lurking in the acquired stock or assets make them more skittish and risk averse.

While no industries are immune from ICE and Justice Department scrutiny, sectors employing historically high numbers of unauthorized workers are at heightened risk. M & A deals in industries such as agriculture, food processing, dining, construction, hospitality, manufacturing and retail probably carry the greatest exposure. Even household names are not immune, as shown in the recent $1,047,110 fine settlement that ICE reached with teen-clothing retailer Abercrombie & Fitch for lapses in the software it used to confirm compliance with Form I-9 (Employment Eligibility Verification) requirements.

Given the increase in enforcement, deal lawyers must take steps to apprise clients of the immigration risks inherent in modern-day M & A transactions, while anticipating and protecting against costly, post-closing eruptions. This article outlines a variety of immigration concerns lurking in M & A deals and suggests precautions that counsel for buyers and sellers should consider when advising their clients.

At the outset, the acquirer's due-diligence checklists should be expanded to address all immigration concerns. Areas of focus relating to the seller's immigration compliance practices and policies should include:

- All of seller's I-9 forms for current, previously acquired, and terminated employees, and associated payroll and tax records, with focus on company policies, consistently or inconsistently applied, of (a) either refraining from maintaining copies or copying of original documents of identity and employment eligibility, (b) lawfully purging documents on separated employees no longer required to be kept once the I-9 "retention period" lapses, i.e., the later of three years from hire date or one year from separation date, (c) using paper-based I-9s or software allowing the electronic signature and storage of I-9 records that comply with DHS regulations, and (d) taking on the I-9 records and related liabilities of entities previously acquired by seller, or, treating acquired employees as new hires and doing new I-9s;

- Seller's possible adoption of, and compliance with, the E-Verify system that confirms employment eligibility through the online accessing of records maintained by DHS or the Social Security Administration (SSA), including whether the seller (a) has entered into federal contracts or subcontracts with mandatory E-Verify clauses, (b) operates in states where E-Verify is required, or (c) has voluntarily signed a Memorandum of Understanding with DHS to use E-Verify, and in any case involving E-Verify, whether the seller (d) has adopted E-Verify at specific sites or at all company locations, and only in cases of federal contractors, whether the seller (e) has confirmed through E-Verify the employment eligibility of solely current and prospective workers assigned to the federal contract or (f) has (as permitted) confirmed the employment authorization of all present and future employees at all company locations;

- The possibility that seller, through its supervisors or owners, has actual or constructive knowledge that any of its workers lack the right to work in the U.S., including (a) the receipt and handling of SSA no-match letters, (b) credible tips (whether the tipper's identity is anonymous or disclosed), (c) social security number discrepancies reported by third parties such as health insurers or pension providers, or (d) admissions against interest by unauthorized workers or renegade managers;

- Co-employment liability imposed by operation of law in cases where the seller's managerial staff direct and control the work of personnel provided by staffing agencies and consulting confirms, especially where the seller relies on oral instructions to vendors rather than written agreements to obtain the services of contingent workers or consultants, or where the seller, under the circumstances, knew or should have known that the vendor relationship was a subterfuge to obtain the services of unauthorized workers;

- Potential liabilities arising in situations where the seller has made representations to government agencies and undertaken compliance obligations in the course of submitting petitions and applications seeking immigration-related legal benefits such as work and travel permits, labor certifications, labor condition applications, immigrant or nonimmigrant visas or green cards (including employment law and contractual commitments made to employees to sponsor them for such immigration-related benefits); and

- Seller's prior history, if any, of immigration-related encounters with enforcement agencies.

Following preliminary due-diligence review, counsel for the seller should have a reasonably good sense of the range and types of immigration-related violations uncovered. In many instances, preliminary due diligence will reveal numerous (typically inadvertent but still "finable") paperwork violations in the initial completion and reverification of I-9 forms. In the authors' experience, an I-9 paperwork error rate of 40% to 60% is not unusual even for businesses that strive to follow the law.

Some paperwork errors may be cured to minimize potential fines and demonstrate good faith, and to start the running of the five-year administrative limitations period on the imposition of fines. Others may be incurable, e.g., where the employee no longer works for the employer. These types of paperwork errors are usually divisible into two categories: (1) technical or procedural failures to comply despite an effort by the employer at good-faith compliance, or (2) substantive errors that cannot be cured, e.g., errors relating to the passage of time when an action was required such as the signing of the I-9 (section 1) by the employee on the date of hire or by the employer (section 2) within three days of the hire date.

Others may involve inconsistent compliance policies, failures to maintain required records, co-employment risks with contingent workers employed by vendors, constructive knowledge of potentially unauthorized employment that the employer has not investigated, or actual knowledge possessed by someone in management that one or more workers are not permitted to work in the United States.

Whether the discovered compliance errors are curable or incurable paperwork violations or more serious exposure risks, buyer's counsel should consider adopting a comparatively new approach first introduced in the vendor-management arena. Buyer should insist that the appearance of a range of immigration errors requires that an independent third-party, i.e., a law firm with employment-related immigration expertise, be retained to conduct a comprehensive immigration compliance audit of the seller. Although seller may resist buyer's demand for an independent audit, buyer could counter that the mere existence of even paperwork errors requires an assessment of the range of fines that ICE could conceivably impose. The argument for an audit is even stronger where other more serious compliance failures of the types described above have been uncovered through preliminary due diligence.

An independent immigration compliance audit would be helpful in flagging correctable errors that seller should cure before the closing, and in quantifying the potential fine range that ICE could impose (for which seller should indemnify buyer). An independent immigration audit might also reveal more serious violations, or could well trigger a loss of a significant cohort of the seller's workforce if I-9 reverification is required and workers either fail to show up for work or are unwilling or unable to complete the current version of the I-9 form by providing acceptable documents of identity and employment eligibility of the worker's choosing. This is because an employer might be presented with original documents of identity and employment authorization that appear to be genuine and relate to the worker but are in fact false or the worker is otherwise unauthorized for employment.

Substantial potential exposure to fines and civil or criminal immigration penalties might make the deal less enticing to the buyer or might result in a negotiated reduction of the purchase price (or a clawback provision that allows the buyer to retrieve a portion of the purchase price if ICE imposes monetary sanctions or the post-closing workforce proves insufficient to maintain the surviving entity's business operations). Alternatively, the buyer might proceed to buy at a correspondingly reduced purchase price, treat all of the seller's workforce as new hires, and require the completion of new I-9s so as to cut off liability for paperwork violations. This may work in an asset deal but not in a stock transaction, since the value of the underlying entity in a stock deal might well be less if ICE later imposed fines or ordered that a substantial component of the newly acquired workforce be terminated for lack of employment authorization. This result flows from the nature of a stock acquisition. The value of a company's stock is closely related to the value of the assets owned by the company. Those assets are diminished in value when immigration fines must be paid and workers terminated for lack of employment authorization. An asset acquisition, by contrast, allows the exclusion of liabilities at the outset. Hence, the excluded liabilities are not assumed by the buyer but instead are borne by the seller.

Moreover, other legal risks arising from immigration exposures might surface. At least one publicly traded company has been sued in a class action under the securities laws alleging that the entity misled investors concerning the financial impact of the loss of a third of its workers resulting from an ICE order to terminate their employment because they were unauthorized to work. Other risks might involve class action liability under federal and state anti-racketeering laws on the theory that an employer's hiring of foreign workers, with knowledge that they lacked the right to work, depressed the wages of lawfully employed workers.

As can be seen, U.S. immigration laws pose far greater risks today than ever before. Business lawyers advising clients in M & A transactions need to take pains to protect their clients and to limit exposure to fines and penalties that might otherwise befall a hapless seller or buyer if vigorous due diligence and a third-party immigration compliance audit are not pursued in the next deal. Otherwise, channeling Socrates, a deal lawyer who overlooks immigration concerns might well conclude that "the unexamined life is not worth living."

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* Angelo A. Paparelli is a partner in Seyfarth Shaw in New York and Los Angeles. Ted J. Chiappari is a partner at Satterlee Stephens Burke & Burke LLP in New York City.