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Massachusetts Wage and Hour Laws: Legal Risks for Businesses in Transition

The laws governing payment of wages, overtime pay, and commissions have become a leading source of employee claims and employer liability. Mistakes in this area can be costly and penalties in Massachusetts include treble damages and individual liability against certain individual corporate officers. Buyers and sellers in corporate transactions must pay close attention to these risks where the transaction may result in termination of employees' employment.

Payment of Wages at Termination

The Massachusetts Payment of Wages Act (the "Wage Act") provides that any employee discharged from employment must be paid his or her wages in full -- including any accrued but unused vacation pay -- on the date of discharge. Many employers are unaware of this provision or choose to ignore it, as it may be difficult to generate an accurate final paycheck on the employee's last day of employment. Employers should make every effort to comply, and should not delay payment of a final paycheck for administrative reasons or until deductions for amounts possibly owed by the employee have been determined.

The requirement to pay accrued but unused vacation time may be particularly troublesome in the context of an asset deal. Although employees are technically terminated at closing by the seller, they often immediately transition to new employment with the buyer. The Wage Act's final payment rule would require payout of vacation time and, therefore, the employees to start with a zero vacation balance -- a result that is often disfavored by employees. It is not uncommon for this problem to be addressed by allowing transferring employees to roll over (without any forfeiture of earned vacation time) their accrued vacation to the new employer, but must be done carefully to avoid potential wage claims and constructive receipt tax issues.

Commissions as Wages

The Wage Act applies to "the payment of commissions when the amount of such commissions, less allowable or authorized deductions, has been definitely determined and has become due and payable to such employee." In other words, unless commissions are both (i) definitely determined and (ii) due and payable under the terms of the commission agreement or plan, an employer does not have to pay such commissions on a weekly, bi-weekly, semi-monthly or monthly basis, or at the time of discharge.

Because commission arrangements often vary from employer to employer, when commissions are definitely determined and due and payable depends on the terms of the commission agreement or plan and the circumstances of the situation. A common problem with commission arrangements is a lack of clarity as to how commissions are to be calculated and when they are to be paid. Since commissions become "wages" under the Wage Act when the amount of such commissions "has been definitely determined and has become due and payable to such employee," employers should strive to avoid ambiguities.

Pay Deferrals May Violate the Wage Act

Postponing employee compensation also may violate the Wage Act, which provides that all employees must be paid at least the minimum wage on a regular basis. Even if a portion of an employee's compensation is deferred (over and above the minimum wage), this can create an unexpected problem if the employee quits or is terminated, at which time the employee must be paid the entire balance of monies owed. Moreover, such practices can have significant negative tax implications (for example, if income is deferred until a later tax year) under Section 409A of the Internal Revenue Code.

Pay Period Misconceptions

Massachusetts law governs how frequently employees must be paid, yet many employers find that they have inadvertently violated these rules. Under Massachusetts law all employees must be paid at least weekly or biweekly (every two weeks) and within six days of the end of the pay period during which wages were earned. Employers who instead pay their employees only twice a month violate these rules in two ways: (1) by paying less frequently than biweekly, and (2) by failing to pay within six days of the end of the pay period. While exempt employees may be paid semi-monthly, or elect to be paid monthly, there is no exception to the biweekly payment rule for non-exempt employees.

Misclassification as Independent Contractors

No review of wage and hour issues facing employers would be complete without mention of the potential problems associated with use of independent contractors. Misclassification of employees as independent contractors can result in liability and penalties for failure to pay overtime, FICA and FUTA contributions, unemployment insurance payments, and workers compensation insurance premiums, as well as subject the employer to other civil and criminal liability, including mandatory treble damages under Massachusetts law.

Salary Payment Does Not Guarantee Exempt Status

A common misconception is that payment of a salary results in exemption from the overtime requirements of the FLSA. In order to be exempt from overtime payments, the employee must be paid on a salary basis and the employee's job responsibilities must also fall within one of the exempt categories, including the "white collar" executive, administrative and professional employee exemptions, and the computer and outside sales employee exemptions. Many salaried employees do not qualify for any exemption from overtime obligations, and relying solely upon whether an employee is paid a salary in categorizing him/her as exempt or non-exempt will almost certainly result in misclassifications.

Risks of Misclassification Under the FLSA and Massachusetts Law

Failure to properly classify an employee as exempt or non-exempt carries substantial risks. Employees who should have been classified as non-exempt will be owed overtime pay (plus interest) for all hours worked in excess of forty per week, going back up to three years. Furthermore, possible penalties for violation of the federal Fair Labor Standards Act ("FLSA") include liquidated damages (payment of twice what is owed), attorneys' fees, and litigation costs. Massachusetts law provides for mandatory treble damages. Employers are also prohibited from retaliating against employees for asserting claims under the FLSA or Massachusetts law.

Individual Liability

For Massachusetts employers, the Wage Act imposes liability not only upon the business itself but also upon the President and Treasurer of the employer and any "officers or agents having the management of such" employer.

For more information regarding the legal risks that Massachusetts wage and hour laws pose for businesses in transition, please contact Scott J. Connolly at *sconnolly@mbbp.com*.

SEC to Funds: Watch the Broker-Dealer Activities

On June 1, 2016, the United States Securities and Exchange Commission (the "SEC") announced and issued an enforcement action (the "Enforcement Action") against Blackstreet Capital Management, LLC ("BCM"), and its founder, Murry Gunty ("Gunty"). The Enforcement Action arose out of actions taken by funds advised by Blackstreet that the SEC alleges required registration by Blackstreet as a broker-dealer. In particular, the SEC noted:

> Although the LPAs expressly permitted BCM to charge transaction or brokerage fees, BCM has never been registered with the Commission as a broker nor has it ever been affiliated with a registered broker. Rather than employing investment banks or broker-dealers to provide brokerage services with respect to the acquisition and disposition of portfolio companies, some of which involved the purchase or sale of securities, BCM performed these services in-house, including soliciting deals, identifying buyers or sellers, negotiating and structuring transactions, arranging financing, and executing the transactions. BCM received at least $1,877,000 in transaction-based compensation in connection with providing these brokerage services.

For a number of years, the SEC has focused on regulating non-registered broker-dealer activity by funds and their managers. On April 5, 2013 David Blass delivered a speech to the Trading and Markets Subcommittee of the American Bar Association, Mr. Blass, at the time the chief counsel in the SEC's Division of Trading and Markets, spoke of the need of fund managers to either limit their dealmaking activities to what was then permitted by the applicable regulations or to register as broker-dealers. Mr. Blass' presentation heralded a number of inspections by the SEC of fund firms engaged in unregistered broker-dealer activities.

However, on January 31, 2014, the SEC issued a No-Action Letter, known as the "M&A Brokers No-Action Letter," that gave some relief to dealmakers that were engaged in M&A activities. Prior M&A Brokers, professionals who were involved in M&A transactions were almost always required to be registered as broker-dealers, a process many found to be expensive and time consuming. However, M&A Brokers opened the door to advisers who could participate in negotiating a transaction and receive transaction-based compensation (always a hallmark of broker-dealer activity), provided that the advisor could meet certain condtions. These conditions included:

- That the transaction involve a change in control of a private company;
- that the adviser not have custody, control, possession of or handle securities issued or exchanged in connection with the transaction;
- that the adviser not be permitted to bind a party to a transaction,
- that the adviser not help finance the transaction; and
- that the buyers actively manage the acquired company after the transaction.

While many practitioners and commentators took the view that M&A

Brokers indicated an intent by the SEC to scale back its enforcement actions against funds and their broker-dealer activities, this is clearly not the case. In a speech on May 12, 2016, to the Securities Enforcement Forum West, Andrew Ceresney, the Director of the Division of Enforcement, noted that the SEC would continue to emphasize the regulation of broker-dealer activity by funds, in large part "[b]ecause it is important to understand that retail investors are significantly invested in private equity." Mr. Ceresney indicated that the SEC would focus its efforts on three topics:

- Advisers that receive undisclosed fees and expenses;
- Advisers that impermissibly shift and misallocate expenses; and
- Advisers that fail to adequately disclose conflicts of interests, including conflicts arising from fee and expense issues.

Given how quickly the Enforcement Action followed this speech, it is clear that the SEC has put unregistered broker-dealer activity by funds clearly in its sights. Among other issues, the SEC found a number of activities that Blackstreet and Gunty had engaged in that took them out of the protections offered by M&A Bankers, in particular that in connection with the acquisition and disposition of portfolio companies or their assets, some of which involved the purchase or sale of securities, BCM provided brokerage services to and received transaction-based compensation from the portfolio companies. This activity caused BCM to be acting as a broker, and BCM had never been registered with the SEC as a broker. The SEC also focused on a number of aspects of the disclosures provided to investors, including whether or not such disclosures were sufficient.

While it is clear that advisers may rely on M&A Bankers when engaging in M&A activity that previously required registration, it is equally clear that the SEC, especially with respect to funds, will be keeping its eye on stringent compliance with the rules.

For more information regarding the SEC's requirements on broker-dealer activities by funds, please contact Mark J. Tarallo at *mtarallo@mbbp.com*.

Importance of Closing Conditions in Mergers *Williams Companies, Inc. v Energy Transfer Equity, L.P.* Court of Chancery of the State of Delaware

On June 24, 2016 the Delaware Court of Chancery ruled on a dispute with implications for lawyers and companies negotiating closing conditions in a merger agreement. The dispute in Williams Companies, Inc. v Energy Transfer Equity, L.P. centered on a legal opinion to be delivered by the purchaser's tax counsel prior to closing. The purchasers were able to terminate the merger agreement when their counsel refused to deliver the opinion. Practitioners negotiating merger agreements will want to pay special attention to the lessons of *Williams* before agreeing to any closing conditions or committing to use "commercially reasonable" efforts to meet pre-closing obligations.

Background

The Williams Companies, Inc. ("Williams"), a Delaware corporation, and Energy Transfer Equity, L.P. (the "Partnership"), a Delaware limited partnership, are major operators in the energy infrastructure sector. The companies entered into a merger agreement in September of 2015. The merger was an unusual structure, designed to accommodate Williams' desire for its stockholders to continue to hold publicly traded common stock. Due to the complex structure, there were potential negative tax ramifications to the merger that the parties negotiated comprehensively.

Under the terms of the merger agreement, the Partnership created a subsidiary into which Williams would merge. The subsidiary would then transfer the former Williams assets and 19% of the subsidiary's common stock to the Partnership, in return for partnership units and $6 billion in cash.

Before the transaction closed, the energy industry, and the market for energy infrastructure, collapsed. In order to purchase Williams, the Partnership planned to borrow the $6 billion in cash using its assets, now greatly devalued, as collateral. The Partnership's management became concerned about its potential debt level as result of the proposed merger and the merger was no longer financially appealing to the Partnership. As a condition precedent to the merger, the Partnership's tax counsel was to issue an opinion that a specific feature of the complex structure should be treated by the tax authorities as a tax-free exchange under Section 721(a) of the Internal Revenue Code (the "721 Opinion"). The Partnership's tax counsel refused to issue the 721 Opinion and the Partnership terminated the merger agreement. Williams brought suit before the Court of Chancery in the State of Delaware, claiming that the Partnership's tax counsel acted in bad faith and the Partnership materially breached its contractual obligation to use "commercially reasonable efforts" to secure the 721 Opinion.

Did Counsel Act in Bad Faith?

Williams' argument that Partnership's counsel acted in bad faith relied on three main points. First, the Partnership wanted an out from the merger. Second, and disputed, was that no reasonable tax attorney could reach the conclusion the Partnership's tax counsel reached when they refused to issue the 721 Opinion. Third, Williams deduced from points one and two that the Partnership's tax counsel must, therefore, be acting at the direction of, or on behalf of, the Partnership, and not based on its independent conclusion, in failing to issue the 721 Opinion. The court noted that the record did not contain any explicit or implicit direction by the Partnership to the Partnership's tax counsel to reach a particular outcome. The court rejected Williams' conclusions. It believed there was evidence that the Partnership's tax counsel reached its conclusion based upon its independent judgment despite counsel's obvious knowledge that its client would like to exit the deal.

The court declined to determine whether the Partnership's tax counsel's interpretation of the Section 721(a) was correct. It determined that it was not appropriate for the court to substitute its judgment on the Section 721(a) issue for that of the Partnership's counsel. Instead the court's role in these cases is to determine whether counsel's refusal to issue the opinion was in good faith, in other words, was counsel's refusal to issue the opinion based on counsel's independent expertise as applied to the facts of the transaction.

Commercially Reasonable Efforts

Having found that the Partnership's tax counsel refused to issue the 721 Opinion in good faith, the court turned to the issue of whether the Partnership was in material breach of its covenant to use commercially reasonable efforts to secure the 721 Opinion. The court noted that the term "commercially reasonable efforts" has not been well defined in the case law but stated "the Partnership necessarily submitted itself to an objective standard—that is, it bound itself to do those things objectively reasonable to produce the desired 721 Opinion." The court had no doubt that the Partnership experienced "bitter buyer's remorse" but "there is simply nothing that indicates to [the court] that the Partnership has manipulated the knowledge or ability of [its tax counsel] to render the 721 Opinion, or failed to fully inform [its tax counsel], or do anything else, whether or not commercially reasonable, to obstruct [its tax counsel's] issuance of the condition-precedent 721 Opinion, or that had a material effect on [its tax counsel's] decision."

The Court's Ruling

The court held for the Partnership, stating "It is clear to me that the [merger], so ardently desired by the Partnership at the time the deal was inked, is now manifestly unattractive to the Partnership. . . It is that motivation on which Williams primarily relies to demonstrate lack of "commercially reasonable efforts" on the part of the Partnership. I approached this matter with a skeptical eye, in light of that motivation . . . however, motive to avoid a deal does not demonstrate lack of a contractual right to do so. . . Because I conclude that [the Partnership's tax counsel], as of the time of trial, could not in good faith opine that tax authorities should treat the specific exchange in question as tax free under Section 721(a); and because Williams has failed to demonstrate that the Partnership has materially breached its contractual obligation to undertake commercially reasonable efforts to receive such an opinion from [the Partnership's tax counsel], I find that the Partnership is contractually entitled to terminate the merger agreement. . ."

The court went on to say, "The merger agreement is subject to Delaware law. Delaware is strongly contractarian, and the presence of a provision in favor of specific performance in case of breach, as the parties contracted for here, must be respected. Conditions precedent to the transaction must be enforced as well, and granting Williams' request to use the power of equity to consummate the proposed transaction would force the Partnership to accept a risk—potential imposition of substantial tax liability— without the comfort of a tax opinion from [its legal counsel]."

Lessons

As the court noted in *Williams*, the meaning of "commercially reasonable efforts" was not well defined in prior case law. *Williams* gives practitioners some guidance. A "commercially reasonable effort" is an objective standard. The courts will ask whether the parties have done those things objectively reasonable to produce the closing deliverable or meeting their commitments.

Williams makes it clear that in Delaware the courts will give deference to contractual provisions as they are written. Closing conditions requiring the opinion of third-parties or legal counsel will be enforced, even if there is an appearance of impropriety or ulterior motives, unless bad-faith on the part of the third-party or legal counsel can clearly be demonstrated. Practitioners who negotiate closing conditions should carefully consider what opinions are required and which parties will be able to waive the closing condition if those opinions are delayed or unavailable.

It is important to note that *Williams* has been appealed and practitioners should continue to follow developments in the case law.

For more information on closing conditions in mergers, please contact Matthew R. Loecker at *mloecker@mbbp.com*.