

## IS A FOREIGN PARENT AN “EMPLOYER” FOR WAGE AND HOUR CLAIMS?

(By Rod Divelbiss)

Wage and hour claims are some of the most “popular” and are potentially some of the most dangerous claims a corporation can face. Unfortunately, the standard for imposing liability for foreign parent corporations in the wage and hour context is broader than the typical claim for ignoring the corporate structure. A shareholder/foreign parent may be dragged into litigation and eventually found liable for the wage and hour “sins” of its United States subsidiary if the Court finds that foreign entity was also an “employer.” “Employer” is defined as “any person acting directly or indirectly in the interest of an employer in relation to an employee.” 29 U.S.C. § 203(d). Courts have held that two or more employers may jointly employ an employee and thus both be liable under the Federal Labor Standards Act. See 29 C.F.R. 791.2(a).

To determine whether a foreign parent may be considered an “employer” under the federal labor code, Courts “look to the “economic reality” behind the relationship and typically consider the following four factors:

- (1) the foreign parent’s corporation’s power to hire and fire employees of the subsidiary,
  - (2) whether the foreign parent supervised and/or controlled employee work schedules or conditions of employment,
  - (3) the foreign parent’s role in determining the rate and method of payment, and
  - (4) whether the foreign parent maintained employment records.
- Bonnette v. California Health & Welfare Agency*, 704 F.2d 1465, 1470 (9<sup>th</sup> Cir. 1983); see also, *Chao v. A-One Med. Servs., Inc.*, 346 F.3d 908, 918 (9<sup>th</sup> Cir. 2003) (citing 29 C.F.R. § 791.2(b)) in which the Court held that “[J]oint employment will generally be considered to exist when (1) the employers are not ‘completely disassociated’ with respect to the employment of the individuals and (2) where one employer is controlled by another or the employers are under common control.

California state law is similar. In *Martinez v. Comb*, 49 Cal. 4<sup>th</sup> 35 (2010), a case involving seasonal agricultural workers, the California Supreme Court held that the definition of “employer” does not encompass individuals or businesses that merely contracted with an employer. Rather the “employer” must exercise some control over the purported employee. Specifically, the Court held that “to employ” has three alternative definitions: (1) to exercise control over the wages, hours, or working conditions; (2) to suffer or permit to work; or (3) to engage, thereby creating a common law employment relationship.

Thus, the foreign parent’s role in dealing with the US subsidiary’s employees should be carefully evaluated. Otherwise, the foreign parent may well find itself embroiled in an expensive wage and hour claim with potential liability exceeding the value of the corporate US subsidiary.

As outlined above, the standard for imposing liability for foreign parent corporations in the wage and hour context is relatively broader than the typical claim for ignoring the corporate structure. In that context corporate liability can be extended to shareholders if the corporation does not act like a distinct entity.

## PUBLIC COMPANIES SHOULDN’T BE AFRAID OF THE “DARK”

(by Andrew Pontious)

More frequently, small public companies are considering the prospect of “going dark,” meaning the voluntary deregistration of their stock under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) in an attempt to avoid statutory obligations to file periodic reports imposed by Sections 13(a) and 15(d) of the Exchange Act. The decision to go dark is based upon the desire to reduce the economical and managerial burden of continued compliance with the reporting requirements of the Exchange Act, including those under the Sarbanes-Oxley Act of 2002. By deregistering its shares, a public reporting company’s obligations to file periodic reports (i.e., Forms 10-K, 10-Q and 8-K) may be suspended and eventually terminated, potentially leading to a lack of publicly available information for the company – a “dark” company. Given the mounting cost and burden of reporting compliance and the current economical environment, “going dark” is no longer accompanied by the negative connotations of past years. Nonetheless, “going dark” does come with certain material disadvantages, including decreased liquidity, lack of access to the capital markets, decreased alternatives for incentive programs and acquisition currency, and trading restrictions.

To “go dark,” the issuer must certify the Securities Exchange Commission (the “SEC”) on Form 15 that it has fewer than 300 shareholders of record, although it typically will have significantly more beneficial owners whose shares are held in street name. (A Form 15 can also be filed by issuers with fewer than 500 shareholders of record if the issuer’s total assets have not exceeded \$10 million on the last day of each of the issuer’s three most recent fiscal years.) For purposes of deregistering, an issuer need only look to the number of its registered holders and DTC positions, not its beneficial owners. (See Section 12 (g)(4) and Rules 12g-4, 12g5-1 and 12h-3(a) of the Exchange Act.) Often, “going dark” will also require the issuer first to

"go private" by engaging in a corporate transaction in accordance with Rule 13e-3 of the Exchange Act with the goal of reducing an issuer's shareholder of record below 300.

Upon the filing of a Form 15, an issuer's obligations to file periodic reports required by Sections 13(a) of the Exchange Act (i.e., Forms 10-K, 10-Q and 8-K) are immediately suspended. Effective 90 days after filing, an issuer's shares are deregistered and its obligations to file periodic reports required by the Section 13(a) of the Exchange Act terminate. An issuer's reporting obligations under Section 15(d) of the Exchange Act are not terminated but only suspended for so long as the issuer's shareholders of record number less than 300 and it has no effective registration statements under the Securities Act of 1933, as amended. (See Rule 12h-3 of the Exchange Act).

No shareholder approval is necessary to "go dark" or file the requisite Form 15. Rather, the issuer must simply meet the requirements discussed above. However, as often there are actual or perceived conflicts of interest among directors and/or among majority and minority shareholders regarding "going dark," an issuer's affiliates should be careful to avoid any appearance of self-dealing or self-interest in "going dark."

## **FOREIGN NATIONALS' MISPLACED CONCERNS REGARDING SERVING AS DIRECTORS OF CALIFORNIA WHOLLY-OWNED SUBSIDIARIES**

(by John Price)

Foreign nationals are frequently asked by international parent companies to serve as officers or directors of California-based wholly-owned subsidiaries. Often these individuals are reluctant to take such a position, given their perception of the litigiousness of Americans. That concern, however, is misplaced because wholly-owned subsidiaries avoid the most common risk associated with serving as an officer or director, that of actions that might be brought by minority shareholders. There remain, however, some minimal risks the individual should consider before accepting the position. These risks arise most commonly from judicial interpretation of the whether the director or officer complied with his or her "duty of loyalty" and "duty of care" and are largely abated by the protections afforded by the "Business Judgment Rule."

In California, like many other states, directors and, by common-law extension, officers owe a "duty of care," which duty requires competency, diligence and exercise of good faith in their decision-making and supervisory functions. Directors also owe the corporation a "duty of loyalty," which prohibits the directors from serving their own interests at the expense of the corporation.

Directors have a strong defense to any claim for breach of duty of care based on what is known as the Business Judgment Rule. That rule protects directors from being second guessed by shareholders and the courts on a particular business decision if the director acts on an informed basis, in good will, and in the honest belief that the decision was in the corporation's best interest.

As a threshold matter, to invoke the Business Judgment Rule the director must demonstrate that he or she (a) was not interested in the

subject of business judgment; (b) was properly informed regarding the subject of the business judgment as appropriate under the circumstances; and (c) rationally believed that the business judgment is in the best interest of the corporation. To ensure that the directors are sufficiently informed, the directors may rely on advice of management and experts in making decisions, provided that they exercise the necessary oversight and inquire into the information upon which their advice is based.

The "duty of loyalty" arises in (a) transactions directly between the corporation and one of its directors or officers, (b) corporate opportunity situations, (c) corporate control contests, (d) transactions between corporations and interlocking boards of directors, (e) executive compensation arrangements, (f) situations in which a director or officer competes with the corporation, and (g) defective disclosure to shareholders. The duty of loyalty arises even when the interested director may not have personally profited. California law provides that a transaction in which a director is interested is not void or voidable if it is approved by the shareholders and the material facts concerning the director's interests are fully disclosed, and shares held by the interested directors are not entitled to vote, or if it is approved by disinterested directors. These safe harbor provisions do not protect a transaction that involves the lack of good faith, waste, or fraud.

There are certain situations where a director or officer could face personal liability for what are essentially corporate obligations and that are not derived from recalcitrant shareholders. The following are the most common:

1. If the corporation does not pay over to the state or federal government payroll taxes.
2. If the corporation is actually insolvent, directors owe creditors the duty to avoid diversion, dissipation, or undue risk to assets that might be used to satisfy creditors' claims. (That said, in most cases, the presumption created by the Business Judgment Rule discussed above will provide a strong defense).
3. If the board of directors declares an illegal dividend or other distribution (even to the parent company), the directors may have personal liability to third party creditors who are hurt by such action.

Even though the risks of serving as a director or officer of a wholly-owned subsidiary are minimal, an individual considering whether to so serve should (a) confirm that the parent and possibly the subsidiary have agreed to indemnify the individual, and (b) confirm that the subsidiary corporation has adequate directors and officers liability insurance. In addition, the individual should confirm that the subsidiary is authorized by its Articles of Incorporation to provide the maximum indemnification allowed under California law, and to eliminate each director's liability for monetary damages to the corporation itself to the maximum extent permitted under California law.

As should be obvious from the preceding discussion, in the case of a wholly-owned subsidiary, the above duties are very unlikely to be problematic.

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