Employer Update

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Impact of Salary History Bans on Asset Deals

By Jeffrey S. Klein, Nicholas J. Pappas, and Marissa K. Zalasky

In This Issue

Imagine a company considering an asset purchase from a business with employees in California. Can the company obtain the compensation and benefits information of these California employees during the due diligence process and then use such information in making offers of employment to the target's employees? The answer to this question depends on how courts will read Section 432.3 of the California Labor Code, effective as of January 1, 2018, which prohibits employers from relying on salary history in considering whether or not to offer employment to "applicants for employment."

In this month's column, we review the language and policy considerations underlying Section 432.3, and we propose strategies buyers may wish to consider in seeking to comply with California law.

Background

In recent years, many jurisdictions have enacted various types of salary history bans. These laws prohibit a variety of activities by employers, ranging from seeking or inquiring into salary history from job applicants, to relying on, using, or screening for salary history information. The list of jurisdictions enacting such laws applicable to private employers now includes California, Massachusetts, Delaware, Oregon, Vermont, Connecticut, New York City, Philadelphia, San Francisco, Puerto Rico, Westchester County, and Albany County.[1]

California law now states that an employer shall not "orally or in writing, personally or through an agent, seek salary history information, including compensation and benefits, about an applicant for employment," CAL. LAB. CODE § 432.3(b), or "rely on the salary history information of an applicant for employment as a factor in determining whether to offer employment to an applicant or what salary to offer an applicant," CAL. LAB. CODE § 432.3(a). However, if the applicant has disclosed the salary history information to the prospective employer "voluntarily and without prompting," the employer may rely on the information, but only in determining the salary for the applicant. CAL. LAB. CODE § 432.3(g).

Various legislative bodies have stated that their intent in enacting salary history bans is to prevent the perpetuation of discrimination in pay on the basis of protected classifications, most frequently sex. Despite the laudable goals of these laws, the constitutionality of such laws remains subject to debate. For example, one federal court recently struck down Philadelphia's

ban on employers inquiring into wage history as an unlawful interference with the First Amendment right to free speech. See *Chamber of Commerce for Greater Philadelphia v. City of Philadelphia*, 2018 WL 2010596 (E.D. Pa. Apr. 30, 2018). The court stated that there was "insufficient evidence to establish the alleged harm of discriminatory wages being perpetuated in subsequent wages such that they contribute to a discriminatory wage gap." *Id.* at *19. Accordingly, the court stated that it was "compelled to find that the Inquiry Provision did not directly advance the substantial governmental interests of reducing discriminatory wage disparities and promoting wage equity." *Id.*

Analysis

The California salary history ban does not define the phrase "applicant for employment." Webster's Dictionary defines "applicant" as "one who applies," and to "apply" as "to make an appeal or request especially in the form of a written application." If the courts were to apply this plain meaning of the term "applicant," then parties to a transaction to buy or sell a business would have the ability to structure their transactions to avoid receiving any "appeal" from the target company's employees, or any form of written application.

The easiest way to structure a sale transaction to avoid the salary history ban is to structure the transaction as a stock sale. Where a buyer purchases the stock of the target company, the employees of the target experience no termination of employment. Because the employees do not apply for a new job, and the new owner of the business does not extend any offers of employment, the employees are not applicants for employment and the salary history ban law does not apply.

When the parties to the transaction instead choose to purchase and sell assets of a business, the employees of the target do not automatically become employees of the buyer upon consummation of the transaction. In an asset purchase, buyers frequently will offer employment to the seller's employees to continue performing the same jobs, at the same salary and with comparable benefits. In those cases, the seller terminates the employment of its employees and the employees commence new employment with the buyer upon their acceptance of the buyer's offer of employment.

When a buyer offers employment to all of a seller's employees at the same salary and with comparable benefits, but without requiring any application by the employees, and without undertaking any job interviews, are the seller's employees "applicants for employment" under the California salary history ban law? So far, no reported cases or administrative pronouncements address this issue.

However, the New York City Human Rights Commission (the "Commission") recently published an FAQ addressing this issue under the salary history ban provision of the New York City Human Rights Law ("NYCHRL"). In its FAQ the Commission stated that "[i]n the context of an acquisition, the employees of the target company are not 'job applicants' for the purposes of the salary history law." New York City Human Rights Comm'n, Salary History Law: Frequently Asked Questions (Oct. 2017), available here. With regard to relying on salary information, the Commission responded to the question, "[m]ay a company seeking to acquire another company use salary information in setting the salary of the employees it will be absorbing from the target company?" as follows:

> It depends. In the context of an acquisition, acquiring companies may rely on salary history information when absorbing employees from the target company and making compensation and structural decisions on a non-individualized basis. However, if employees of the target company are being asked to interview for positions with the acquiring company, the salary history law may be implicated. In those circumstances, it is recommended that any salary information about employees from the target company that is disclosed during the acquisition due diligence process not be shared with hiring managers making decisions about compensation. *Id.*

This FAQ reflects a common sense reading of the term “applicant” in the statute. Specifically, the Commission appears to acknowledge that if a buyer does not make individualized decisions about hiring employees of the target company and does not interview such individuals for jobs, the employees of the target are not “applicants” within the meaning of the law.

The Commission’s FAQ suggests a path forward for parties to asset sale transactions. First, if the buyer wishes to continue the employment of the seller’s employees in the purchased business, the buyer can do so by avoiding any actions which would treat the seller’s employees as job applicants. For example, if a buyer requests salary and benefit data during the due diligence process, the buyer should explicitly request the data for purposes unconnected with making offers of employment to individual candidates. In particular, a buyer may request salary and benefits data in connection with financial valuation or assessing legal compliance. Second, the buyer may wish to take steps to ensure that the buyer does not use the salary and benefits data in making offers of employment. One way to do this is for the buyer to offer employment to all of the employees working in the target business, without using or relying upon the salary or benefits data. The buyer may ensure that its staff responsible for making job offers, typically the Human Resources department, neither reviews nor relies upon the data by creating an ethical wall within the company, which precludes such employees from receiving access to the data.

But how will the buyer set the initial salary and benefit levels for the employees to whom it has offered employment? The Commission’s FAQ construing the NYCHRL suggests that the buyer may use salary and benefits history information in “absorbing” employees into the buyer, presumably after offers of employment have been made at existing salary and benefit levels. Alternatively, the buyer may choose to set terms and conditions of employment without using the salary and benefit information obtained from the seller, using its own resources to set initial terms and conditions. However, in either case, once the asset sale transaction has closed and job offers have been accepted, the buyer may, of course, decide to change terms and conditions as it chooses, including based on salary and benefit data acquired in the transaction.

But what if the buyer does not wish to extend offers of employment to all of the seller’s employees, or to certain individuals within a department or other operational unit? In that case, the buyer should establish the criteria it used to make offers of employment, that are demonstrably not based on salary, for example using reverse seniority or redundancy of positions. As noted in the FAQ, the touchstone is to avoid individualized consideration of the seller’s employees. Those individualized considerations may form the basis for an argument that the buyer considered the seller’s employees to be “applicants” for the job and that it arguably used their salary and benefit levels in choosing among such ostensible “applicants.”

Practice Pointers

As discussed above, buyers acquiring assets in California, and possibly other jurisdictions, should take the following steps to maximize their compliance with applicable salary history bans:

- Counsel for both buyers and sellers should raise the issue of the salary history ban at the outset of negotiations, and consider whether a stock purchase may be a more effective structure for the transaction;
- Buyers requesting salary and benefit information during due diligence should establish at the outset the purposes for which they will use the information and which staff members will use the data in connection with the transaction;
- Buyers may wish to limit the use of salary and benefit data to financial valuation and/or assessing legal compliance, and avoid relying on the data in making offers of employment, at least until after offers of employment (at existing salary and benefit levels) are accepted and employment has commenced; and
- If the asset sale does not close, the buyer should arrange for the return or destruction of the salary and benefits data.

Given the dearth of authority on salary history bans, employers should seek the advice of counsel at each step in the transaction.

[1] *See* CAL. LAB. CODE § 432.3 et seq.; MASS. GEN. LAWS ch. 149, § 105A et seq.; DEL. CODE ANN. tit. 19, § 709B et seq.; OR. REV. STAT. § 652.210 et seq.; H. 294, 2017-2018 Gen. Assemb., Reg. Sess. (Vt. 2018); Public Act No. 18-8, 2018 Gen. Assemb., Reg. Sess. (Conn. 2018); N.Y.C. ADMIN. CODE § 8-107(25) et seq., PHILA. CODE § 9-1103 et seq., S.F., CAL., POLICE CODE § 3300J.1 et seq.; P.R. Act 16-2017 (Mar. 8, 2017); Westchester County, N.Y., § 700.03(a)(9) et seq.; Albany County, N.Y., Local Law No. P for 2016 (Oct. 10, 2017). *See also* Jeffrey S. Klein and Nicholas J. Pappas, "New York City Bans Employers' Inquiries Into and Use of Salary History," NEW YORK LAW JOURNAL (June 6, 2017).

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If you have questions concerning the contents of this issue, or would like more information about Weil's Employment Litigation and Executive Compensation & Benefits practices, please speak to your regular contact at Weil, or to the practice group members listed below.

Practice Group Members:

Jeffrey S. Klein
Practice Group Leader
New York
+1 212 310 8790
jeffrey.klein@weil.com

Frankfurt
Stephan Grauke
+49 69 21659 651
stephan.grauke@weil.com

London
Ivor Gwilliams
+44 20 7903 1423
ivor.gwilliams@weil.com

Miami
Edward Soto
+1 305 577 3177
edward.soto@weil.com

New York
Sarah Downie
+1 212 310 8030
sarah.downie@weil.com

Gary D. Friedman
+1 212 310 8963
gary.friedman@weil.com

Steven M. Margolis
+1 212 310 8124
steven.margolis@weil.com

Michael Nissan
+1 212 310 8169
michael.nissan@weil.com

Nicholas J. Pappas
+1 212 310 8669
nicholas.pappas@weil.com

Amy M. Rubin
+1 212 310 8691
amy.rubin@weil.com

Paul J. Wessel
+1 212 310 8720
paul.wessel@weil.com

Silicon Valley
David Singh
+1 650 802 3010
david.singh@weil.com