BUSINESS LAW TODAY

January/February 2010

- **Top five business immigration law issues**
  Why are businesses so concerned about immigration law and policy? Perhaps it is because, in a global economy, it is more important than ever that key personnel be able to cross borders expeditiously, with certainty and frequency.
- **The administration's new work site enforcement initiatives**
  The Obama administration has announced new work site enforcement initiatives and goals that will likely increase the number of investigations as well as I-9 and H-1B audits.
- **Creating a global workforce**
  To successfully compete on a global scale, multinational corporations must ensure that their most qualified personnel can assume positions within the organization anywhere in the world.
- **Immigration obligations in times of economic downturn**
  The year 2009 saw the largest bailout passed in the history of the United States, massive layoffs, drops in the stock market, a credit crisis, and unprecedented unemployment rates. As a result, in order to remain competitive, or even just to stay in business, employers are faced with difficult decisions regarding terminations, pay cuts, and hiring freezes.
- **Bothersome immigration buzz spells trouble for M&A deals**
  Too often, corporate lawyers and their clients have viewed immigration law issues as merely peripheral to merger and acquisition transactions. A new federal policy memorandum, however, issued by U.S. Citizenship and Immigration Services (USCIS), a unit of the Department of Homeland Security, will bring immigration concerns front and center.
- **Reining in directors and officers in corporate America**
  The recent corporate and financial scandals and the ensuing economic turmoil have led some people to question whether directors and officers of public corporations should be exposed to greater risk of personal liability as a means of curbing what they perceive as excessive risk-taking by these corporate managers.
- **Representing independent directors after Sarbanes-Oxley**
  Seven years have passed since Congress enacted the Sarbanes-Oxley Act (SOX). SOX was the result of highly publicized hearings conducted by both houses of Congress in the aftermath of the scandals involving fraud and mismanagement at such major U.S. companies as Enron, Tyco, Adelphia, and WorldCom.
- **Negotiating the loan commitment**
  As credit markets rebound, companies will increasingly seek financing for their businesses. Financing may take many forms: revolving credit loans, loans to finance the acquisition of a target company, or construction loans, to name a few.

Departments:

- **Snap Judgments**
- Focusing on Pro Bono: **An immigrant's need for representation**
  Legal representation always matters, but the need for representation intensifies when the most basic rights are at stake.
- Keeping Current: **Securities - Are your Regulation FD compliance procedures sufficient?**
  During late September, the Securities and Exchange Commission settled a civil action relating to a violation of Regulation FD, which prohibits selective disclosure by public companies of material nonpublic information.

- Keeping Current: **[Securities - *SEC to rule on Rule 14a-11 and Rule 14a-8 proposals by early 2010*]()**
  The 2011 proxy season is expected to be unlike any seen to date. Securities and Exchange Commission (SEC) Chair Mary Schapiro recently announced her hopes "to finalize the [proposed proxy access] rules early in the new year [2010]."
- Keeping Current: **[Securities - *Recent SEC changes impact investigations*]()**
  The Securities and Exchange Commission (SEC) has made significant changes to its policies and practices in its Enforcement Division, signaling swifter and more focused investigations.

Business Law Today

Volume 19, Number 3 January/February 2010

Top five business immigration law issues

What employers need to know in today's economy

By H. Ronald Klasko

Why are businesses so concerned about immigration law and policy? Perhaps it is because, in a global economy, it is more important than ever that key personnel be able to cross borders expeditiously, with certainty and frequency. Perhaps it is because U.S. companies are competing more than ever with foreign companies for the best and brightest around the world. Perhaps it is because shockingly high percentages of the top graduates of U.S. universities, especially in STEM (Science, Technology, Engineering, Mathematics) fields, are foreign nationals. Perhaps it is because the government raids resulting in criminal prosecutions of employers and their managerial personnel for employing illegal aliens have caught everyone's attention. Perhaps it is because immigration laws create unintended consequences for employers involved in downsizing their workforces or taking other measures to cope with a down economy.

No matter which, or how many, of these factors are leading businesses to increasingly focus on immigration law issues, immigration is a hot topic in the business community. With the president stating that he intends to push hard in 2010 for a major reform of the country's immigration laws, including those affecting businesses, these issues will likely be coming even more to the fore in the consciousness of American business.

The following five issues are at the center of businesses' concerns today.

1. Immigration Law in a Downturn

Terminations, layoffs, forced leaves of absence, hiring freezes, salary reductions, benefits reductions, reductions in hours, furloughs: all are unfortunate ramifications of today's economic woes. Although businesses are generally well aware of the consequences of these actions under U.S. labor laws, they are not always as aware of the consequences under U.S. immigration laws. Businesses operating in the United States should be aware because the result of adverse

employment actions can be quite severe for both the employer and its foreign national employees.

The most common visa category used by employers hiring foreign national employees at a professional level is the H-1B visa. An H-1B visa allows an individual to come to the United States temporarily to perform services as a professional in a specialty occupation. Each adverse employment action listed above potentially implicates the immigration law and the status of both the employer and the foreign national worker.

Termination or Layoff of H-1B Employee. For purposes of the immigration laws, terminating an H-1B employee is not as simple as issuing a pink slip. Until the employer notifies the Department of Labor (DOL), notifies U.S. Citizenship and Immigration Services (USCIS), and offers the employee the return cost of transportation to that person's home country, an employer that thought it had terminated an employee may find itself having a continuing wage obligation to a supposed former employee.

Additionally, if a termination or layoff involves U.S. workers, and if the U.S. workers are in a related occupation, the employer may not be able to proceed with the process to confer permanent residence (green card) status on a foreign national employee unless it notifies and considers the laid-off U.S. workers.

Leave of Absence. If an H-1B employee requests a leave of absence, there is no impact on the employer. However, if the employer, as a cost-saving measure, requires its employees to take a leave of absence, the employer has a continuing wage obligation to pay foreign national H-1B employees even if it does not have an obligation to pay its U.S. workers in the same situation.

Salary and Benefit Reduction. The employer of an H-1B employee must pay the employee the higher of the "actual wage" (the wage it pays comparable U.S. workers) or the "prevailing wage" (the average wage paid by other employers to similar employees in the geographical area). So what happens if the employer's entire workforce receives an across-the-board wage reduction? Normally, there would be no legal impact on the employer arising from such treatment of U.S. workers, but there is potential legal liability for employers who hire foreign workers. As long as the foreign national employees are treated the same as U.S. workers at the company, there is no actual wage problem for the employer. The employer, however, is still obligated to pay the higher of the actual wage or the prevailing wage. So, the company may find itself with a back-pay obligation if the salary reduction puts the H-1B employee below the prevailing wage level, despite the company's equal treatment of its employees.

Reduction in Hours. As a cost-saving measure, what if the company reduces the hours of its employees? If the reduction in hours results in an H-1B employee changing from full-time to part-time status with a concomitant reduction in pay, even for a temporary period of time, the employer has violated the immigration laws. The employer will find itself getting fewer hours of work but, through ultimate enforcement of the law, paying the same full-time wage as required under the immigration laws.

The bottom line: seemingly prudent measures by an employer to deal with a business downturn may cause violations of the immigration laws. Employers should seek counsel before taking any action that might affect the wage-and-hour status of any foreign national working for them.

2. Enforcement Is a Priority
Ever since 1986, employers have had an obligation to verify the identity and employment authorization of their workforces. This is done through the I-9 process. This is old news.

What's not old is how the government (U.S. Immigration and Customs Enforcement or ICE) is enforcing these obligations. Until recent years, enforcement of the employer sanctions laws has been almost uniformly through civil provisions of the law. In many cases, the dollar amount of any civil penalty has been considered a slap on the wrist; no more for some employers than the cost of doing business.

That all changed during the latter years of the Bush administration and is continuing in the Obama administration. The focus now is on criminal enforcement against employers who knowingly hire employees without authorized immigration status. Enforcement has been through the mechanism of often highly publicized raids, which, needless to say, can disrupt business operations and create negative publicity. All of this has made some employers rethink the way they operate. "See no evil, hear no evil," "don't ask, don't tell" employers are abandoning their lax immigration policies in light of the potentially dire consequences. The answer of effective employer response to the law does not lie in asking more questions of prospective employees about immigration status, which risks potential violations of national origin and citizenship discrimination laws. The best practice is

for companies to establish uniform and consistently followed corporate immigration policies that are communicated to all supervisory and hiring personnel with the goal of establishing a corporate culture of full compliance with the immigration laws.

To this end, employers are increasingly seeking immigration counsel for I-9 reviews, development of corporate immigration policies, and other protective measures.

3. Requirement to Use E-Verify
E-Verify is a relatively new government program whereby employers can obtain electronic verification from the government of an employee's authorized work status. This program remains voluntary for most employers.

The government would like to see this program become mandatory for all employers. Right now, it is required only for federal contractors under an Executive Order implemented in recent months.

Many employers are presently in the process of determining, with immigration counsel, whether to sign up for E-Verify while it is still a voluntary program. With E-Verify comes the right of ICE to inspect the employer's records without notice and the use of a government database that is not always accurate. One of the drawbacks of E-Verify is that employers can only do so for new hires; the employer gets no immunity from the government for its previously hired workforce. For employers in industries with a traditionally sizable illegal alien workforce—landscaping, construction, hospitality, to name a few—the peace of mind of knowing that newly hired workers are authorized employees likely outweighs any downside risks. For other employers, however, the downside risk may outweigh the potential benefits.

4. Quotas Don't Reflect Reality
The current quotas for immigrant and nonimmigrant visa categories, established by statutes decades ago, bear no resemblance to business realities in 2010.

For example, H-1B quotas are so low that, in a normal economic year with normal hiring patterns, employers have one day per year in which to file H-1B petitions for any and all foreign national professional employees whom they recruit from U.S. universities or from overseas. And, in many years, even if their application is filed on the first available day (April 1), employers are subjected to a random lottery since more applications are filed on the first day than there are visa numbers available. This system does not comport with business reality or with common sense.

Companies employing lesser-skilled workers, such as resort workers, landscapers, hospitality workers, etc., face similar quota problems under the H-2B temporary seasonal worker program. Even though these workers may be essential to the operations of the U.S. business, a separate H-2B quota that does not come close to meeting demand results in companies being unable to staff essential positions.

Equally outdated are the immigrant (green card) quotas. Let's say that an employer wants to employ a foreign national employee on a permanent or indefinite basis. In order to do so, the employer must satisfy the U.S. Department of Labor, through an extensive recruitment process, that it has been unable to find a qualified, interested, and available U.S. worker to take the position. Only if the DOL is satisfied that no U.S. worker is available to fill the position, and that the employer needs someone to fill the position immediately, will the DOL issue a labor certification. You might think that completing this process would result in the U.S. employer being able to hire the foreign national worker, whom it needs immediately, without delay. Not even close. Depending upon the education level required for the position and the country of the foreign national's birth, the foreign national worker may not be able to obtain permission to work for that employer for many years, possibly even a decade or more. This is hardly a sensible system, and the quotas need to be updated to meet the needs of a modern economy.

5. The EB-5 Regional Center Program
Let's say a foreign national wants to make a substantial investment in a business in the United States that will create employment for at least 10 U.S. workers. If the investment is at least $1,000,000 ($500,000 in high unemployment or rural areas), the law provides that the foreign investor can obtain a green card in the EB-5 category. However, largely because of a series of highly restrictive interpretations by USCIS, this immigration category has been underutilized.

Recently, the EB-5 category has become hot again because of substantial and increasing interest in the EB-5 Regional Center program. Regional Centers are government-approved projects—often construction projects—that USCIS has certified will provide substantial employment opportunities for U.S. workers, either directly or indirectly, in the community. An investor who invests the requisite amount of money—usually $500,000, sometimes $1,000,000—in a government-approved

Regional Center may be able to obtain a green card more expeditiously than through any other means available. The Regional Centers have attracted large numbers of developers who, unable to obtain financing from traditional sources, seek capital inflow from foreign investors. These investors are willing to accept below-market returns because they are obtaining the significant benefit of a U.S. green card. This program is a classic win-win scenario: it provides a source of capital at a time when the capital markets are only reluctantly thawing; it creates infrastructure construction where it is sorely needed; and it creates jobs in a time of high unemployment. The popularity of this program is evidenced by the fact that the number of government-approved Regional Centers has more than tripled in the last couple of years.

While this program may provide maximum flexibility for an investor to live anywhere, work anywhere, or not work as that person chooses, and obtain permanent residence status for his or her whole family, the program is riddled with traps for the unwary. Immigration counsel experienced in dealing with EB-5 matters, as well as financial, business, tax, and/or security advisors, are highly recommended for foreign investors/prospective immigrants seeking to move to the United States under the auspices of this program.

Conclusion
The Obama administration has stated its intention to seek a once-in-a-generation overhaul of U.S. immigration laws. If that happens—and it is not only possible but likely that it will happen in 2010 or 2011—a whole new list of immigration law issues will arise. For the present, at least, the issues discussed in this article are important for business lawyers in assisting their clients in navigating a complex immigration law and enforcement landscape.

What Every Lawyer Needs to Know About Corporate Immigration Issues

Audio CD Package

In today's global economy, immigration laws have ever greater impact on U.S. and foreign-owned businesses. Companies that fail to follow immigration compliance laws have recently been subject to raids and civil and criminal liability. This program is designed to raise awareness of the areas where business law and immigration law intercept.

Klasko is a partner at Klasko, Rulon, Stock & Seltzer, LLP, in Philadelphia. His e-mail is rklasko@klaskolaw.com.

Back to Top

© 2012 ABA, All Rights Reserved

Ac

Business Law Today

Volume 19, Number 3 January/February 2010

The administration's new work site enforcement initiatives

Focus on employer compliance will increase audits and investigations

By Elise Fialkowski

The Obama administration has announced new work site enforcement initiatives and goals that will likely increase the number of investigations as well as I-9 and H-1B audits. In many cases, these audits may be the preamble to criminal enforcement. The administration has pledged to aggressively investigate employers and pursue criminal enforcement wherever possible. While criminal enforcement against employers who hire unauthorized workers began under the Bush administration, recently criminal enforcement actions also have been brought in the H-1B context for egregious violations. The Obama administration has stated that, even more so than the prior administration, the focus will be on employer compliance with immigration rules.

I-9 Enforcement

Under the Immigration Reform and Control Act (IRCA), all employers are required to verify that individuals hired after November 6, 1986, are eligible to work in the United States. Form I-9, Employment Eligibility Verification, issued by the Department of Homeland Security, is the form used by employers to document that employees have authorization to work in the United States. The employee must first fill out section 1 of Form I-9 and produce documentation evidencing identity and work authorization. A variety of documents are acceptable evidence of employment authorization and identity for Form I-9. There are "List A" documents that provide evidence of both identity and work authorization. Examples include a U.S. passport or a green card. Employees also may present a combination of a "List B" identity document and a "List C" work authorization document. Examples of such combined documents include a "List B" driver's license and a "List C" social security card. The employer cannot ask the employee to provide specific documents; rather, the employee should be presented with the list of acceptable documents from which he or she can choose which document or documents to submit. In completing section 2 of the I-9, the employer affirms that it has reviewed the documents and they appear to be reasonably genuine and to relate to the employee. An employer must retain these I-9 forms for

the longer of three years after hire or one year after termination and make them available for audit.

The Obama administration has pledged to continue—and in fact increase—vigorous criminal enforcement against employers that employ unauthorized workers. The Bush administration conducted a series of high-profile raids that resulted in criminal charges against employers as well as the apprehension of large numbers of undocumented workers. For example, in 2008 under the Bush administration, Immigration and Customs Enforcement (ICE) made 5,184 administrative arrests of unauthorized alien workers and 1,103 criminal arrests tied to work site enforcement. Of the individuals criminally arrested, however, only 135 were owners, managers, supervisors, or human resource employees. The majority of the remainder were workers charged under identity theft statutes. Janet Napolitano, Obama's secretary of homeland security, has indicated a shift away from apprehension of the undocumented workers in large-scale raids to a clear focus on employers including detailed up-front investigation on employer compliance prior to enforcement activity.

The large-scale raids under the Bush administration enraged the Latino community and religious leaders, immigrant advocates, and civil liberties groups important to the Democratic base and they stepped up pressure on Obama to stop them. In response, Janet Napolitano has charted a middle course, ordering a review of which immigrants will be targeted for arrest and emphasizing that she intends to focus even more on prosecuting criminal cases of wrongdoing by companies. Such action is consistent with her testimony during her confirmation hearing in which she stated that she expects "to increase the focus on ensuring that employers of unlawful workers are prosecuted for their violations." Moreover, she pledged to subject employer violators to "appropriate criminal punishment" and to encourage employers to work with federal immigration agents "to establish sound compliance programs that prevent unlawful hiring."

On April 30 of this year, the Department of Homeland Security (DHS) and ICE, the enforcement branch of DHS, issued a new Worksite Enforcement Overview and Worksite Enforcement Strategy Fact Sheet. Consistent with prior statements, both these documents announced that Napolitano has issued a directive "outlining that ICE will focus its resources in the work site enforcement program on the criminal prosecution of employers who knowingly hire illegal workers in order to target the root cause of illegal immigration." The Strategy Fact Sheet emphasizes that ICE will aggressively investigate using an array of sources including "tips from the public, reports from a company's current or former employees, even referrals from other law enforcement agencies" as well as a variety of techniques commonly used in criminal prosecutions. The fact sheet emphasizes that, through these methods, ICE will aggressively investigate and pursue trafficking, smuggling, harboring, visa fraud, document fraud, money laundering, and other criminal conduct by employers. It is clear that the Obama administration is focusing on significant up-front investigation rather than large-scale raids.

In October 2009, pursuant to a Freedom of Information Act request, ICE released its internal Worksite Enforcement Strategy policy memorandum underlying its April 30 fact sheet ("the Memorandum"). The Memorandum leaves absolutely no doubt that the clear focus is on employers, including criminal enforcement wherever possible: "The criminal prosecution of employers is a priority of ICE's work site enforcement program and interior enforcement strategy. ICE is committed to targeting employers, owners, corporate managers, supervisors, and others in the management structure of a company for criminal prosecution through the use of carefully planned criminal investigations."

Not only will ICE use traditional criminal enforcement methods, but the Memorandum emphasizes that administrative tools will be used "to advance criminal cases, and, in the absence of criminal charges, to support the imposition of civil fines and other available penalties." Indeed, the Memorandum makes clear that the "the most important administrative tool is the Notice of Inspection (NOI) and the resulting Form I-9 audit" as it not only will support the imposition of civil fines and other available penalties, but it "will often serve as an important first step in the criminal investigation and prosecution of employers."

Consistent with this use of I-9 audits as the key administrative tool, ICE announced a nationwide initiative to audit employers' Form I-9 employment eligibility verification records. As part of this initiative, in the first week of July 2009 alone, ICE issued Notices of Inspection to 652 employers across the country. In comparison, only 503 Notices of Inspection were issued in all of fiscal year 2008. This widespread enforcement initiative is much different than any in the past. In the past, initiatives often focused on the most likely offenders—employers in industries such as meat-packing, construction, landscaping, and manufacturing—commonly believed to regularly hire unauthorized workers. While certain of these businesses were included within the 652 I-9 audits, the reach was much broader to include a wide variety of businesses throughout the entire

country. The message is clear—no employer is safe from an I-9 audit and investigation.

In addition to using I-9 audits to advance criminal cases, ICE will pursue any available penalty, including civil fines and debarment from federal contracts. Currently, employers who fail to properly complete the required I-9 documentation face a civil fine of up to $1,100 per employee, while those found to have knowingly hired and continued to employ an unauthorized worker face a civil fine of up to $3,200 per employee for a first-time offense and a civil fine of up to $16,000 per employee if an employer has more than two offenses. As ICE recognizes in its Memorandum, debarment "carries highly significant consequences." Accordingly, ICE also has been increasingly pursuing debarment to preclude companies that knowingly hire unauthorized workers from securing work on federal contracts.

In order to avoid potential liability, employers are advised to develop and implement detailed I-9 policies and practices. ICE recommends that employers, at a minimum, establish an internal training program, with annual updates, on how to manage completion of Form I-9 and how to detect fraudulent use of documents in the I-9 process; permit the I-9 and any E-Verify process to be conducted only by individuals who have received training; and include a review of the completed I-9 and documents by a second person as part of each employee's verification to minimize the potential for a single individual to subvert the process. Most effective I-9 compliance policies will track these recommendations.

Internal audits—conducted before ICE comes knocking on the door—are essential to limit liability and assess compliance. Indeed, once an NOI is issued, the employer has only three days to respond and produce all I-9 records. Accordingly, should an NOI be issued, businesses are well advised to contact their immigration counsel as quickly as possible. It is also advisable, to the extent possible given the limited time frame, that the company conduct an audit of all I-9s and make any allowable corrections. Employers, however, must be careful to follow proper procedures at all times in any such audits, or face possible additional scrutiny. Employers, for example, should initial and date any correction clearly showing that the I-9 was corrected pursuant to audit. Company representatives responding to the NOIs should always retain copies of any documentation submitted to ICE. Employers who can demonstrate good-faith efforts to comply with immigration laws are more likely to avoid criminal penalties and be assessed lower-level civil fines if violations are uncovered.

It is important to note that although the government has increasingly touted E-Verify, the government's electronic employment eligibility program, as a way for an employer to increase compliance, E-Verify does not insulate an employer from I-9 enforcement actions. E-Verify does not exempt employers from I-9 completion. In order to use E-Verify, an employer must register online with DHS and accept the electronic Memorandum of Understanding (MOU), an agreement between the employer, the SSA, and DHS that details the responsibilities of each with regard to E-Verify. Although an employer who verifies work authorization under E-Verify is presumed to not have knowingly hired an unauthorized alien queried through the system, the E-Verify MOU itself clearly provides participation does not provide a safe harbor from work site enforcement. Indeed, raids against participating employers continue, as evidenced by the August 2008 raid conducted by ICE at Howard Industries, a Mississippi manufacturer of electrical products that participates in E-Verify.

In signing the MOU, the employer also agrees to allow the federal government and designees to conduct site visits, have full access to employment records, and interview employees. The government has refused to limit this provision to E-Verify records and related I-9s. By entering into such an MOU, the employer is waiving its Fourth Amendment rights and allowing the government free access to employment records, including I-9s completed prior to participation in E-Verify. It is also important to emphasize that to the extent that E-Verify provides any greater protection than that afforded by an employer following the standard I-9 process, such protection only extends to those employees queried under the E-Verify system. E-Verify currently only allows employers to verify the employment of new hires following enrollment and it does not allow for verification of outside contractors or verification of existing current employees. The only exception is under the Federal Contractor Rule. Therefore, E_Verify will not provide any protection with regard to past hires (except for employees assigned to qualifying federal contracts or employees queried under the 180-day option), yet the MOU allows the government unimpeded access to those records.

In addition, recent information released regarding data mining of E-Verify suggests that far from providing protection, the use of E-Verify could result in investigations or enforcement actions. In December 2008, U.S. Citizenship and Immigration Services (USCIS) and ICE negotiated a Memorandum of Agreement (MOA). Pursuant to this MOA, the USCIS Verification Division is charged with (1) the identification and pursuit of suspected employer and employee misuse,

abuse, and fraudulent use of E-Verify and (2) the referral of suspected employer and employee misuse, abuse, and fraudulent use of E-Verify to ICE for investigative consideration. Examples of information reviewed include violations regarding employment of unauthorized aliens, failure to use E-Verify for all required employees, and retaining employees after an E-Verify Final Non-Confirmation. Even more troubling, in May 2009, DHS proposed two regulations that would further allow for an expansion of data mining and enforcement activities based upon E-Verify. In these regulations, DHS announced that it intends to establish a system of records in order to mine the E-Verify data to support monitoring and compliance activities.

H-1B Work Site Enforcement

The H-1B visa allows companies to employ persons temporarily in a "specialty occupation" in the United States, provided that the employer makes certain attestations that the employment of an H-1B worker will not adversely affect the wages or working conditions of the employer's U.S. workers. In addition to the aggressive pursuit of work site enforcement actions against employers with unauthorized workers by ICE, the Department of Labor (DOL) has been actively auditing H-1B employers to ensure that they are in compliance with all H-1B requirements, including, for example, requirements relating to Labor Condition Application (LCA) posting, payment of required wages, public examination of files, and any required nondisplacement inquiries. H-1B employers should be attentive to their wage and hour obligations, ensuring that terminations are effective for purposes of avoiding back-pay claims, and comply with all wage, benefit, notice, and nonbenching requirements. Failures in these areas can result in significant back-pay awards, civil fines, and debarment.

Employers can expect to see increased enforcement in this area by an energized and invigorated DOL under the Obama administration. Indeed, it was recently reported that 250 new investigators are being hired by the DOL—additional hiring that will increase the staff in the division by more than a third. President Obama's new labor secretary, Hilda Solis, has asserted that she will aggressively pursue violations, stating, "There is a new sheriff in town."

Just as the government has turned to criminal enforcement of I-9 requirements, the government has begun to pursue criminal enforcement actions against H-1B employers. As just one example, on January 22, 2009, the federal government filed a 10-count criminal indictment against Vision Systems Group, Inc., an H-1B consulting company, in the U.S. District Court for the Southern District of Iowa. The indictment includes one count of conspiracy, eight counts of mail fraud, and one count of "Notice of Forfeiture" in the amount of $7.4 million. In the indictment, the government alleged that Vision Systems submitted false statements and documents in support of their visa petitions, which were mailed or wired to state and federal agencies. Allegations of such false statements include, for example: submissions of LCAs with false representations as to work location, submission of applications that omitted that the employee would be working at a third company as a consultant, submission of LCAs listing a prevailing wage for Iowa when in fact the employee worked in another state, submission of documents falsely representing the residential address of employees, and submission of quarterly reports claiming to employ more workers in Iowa than were actually employed.

Following this indictment, on February 11, 2009, as part of their extensive investigation into suspected H-1B visa fraud, mail fraud, and conspiracy by Vision Systems, ICE agents arrested 11 individuals in seven states. Among the crimes charged against these individuals involved with Vision Systems were conspiracy, mail fraud, wire fraud, and making false statements in an immigration matter.

FDNS Site Visits

Not only is DOL actively auditing compliance with H-1B LCA obligations, but USCIS has begun to expand its program of visits to the work sites of employers that sponsor foreign workers. The site visits are conducted by USCIS's Fraud Detection and National Security (FDNS) unit. USCIS recently announced that at least 20,000 FDNS site visits are planned.

Although FDNS has conducted site visits for some time, most particularly with regard to religious worker petitions, in the beginning of the 2009 fiscal year, FDNS developed the Administrative Site Visit and Verification Program (ASVVP), which employs private contractors to conduct site visits on behalf of USCIS. These contractors supplement 600 FDNS staff housed in various offices throughout the United States and are being used not only to investigate religious organizations but also to conduct random inspections of other employment-based visa petitioners. While many of these site visits have recently been conducted with regard to H-1B petitions, the program is not limited to H-1B petitions and may include any other type of nonimmigrant or immigrant employment-based petition.

These site visits are used to verify information provided by the employer in immigration petitions,

including not only employer information but also whether the employees are working in compliance with the information contained in the petition and the employer's attestations (including for example, hours, job duties, education requirements, rate of pay). Typically, the officer will arrive unannounced and ask to speak to an employer representative as well as the foreign national employee. The officer also may ask to speak to the employee's manager. The officer also may ask to tour the work site and ask for certain documents, including, for example, payroll records, corporate information, and employee identification such as a driver's license or passport.

In addition to verifying the validity of data contained in an employer's immigration petitions, FDNS officers use information collected during site visits to help USCIS develop a fraud detection database. FDNS officers and contractors gather information to develop employer profiles including factors that could indicate fraud. FDNS will refer suspected cases of fraud to ICE for review and criminal prosecution.

As in the I-9 context, employers are well-advised to establish effective H-1B compliance programs. Employers filing H-1B petitions must closely follow H-1B rules and regulations or face significant back-pay awards, fines, debarment from the H-1B program, and even possible criminal prosecution. It is essential to ensure that the H-1B employer not only fulfills all initial regulatory requirements including proper completion of the public examination file, but also that the employer ensures H-1B employees are working consistent with the terms of the filed H-1B petitions and related LCAs. This duty continues after filing for the full duration of H-1B status. Any changes to the duties or work location must be discussed with counsel so that appropriate action, including, for example, the filing of a new LCA and/or an amended H-1B petition, is undertaken. Employers also must be prepared for FDNS inspections. Employers are well-advised to consult with their counsel to develop a policy and program to quickly respond to any such inspections. Such a program should include education of managers and staff regarding such site visits. Employees, for example, must clearly be advised never to guess at any answers. Similarly, it is advisable for businesses to designate key employees with overall responsibility to respond to such site visits. These employees should have quick access to copies of the relevant H-1B petitions and be knowledgeable about information contained in such filings. These policies also should include a review of H-1B petitions to confirm accuracy and policies and procedures to deal with any changes to the terms and conditions of employment.

Additional Resources

For more reading on a similar topic, you can retrieve the following article on the *Business Law Today* website at www.abanet.org/buslaw/blt. All issues since 1998 may be accessed under the "Past Issues" heading at the bottom of the web page.

The Immigration Crackdown on Employers
The government steps up work site enforcement
By Roger Tsai
Business Law Today
July/August 2007
Volume 16, Number 6

Conclusion

The time for immigration compliance has come. Not only should businesses ensure that they do not hire or continue to employ unauthorized workers, but they must also ensure that they are in full compliance with all regulatory requirements, including, for example, H-1B rules and regulations. Establishing internal "best practices" to avoid liability is critical. Effective compliance programs and training are essential to limit liability in this age of increased enforcement.

What Every Lawyer Needs to Know About Corporate Immigration Issues

Audio CD Package

In today's global economy, immigration laws have ever greater impact on U.S. and foreign-owned businesses. Companies that fail to follow immigration compliance laws have recently been subject to raids and civil and criminal liability. This program is designed to raise awareness of the areas where business law and immigration law intercept.

Fialkowski is a partner at the Philadelphia office of Klasko, Rulon, Stock & Seltzer, LLP. In addition to employment-based immigration work, she has particular experience in advising employers with

regard to compliance with the Immigration Reform and Control Act, including I-9 Employment Eligibility Verification and work site enforcement issues. She can be reached at efialkowski@klaskolaw.com.

Back to Top

© 2012 ABA, All Rights Reserved

Ad
Follow ABA

FREE CLE for Members
Scientific Trial Preparation: Are You Ready?
Featuring Daniel W. Dugan, Monday, 12/16, 1:00 p.m. ET

Sponsored by Bank of America
Register Now

Business Law Today

Volume 19, Number 3 January/February 2010

Creating a global workforce

Transferring non-U.S. citizen personnel to the United States

By Bryan Y. Funai and Esther Contreras

To successfully compete on a global scale, multinational corporations must ensure that their most qualified personnel can assume positions within the organization anywhere in the world. Much uncertainty exists with the transfer of foreign personnel to an affiliated U.S. company. U.S. immigration laws are becoming increasingly complex and are often misinterpreted by U.S. Citizenship and Immigration Services (USCIS) adjudicators who have little experience or understanding of the realities of the worldwide business environment. In addition to navigating the immigration complexities, many employees are only transferred temporarily and additional issues must be examined, such as tax liability and the ability of spouses to work and dependent children to attend school in the United States. Depending on the nature of the transfer and length of assignment, procedures may be taken that will streamline the process of transferring employees to the United States and provide a degree of certainty to the application of U.S. immigration laws.

Temporary Business Trips

In many cases, an employee's services may only be necessary for a limited period of time to attend business meetings, carry out business transactions, participate in conferences or negotiations, or receive limited training. The sale and shipment of complex machinery to a business in the United States might require the assistance of technical personnel to install, troubleshoot, or train American workers on the machinery. These types of assignments are usually short-term (one year or less) in nature where the foreign national personnel maintain their employee status at the entity overseas. Under such circumstances, the B-1 visa classification for business visitors is the ideal solution.

The B-1 classification allows persons to enter the United States temporarily to render services for his or her employer abroad. The B-1 classification requires that all salary and other remuneration (with the exception of certain meal and living expenses) must be paid by the employer outside of

the United States. Additionally, the benefit of any services rendered by the employee should accrue to the benefit of the employer outside of the United States. Furthermore, the employee must not be "working"; that is, he or she cannot be rendering services directly to, accepting a salary from, or performing services for a U.S. entity that would normally call for the payment of salary or other remuneration. Traditionally, employers have used the B-1 classification to send employees to the United States to attend various types of meetings (board of directors, sales, staff, and operational), to participate in business negotiations, and to participate in U.S. litigation. Technical personnel may use the B-1 classification for the purpose of installing machinery and equipment, provided that it was shipped from a non-U.S. source and the contract for the purchase expressly stated that installation was to be included in the sale.

Finally, the B-1 classification may be used to dispatch non-U.S. employees to the United States for the purposes of receiving limited training. This classification is referred to as B-1 in lieu of H-3 (H-3 is a trainee classification). In addition to the aforementioned requirements for the B-1 classification relating to salary, remuneration, and work, the employee's visa application materials should include a detailed letter explaining the training program. The letter should clarify the type and amount of training to be provided; the quantity, if any, of substantive work that may be performed incidental to the training; and the reasons why this training is not available in the employee's home country.

Foreign national personnel can enter the United States for short-term business purposes either under the Visa Waiver Program (VWP) or by obtaining a B-1 business visitor visa. The VWP is limited to individuals who are nationals of one of a select 35 countries, which include much of Western Europe, Australia, Singapore, and South Korea. The maximum authorized period of stay in the United States under the VWP is 90 days. Foreign national employees on assignments of longer duration or who are not eligible to enter under the VWP must first apply for a B-1 visa at a U.S. consulate in his or her country of residence. Upon entering the United States, the B-1 visitor can be granted a maximum period of authorized stay of one year, although three to six months is more common. An extension of stay is not permitted, nor may the employee change to a different immigration status. Because the B-1 employee is not eligible to work in the United States (as previously defined), the employee will not be eligible to apply for a U.S. Social Security number and, consequently, cannot apply for a state driver's license.

E-1 and E-2--The Treaty Visas

Employees at multinational corporations that are owned by nationals of one of the 80 countries that have entered into a Treaty of Friendship, Commerce and Navigation (FCN Treaty) with the United States, and who are of the same nationality as the country where the entity is based, may apply for the E-1 or E-2 visa. The E-1 visa companies, or "Treaty Traders," must be engaged in substantial trade with the United States (substantial being defined as more than 50 percent of all international trading activities). An E-2 visa company, or "Treaty Investor," must have made a substantial investment in the United States. A substantial investment is one that provides more than just a standard of living for the investor and his or her family. Additionally, to demonstrate that an investment is substantial, the Treaty Investor must establish that the funds are actually at risk: investment of funds in a stock brokerage account, regardless of size, is not an investment for E-2 purposes.

A foreign national employee must possess the same nationality as the Treaty Trader/Investor and can be transferred to the United States as an executive, as a manager, or in a special qualifications capacity. The E visa does not require individuals to have previously worked at the foreign company. E visas are issued for a maximum of five years and, unlike other work-related nonimmigration classifications, the visas can be renewed indefinitely, which affords the Treaty Trader/Investor considerable flexibility. Upon entering the United States, the E visa holder can be issued a period of stay for two years from the date of entry into the United States, regardless of the expiration date of the visa. Subsequent entries into the United States will likewise result in a period of stay of two years from the date of entry. E visa holders who travel frequently overseas could theoretically never have to file an application with the USCIS to extend their stay.

While the E visa can be used for smaller entities, in most instances the E visa is used by multinational corporations for the transfer of mid- to upper-level employees. Because the E visa is limited to employees who have the same nationality as the company that has entered into the FCN Treaty with the United States, the transfer of executives from countries other than the FCN Trader's country would not be eligible for the E visa. Additionally, E visa foreign nationals may be able to be transferred to other U.S.-based subsidiaries or affiliates of the FCN Treaty company without prior USCIS approval.

Applying for the E visa consists of an initial application directly at the U.S. embassy or consulate in the employee's country of residence. Most consular posts that accept E visa applications

specifically require that the petitioning company first register with the consular post. To register, a company would submit to the consular post its corporate information and documents, such as articles of incorporation, financial statements, stock ownership information, and employee staffing lists. Most consular posts also require that the E registration be maintained on an annual basis.

L-1 Intracompany Transferees

When a company or employee does not qualify for an E visa, the employee may be assigned to the United States in an L-1 classification. The L-1 visa is available to intracompany transferees who have been employed at the foreign entity for at least one year in the three years prior to the application and are coming to the United States to work at an affiliated company in an executive, managerial, or specialized knowledge capacity. The foreign employment also must be classifiable as executive, manager, or specialized knowledge in nature; however, there is no requirement that the position be the same.

Unlike the E visa, an L-1 intra-company transferee must first obtain approval from the USCIS. The U.S. company must file a petition with the USCIS and when approved, the employee may then apply for the L-1 visa at the U.S. consulate in the employee's place of residence. The L-1 visa imposes a limitation on the amount of time that the employee may remain in the United States. In the case of executives and managers, the total period of time allowable is seven years. In the case of persons with specialized knowledge, the total period of time allowable is five years. The L-1 visa is issued for an initial three-year period with subsequent two-year extensions and the period of authorized stay is limited through the duration of the visa. In order to renew the visa or extend the authorized stay, a petition for an extension of stay must first be filed. As a general rule, L-1 intracompany transferees are limited to employment at the location listed on the USCIS application and must generally work in the position stated in the application.

Of particular usefulness to larger multinational corporations is the L-1 Blanket program. The L-1 Blanket, as the name implies, affords comprehensive coverage of a multinational company and all of its listed subsidiaries and affiliates under one petition and approval for all qualified foreign national employees who will come to the United States in an executive, managerial, or professional specialized knowledge capacity. The Code of Federal Regulations at 8 C.F.R. § 214.2(i)(4) et seq. states that, in order to qualify for the L-1 Blanket coverage, the company must establish that

1. the company maintains an office in the United States that has been doing business for at least one year;

2. the company has at least three domestic and foreign branches, subsidiaries, and affiliates; and

3. the company and the other qualifying branches, subsidiaries, and affiliates of the company
    1. have applied for and obtained approval of at least 10 L-1 petitions in the previous 12 months; or
    2. have U.S. subsidiaries and affiliates that have combined annual sales of at least $15 million; or
    3. have a total U.S. workforce of at least 1,000 employees.

It is not necessary that the company list all its subsidiaries, affiliates, or branches on the blanket application, but only those companies that are so listed will be afforded classification under the L-1 Blanket and be able to take advantage of its benefits.

As with the individual L-1 classification, executives and managers may be transferred to the United States utilizing the L-1 Blanket. However, the L-1 specialized knowledge classification under the L-1 Blanket is limited to "specialized knowledge professionals." A "specialized knowledge professional" is a person who, in addition to having specialized knowledge of the company's processes and procedures, also has attained a minimum education of a baccalaureate degree or the equivalent.

The benefit of the L-1 Blanket as opposed to the individual L-1 application is that the L-1 Blanket visa holder may be transferred to other entities listed on the blanket application as long as the person will be performing substantially the same job duties as when he/she originally entered the United States. In the event that the job duties will be different, it will be necessary to obtain USCIS approval prior to the transfer. In addition, persons who apply pursuant to the L-1 Blanket will be allowed to submit their application directly to the U.S. consular post in their place of residence and will not have to submit an individual application with the USCIS. This will save

considerable time and expense, as well as uncertainty over the inconsistent review and adjudication of individual L-1 applications.

H-1B Specialty Occupation Worker

In the event that an employee does not qualify as a B-1 temporary visitor, E Treaty Trader or Treaty Investor, or L-1 intracompany transferee, the visa of last resort is the H-1B Specialty Occupation Worker. While the H-1B classification is the most well-known work-related visa, having been utilized by numerous high-tech companies and consulting companies for the hiring of technical personnel, from a corporate planning standpoint, because of various issues and restrictions, the H-1B visa should be used for the transfer of expatriate personnel only if the foreign national will not qualify for any of the other visas.

In order to qualify for the H-1B classification, the employee must establish that he or she has earned a bachelor's degree or the equivalent in a field of study directly related to the position being offered. The employer must establish that the position being offered is one that typically requires a bachelor's degree. Furthermore, the employer also must comply with Department of Labor requirements for the payment of a prevailing wage for the position in the area of intended employment. The employer also must post the proposed position on the company premises, listing the job duties and rate of pay. Finally, in the event of a termination of the H-1B employee, the employer must pay for the return transportation to the employee's last country of residence. If approved, an H-1B employee may remain in the United States for a maximum of six years, subject to special provisions allowing a longer period of stay if the employee is in the process of applying for Permanent Resident Status (green card).

The requirements to qualify for H-1B classification are stringent and take much of the decision making away from the company. The H-1B classification has an annual numerical limitation of 65,000 visas. In prior years (2009 being a notable exception) the quota of visas was exhausted within the first week after the filing period opened, resulting in further uncertainty over whether a person will be accorded H-1B classification. In most instances, the H-1B classification is utilized when hiring foreign national personnel who are not expatriates or who have been recently hired overseas and do not have the requisite one year of employment needed for L-1 classification or are not of the same nationality as the FCN Treaty company.

Other Considerations

In determining the course of action to be taken in transferring foreign national personnel to the United States, the following additional factors should be borne in mind:

Worldwide Taxation. Persons who are considered to be residents of the United States for tax purposes (which is often determined regardless of visa classification) will be required to declare worldwide income. While credits and deductions are available in the United States for income earned abroad and taxes paid to a foreign government, an analysis of worldwide income must be conducted to determine if additional withholdings or estimated tax payments should be made. Because expatriates may continue to receive remuneration from foreign sources, the result can be an under-withholding of U.S. income taxes with a later assessment of penalties and interest.

As of the date of this article, the following countries are participants in the Visa Waiver Program:

Andorra	Australia	Austria	Belgium
Brunei	Czech Republic	Denmark	Estonia
Finland	France	Germany	Hungary
Iceland	Ireland	Italy	Japan
Latvia	Liechtenstein	Lithuania	Luxembourg
Malta	Monaco	The Netherlands	New Zealand
Norway	Portugal	San Marino	Singapore
Slovakia	Slovenia	South Korea	Spain
Sweden	Switzerland	United Kingdom	

Click for a Printable Version of this Table

Social Security and Welfare Taxes. As a part of tax withholdings, all U.S. taxpayers must withhold for Social Security. Prior to the transfer of foreign national personnel, it should be determined whether the foreign national personnel will be covered under one of

the Social Security Totalization Agreements that have been entered into between the United States and certain countries and, if applicable, application for a certificate of coverage should be submitted with the proper agency.

As of the date of this article, the following countries have entered into Treaties of Friendship, Commerce and Navigation with the United States and are eligible for either E-1 classification, E-2 classification, or both:

Albania	Argentina	Armenia	Australia
Austria	Azerbaijan	Bahrain	Bangladesh
Belgium	Bolivia	Bosnia & Herzegovina	Brunei
Bulgaria	Cameroon	Canada	Chile
China (Taiwan)	Colombia	Congo	Costa Rica
Croatia	Czech Republic	Denmark	Ecuador
Egypt	Estonia	Ethiopia	Finland
France	Georgia	Germany	Greece
Grenada	Honduras	Iran	Ireland
Israel	Italy	Jamaica	Japan
Jordan	Kazakhstan	Korea (South)	Kyrgyzstan
Latvia	Liberia	Lithuania	Luxembourg
Macedonia	Mexico	Moldova	Mongolia
Morocco	The Netherlands	Norway	Oman
Pakistan	Panama	Paraguay	Philippines
Poland	Romania	Senegal	Singapore
Slovakia	Slovenia	Spain	Sri Lanka
Suriname	Sweden	Switzerland	Thailand
Togo	Trinidad & Tobago	Tunisia	Turkey
Ukraine	United Kingdom	Yugoslavia	

Click for a Printable Version of this Table

As of the date of this article, the following countries have entered into bilateral Social Security Agreements with the United States:

Australia	Austria	Belgium	Canada	Chile
Czech Republic	Denmark	Finland	France	Germany
Greece	Ireland	Italy	Japan	Luxembourg
The Netherlands	Norway	Poland	Portugal	South Korea
Spain	Sweden	Switzerland	United Kingdom	

Click for a Printable Version of this Table

Employment by Dependent Spouses. The foreign national spouse may wish to work in the United States. While spouses and children under the age of 21 are generally accorded dependent status, which allows them to accompany the employee to the United States, employment is generally not permitted. However, spouses, but not dependent children, of E and L visa holders are allowed to apply for employment authorization in the United States and, if granted, may commence employment on a full- or part-time basis.

Education for Children. Dependent children are allowed to attend public school without applying for a separate student visa. Because there is technically no dependent classification for a B-1 business visitor, dependents are granted B-2 classification as visitors for pleasure. While current regulations prohibit persons from attending school in B-2 classification, the dependents of B-1 visa holders are exempted because their studies are incidental to their primary purpose, which is to accompany their B-1 parent.

Conclusion

The decision to transfer personnel to the United States is one that takes considerable forethought and planning. Most multinational corporations should explore both registering as an E company and obtaining L-1 Blanket approval, which will afford the maximum amount of flexibility for transferring personnel to the United States. The B-1 classification is useful for temporary stays but not for long-term assignments. Lastly, the H-1B classification should be considered the visa of last resort for transferee purposes and used only in the event that the employee will not qualify as an E or L employee. Companies interested in transferring employees to the United States should consult with experienced immigration counsel to discuss their company's needs and the immigration options available for their workers.

What Every Lawyer Needs to Know About Corporate Immigration Issues

Audio CD Package

In today's global economy, immigration laws have ever greater impact on U.S. and foreign-owned businesses. Companies that fail to follow immigration compliance laws have recently been subject to raids and civil and criminal liability. This program is designed to raise awareness of the areas where business law and immigration law intercept.

Funai is a principal in Masuda, Funai, Eifert & Mitchell, Ltd., where he practices in the areas of

corporate and employment-based immigration and nationality law. Contreras is an associate attorney in the firm's Immigration Practice group, where she focuses her practice on employment-based immigration and nationality law. Their respective e-mails are bfunai@masudafunai.com and econtreras@masudafunai.com.

Back to Top

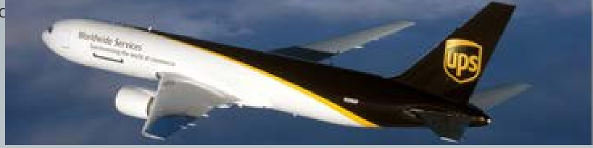
For the Public
ABA Approved Law Schools
Law School Accreditation
Public Education
Public Resources

Resources For
Bar Associations
Diversity
Government and Public Sector Lawyers
Judges
Law Students
Lawyers of Color
Lawyers with Disabilities
Lesbian, Gay, Bisexual & Transgender Lawyers
Military Lawyers
Senior Lawyers
Solo and Small Firms
Women Lawyers
Young Lawyers

Stay Connected
Twitter
Facebook
ABA Career Center
Contact Us Online

Terms of Use | Code of Conduct | Privacy Policy | Your Privacy Rights | Copyright & IP Policy | Advertising & Sponsorship | © 2012 ABA, All Rights Reserved

Ad
Follow ABA



Business Law Today

Volume 19, Number 3 January/February 2010

Immigration obligations in times of economic downturn

Consequences of workforce changes involving foreign nationals

By Kate Kalmykov

The year 2009 saw the largest bailout passed in the history of the United States, massive layoffs, drops in the stock market, a credit crisis, and unprecedented unemployment rates. As a result, in order to remain competitive, or even just to stay in business, employers are faced with difficult decisions regarding terminations, pay cuts, and hiring freezes. Managing the legal aspects of downsizing or corporate restructuring is never easy. For companies that employ foreign nationals, it is even more complicated as there are significant immigration-related consequences that must be addressed when downsizing. Termination of foreign nationals may impact an employer's obligations under the regulations of both the U.S. Citizenship and Immigration Services (USCIS) and the Department of Labor (DOL).

In situations where a foreign national is working pursuant to an employer's sponsorship, the employer has an affirmative responsibility to notify USCIS if the foreign national is terminated. Certain visas require the employer to provide the foreign national with return transportation and may subject employers to a variety of wage and benefit obligations governed by the DOL. If foreign national employees are terminated and the proper steps are not taken by the employer, the employer may be liable for back pay to the foreign national, and may be subject to steep penalties for noncompliance.

Even if companies are not terminating the foreign national, there are still significant immigration issues to address. For example, changes in the corporate structure may have implications for the validity of the foreign national's nonimmigrant status. Moreover, terminations in other sectors of the employer's workforce, or even in the industry more generally, can jeopardize an employer's ability to petition for permanent resident status on behalf of foreign nationals.

The economic downturn has brought greater government scrutiny to employment-based

immigration. Employers must protect themselves and their employees from common problems associated with terminations and corporate downsizing. Employers who fail to take the proper measures may be subject to lawsuits by terminated employees or to investigations by both the USCIS and DOL. This article will discuss the legal obligations that a company must take to reduce its exposure to this liability. In these uncertain times, diligent follow-up by company human resource representatives or those in the immigration function will be essential to ensure a smooth transition.

Termination of Nonimmigrants

The new restrictions imposed on the recipients of the Troubled Asset Relief Program bailout regarding the hiring of foreign workers have placed national focus on the H-1B nonimmigrant work visa. The most common type of work visa, the H-1B, is available to employers that wish to temporarily employ foreign workers in a specialty occupation for which at least a bachelor's degree or its equivalent is required. Employers that sponsor an H-1B worker are required to make an attestation to the DOL that they will pay the worker for the duration of said status. This attestation is made in what is known as a Labor Condition Application (LCA) and requires the employer to agree to pay the H-1B employee a salary that is equal to or exceeds the prevailing wage for the listed occupation in the geographical area of intended employment.

With many employers facing hard economic times, they are often tempted to either bench employees or reduce their compensation by a certain percentage. Both of these scenarios are problematic in the immigration context. While benching may be common practice in some industries such as computer consulting, where H-1B employees are benched between assignments, it is a violation of immigration regulations. The LCA attestation requires the employer to commit to compensating the H-1B worker even if he is in nonproductive status. The employer's obligation to begin payment commences no later than 60 days after the H-1B petition for change of status is effective (if a change or extension of status was requested) or 30 days after the H-1B nonimmigrant enters the United States (if this is a new petition). Likewise, employers that are tempted to reduce salaries as a response to the economic downturn must ensure that they continue to pay their H-1B workers at least the minimum salary stated on the LCA. Employers who violate these statutory requirements are liable for back pay in addition to penalties for noncompliance.

The H-1B wage payment obligation ends only after there has been a bona fide termination of employment. Although DOL previously accepted written notice to the employee as satisfying this requirement, a recent decision by the agency's Administrative Review Board held that an employer was obligated to continue to pay the salary until the employer withdrew both the LCA with the DOL and the H-1B petition with the USCIS. Employers who do not comply with these requirements are at risk of having to pay the employee's salary through the entire validity of the H-1B status. In addition, H-1B employers are required to maintain a public access file as well as the LCA for inspection until one year beyond the end of the period of employment specified on the LCA form. Payroll records must be maintained for at least three years from the date of creation of the record. Penalties will quickly add up if DOL determines that an employer has not complied with these requirements.

Federal regulations also require an employer that terminates an H-1B worker before the end of his or her authorized stay to provide the reasonable costs of return transportation to the employee's last country of residence. This requirement does not apply to the H-1B employee's dependents nor does it apply if the employee terminates the employment relationship.

In addition to the H-1B visa, there are a number of other nonimmigrant work visas that employers may use to bring workers to the United States. These visas are attractive because, unlike the H-1B visa, there is no limit on the number of visas issued annually. Moreover, other nonimmigrant work visas do not require employers to file an LCA with the DOL, meet a prevailing wage requirement, or make attestations to the DOL regarding working conditions, wages, or employment terms.

Employers that sponsor workers using the O-1 classification for extraordinary ability aliens are required to notify the USCIS of any changes in the terms and conditions of employment. Additionally, the O-1 petitioner is jointly and severally liable for the reasonable cost of return transportation to the employee's last country of residence. There is a similar requirement for employers of P visa athletes, artists, or entertainers to provide the costs of return transportation to the employee upon termination of the employment. By contrast, employers that have sponsored employees for the L-1 intracompany transferee visa or the TN classification for Mexican or Canadian professionals under NAFTA are not required to pay the costs of the employee's return transportation or to notify USCIS of the termination of employment.

Pending Green Card Applications

Hiring personnel should be aware that there are no grace periods provided for terminated employment-based nonimmigrants to remain in the United States. Those employers that seek to hire employees who have remained in the United States after the termination of their employment should work with immigration counsel to ensure that they properly file applications on their employees' behalf.

Additionally, where an employing organization changes its structure as a result of a merger, acquisition, or corporate restructuring, new petitions may need to be filed on behalf of the organization's workforce. This requirement will hinge on whether the terms and conditions of employment under the new corporate structure differ from the original position for which the nonimmigrant was hired and whether the organization has succeeded to all of the interests and obligations of the original employer.

Termination of employment can have serious repercussions on an employee's ability to obtain permanent residency if the terminating employer was the sponsor for such benefit. An essential point in this context must be clarified: employer-sponsored applications for permanent residency are for offers of prospective employment. Therefore, the employee must intend to work with the employer upon the approval of the final step of the permanent residency application.

Most companies seeking to obtain permanent residence for their foreign national employees must obtain a labor certification known as PERM from the DOL as a first step in the residency process. As a result of PERM's rigid requirements, even those employers that do not terminate workers may find that they have to address USCIS and DOL concerns. This is because sponsoring PERM labor certifications requires employers to establish that they have adequately tested the labor market and have not identified a U.S. worker qualified for the position. Employers also must indicate whether, in the last six months, they have had layoffs at any worksite, and in a same or similar occupation. If so, the employer must indicate whether they have notified laid-off workers of this job opportunity. The employer's obligations become more convoluted in cases of businesses that have had stealth layoffs or reorganized. Interestingly, there is no clear guidance on how an employer should notify former employees of the position, and it remains to be seen how stringent the DOL will be in regulating this requirement.

Employers that file PERM applications where layoffs have occurred within the area of intended employment also can expect greater scrutiny of their recruitment efforts by the DOL. For example, at a June 2009 meeting of the American Immigration Lawyers Association, representatives from the DOL noted that an application for a financial analyst position in New York City would be heavily scrutinized as an example of a particular occupation and location where there might be qualified U.S. workers available due to recent financial industry layoffs. Note that this is irrespective of whether or not the employer has had layoffs at its organization. If the DOL believes that the employer's recruitment efforts were insufficient, they may audit the employer in order to perform an extensive review of the recruitment. If they deem the efforts insufficient and not taken in good faith, they can impose supervised recruitment for all future PERM filings. Supervised recruitment requires the employer to receive advance approval from the DOL for all recruitment efforts to ensure that U.S. workers are fully considered for available positions.

Since PERM applications are specific both to the employer and to the position for which they are sought, they cannot be transferred to another employer or even to another position with the same employer. They are invalid, with several caveats. If the employer intends to rehire the worker once its business rebounds from the economic downturn, it may be possible to salvage the application, depending on how far along in the process it has proceeded.

If the employee has received PERM certification, the outcome of the employee's ability to obtain a green card hinges on when the termination of employment occurs. Generally, after a PERM is certified, an employer files an I-140, Immigrant Petition for Alien Worker, on behalf of the employee. The immigrant petition establishes that the employer can in fact pay the employee the proferred wage and that the employee has the qualifications listed in the PERM application. The third step of the process is the actual permanent residency application, known as the I-485, Application for Adjustment of Status. Assuming that a worker only has an approved I-140 immigrant petition and no pending I-485 permanent residency application, the I-140 would become null and void after a layoff. However, if the sponsoring employer has the intention of rehiring the worker after the approval of the I-485 permanent residency application, the I-140 immigrant petition remains valid because green-card sponsorship is for prospective employment.

However, there is some good news for the worker if the employer has no intention to rehire him or her after the approval of the PERM application. If the worker has to restart the permanent residency process with a new employer, the worker can retain the original priority date from the

original PERM case or I-140 filing for the new permanent residency application. This scenario is covered by the American Competitiveness and Workforce Act, which permits an employee to "port" to another employer. Portability allows employees with pending permanent residency applications to switch employers without having to refile the petition from the beginning, if they can demonstrate that the new position is the same or similar to the original position. In addition, the I-140 Immigrant Petition filed by the original employer with the USCIS must have been approved and the employee's I-485 permanent residency application must have been pending for more than 180 days. During a recession, finding work in one's occupation may be especially difficult. However, if an employee accepts employment in a field not closely related to the field that served as the basis for the permanent residency application, portability may not be available.

In cases of corporate reorganization, companies that are deemed to be successors in interest to the original PERM application do not need to file a new application on behalf of the employee. Rather, they may file an immigrant petition with the USCIS showing that they have assumed the rights, duties, and obligations of the original employer and that they will continue to operate the same type of business and offer the employee the same position. I-140 immigrant petitions filed on behalf of multinational managers or executives in particular will need to be reviewed on a case-by-case basis, as changes in the corporate relationship can impact the applicant's ability to obtain his or her green card.

As mentioned above, certain individuals are not subject to PERM. In fact, certain aliens can sponsor themselves for residency in the extraordinary ability or national interest waiver categories. Although these aliens will not have their permanent residency applications impacted by the loss of a specific job, they will still need to demonstrate their intent and likelihood of continuing to work in their field of expertise upon approval of the permanent residency application.

Employer Compliance Considerations
Companies reducing their workforce also should note that federal regulations relating to the I-9, Employment Eligibility Verification Form, require employers to retain I-9s for inactive employees for three years from the date of hire or one year from the date of termination, whichever is later. I-9 forms that no longer need to be retained should be discarded to minimize liability. Employers that rehire former employees within three years must reverify their work eligibility if the employee is no longer authorized to work on the same basis as indicated on the original I-9 form.

In the context of a merger or acquisition, the company should carefully review the I-9 documentation of the acquired foreign nationals to ensure that they are in valid status and authorized to work. Failure to comply with I-9 requirements may result in penalties. It is advisable prior to beginning a corporate restructuring to have counsel examine the I-9 compliance of the entity by conducting an internal audit. In these instances, it is prudent to have I-9 representations and warranties required at the closing.

Conclusion
As many companies try to rebound from this economic crisis, they must make difficult business decisions on a daily basis. Layoffs, terminations, and corporate restructuring can result in a variety of thorny issues. As every situation is unique, companies should work with competent immigration counsel to ensure that they are in compliance with immigration regulations governing changes in the employment relationship.

What Every Lawyer Needs to Know About Corporate Immigration Issues

Audio CD Package

In today's global economy, immigration laws have ever greater impact on U.S. and foreign-owned businesses. Companies that fail to follow immigration compliance laws have recently been subject to raids and civil and criminal liability. This program is designed to raise awareness of the areas where business law and immigration law intercept.

Kalmykov is an associate in the New York City office of Klasko, Rulon, Stock & Seltzer, LLP, where she focuses her practice on business immigration and compliance. Her e-mail is kkalmykov@klaskolaw.com.

Back to Top

© 2012 ABA, All Rights Reserved

Ad
Follow ABA

AMBASSADORS : REPRESENTING LAWYERS OF COLOR IN THE BUSINESS LAW SECTION
APPLY FOR THE 2014 — 2016 BUSINESS LAW AMBASSADORS PROGRAM.

Business Law Today

Volume 19, Number 3 January/February 2010

Bothersome immigration buzz spells trouble for M&A deals

New homeland security memo complicates employee transfers

By Angelo A. Paparelli

Too often, corporate lawyers and their clients have viewed immigration law issues as merely peripheral to merger and acquisition transactions. A new federal policy memorandum, however, issued by U.S. Citizenship and Immigration Services (USCIS), a unit of the Department of Homeland Security, will bring immigration concerns front and center. The memorandum both adds to and subtracts from the problems faced by deal makers and their counsel in assuring that critical human assets remain available to the acquiring entity after the transaction closes.

We're from the Government and We're Here to Help

On August 6, 2009, USCIS issued new guidance to its officers with the stated purpose of allowing greater flexibility in evaluating the immigration consequences of corporate restructurings. The memorandum provides a roadmap to help immigration officers decide whether a particular merger, acquisition, spin-off, or other restructuring will preserve or destroy employment-based immigrant visa benefits previously sought or secured for the seller's employees. In agency parlance, USCIS officers must follow the new instructions in deciding the issue of "immigration successorship in interest."

Simply put, if successor-in-interest designation is granted, immigration benefits are maintained without a hiccup. These include eligibility for green-card status (the right to remain permanently in the United States and pursue citizenship) as well as pipeline benefits for foreign employees and their families. If the designation is denied, however, terrible outcomes may ensue: foreign workers could lose employment authorization and be required to find a different immigration-authorized job or employer, and then start all over in the years-long path to U.S. permanent residence and citizenship. Otherwise, the workers, along with their families, must leave the country or face removal (a legal form of banishment from the United States previously known formally as deportation).

Worse yet to deal makers and their lawyers, an actual or feared refusal by USCIS to recognize immigration successorship, and the resulting separation of key foreign workers from their U.S. counterparts, may cause the deal to lose value and fail.

The August 6 memorandum, issued under the name of Donald Neufeld, USCIS's Acting Associate Director for Domestic Operations, begins by purporting to distinguish (but effectively overruling) a precedent decision that had created a barrier for asset acquisitions. *Matter of Dial Auto Repair Shop, Inc.*, 19 I & N Dec. 481 (Comm'r 1986) (*Dial Auto*), required that if employment-based immigrant visa eligibility is to continue (without the need to restart the green-card process), an acquiring company must assume all assets and all liabilities of the acquired business.

Although a succession of informal letters from agency officials gradually relaxed the *Dial Auto* requirement that the buyer assume all of the acquired company's assets and liabilities, these informal letters had no precedential effect. Some immigration officers adhered to *Dial Auto* and others applied a relaxed (albeit unofficial) successorship standard, granting continuity of immigration benefits on the mere assumption of substantially all assets and liabilities of a business division rather than the entire entity. More recently, the range of immigration successorship possibilities has vacillated between two extreme positions: the strict *Dial Auto* "all-assets/all-liabilities" standard and a very lenient criterion, namely, the assumption of only immigration-related assets and liabilities (presumably including Form I-9 [Employment Eligibility Verification] recordkeeping and the representations made by the seller in pending and approved work-visa and green-card petitions).

To the delight of deal makers whose acquisitions had crashed into *Dial Auto*,the August 6 memorandum acknowledged that deals do not always occur as previous government bureaucrats had envisioned:

> USCIS recognizes that business practices change over time, particularly in the areas of acquisitions, mergers, and transfers of assets and liabilities between entities . . . [Business] entities do not always wholly assume the assets and liabilities of entities they acquire or merge with and that businesses may choose not to assume certain assets or liabilities in connection with a perfectly legitimate transaction.

New Federal Test for Successorship

USCIS now recognizes that "a valid successor-in-interest relationship may still be established in certain instances where liabilities unrelated to the original job opportunity [of the sponsored foreign worker] are not assumed by the successor; e.g., where the successor does not assume the liability of pending or potential sexual harassment litigation, or other tort obligations unrelated to the job opportunity" extended to the foreign worker.

Unlike the informal agency guidance recognizing a successor's right to step into the predecessor's immigration-successorship shoes if only the "immigration-related" assets and liabilities are assumed, USCIS has now formally adopted a different test. The August 6 memorandum focuses not on immigration-related liabilities in general but rather on legal liabilities related to the particular job opportunity offered to the foreign worker.

Under the new USCIS interpretation, actual or potential pre-closing liabilities related to the predecessor's foreign-worker job opportunities such as claims of sexual harassment, discrimination, torts, or union grievances, if not assumed by the acquirer, could cause USCIS to deny successor-in-interest designation. This standard could spell trouble for deal makers if the seller employed legions of workers in the same occupation, say, software engineer, that also included foreign workers, and that position had become the subject of dispute, whether by a single plaintiff or in a class

Web Resources

Memorandum of Donald Neufeld, Acting Associate Director, Domestic Operations, USCIS, *Successor-in-Interest Determinations in Adjudication of Form I-140 Petitions; Adjudicators Field Manual (AFM) Update to Chapter 22.2(b)(5) (AD09-37)*, HQ 70.6.2, Aug. 6, 2009, *available at* http://tinyurl.com/yaej97k.

The USCIS August 6, 2009, memo is also analyzed in Angelo A. Paparelli, *USCIS Puts Silent Kibosh on Successorship in Interest for High-Achieving Immigrants*, Sept. 10, 2009, *available at* http://www.nationofimmigrators.com/?p=271; and Angelo A. Paparelli, *New Homeland Security Memo Poses Problems for M & A Deals*, N.Y. L.J. (Oct. 14, 2009), *available at* http://tinyurl.com/yfv9zc2.

The evolution of increasingly lenient eligibility requirements for immigration successorship by the INS and USCIS is

action suit. Buyers should be cautious in planning for acquisitions involving occupations in dispute that may require immigration successorship.

discussed in Angelo A. Paparelli, *Assuage Therapy—Enticing M & A Lawyers to Help with Immigration Successorship* (June 2008), *available at* http://tinyurl.com/yz5n8fz; and Alan Tafapolsky, Angelo A. Paparelli, A. James Vazquez-Azpiri and Susan K. Wehrer, *Thriving on Change: How to Solve Immigration Problems in Merger & Acquisition Deals*, in New Rules for the New Millennium (AILA 2001). These articles discuss immigration successorship in the context of nonimmigrant work visa categories and employment-based green-card classifications.

New Items for the M&A Checklist

The August 6 memorandum adds a variety of new paperwork requirements. To qualify as an immigration successor, the acquiring enterprise must be prepared to file an immigrant visa petition (on Form I-140) and submit a variety of documentary evidence, some of which may be unavailable. The petition must include proof that:

1. *The job opportunity offered by the successor is the same as the job opportunity originally offered by the seller.* The evidence must show that the job location, duties, and requirements are identical, although given the passage of time, USCIS will allow a higher rate of pay. The August 6 memorandum states that "[a] successor in interest claim will fail if the successor is requesting that USCIS accept any changes to the items specified on the labor certification that related to the labor market test." (A labor certification is issued by the secretary of labor upon the submission of proof by the employer, following a good faith recruitment effort, that no U.S. workers are qualified, willing, and available to fill the job offered at the locally prevailing wage to the foreign employee.) Rare is the deal, however, where after the dust settles the job duties of the seller's employees who continue working for the acquirer remain identical. Regrettably, the memorandum prevents any change related to the labor market test; substantial similarity of duties is insufficient.

2. *The job opportunity previously offered by the seller to the foreign worker in the labor certification application is continuously "valid" before and after the transaction closes.* This means that immigration successorship will fail if (a) the job at any time ceases to exist within either the selling or buying entity, (b) the seller ceases business operations before the closing, or (c) the seller (pre-closing) or buyer (post-closing) lacks the continuous ability to pay the wage offered in the labor certification. Since the seller's continuity of business operations and ability to pay the proffered wage must persist until closing, the acquirer's counsel should make sure that due-diligence efforts include the collection of evidence establishing uninterrupted business activities and financial viability. If either of these items of evidence cannot be established, then perhaps the buyer should walk away or pay less, since immigration successorship may be at risk.

3. *The acquirer has "fully describe[d] and document[ed] the transfer and assumption of the ownership of the predecessor by the successor."* USCIS suggests that the evidence required to document the transfer and assumption of ownership may include agreements of sale and acquisition, mortgage closing statements, SEC Form 10-K, audited financial statements of the acquired and acquiring firms for the year of transfer, business licenses, legal instruments used to "execute the transfer of ownership," and press releases or published reports describing the transaction. The evidence also should show that the acquiring entity has assumed liabilities associated with the jobs offered to foreign workers who seek to preserve immigration benefits through the acquirer's status as a successor in interest.

Differing USCIS Interpretations

The memorandum offers good news beyond its elimination of the *Dial Auto* test. The agency recognizes an informal practice that had saved many a small forest by eliminating multiple copies of identical documentation required to "prove up" the details of a large acquisition. Now, with the prior permission of the director of the particular USCIS Regional Service Center in the job location, a successor may submit one set of "consolidated evidence" even if the request for successor-in-interest designation covers multiple foreign workers (as long as a separate Form I-140 employment-based immigrant visa petition, along with evidence of the particular job opportunity, is submitted for each employee).

USCIS also accepts situations in which the acquirer may dispense with the filing of a new or amended Form I-140 immigrant visa petition:

- If the original petition was approved under the first preference "extraordinary ability" category or the second preference national-interest waiver procedure (other than for physicians in medically underserved areas), a new Form I-140 is not required. These categories permit self-petitioning by the foreign worker. Thus, because a sponsoring U.S. employer is not necessary to gain original approval, a change in corporate structure is thought irrelevant to eligibility.

- In a labor certification case, where the changed circumstances relate to matters that would not have affected the outcome of the employer's test of the labor market, then there is no need to request successor-in-interest designation. USCIS cites two examples: (1) the choice of a new entity name or the adoption of a new fictitious business name ("so long as the ownership and legal business structure of the petitioning employer remains the same") and (2) a change in the location of the foreign worker's job, as long as the new place of work is within normal commuting distance.

- The passage of time coupled with agency inaction may resolve some successor-in-interest cases without the filing of burdensome evidence of ability to pay or submission of voluminous deal documents, but merely with the successor's filing of a letter explaining the new job requirements and duties and demonstrating why the new position is in the same or a similar occupational classification. This dispensation arises in situations where the job flexibility ("portability") provisions apply, Immigration and Nationality Act § 204(j); 8 U.S.C. § 1154(j). Under this provision, a foreign worker may still be eligible for green-card status even if he or she changes jobs or employers by satisfying four conditions: (1) 180 days have elapsed from the submission of the green-card (adjustment of status) application, (2) the initial employer's Form I-140 petition has been or will be approved, (3) the adjustment of status application remains unadjudicated, and (4) the new job is in the same or a similar "occupational classification" as the originally sponsored position.

The good news in the August 6 memorandum is overshadowed, however, by two USCIS bombshells:

- Although the new instructions allow immigration successorship with "transfers in whole or in part" (thus allowing the spin-off of merely a business division), transactions that do not involve "a clearly defined business unit" are disqualified. USCIS offers the example of the sale of a patented chemical formula between two entities where the seller ceases production of the chemical and then fills its requirements by purchasing the product from the buyer. Successor-in-interest designation for immigration purposes is not allowed, according to USCIS, because the seller "merely sold the manufacturing rights for a given product to [the buyer] without the transfer of the other related assets located within its business unit." Time will tell whether USCIS will limit this interpretation to wholly unrelated entities. While the agency's view may be appropriate in "naked" sales of intellectual property rights between unrelated parties, there is no apparent justification for prohibiting related entities within a multinational family of companies from enjoying the benefit of immigration successorship in a business restructuring that involves an intra-family transfer of IP rights without necessarily effecting a spin-off of a particular business unit.

- The August 6 memorandum asserts (incorrectly, in the author's view) that "[s]uccessor-in-interest determinations are principally relevant to the continuing validity of a labor certification." USCIS then proceeds to repudiate 25 years of agency practice by denying successor-in-interest designation to two classes of "priority workers" under the employment-based first preference immigrant visa category for which it had been routinely available:

  > An employer seeking to classify the alien as an EB1 Multi-National Executive of EB1 Outstanding Professor or Researcher . . . must file a new I-140 petition and establish the alien's eligibility under the requested category's specific eligibility requirements.

USCIS has not explained why it views immigration successorship "principally" through the lens of the labor certification procedure. The agency and its predecessor, the Immigration and Naturalization Service, have long accorded successor-in-interest designation to a host of nonimmigrant work visa categories that are exempt from the labor certification requirement. Similarly, both agencies have historically granted the designation to the EB1 Multi-National Executive or Manager immigrant visa classification, a kissing cousin of the L-1 nonimmigrant visa (available to key workers who hail from a foreign affiliate) and often a second cousin to the E-1 and E-2 nonimmigrant visas (for managers, executives, and personnel with essential skills coming to serve treaty-protected enterprises).

The wholesale elimination of eligibility for immigration successorship under the EB1 Multi-National Executive or Manager and the EB1 Outstanding Professor or Researcher immigrant visa categories should deeply concern deal makers and their corporate counsel once its significance becomes apparent. What this means is that—without explanation—USCIS will likely deprive immigration transfer status to many of the highest of high achievers who make the deals worth doing.

When key intracompany managers and executives reapply for green-card benefits (because they

are viewed by USCIS as ineligible for successorship), they may no longer be allowed to invoke the same legal basis for eligibility as they enjoyed with the acquired company. Their former eligibility rested on the predicate that they brought invaluable expertise and knowledge from an affiliated entity abroad (which they gained in one of the last three years before entry to the United States as a nonimmigrant worker). After a restructuring, even if the former employer abroad and the U.S. employer are both acquired by the buyer, these key employees may be disqualified from EB1 eligibility if they are precluded from qualifying for successor-in-interest benefits. As a result, these workers may be required to find an alternative green-card category, if one is available (e.g., the labor certification approach could take more years than the manager or executive may be allowed to remain in the United States). Otherwise, these uniquely valuable employees may be required to leave the United States and take their experience and talents with them.

The situation for EB1 Outstanding Professors and Researchers swept up in a corporate restructuring may not be much better. If denied eligibility for immigration successorship, they will be required to assemble fresh evidence to demonstrate "sustained" outstanding achievement, something that may be impossible if their work is subject to trade-secret and nondisclosure restrictions. They also will likely face the subjectivity in decision making that arises when a different immigration officer makes a qualitative assessment of the individual's accomplishments. Since there is no res judicata effect accorded to a prior officer's determination of "outstanding" achievement, a new Form I-140 petition under this category could conceivably be denied. The daunting challenge, then, might be the same as for the Multi-National Executive or Manager: find another suitable employment-based green-card category, if one is available, or leave the country with your brains and talent.

Conclusion

USCIS is wrong to proclaim in a memorandum drafted without stakeholder consultation that only certain foreign workers whose employers are involved in new business combinations (those holding labor certifications) are allowed to continue their pursuit of permanent residence in the United States while other noncitizen employees (likewise affected by corporate restructurings, but in different immigrant visa categories) are precluded.

USCIS should not limit eligibility by a wooden view of immigration successorship while proclaiming an intention to adjust to changing business practices. The memorandum speaks a good game, but the agency's newfound flexibility is difficult to discern. If the transfer of vital human assets in a corporate restructuring is to continue, the business community and the corporate and immigration bars must advocate for a commonsense and workable regulation of successorship. They can do this in one of three ways: legislative advocacy in Congress and the White House, a request for rule making, or litigation against USCIS.

What Every Lawyer Needs to Know About Corporate Immigration Issues

Audio CD Package

In today's global economy, immigration laws have ever greater impact on U.S. and foreign-owned businesses. Companies that fail to follow immigration compliance laws have recently been subject to raids and civil and criminal liability. This program is designed to raise awareness of the areas where business law and immigration law intercept.

Paparelli is a partner in Seyfarth Shaw LLP, practicing in Southern California and New York. His e-mail is apaparelli@seyfarth.com.

 © 2012 ABA, All Rights Reserved

Business Law Today

Volume 19, Number 3 January/February 2010

Reining in directors and officers in corporate America

In Delaware, the answer is not to expand their personal liability

By Dominick T. Gattuso and Vernon R. Proctor

The recent corporate and financial scandals and the ensuing economic turmoil have led some people to question whether directors and officers of public corporations should be exposed to greater risk of personal liability as a means of curbing what they perceive as excessive risk-taking by these corporate managers. Indeed, some have even called for the federalization of this and other related aspects of state corporate law, arguing that the states, and Delaware in particular, have not acted aggressively to hold corporate managers accountable.

In point of fact, Delaware's legislature and its courts have responded to the call to rein in directors and officers, albeit in a balanced, pragmatic manner that embodies a deep understanding of both the practical limitations facing directors and officers of publicly held corporations and the need to encourage investor confidence.

The General Assembly's Response

The Delaware General Assembly did not expand the personal liability of directors and officers for fiduciary violations by narrowing the robust statutory protections afforded to directors under section 102(b)(7) of the Delaware General Corporation Law (the DGCL), which protects directors from personal liability for money damages for violations of their duty of care; section 141(e), which protects directors' good faith reliance on the reports of experts and management; or section 145, which provides directors (and officers) with statutory indemnification and advancement rights.

However, in 2009, the general assembly amended the DGCL in several material respects to provide shareholders with additional checks on the power of directors and officers. Newly added sections 112 and 113 provide shareholders of Delaware corporations with greater access to the ballot box. For example, under section 112, the company's bylaws may be amended to require

shareholder nominees for board seats to be included in the company's proxy materials. The bylaws also may be amended to permit shareholders to seek reimbursement for proxy solicitation expenses, pursuant to section 113. Next, the general assembly addressed "empty voting" by revising several sections of the DGCL, including section 213(a). As amended, section 213(a) allows a board to establish a record date for determining those shareholders entitled to notice of a meeting and a later record date for ascertaining those shareholders entitled to vote at the meeting. Finally, and perhaps most interestingly, newly added section 225(c) authorizes the Court of Chancery to remove a director who failed to act in good faith, if his or her removal is necessary to avoid irreparable injury to the company. A section 225(c) claim may be brought derivatively or directly. These amendments, coupled with existing provisions of the DGCL, potentially provide shareholders with substantial power to remove corporate directors and officers who cause the company to act in a manner that the shareholders deem excessively risky.

The Delaware Court's Response

Like the general assembly, in recent years the Delaware courts have made a conscious decision not to alter the standards of conduct for directors and officers and, thereby, expose them to greater risk of personal liability. Instead, the courts have clarified the standards for evaluating director and officer conduct, while reaffirming that the business judgment rule remains an integral component of the state's corporate jurisprudence. For example, in *In re Emerging Communications Shareholders Litigation*, 2004 WL 1305745 (Del. Ch. May 3, 2004, revised June 4, 2004), Justice Jacobs, sitting on the Delaware Court of Chancery by designation, ruled that a director had violated his fiduciary duty of "loyalty and/or good faith" by voting to approve a merger transaction because he possessed special financial expertise and knowledge of the industry and, therefore, knew, or should have known, that the merger price was unfair. The director's refusal to speak out against the fairness of the merger was explainable by one of two mindsets: either the director made a deliberate judgment to further his own personal business interests by voting in favor of the deal, or he "'consciously and intentionally disregarded' his responsibility to safeguard the minority stockholders from the risk, of which he had unique knowledge, that the transaction was unfair." Several scholars and practitioners read the decision in *Emerging Communications* as providing for a heightened standard of conduct for directors with special expertise in a particular area (e.g., finance, accounting, law), thereby exposing this subgroup of directors to greater personal liability for a fiduciary violation. However, a more nuanced reading of *Emerging Communications*, and one that is supported by dicta in *In re Citigroup, Inc. Shareholder Derivative Litigation*, 964 A.2d 106 (Del. Ch. 2009), is that directors possessing specialized knowledge or expertise will be held to the same standard of conduct as any other director, though they may lose the protection afforded by section 141(e) of the DGCL if they are unable to rely in good faith on the report of an expert or management. Thus, it is not the director's special expertise that gives rise to a greater risk of personal liability, but the inability to take advantage of the section 141(e) safe harbor.

Two years after *Emerging Communications*, in *In re Walt Disney Co. Derivative Litigation*, 906 A.2d 27 (Del. 2006), the Delaware Supreme Court reaffirmed the significant protections afforded to Delaware directors by the business judgment rule and offered "conceptual guidance" on the duty to act in good faith, explaining that "fiduciary action taken solely by reason of gross negligence and without any malevolent intent" does not constitute bad faith. Rather, to establish that a director failed to act in good faith, a plaintiff must show something more, such as "fiduciary conduct motivated by an actual intent to do harm [i.e., subjective bad faith]" or "a conscious disregard for one's responsibilities . . ." Importantly, these are but two examples of bad faith. As the court explained, "[t]here may be other examples of bad faith yet to be proven or alleged . . ." A few months later, in *Stone v. Ritter*, 911 A.2d 362 (Del. 2006), the Delaware Supreme Court explained that, where an independent director is accused of failing to satisfy his or her oversight duties, fiduciary liability will not result ipso facto from a failure to act in good faith, and that there is no separate fiduciary duty of good faith. Rather, liability will attach only upon a showing that the director breached his or her duty of loyalty by "intentionally fail[ing] to act in the face of a known duty to act, demonstrating a conscious disregard for his [or her] duties." *Stone*, like *Disney*, reaffirmed Delaware's commitment to retaining the robust protections afforded to directors and officers under the business judgment rule.

Nor has the recent meltdown in the capital markets altered Delaware's view on oversight duties, the application of the business judgment rule, or the expansion of personal liability, as evidenced by three key decisions from the Delaware courts in the first three months of 2009. In *Lyondell Chemical Co. v. Ryan*, 970 A.2d 235 (Del. 2009), the Delaware Supreme Court reversed the trial court's decision, finding that imperfection of process in a sale transaction was not synonymous with bad faith. The class plaintiffs alleged that Lyondell's independent directors breached their fiduciary duty by failing to be actively involved in the process of selling the company to Basell AF. Lyondell's directors moved for summary judgment, arguing that their inaction amounted to a breach of the duty of care, at most, and that they were exculpated from liability under the section

102(b)(7) provision in the company's charter. The chancery court denied the summary judgment motion, even though the directors had no conflicts, were independent, had met several times to consider options, received a fairness opinion, relied on the advice of financial and legal advisors, and obtained a 45 percent premium over the market price. The court reasoned that a more developed record was necessary to determine whether the directors intentionally disregarded a known duty to act in accordance with the sale process envisioned by *Revlon* and its progeny, characterizing the directors' approach as one of "slothful indifference" and "do nothing, hope for an impressive-enough premium, and buy a fairness opinion . . ." However, in a sharply worded decision, the Delaware Supreme Court reversed, holding that a flawed effort to satisfy one's fiduciary duties is not bad faith conduct sufficient to breach the duty of loyalty. Such a breach exists only where directors "knowingly and completely fail[] to undertake their responsibilities . . ."

The Court of Chancery has been forthright in determining when the allegations of a complaint are sufficient to deprive defendant directors of a limited liability shield. Consider the recent decision of Vice Chancellor Strine in *American International Group, Inc. Consolidated Derivative Litigation*, 965 A.2d 763 (Del. Ch. 2009). In *AIG*, the court addressed a complaint containing a detailed description of an integrated and multifaceted financial fraud that, in its view, amounted virtually to a "criminal enterprise." Specifically, the court determined that allegations of fiduciary misconduct against the chief executive officer of AIG (Greenberg) and members of his "inner circle" were sufficiently detailed to survive the "plaintiff-friendly" pleading threshold imposed by Rule 12(b)(6). The court's opinion was focused principally upon the allegations concerning two members of the "inner circle," Matthews and Tizzio, who were at top levels of AIG management and intimate colleagues of Greenberg. In a nutshell, the pervasive scheme described by the plaintiffs included "transactions designed to hide AIG's true financial situation, illegal schemes to avoid taxes, selling illegal financial products to other companies, and schemes to rig markets." The harms allegedly incurred by AIG included the payment of $1.6 billion in fines and penalties, $440 million in settlement payments, $800 million in disgorged profits and penalties, and the restatement of financial statements to the tune of a $3.5 billion "hit" to shareholders' equity.

The court found that this was one of the relatively rare pleadings that stated a claim for relief under the "duty of oversight" rubric: "[T]he complaint pleads details about the fraudulent schemes that, when taken with the pled facts regarding Matthews' and Tizzio's roles at AIG, support the inference that they knew of and approved much of the wrong-doing." Put differently, the allegations were more than sufficient to support an inference of "conscious disregard" and other bad faith conduct for purposes of *Stone* and related cases. The court also noted that "for present purposes, it is inferable that even when Matthews and Tizzio were not directly complicitous in the wrongful schemes, they were aware of the schemes and knowingly failed to stop them."

In the limited liability context, the Court of Chancery has expressly recognized the close interplay between the business judgment rule and managerial risk taking. In *In re Citigroup Inc. Shareholder Derivative Litigation*, 964 A.2d 106 (Del. Ch. 2009), the shareholders of one of America's largest financial services companies filed a derivative action against the directors and officers of the company, alleging primarily that the defendants had breached their fiduciary duties by failing to provide oversight of management with respect to Citigroup's exposure to deteriorating conditions in the subprime mortgage market. Specifically, the plaintiffs alleged that the directors had ignored certain "red flags" that, in the plaintiffs' view, should have alerted the board to those problems and the attendant need to provide for adequate financial reporting and controls. The Court of Chancery dismissed almost all of the plaintiffs' claims for failure to comply with the demand requirements of Rule 23.1. The court noted that, in contrast to the usual corporate oversight claim, the Citigroup plaintiffs' "claims are based on defendants' alleged failure to properly monitor Citigroup's *business risk*, specifically its exposure to the subprime mortgage market."

The Court of Chancery, in *Citigroup*, essentially found that, under the guise of such traditional oversight claims, the plaintiffs were actually attempting to hold the defendant directors liable "for making (or allowing to be made) business decisions that, in hindsight, turned out poorly for the Company." The plaintiffs' pleadings were fatally undercut by the lack of specific allegations raising a reasonable doubt that the director defendants had acted in good faith: the court noted that the plaintiff did not even allege such basic elements of bad faith conduct as "how the board's oversight mechanisms were inadequate or how the director defendants knew of these inadequacies and consciously ignored them." The court rejected the plaintiffs' invitation to accept their post hoc reasoning that the corporate losses were attributable to breaches of fiduciary duty. In the chancellor's view, a different result would have effectively straitjacketed the directors of Citigroup and other Delaware corporations in the proper and reasonable exercise of their business judgment: "Citigroup was in the business of taking on and managing investment and other business risks. To impose oversight liability on directors for failure to monitor 'excessive' risk

would involve courts in conducting hindsight evaluations of decisions at the heart of the business judgment of directors. Oversight duties under Delaware law are not designed to subject directors, even expert directors, to *personal liability* for failure to predict the future and to properly evaluate business risk." The court was evidently concerned that a stricter standard would have deterred board efforts to maximize shareholder value.

Delaware's reluctance to expand the personal liability of directors for fiduciary violations is an acknowledgment that directors are not omniscient. Nor can they be, given their role in the corporate enterprise, as the Delaware Supreme Court acknowledged in *Stone*: "the directors' good faith exercise of oversight responsibility may not invariably prevent employees from violating criminal laws, or from causing the corporation to incur significant financial liability, or both . . ." Indeed, that oversight role is more suited to corporate officers who are responsible for managing the day-to-day affairs of the corporate enterprise. And, under Delaware law, it is those individuals that bear the greatest risk of personal liability for fiduciary violations. Though corporate officers owe the same fiduciary obligations as directors, they do not benefit from the full spectrum of statutory and common law liability protections available to directors, as the Delaware Supreme Court recently acknowledged in *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009). This is not surprising, nor is it unwarranted, given that senior management typically have effective daily control of the company's operations and, thus, are in a much better position to monitor the activities of employees.

The Correct Response

Arguably, Delaware's measured response to the call for expanding the personal liability of directors and officers reflects a balancing of the need for good corporate governance with the realization that an appropriate level of risk is necessary for continued economic growth. Recognizing the bedrock principle of separation of ownership from management, Delaware's corporate law scheme, as construed by the courts, fosters investment in the corporate enterprise while allowing corporate directors and officers considerable flexibility to manage business risk and opportunity in order to maximize shareholder value. The limited liability protections for directors, officers, and stockholders are not absolute: normally, the business judgment rule is the "default rule," but stricter scrutiny will be applied by the courts if circumstances warrant. Even in these turbulent economic times, the process still works, and care should be taken to avoid stifling prudent risk taking in the name of enhancing investor protection.

Gattuso is special counsel and Proctor is a partner with Proctor Heyman LLP, Wilmington, Delaware. The authors practice in the areas of corporate, alternative entity, and commercial litigation. Their views expressed herein do not necessarily represent the views of Proctor Heyman LLP or the firm's clients. Their respective e-mails are vproctor@proctorheyman.com and dgattuso@proctorheyman.com.

 © 2012 ABA, All Rights Reserved

Follow ABA

Ad

Business Law Today

Volume 19, Number 3 January/February 2010

Representing independent directors after Sarbanes-Oxley

The growing role of independent counsel

By James M. Lyons

Seven years have passed since Congress enacted the Sarbanes-Oxley Act (SOX). SOX was the result of highly publicized hearings conducted by both houses of Congress in the aftermath of the scandals involving fraud and mismanagement at such major U.S. companies as Enron, Tyco, Adelphia, and WorldCom. Hailed as a landmark and comprehensive legislative scheme, SOX was intended to reform corporate governance and behavior, increase the standards of accountability for the accounting profession, and ensure the reliability of financial statements of public companies. An independent accounting oversight board was created, auditor independence mandated, corporate governance and responsibility standards strengthened, and financial accuracy obligations imposed on senior management of public companies. In 11 titles, Congress addressed what it perceived to be the corporate governance and auditing shortcomings that had contributed to the scandals culminating in the bankruptcy of Enron.

Title III put specific obligations on public companies for financial reports and set standards for audit committee independence and responsibilities. The audit committee was required to appoint, set compensation for, and oversee the company's auditors, and the auditors were required to report to the audit committee. Audit committee members were required to be members of the board of directors and be independent (i.e., have no direct or indirect affiliation with the company other than serving on the board of directors and the board's committees). Finally, the audit committee was required to establish procedures to handle accounting complaints including complaints from confidential, anonymous employee sources.

Section 301 of Title III also empowered the audit committee to engage counsel and other outside experts at the company's expense and in its sole discretion. This appeared to herald a new function for outside counsel in advising and assisting directors of public companies to meet their responsibilities to shareholders, regulators, and the public. In fact, section 301 and this newly

created statutory authority largely recognized and codified existing best practices and procedures. Outside experts, particularly lawyers, have been employed for many years by the boards and the audit committees of boards of public companies in a variety of settings.

Functions of Independent Counsel

Corporate independent counsel have served four distinct functions. First, they have been counsel or special committees empowered by statute or corporate bylaws to investigate and determine the merit of derivative claims asserted by shareholders in the company's name. Second, independent counsel have been engaged by public companies, their boards, or committees to conduct internal investigations in a wide variety of circumstances where corporate misconduct has been alleged and independent investigation is warranted, either in connection with regulatory or other inquiries, or where criminal violations or civil claims have been or may be asserted. These investigations often present complex questions of attorney-client privilege, attorney work product, and confidentiality.

Third, outside counsel have been regularly employed to represent independent directors of public companies where transactions involving management (e.g., leveraged buyouts) are contemplated or in merger and acquisition transactions where management's interest may be different from that of the corporation. Typically, an independent committee of the board is formed consisting of members with no ongoing interest in the transaction. These independent committees are formed on an ad hoc basis, are represented by independent counsel, and rely on advice as to the fairness of the transaction from a financial point of view from a disinterested investment banking firm or other financial expert. They not only are established for acquisitions but also can act to consider corporate decisions to sell assets or businesses or otherwise restructure the company. Again, key decisions can be made by members of the board who are disinterested in the transaction and therefore require independent financial and legal advice.

Finally, outside counsel have been routinely engaged to deal with legal issues for the corporation or its board when the office of the general counsel may be conflicted by relationships to, or involvement in, corporate activities that have been called into question. For example, corporate general counsel increasingly take on nonlegal duties in management or corporate administration. Wearing these multiple hats can create a need or preference for advice to the board from outside counsel who is independent and without other entanglements that might affect or appear to affect independent judgment. Independent counsel also should be considered when a merger or acquisition triggers a change in control. Under these circumstances, senior management, including the general counsel, may have accelerated financial benefits (e.g., stock options) that create a substantial financial interest in the outcome of the transaction.

SOX and In-house Counsel

SOX imposed new responsibilities that directly affect in-house counsel. For example, section 307 requires those attorneys "appearing and practicing" before the SEC to report evidence of material violations of securities law or breach of fiduciary duty or similar violations by the company or its agents to the chief legal counsel or chief executive officer of the company. If the response of the chief legal counsel or CEO is not "appropriate to the evidence," the lawyer is then required to report the matter to the audit committee of the board of directors, to another committee of independent directors, or directly to the board of directors.

The SEC rules implementing section 307 specifically allow, but do not require, the attorney to reveal confidential information to the commission without the company's consent if the attorney reasonably believes it is necessary to prevent the commission of a material violation, perjury, or a false statement proscribed by 18 U.S.C. § 1001. Disclosure to the commission also can be done to rectify the consequences of a material violation by the company that caused or may cause substantial injury to the financial interests of the company or its investors. In a preemption-like maneuver, the SEC rules specifically provide that, where the standards of a state or other U.S. jurisdiction where an attorney is admitted or practices conflict with these rules, SEC rules govern.

Independent Counsel and Corporate Governance

While Congress increased the responsibilities of in-house counsel, it also established a specific place for outside counsel in audit committee functions, responsibilities, and outcomes. Section 301(5) contains a simple but empowering sentence: "Each audit committee shall have the authority to engage independent counsel and other advisors as it determines necessary to carry out its duties."

The law also directs each public company to provide appropriate funding as determined by the audit committee for the payment of compensation to any advisors employed by the audit committee under paragraph (5).

Before SOX, the duties of an audit committee were both broad and specific. The audit committee was charged with reviewing the company's financial performance, public financial reports, budgets, and internal controls. In section 404, SOX took those responsibilities a big step further by mandating that an annual report contain a yearly assessment of the effectiveness of the internal control structure and procedures of the company for financial reporting. Audit committees, working with the company's internal auditors and the company's outside auditing firms, are thus required to develop a thorough and comprehensive process to review internal controls of the company in order to make a meaningful and credible annual internal control report. Independent counsel can be of value here in advising the audit committee on the institution of section 404 testing, monitoring, and correcting procedures for internal controls and improvements in such chronically difficult areas as cash accounts and wire transfers.

About nine months after SOX was enacted, the ABA Task Force on Corporate Governance issued its report recommending corporate governance policies. This followed an earlier report by the Task Force on Corporate Responsibility that had recommended that both the audit committee and the compensation committee should be authorized to retain independent counsel.

Post-SOX commentary has been instructive but not uniform. Professors Hazard and Rock addressed the issue of outside directors retaining independent counsel in their article "A New Player in the Board Room: The Emergence of the Independent Directors Counsel," 59 BUS. LAW. 1389 (2004). The professors not only endorsed the notion of independent board counsel for the retention and termination of a CEO but predicted that the requirements of SOX would "lead to the emergence of counsel for the independent directors" and "a new player in the board room." In the same publication, however, former Chief Justice Norman Veasey of the Delaware Supreme Court opined that independent directors' counsel should be limited to those situations where a "real need to assist and counsel independent directors" existed and that use of independent counsel on a "generalized or continuing basis" might not provide a cost benefit, would not advance constructive board skepticism (of management), and could lead to "unnecessarily contentious board rooms."

For those of us who have dealt with the situations in real boardrooms and committees, the answer lies somewhere in the middle and is, of course, situation driven. For example, it is common for general counsel to recognize the discomfort, if not conflict, in dealing with CEO hiring or termination and welcome, if not insist on, outside counsel being retained to advise the compensation committee as well as the board. On other matters of corporate governance and good practice, such as annual board and committee peer evaluations and reviews, outside counsel can be an independent facilitator and honest broker who is not bound to the company or senior management. This does not seem to create undue boardroom contention but actually may serve to avoid it. Think, for example, of a situation where board members are privately critical of the members of the compensation committee for being unduly generous and not sufficiently demanding of management performance. Or consider where an entire compensation committee or board is prone to lax performance metrics for pay of its senior officers. Is a general counsel really going to feel comfortable in challenging the person or persons who set his or her salary and bonus for the coming year? Isn't this a better position for independent outsiders to give advice to the board? And can't shareholder and public confidence be enhanced at a reasonable cost?

Another example in this area is the so-called shareholder say-on-pay movement of recent years. Here, shareholders of major public companies demand the right to either ratify or vote on severance packages for senior executives that exceed multiples (e.g., three times) of base executive pay and benefits. (Congress in the new economic stimulus package is currently suggesting a similar concept for companies that take TARP funds.) Generally speaking, general counsel and other senior management have employment contracts that contain severance packages that could fall within this range and might well be the subject of a shareholder proposal in the proxy statement and a stormy session at the annual meeting. Are the compensation committee and the board better served on these matters by in-house counsel with an obvious interest in the outcome or experienced public company compensation consultants and independent counsel retained for this purpose? And, in the end, can one truly question if the modest cost was worth the benefit?

Uses of Independent Counsel

Since SOX, practices have also developed and evolved within the corporate world to use independent counsel for traditional roles as well as expanded SOX roles. Independent counsel can be useful in several areas. First, they can review company-prepared draft minutes for the board and its committees to ensure completeness and accuracy and, where appropriate, make sure questions and concerns raised by members of the board with management are recorded. I do not suggest transcript-like minutes, recording everything said by everyone for page upon page. (Can you imagine the depositions of the directors as they are tediously taken line by line through minutes of meetings years ago and their individual and conflicting recollections compared?) Nor do

I recommend minutes that simply state that "discussion was held" and then record the vote; there is little of defensive value here. Again, a middle ground will serve the purpose of recording the significant issues raised and the directions given by the board to senior management. For example, assume the audit committee is presented with a finding of material weakness or substantial deficiency in an internal control by the outside auditors. A statement in the minutes that identifies the specific problem area, articulates an understanding of the issues presented, and records the direction of the audit committee to address and resolve them will establish diligence, good faith, and business prudence in what are often arcane and complicated accounting matters. A simple review of the minutes at the next meeting provides a checklist for follow-up by the committee or board and an opportunity to discharge its duties in this regard. And, of course, these statements can be particularly useful in future litigation where board members are called upon to demonstrate their diligence and business judgment in complicated discussions that occurred years earlier.

Second, independent counsel can prepare and maintain minutes or notes of executive sessions of the board. Privilege questions are raised here, too, but an argument can be made that legal advice sought or given in these sessions is to the independent members of the board as a group and not as individuals. This would allow a further argument that the group, not the entire board (or company), is the client. Bear in mind that these notes may well be discoverable and not protected by the work product doctrine unless litigation is either pending or reasonably contemplated at the time.

Third, independent counsel can review annually the company's code of conduct and committee and board charters to ensure continuing compliance with corporate governance best practices and ongoing improvement in board governance performance. Fourth, they can review the company's quarterly earnings reports and annual reports, especially for Legal Proceedings and Management Discussion and Analysis. The purpose here is not to duplicate the work of the general counsel or outside disclosure counsel but to ensure that two often potentially troublesome areas (other than the accounting footnotes) are reviewed by another pair of eyes representing only the interests of the board and not the company.

Yet another value of independent counsel to the audit committee is to serve as a kind of lifeguard to observe the meetings of the committee and its interactions with management, internal auditors, outside auditing firms, and the company's compliance and ethics officers. A savvy audit committee regularly questions internal and external auditors to assure themselves that the auditing plan is reasonable and thorough, that the key areas of the company's business are in fact being reviewed and tested, and that the internal auditors have adequate resources and staff to do the job. Most critically, the audit committee must be attentive that senior management has set the right tone at the top. This is to ensure proper audit cooperation and scrutiny and that the highest ethical standards consistent with the company's code of conduct are maintained. Too often in the past, companies have fallen victim to the pressure to make the numbers, particularly in down economic times. Corners can get cut and important safeguards overlooked or circumvented. Securities fraud is often the result of people trying to do what they thought was expected of them or trying to keep their jobs by meeting unrealistic expectations. The vigilance of the audit committee needs to be even greater in tough times, and independent counsel can provide an effective outside aid to the committee in meeting their growing responsibilities to shareholders, regulators, and the public.

The advantage of independent counsel is enhanced by a background and ongoing relationship that gives the independent counsel familiarity with the corporation, its management, business, and operations. This creates a continuity with issues that have been addressed previously by the board or its committees. A good working relationship with the in-house legal and compliance departments is required but takes time to develop. Care must be taken, however, to ensure and maintain this independence, and other relationships or representation of the company or its employees should be generally avoided.

Finally, independent counsel, within the context of section 301 and otherwise, provides an additional level of insurance to members of the board. It is well established that board members may reasonably rely on management, advice of in-house counsel, auditors, and other experts in meeting their fiduciary responsibilities and satisfying the business judgment rule. Advice from independent counsel provides yet another level of protection or insurance that board members would be well advised to employ.

Conclusion

In conclusion, the role of independent director counsel after SOX continues to develop and grow toward a greater use of such counsel to represent independent members of corporate boards and board committees. Conditions and circumstances calling for such representation obviously change

from case to case and, at least so far, have not resulted in a standard operating procedure where such independent counsel become, in effect, shadow general counsel for the corporation. Given the statutory mandate of section 301 for audit committees' retention of outside experts, however, it would certainly behoove audit committees specifically and boards of directors generally to consider the additional protection and advice that independent directors' counsel can provide to the ever-increasing array of complex legal problems and responsibilities of boards of public companies.

Additional Resources

For more reading on a similar topic, you can retrieve the following article on the *Business Law Today* website at www.abanet.org/buslaw/blt. All issues since 1998 may be accessed under the "Past Issues" heading at the bottom of the web page.

> **In re The Walt Disney Company derivative litigations**
> *A new standard for corporate minutes*
> By Cullen M. "Mike" Godfrey
> *Business Law Today*
> July/August 2008
> Volume 17, Number 6

Lyons is a partner at Rothgerber Johnson & Lyons LLP in Denver. His e-mail is jlyons@rothgerber.com.

 © 2012 ABA, All Rights Reserved

Ad

Business Law Today

Volume 19, Number 3 January/February 2010

Negotiating the loan commitment

The borrower's perspective

By John N. Oest

As credit markets rebound, companies will increasingly seek financing for their businesses. Financing may take many forms: revolving credit loans, loans to finance the acquisition of a target company, or construction loans, to name a few. Loans may be short- or long-term, may fully amortize, or may have a balloon maturity date.

This article stresses the critical importance of the initial steps when approaching a loan commitment and outlines effective approaches for a borrower negotiating a commitment for the most common type of credit agreement: a facility that the company will use for most of its credit needs. Common components of such a facility will include (1) an agreement to borrow and repay loans from time to time for use as the borrower's working capital; (2) an agreement for an amortizing term loan, often for capital items such as equipment purchases; and (3) an agreement by which the lender agrees to issue letters of credit to third parties as requested by the borrower, typically suppliers to the borrower. These loans will almost invariably be secured by most, if not all, the property of the borrower.

Negotiate Critical Terms Before Signing

Loan agreements are always one-sided in favor of the lender. No matter how persistent the borrower, the final documents will impose numerous covenants and restrictions on the borrower and afford the lender a wide range of rights. It is important for any borrower to be realistic about what it can hope to achieve.

The borrower's most important strategy, by far, is to negotiate critical loan provisions before it signs the commitment, not after. Never forget that what the lender is selling is fungible: money. At the commitment stage, the borrower may actually or purportedly be negotiating with other lenders. This is the moment when the loan officer will be the most flexible in order to get the loan

in the door. It is important that the borrower recognize this and negotiate its wish list early before signing anything or making any kind of deposit. Engaging counsel is also critical. Many a borrower has lived with an oppressive loan agreement because its lawyer arrived only in time to review final loan documents, which by then memorialized a deal cast in stone.

Who Is Committed to What?
A loan commitment is like any other contract: a binding agreement enforceable in accordance with its terms.

A borrower often relies heavily on the lender's funding commitment. An existing loan might be maturing. The borrower may have signed a contract to purchase a company or a piece of land, and the closing date is rapidly approaching. The borrower can never have complete assurance that the lender will close the loan when needed because of various conditions precedent that the borrower must meet. But there are still several ways to mitigate this risk.

Loans, particularly large loans, are frequently syndicated--meaning that an arranger will act as the lead for a consortium of lenders. Loan commitments often condition the lender's obligation on its ability to assemble such a syndicate, but this condition should be resisted. The borrower cannot control the syndication process and does not want to discover at the 11th hour that the lead lender's syndication efforts were unsuccessful. The borrower should insist that the lead lender bear the risk (if it can legally do so within its lending limits) of its failure to syndicate, perhaps initially funding more than it might like but retaining the right to syndicate the rest later. If need be, the early addition of a second lender might enable the two to fund the facility within regulatory limits.

It is critical to obtain lender preclearance of problems or bad facts. Such matters may include pending litigation, title issues on real estate, environmental conditions, or important clauses in critical contracts (such as employment or supply contracts). The borrower should front-end these issues for several reasons: first, to establish its credibility with the lender; second, to obtain preapproval if possible; and, finally, to give everyone time to solve them should that be required.

The borrower also should seek to delay paying the commitment fee until closing. If this is not achievable, the borrower should negotiate for the right to a refund of the fee if the loan fails to close for any reason other its own willful default. This means the borrower will be exposed (and ought to be exposed) to loss of the commitment fee if it simply finds another loan it prefers. On the other hand, if the loan does not fund because of any of the escape hatches in the loan commitment, the borrower should receive a refund. The borrower will need to concede that the lender can deduct from the refund its reasonable out-of-pocket expenses to third parties, such as lawyers and appraisers. Any fees that are deposited should bear interest for the benefit of the borrower.

Loan commitments typically have a drop-dead date after which the lender need not fund for any reason. In addition to negotiating a commitment fee refund in such an instance, consider requesting extension rights, even if such extensions come at a price.

Most borrowers incorrectly view their commitment as an option to borrow if the borrower so chooses. Most well-drafted commitments, however, will contain language something like the following: "Lender agrees to lend to Borrower, *and Borrower agrees to borrow from Lender*, the full amount of the Loan." Borrowers have been successfully sued by lenders for failure to close loan transactions. The commitment letter should recite that forfeiture of the commitment fee is the sole and exclusive remedy of the lender against the borrower for failure to close the loan.

Negotiating at the Commitment Stage
From the borrower's perspective, the entire set of loan documents would be negotiated before it signed anything. This result is rarely obtainable or even desirable, however, because the parties want to determine whether they can sketch even a broad outline of their agreement before undertaking the additional legal and due diligence expenses attendant to closing a loan. The issues that should be negotiated up front will vary from transaction to transaction, so the following items should not be viewed as the definitive list. All are important enough, however, to warrant serious early consideration.

Financial Terms
The basic financial terms must always be spelled out. These terms would include:

- The amount that may be borrowed.

- The applicable interest rates. Any fixed rate of interest should be stipulated. If the rate will vary, specify the underlying index. For a "prime-based" loan, specify whether it is based on the lender's

"announced" prime rate or a widely quoted rate from some other major financial institution.

- The maturity date of the loan.
- Any rights to extend the maturity date and the conditions for doing so. Be sure the lead time required is not too onerous.
- A description of the fees and their due dates. When will fees be deemed to have been earned? Can the bank's outside legal fees be capped, or at least estimated?
- Financial covenants such as debt service coverage ratios, tangible net worth requirements, or capital expenditure limitations.
- Calculation of interest. On what basis will interest be calculated? For example, will it be based on a 365/6-day calendar year, a 360-day year of equal 30-day months, or some other convention?

Loan Availability
Almost all commercial credit facilities are secured by personal property of the borrower: typically accounts receivable, equipment, and inventory. The lender will want a cushion for each collateral class and will agree to lend only against pre-agreed percentages of eligible collateral. Further sublimits are common. A typical lending formula for a $10,000,000 loan might read as follows: "85% of Eligible Accounts (but in no event more than $6,500,000) plus 70% of Eligible Inventory (but in no event more than $2,500,000) plus 70% of the value of Eligible Equipment (but in no event more than $1,000,000)."

The definitions of items such as "Eligible Accounts" can be a trap for the unwary. Lenders have legitimate reasons for limiting the kinds of accounts they will consider eligible. Accounts due from affiliates or an overconcentration of accounts from one supplier are but two types of accounts that might be defined as ineligible. There is no substitute for having the borrower's chief financial officer obtain, at the earliest possible stage, the lender's definitions and formulas, then computing how much the company will be able to borrow. Borrowers often realize too late that the actual loan proceeds to be delivered into their hands at closing will be insufficient.

Prepayment Rights
Borrowers commonly assume that there is no problem if the commitment (and the loan documents) is silent on prepayment. Unfortunately, prepayment may be a big problem. Various courts have held that, absent a specific right to prepay, a commercial lender is entitled to the benefit of its bargain—payment of the agreed-upon rate of interest over the agreed-upon period of time. The solution is obvious: insist on an express right to prepay at any time, in whole or in part, and without penalty or premium.

Lenders often resist this request, however, and insist on prepayment restrictions because if a borrower prepays in a declining-interest-rate environment, they will be forced to relend their repayment proceeds at a lower rate. These restrictions can range from outright prohibitions (termed "lock-outs") to requirements that the borrower pay premiums based on yield-maintenance formulas designed to ensure the lender's profit on the loan. The yield-maintenance premium is often based on the difference between the interest rate under the loan and the yield the lender would receive on reinvesting the prepaid amounts in a U.S. treasury security of comparable duration.

A borrower wants to shorten any lockout period and/or seek to minimize the amount payable under a yield-maintenance provision. One way to do the latter is to ask that the yield-maintenance formula use the treasury rate "plus 50 basis points" (or some other number) as the measuring point rather than simply the treasury rate. The lender is often lending at a rate 125 to 150 basis points above treasuries so its yield on the reinvested prepayments will likely be higher than the treasury rate. This compromise still permits the lender to recoup lost profits, but it also presumes that the lender will be able to deploy its funds at something above the flat treasury rate.

Most mortgages permit, and some require, that condemnation or casualty proceeds be applied to pay down the debt. If the borrower is forced to retire debt early because of a catastrophe such as a condemnation or casualty, it should not suffer the further indignity of a prepayment penalty. Most lenders will grant this exception.

Escrows
Lenders often require a borrower to escrow funds in an account (often called an "impound account") to assure that certain periodic payments are made: typically, real estate taxes and insurance premiums. These accounts are initially funded with a lump-sum deposit at closing, either from the borrower's existing funds or from loan proceeds, then augmented periodically. Withdrawals are made annually or semiannually depending on the circumstances. Lenders typically resist paying interest on these accounts.

The borrower should seek to eliminate this requirement or, in the alternative, to permit the lender to require an escrow only if there is an event of default under the loan documents. The borrower also should ask that deposits bear interest.

Due-on-Sale
Examine almost any mortgage and one will find a due-on-sale clause. This clause permits the lender to declare a default and accelerate the balance of the loan if the borrower sells the real estate to a third party without the lender's written consent. In a pure real estate loan, where real estate is the sole collateral, this is a difficult clause to challenge. In the context of a broader loan facility, however, other approaches may be possible unless the property in question is a critical part of the borrower's operations--such as its main manufacturing plant.

One approach is to require that the lender's discretion in consenting to a transfer be reasonably exercised. A second, and probably preferable, approach is a partial release agreement in which the borrower is permitted to dispose of the mortgaged property provided that the net proceeds of the sale are used to pay down the loan. It is important for the borrower to remember, however, that it might not be able to reborrow these funds if the remaining collateral package does not generate enough availability under the lending formula.

Change of Control
If the borrower is not a publicly traded company, the lender will often forbid transfers of equity interests in the borrower. One need not probe deeply, however, to learn that the lender's primary concern is a change of control. The lender knows, and is presumably comfortable with, the management expertise and style of the persons with whom it has negotiated the loan. It is not relying solely on its collateral to assure repayment; it is relying as well on the skill of the borrower's lead player(s).

The borrower will probably need to accede to restrictions on transfers of equity interests but should seek permission for transfers that do no violence to the lender's primary concern. Permitted transfers might include (1) transfers of limited partnership or membership interests; (2) transfers of equity interests that do not result in a change of control; (3) transfers into inter vivos or testamentary trusts for estate planning purposes (so long as the persons responsible for voting or managing the interests transferred into the trust remain the same); (4) transfers among existing equity holders (so long as there is no change in control); and (5) transfers to affiliates.

Other Debt or Encumbrances
Lenders never want to compete with other creditors. Accordingly, loan agreements typically forbid other indebtedness (anti-debt restrictions) as well as security interests in favor of other lenders (anti-lien restrictions).

A borrower can typically obtain exceptions to the anti-debt restrictions, permitting the borrower to incur the following types of debt: (1) unsecured trade debt incurred in the ordinary course of doing business, (2) debt subordinated to the lender on terms reasonably acceptable to the lender, (3) intercompany indebtedness, (4) purchase money debt (so long as the debt is not in an amount greater than the initial value of the asset), and (5) capital leases, which may be treated as debt for some purposes. Occasionally, but not often, the borrower also may be able to negotiate a basket entitling the borrower to incur additional unsecured debt up to a pre-agreed maximum.

Exceptions to anti-lien restrictions are even narrower but might include (1) specified existing liens, (2) nonconsensual liens imposed by operation of law (such as inchoate mechanics' liens), (3) liens securing permitted purchase money debt, and (4) tax liens or judgment liens that are being contested in good faith and in such a manner as not to jeopardize the lender's collateral position.

Guarantors
The nature, content, and scope of guarantees can only be touched on in this article. The borrower must understand, however, precisely what guarantees will be required and from whom. If there are multiple guarantors, resolve at once whether the guarantors will be jointly and severally liable.

Lenders always hold out for broad liability, but guarantors just as vigorously resist it.

Even if the loan must be guaranteed, the guarantors should consider ways to reduce or even eliminate their exposure. Can the guaranty be limited to a specific maximum? Can the guaranty exclude principal and be limited to interest and other carrying charges (a carry guaranty)? Can the guaranty be structured as an earn-out guaranty pursuant to which the guarantor is excused if, for example, the borrower reaches (and, depending on the agreement, maintains) certain specified financial targets, such as net operating income, net worth, or debt-to-equity ratios?

Lawyers for a borrower should strongly consider advising guarantors to obtain separate counsel. The interests of a guarantor will frequently be directly adverse to those of the borrower.

Lawyers' Opinions

A general enforceability opinion will be required by almost every lender in which the borrower's counsel recites, among other things, that the loan documents have been validly authorized, executed, and delivered and that they are enforceable in accordance with their terms (subject to applicable bankruptcy laws and laws affecting creditors' rights generally). In many instances, the lender will require outside counsel to provide the opinion, so a corporate borrower is well advised to understand early whether it can rely solely on in-house counsel.

Disputes over legal opinions are almost always unproductive and expensive. Whether or not it is possible to get a draft of the form opinion at the commitment stage, the commitment should list the items on which the lawyer must opine. Pay particularly close attention to whether the lawyer will be asked to opine that the lender has a perfected security interest in the collateral. Most firms will deliver this opinion, although negotiation over the qualifications and assumptions can take time.

If the lender wants an opinion that its liens have a first priority, serious problems can arise because most prominent law firms refuse to deliver such an opinion. Lenders are far less prone to request this opinion now than in years past, but the careful borrower will make sure the lender does not require it.

If the borrower's real estate collateral is located in multiple states, local counsel will probably need to be retained to deliver enforceability opinions for various security documents granting liens in those states. The cost of local counsel should be anticipated and budgeted from the outset.

Conclusion

Negotiating a loan commitment and agreement can be a struggle for the borrower. The lender has all the money and with that comes most of the leverage. Large portions of the loan agreement will always remain off limits. Nonetheless, issues critical to the borrower abound and must be negotiated at once. Never forget that the lender is weakest at the outset, making this the time to order your priorities and ask for what is most important.

Oest is a lecturer at law at the University of Chicago School of Law. His e-mail is jost@rcn.com.

Back to Top

 © 2012 ABA, All Rights Reserved

Ad
AMICUS ATTORNEY PRACTICE MANAGEMENT SOFTWARE
Celebrating 20 Years
SIGN UP FOR FREE TRIAL
800-472-2289 amicusattorney.com

Business Law Today

Volume 19, Number 3 January/February 2010

Snap Judgments

By Molly Thomas

YouTube, I Tube, LawTube

Part directory, part marketing tool, LegalTube is a recently launched website that hopes to make introductions between lawyer and potential client, reports the *Connecticut Law Tribune*. The site is intended to mimic that initial conversation for a prospective client—learning about the lawyer's personal style, experience, areas of expertise, and answers to general queries. As opposed to a standard directory where only certain text information is available, lawyers participating in LegalTube can not only give virtual tours of their offices, but also give viewers insight into their firm, their personality, and their background. Most videos are around two to three minutes in length and LegalTube's search features allow users to search by practice area as well as by state. In addition to the video listings, LegalTube also posts episodes of Birmingham, Alabama, night court proceedings in a series called "Law After Dark."

Looking for Leaks

Companies nervous about sensitive information sneaking out the door, or, rather, the e-mail outbox, are taking extra steps to monitor employee activity—some are hiring staff specifically to monitor outgoing e-mail, reports the *National Law Journal*. A study by Proofprint found that 38 percent of large U.S. employers are scrutinizing outbound e-mail for leaks of confidential information. That number is up from 29 percent in 2008. E-mails aren't the only communications that have employers worried—as social networking sites such as Twitter and Facebook have grown in popularity, so have reprimands and even firings over misuse of such sites. Eight percent of companies in the Proofprint study reported firing an employee in the last 12 months over issues initiated via social networking sites. Seventeen percent reported having disciplined an employee in the past 12 months over violations of blog or message board company policies, up from 11 percent last year.

Part-Timer Popularity

According to the Project for Attorney Retention, or PAR, an organization that promotes a healthy work-life balance for lawyers, the number of partners working part time has increased drastically since 2006, from 1.6 percent to around 12 percent this year, reports the *American Lawyer*. Part-time partners are still generating quite the profit for their firms though, with many respondents reporting billing between 1,200 and 1,600 hours per year. What might be even more of a surprise is the number of litigators in the part-time wave. "Back 10 years ago, people said you can't work part-time as a litigator," said PAR director Cynthia Calvert. "But that's not true. With litigation, there's more peak and valley, and you can work intensely sometimes and not others." Insurance and mergers and acquisitions still don't make up a significant percentage of lawyers working part time. Large New York firms were mostly absent from the PAR study, raising the point that had they been included, the results may not have tipped so heavily toward a burgeoning new trend.

Sorry Stapling Skills

The *New York Law Journal* reports that a judge threw out a tort action in Queens, New York, in part because of a poor stapling job. The judge wrote, "The poor stapling of the papers was so negligent as to inflict, and did inflict repeatedly, physical injury to the court personnel handling them. Such negligence on the part of counsel shows a lack of consideration." According to a clerk for the judge, the poorly stapled complaint drew blood twice.

Small Business Reprieve Ends

Smaller businesses, those whose marketing capitalization is less than $75 million, will now have to comply with Section 404, or the auditing provision of the Sarbanes Oxley corporate reform law, as decided by the Securities and Exchange Commission recently, reports Reuters. The law was passed in 2002 after a surfeit of scandals had weakened consumer trust in capital markets. Although the compliance decision had been delayed multiple times, as of June 15, 2010, small companies will have to report their internal controls' effectiveness. They had previously been exempt because of their disproportionately higher costs of compliance versus larger firms.

Big Change for Bar Exam?

According to the *National Law Journal*, several states are considering one of the biggest changes in bar procedure in recent history: a uniform bar exam that would nationally standardize qualifications for lawyers. According to Erica Moeser, the president of the National Conference of Bar Examiners (NCBE), "roughly 10" states intend to use the uniform exam by 2011, although which states those might be is not yet clear. As of yet, New York, California, Illinois, the District of Columbia, Florida, and Texas have all decided not to participate, and being the largest legal markets in the nation, their pass on the movement is significant. Concerns include scoring issues and scheduling conflicts, not to mention the worry that a uniform exam would discount important concepts that differ from state to state. The uniform test would consist of three test components developed by the NCBE— the Multistate Bar Exam, already in use by 22 jurisdictions; the Multistate Essay Exam; and the Multistate Performance Test. For the test to become truly uniform, score conformity and portability would have to be established in order for applicants' scores to be honored by all participating states. Scoring currently varies between jurisdictions according to scales and question type. Participating states could still require a state-specific component of the exam, but the score on that portion would not factor into the portable score.

Twitter Writ

The United Kingdom's first ever injunction via Twitter was ordered recently, according to *New York Lawyer*. The court determined that the social networking site was the best method to serve to reach an anonymous person using the same site to impersonate Donal Blaney, the right-wing blogger and owner of Griffin Law. The next time the user opens his or her Twitter account, he or she will receive a message from the High Court with an order to discontinue posting, to clear past messages, and, via web link form, to identify him or herself to the court. Twitter's success has been followed by hundreds of impersonators, in particular of celebrities, a problem that was so common that the site has launched a program in which a seal of authenticity appears on the pages of high-profile Twitter users. The implications of this decision get closer to the heart of the Internet anonymity issue, and Matthew Richardson, the barrister behind the injunction, saw this as a victory, saying in a statement, "People have to learn that they can no longer hide behind the cloak of anonymity the Internet provides and break the law with impunity." Others were impressed with the highly contemporary nature of the issue and the fact that the courts were so

willing to adapt their delivery methods. "The law tends to be quite cumbersome and slow," said Strathclyde University faculty member Dr. Konstantinos Komaitis, "so to have a court deliberate on something like Twitter—so hot, so relevant—it shows quite impressive engagement."

Back to Top

 © 2012 ABA, All Rights Reserved

Business Law Today

Volume 19, Number 3 January/February 2010

Pro bono in action

By Jill E. Family

An immigrant's need for representation

Legal representation always matters, but the need for representation intensifies when the most basic rights are at stake. In immigration removal (deportation) cases, the federal government adjudicates whether an individual may live and work in the United States, or whether that person must relocate to another country. Reasons for wanting to be in the United States vary, from a desire to remain with family to a fear for one's life in a home country. In these immigration proceedings, an executive branch employee, an immigration judge, applies the Immigration and Nationality Act, a body of statutes long recognized to rival the income tax code in complexity. With so much at stake and with laws so complex, attorney representation is essential. Unfortunately, however, 60 percent of individuals appearing in immigration court do so without an attorney, and that number has risen to higher than 80 percent for individuals detained during their immigration court proceedings. There is no government-appointed counsel in immigration cases.

The Pennsylvania Immigration Resource Center, or PIRC, is a nonprofit legal services provider helping unrepresented individuals detained during their immigration proceedings. Immigration detention, while technically civil detention, often means that a foreign national, charged only with the civil offense of an immigration violation, is placed in a prison that also houses criminal offenders. PIRC works closely with those immigrants detained at the York County Prison in York, Pennsylvania. Through a contract with the federal government, the York County Prison holds individuals

To donate your services . . .

Many national programs and agencies can facilitate pro bono participation in efforts to help ICE detainees, including the ABA Commission on Immigration. For contact information regarding free or low-cost legal services for immigrants and refugees in your area, visit the interactive

awaiting immigration proceedings. These individuals are often transferred from out of state to York County, an agricultural region located in south central Pennsylvania. Detainees are removed from their home communities to an area where there are few legal services providers. Isolated, these foreign nationals face the challenge of overcoming language barriers and the complexity of the law itself if they attempt self-representation.

map found at www.abanet.org/publicserv/immigration/legal_services_directory_map.shtml or contact the commission at 202-662-1005 or immcenter@abanet.org.

Pro bono immigration centers like PIRC work to fill the huge need for representation for immigration detainees. Detained individuals may prepare for their immigration hearings through PIRC's Legal Orientation Program. This program is funded through a Department of Justice contract. Through the program, PIRC delivers group legal orientations, individual orientations for unrepresented detainees, and self-help workshops and arranges pro bono referrals. With these services, PIRC seeks to empower unrepresented immigrants to evaluate and present any defenses against removal from the United States. Though constrained by its resources, PIRC does provide direct representation through some of its other programs to a limited number of detainees. Direct representation services are reserved for the most vulnerable immigrants in detention, including torture survivors and individuals with mental health and/or physical disabilities. Managing Attorney Megan Bremer shared a recent experience representing a PIRC client:

> Representing people in detention is not only a way to uphold the integrity of the judicial system, but to humanize the process. For example, I represented a refugee from Liberia. When the war descended on his village, my client was forced to witness unthinkable brutal acts upon his children. When, despite our arguments, the judge ordered removal to Liberia, my client took my hand and thanked me for believing that he deserved his day in court and for ensuring that he did not have to face his memories alone. It was then that I understood the real power of standing by someone's side in court.

In these direct representation cases, PIRC will continue representation of the foreign national through an administrative appeal and, if necessary, a federal court appeal.

PIRC provides about 1,200 detained foreign nationals a year with a helping hand in a cold, technical, and impersonal system. That PIRC does this with a limited staff and a limited budget makes its efforts even more impressive. "The need for our services far exceeds our capacity to provide assistance. It's a David and Goliath scenario," PIRC's executive director, Angela Eveler, explained. "Our passion for justice drives us forward." PIRC consists of a dedicated crew of three who provide legal services: Managing Attorney Bremer, Lindsay Jenkins, and Andrew Mahon. Eveler oversees its operations with the help of an administrative assistant, Rosina Stambaugh.

A group of local attorneys founded PIRC in 1996, in response to the legal needs of a wave of detainees housed in York after the Chinese ship *Golden Venture* ran aground off Long Island, New York. The ship carried approximately 300 Chinese refugees who were fleeing persecution. Since then, PIRC has become the leading provider of legal services to individuals in immigration detention in Pennsylvania. PIRC also plays a national role. It is a leader in the movement to provide due process protections for individuals with mental disabilities in immigration proceedings. It also plays a national role because Pennsylvania is a major source of immigration detention bed space for the federal government. The government transfers foreign nationals found all over the country to Pennsylvania for detention. For example, right now, the Berks Family Shelter, in Berks County, Pennsylvania, is the government's only immigration detention center dedicated to housing families. Also, the York County Prison is an immigration detention hub for the Northeastern United States.

PIRC is always excited to reach out to those who are interested in learning more about its mission and services. "PIRC is dependent on the hard work and efforts of its volunteers and pro bono attorneys. They serve in an important role to ensure that access to justice is available to the most vulnerable in our society," said Eveler. To learn more, visit www.pirclaw.org, or contact Angela Eveler directly at aeveler@pirclaw.org.

What Every Lawyer Needs to Know About Corporate Immigration Issues

Audio CD Package

In today's global economy, immigration laws have ever greater impact on U.S. and foreign-owned businesses. Companies that fail to follow immigration compliance

laws have recently been subject to raids and civil and criminal liability. This program is designed to raise awareness of the areas where business law and immigration law intercept.

Family is an associate professor of law at Widener University School of Law in Harrisburg, Pennsylvania. Her e-mail is jefamily@widener.edu.

Back to Top

Business Law Today

Volume 19, Number 3 January/February 2010

Keeping Current: securities

By Michael R. Littenberg

Are your Regulation FD compliance procedures sufficient?

During late September, the Securities and Exchange Commission settled a civil action relating to a violation of Regulation FD, which prohibits selective disclosure by public companies of material nonpublic information. Regulation FD actions are fairly infrequent, this being the first since 2007, and one of only a handful since Regulation FD was adopted in 2000. The moral of this particular tale is that thoughtful Regulation FD compliance policies and procedures can help to mitigate the consequences of a violation, which in this case avoided making a bad week even worse.

In this particular action, Christopher Black, at the time the chief financial officer of American Commercial Lines, Inc. (ACL), an operator of barges and tow boats, was alleged to have intentionally selectively disclosed a revised earnings forecast to a limited group of analysts. As the CFO, Black was one of ACL's two designated investor relations contacts. In that role, he put together ACL's investor relations policy, which included a section on Regulation FD, and, on at least two occasions, received training from ACL's counsel that included material addressing Regulation FD.

ACL's policy was to offer forward-looking guidance only once each year during its February investor conference call. During its February 2007 call, ACL projected full-year earnings per share of between $1.75 and $1.95. However, by May 2007, ACL management concluded that 2007 earnings would be significantly below previous publicly announced guidance. Second quarter 2007 earnings also were expected to fall far short of analyst expectations. Like many companies facing a similar set of circumstances, ACL decided to put out revised full-year guidance and a forecast for the second quarter.

And now we get to the beginning of Black's bad week.

On June 11, 2007, ACL put out a press release projecting annual EPS of between $1.45 and $1.65 and indicated that second quarter 2007 earnings would look "similar to the first quarter," during which EPS was $0.20.

Over the next few days, Black and the CEO went on a previously scheduled trip to meet with analysts who covered ACL. Among other things, they answered questions concerning the guidance contained in the June 11th press release. Upon returning from the trip, Black proposed sending an e-mail to all of the analysts summarizing the information discussed in the various meetings, since Black and the CEO had not been able to meet with all of the analysts as a single group. ACL's CEO agreed. He asked Black to send the e-mail by the close of business on Friday, June 15th, after first providing a draft to outside counsel to review. However, Black was unable to finish the e-mail by then and sent a draft to his personal e-mail address so that he could finish it over the weekend.

And then things started to go off the skids . . .

At some point before leaving work that Friday, Black received an updated internal analysis indicating that second quarter EPS could be as low as $0.13, which was significantly below the projection contained in the press release from earlier that week. On Saturday, Black sent an e-mail from his home account to the eight sell-side side analysts who covered ACL indicating that ACL expected "EPS for the second quarter will likely be in the neighborhood of about a dime below that of the first quarter," or approximately $0.10 per share. Before sending out the e-mail, Black did not circulate it internally within ACL or to outside counsel.

When trading opened on Monday, ACL's stock dropped significantly, by 9.7 percent, on heavy volume that represented almost a threefold increase in average trading volume up to that point in June.

ACL's CEO learned of Black's e-mail that Monday morning and ACL put out a Form 8-K disclosing the contents of his e-mail at the end of the trading day.

The SEC concluded that Black understood the requirements of Regulation FD and was aware that Regulation FD covered his communications with analysts and investors, that the earnings guidance information was material, and that the analysts had no duty to keep the information confidential. As part of the settlement, Black agreed to pay a fine of $25,000.

More importantly, from the company side, the action underscores the importance of having in place effective Regulation FD compliance policies and procedures. In this instance, the SEC declined to institute enforcement proceedings against the company—which is atypical when there is a Regulation FD violation—because it had "cultivated an environment of compliance" and took remedial measures to address the Regulation FD violation.

The compliance measures highlighted by the SEC included the following:

- A written investor relations policy that included a section addressing the requirements of Regulation FD.
- Periodic Regulation FD compliance training by counsel.
- The existence of an earnings guidance policy.
- Review by counsel of proposed written communications to analysts.
- Prompt corrective disclosure upon learning of the Regulation FD violation and self-reporting of the violation to the SEC.
- Adoption of remedial measures to address the violation and to prevent it from recurring.

Public companies of course need to tailor their Regulation FD compliance procedures to their own particular circumstances. However, all public companies should use this most recent action as a catalyst for evaluating the sufficiency of their Regulation FD compliance procedures and whether those procedures are followed in day-to-day practice. This action also underscores the

importance of having in place, in advance, a crisis management plan that enables the company to quickly address both intentional and nonintentional Regulation FD violations.

Littenberg is a partner in the New York office of Schulte Roth & Zabel LLP, where he specializes in representing public companies in transactional and ongoing compliance matters. He can be reached at michael.littenberg@srz.com or through LinkedIn.

Back to Top

 © 2012 ABA, All Rights Reserved

Follow ABA

Ad

Business Law Today

Volume 19, Number 3 January/February 2010

Keeping Current: securities

By Michael B. Hurley and F. Mark Reuter

SEC to rule on Rule 14a-11 and Rule 14a-8 proposals by early 2010

The 2011 proxy season is expected to be unlike any seen to date. Securities and Exchange Commission (SEC) Chair Mary Schapiro recently announced her hopes "to finalize the [proposed proxy access] rules early in the new year [2010]." The SEC's proposals fill a tome, coming in at over 250 dense pages, but can be distilled down to the position that proxy reform is necessary due to a "loss of investor confidence" and "serious concerns about the accountability and responsiveness of some . . . boards of directors to the interests of shareholders."

History

The battle over proxies has been ongoing for many years, but proponents of greater shareholder access tend to gain momentum during times of economic crisis. In 2003, the SEC issued a proposal that would have enabled long-term, significant shareholders to include their director nominees in a company's proxy statement. As recently as 2007, the SEC introduced a proxy access proposal narrowing the exclusionary power companies have over shareholder proposals. Those proposals are precursors to the ones currently under consideration but were abandoned after receiving resoundingly negative comments. So what has changed? The severity of the economic downturn in 2008-2009 has exacerbated investors' perception that boards are unresponsive to their demands, and the SEC's newly appointed commissioners have taken a cue from the White House and Congress to expand federal powers in securities regulation.

Highlights of Current Proposals

Under the Rule 14a-11 proposal, a shareholder or shareholder group would be eligible to have its nominees included in the company's proxy materials if it meets certain eligibility requirements. As an example, the shareholder must own a minimum amount of a company's outstanding voting shares for at least one year: (1) at least 1 percent of a large accelerated filer

(market value > $700 million); (2) at least 3 percent of an accelerated filer (market value > $75 million but < $700 million); or (3) at least 5 percent of a nonaccelerated filer (market value of < $75 million).

Under the 14a-8 proposal, the current "election exclusion" that companies have used to keep out shareholder proposals regarding director elections from proxy materials would be narrowed to effectively permit the inclusion of these shareholder proposals. Under the anticipated new regime, a shareholder proposal that would amend provisions of a company's bylaws concerning the nomination procedures or disclosure provisions would not be excludable.

Preparing Your Client

Attorneys must assess what consequences the proposed rule changes would have for their corporate clients. The lawyers should review clients' bylaws and other governing documents to determine if the procedures for nominating directors and assessing a nominee's qualifications will conform to the new regime or should be altered to comply. For instance, companies may wish to adjust the size of their board of directors. The proposal would permit the nomination of one director or up to 25 percent of the board, whichever is greater. If the result of the 25 percent calculation is fractional, the maximum number of directors that could be nominated would be rounded down. The rounding down of the cap has direct implications for the size of a board. Additionally, clients need to more closely monitor their shareholder list to identify eligible shareholders or shareholder groups that might avail themselves of the new rules. These are just two examples of the many that must be considered when crafting a plan that best responds to the needs of corporate clients.

Reuter is a partner and Hurley is a law clerk at Keating Muething & Klekamp PLL, Cincinnati, Ohio. Their respective e-mails are freuter@kmklaw.com and mhurley@kmklaw.com.

Back to Top

© 2012 ABA, All Rights Reserved

Business Law Today

Volume 19, Number 3 January/February 2010

Keeping Current: securities

By David B. Bayless and Tammy Albarrán

Recent SEC changes impact investigations

The Securities and Exchange Commission (SEC) has made significant changes to its policies and practices in its Enforcement Division, signaling swifter and more focused investigations.

Key Appointments

Chairwoman Mary Schapiro made an unprecedented selection by choosing Robert Khuzami, a former federal prosecutor and Chief of the Securities Fraud Unit of the U.S. Attorney's office in the Southern District of New York, as the SEC's new Director of the Division of Enforcement. Never before has a former federal criminal prosecutor led the SEC's Enforcement Division. The new Director of the SEC's New York regional office, George Canellos, is also a former federal criminal prosecutor.

These appointments have translated into recently announced significant changes to the SEC's investigative process. To understand their significance, let's review the historical problems with SEC investigations.

Lengthy SEC Investigations

Typically, SEC investigations are lengthy, often taking years to complete. Many factors cause this. First, the SEC staff's tendency is not to focus on a few key individuals. Instead, they cast a wide net, obtaining documents and taking sworn testimony from anyone remotely connected to the conduct at issue.

Second, the staff was not organized into specialized subject matter groups. So, for example, the staff investigating the municipal securities markets may have no experience whatsoever in that area, and so must learn the subject matter as it investigates.

Third, the staff must have a formal order of investigation to issue subpoenas for documents and testimony. But approval of all five SEC commissioners was needed to obtain this. This cumbersome process often led the staff to avoid seeking a formal order and, instead, give companies and individuals plenty of time to conduct internal investigations, locate and produce documents, discuss limiting issues, refine the scope of the requested documents with the staff, and provide voluntary testimony. This informal process led to further delay.

Fourth, the SEC staff has never had a customary practice of granting immunity to peripheral players to make a case against key individuals at the heart of the alleged misconduct. Instead, they pursue each individual who may have violated the federal securities laws, even if one person has less culpability and could help bolster an enforcement action against a more culpable person. Similarly, while companies may get credit for cooperation, the SEC has not had such a policy for individuals. So, counsel for individuals have not flipped their client to provide evidence against others to get leniency.

Finally, when the investigation ends and the staff notifies targets of its intention to recommend an enforcement action through a Wells notice, the list is often long. For example, in a revenue recognition investigation, expected targets are the CEO, CFO, and chief accounting officer. But the SEC staff often targets salespeople and lower-level accounting staff. Such individuals often were not aware of any problem, but the staff argues that they failed to respond to red flags. Such peripheral individuals must prepare Wells submissions and request meetings with senior SEC officials. And, if the SEC takes an aggressive settlement position, such individuals have little incentive to settle if they have the financial means--personally, or through insurance or indemnification—to defend themselves. This leads to more delays.

More Focused Investigations

Criminal prosecutors typically focus their investigations on the main wrongdoers and use marginal players to build their case. Given the high burden of proof, criminal prosecutors must think carefully before charging those on the periphery. And prosecutors turn marginal players against the principal wrongdoers in return for immunity or a reduced sentence. Finally, federal prosecutors are typically organized into subject matter teams that develop expertise.

Modeled on his criminal prosecutorial background, Khuzami recently announced significant changes to the SEC's Enforcement Division designed to expedite the process. The first change is establishing specialized subject matter units. Each unit will be headed by a unit chief and staffed nationally by members with relevant expertise who will receive special training. The goal is to bring to bear greater expertise, sophistication, and experience on understanding complex products, transactions, and industry practices.

Specifically, the existing Subprime Working Group will continue to focus on credit products, including mortgage-related securities. And five new specialized units will be created. The Asset Management Unit will focus on investment advisers, investment companies, hedge funds, and private equity funds. It will address disclosure, valuation, portfolio performance, due diligence and diversification, transactions with affiliates, misappropriation, and conflicts of interest. The Market Abuse Unit will focus on large-scale market abuses and complex manipulation schemes by institutional traders and market professionals. The Structured and New Products Unit will focus on complex derivatives and financial products, including securitized products. The Foreign Corrupt Practices Act Unit will work with foreign agencies to uncover bribery of foreign officials by U.S. companies to obtain government contracts and other business. Finally, the Municipal Securities and Public Pensions Unit will focus on disclosure, tax, arbitrage-driven activity, and pay-to-play schemes in which money managers pay kickbacks to obtain advisory business.

A second change is Khuzami's decision to delegate certain authority to those below him and to create a less hierarchical management structure. He has delegated to senior officers the authority to make case decisions, such as routine settlements, Wells calls, and opening of new matters. And--the commission having delegated to him the authority to issue formal orders of investigation--Khuzami has, in turn, delegated this authority to senior officers below him. So the staff will not need prior approval from the commission or Khuzami himself to issue subpoenas. Khuzami also has eliminated the branch chief position (a first-level supervisory role) to create a flatter and more streamlined management structure.

Third, Khuzami will require senior division officials to approve all tolling agreements, which will be granted only as an exception, not the rule. This is intended to prevent extended delays in completing investigations. He also intends to shorten the action memo (a memo from the staff to the commission that recommends an enforcement action) and subject it to fewer reviews.

Fourth, the staff will use several new enforcement tools designed to reward extraordinary cooperation. These include new standards governing cooperation by individuals and delegating authority to submit immunity requests to the Department of Justice. It also will provide witnesses with early oral assurance that they will not be charged. When appropriate, the staff will recommend to the commission deferred prosecution agreements with individuals or entities, subject to full cooperation, waiver of statutes of limitations, and compliance with certain undertakings. These significant changes give the staff greater flexibility to negotiate immunity or leniency for persons with important evidence against other persons.

Finally, Khuzami intends to address personnel issues. The Enforcement Division will triple the previous number of paralegals and support personnel, and hire more Trial Unit lawyers. A new position, Chief Operating Officer, has been created and filled to oversee project management, workflow, and information technology. Lastly, a new Office of Market Intelligence will collect and analyze the hundreds of thousands of tips and complaints that the SEC receives yearly.

Conclusion

These significant changes are intended to speed up and create more efficient SEC investigations. And they may well do so. But unintended consequences may result. Speed and efficiency are not coextensive with fairness. Within the world of the SEC, the Madoff case and similar Ponzi schemes--which are simply theft--are not the norm but the exception. SEC investigations often focus after the fact on disclosure issues that involve difficult matters of judgment by corporate executives. By distancing experienced senior SEC officials from important decision-making points, the danger is that charging or settlement decisions will be made without careful consideration. So, these changes may lead to unwarranted charges and more litigation, not less.

Bayless is a partner and Albarrán is special counsel at Covington & Burling LLP in San Francisco. Their respective e-mails are dbayless@cov.com and talbarran@cov.com.

Back to Top

 © 2012 ABA, All Rights Reserved