THOMPSON HINE

Business Law Update

Winter 2016

M&A – Private Targets

Earn-Outs in Recent Private M&A Deals

By Tony Kuhel & Benjamin C. Galea

In their book, *Negotiation Genius: How to Overcome Obstacles and Achieve Brilliant Results at the Bargaining Table and Beyond*, Harvard Business School professors Deepak Malhotra and Max H. Bazerman advocate for contingency contracts as an effective tool in negotiations that involve a dispute relating to the future performance of some good or service. These contracts establish an agreement between the parties that allows them to make a deal but defer the final terms until some point in the future at which the value of that good or service will be clear. Contingency contracts can salvage deals but, the authors warn, also have the potential to foil a party's expectations though traps such as asymmetrical information and incompatible incentives. Therefore, experience and attention to detail are invaluable when negotiating and drafting contingency contracts.

In the M&A arena, contingency contracts often manifest themselves in the form of earn-out provisions. The typical earn-out provides the seller with the right to receive additional consideration after the deal closes if the acquired business goes on to achieve certain performance conditions. Based on our survey of private M&A transactions filed with the Securities and Exchange Commission in the third quarter of 2015, earn-outs are relatively uncommon, appearing in only 15 percent of those deals. Despite this relative infrequency, earn-outs were utilized in M&A transactions in a variety of industries during the period, including food and beverage, energy, health care, manufacturing, media and technology.

Even without an understanding of the parties' perceptions of the likelihood that the acquired business will satisfy the earn-out's performance conditions, a third-party observer can evaluate an earn-out package based on the legal protections that it affords each party.

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For more details on any of the topics covered in this *Business Law Update*, please contact the authors via the links at the end of each article or David R. Valz, editor-in-chief. For information on our Corporate Transactions & Securities practice, please contact Frank D. Chaiken, practice group leader.

When negotiating an earn-out, a seller generally aims to structure a deal that:

- provides for prorated payments if the business meets a minimum performance requirement but falls short of the negotiated targets;
- grants information and audit rights to monitor the performance of the business during the earn-out period;
- entitles the seller to be involved in, or control the buyer's management of, the business; and
- provides security for the earn-out payments.

A buyer, on the other hand, typically works toward an earn-out that:

- denies payments if the business fails to meet the performance conditions;
- limits the seller's information and audit rights with respect to the business;
- allows for the buyer to manage the business without interference or restrictions; and
- provides the ability to offset the seller's post-closing indemnity and purchase price adjustment obligations against the earn-out payments.

Though not very common in recent M&A transactions, earn-out provisions have the potential to be useful negotiating tools when a deal is threatened by uncertainty surrounding the target company's future performance.

With these objectives in mind, Edgewater Technology's August 17, 2015 agreement to acquire substantially all of the assets of Branchbird appears to be one of the more seller-favorable earn-out deals of the third quarter of 2015. The Branchbird purchase agreement provides that Edgewater, a strategic consulting firm, will pay Branchbird $2.8 million in cash at closing for Branchbird's Big Data business with an additional $2.4 million in cash tied to the business's financial performance during the two years following the closing. If the acquired business surpasses specified revenue and EBITDA floors during each year in the earn-out period, Branchbird is entitled to escalating payments based on those financial measures, subject to annual caps. To complete the acquisition, Edgewater formed a new subsidiary to acquire the business and agreed that the new subsidiary would produce its own financial statements to use as the basis for calculating the earn-out payments and, if necessary, provide the basis for an independent accounting firm to resolve any related disputes. The introduction of a single-purpose acquisition subsidiary also allowed Branchbird to bargain for the subsidiary's agreement to operate the business to maximize the earn-out payments and, to that end, not to engage in any business combination or change-of-control transaction during the earn-out period. The Branchbird deal's earn-out provisions also prevent Edgewater from terminating Branchbird's principals, who entered into employment agreements with Edgewater in connection with the deal, without cause until the earn-out period expires.

The partial payments, business-specific financial reporting, restrictive covenants and seller involvement in the Branchbird earn-out certainly seem to be a good bargain for Branchbird and its principals. The third quarter of 2015 did, however, see a few seller-favorable earn-out provisions that did not make their way into the Branchbird deal. Unlike M&A transactions without the concept, earn-out deals that involve financial performance conditions often include calculations that reveal, at least in part, the buyer's method for valuing the business. For the seller, the presence of these formulas in the purchase agreement increase the risk that the buyer will attempt to use that math to argue that the amount of its indemnifiable losses should be determined, and magnified, according to the same logic. To eliminate this risk, some earn-out deals, such as Autoliv's July 16, 2015 agreement to acquire M/A-COM Technology Solutions Holdings's automotive business, expressly include a provision that prevents the buyer from recovering damages computed on the basis of a multiple of earnings or other valuation methodology, regardless of whether the parties arrived at the purchase price or earn-out payments through the application of any such formula. Although sellers often seek to include similar provisions to limit the calculation of the buyers' indemnifiable losses, this restriction, with an express reference to the earn-out methodology, is even more important in deals with earn-out provisions tied to financial performance conditions.

From the other side of the table, SolarCity's August 5, 2015 acquisition of Ilioss, a solar energy company operating in Mexico, was an earn-out deal with particularly buyer-friendly provisions. The solar energy systems firm paid Ilioss's stockholders $9.5 million in cash at closing and gave them the opportunity to earn two earn-out incentives: a $5 million cash payment if the business installs and operates a battery storage system that generates at least one megawatt for commercial customers by June 16, 2016, and an undisclosed amount for each megawatt that its systems provide between the closing and December 31, 2019. Not only do these operational performance conditions permit SolarCity to avoid any additional payments to the sellers if the business does not achieve its milestones, but, unlike the financial triggers in the Branchbird deal, they also allow the parties to monitor the acquired business's progress toward the earn-out targets without the need for SolarCity to provide complete financial statements to the sellers and eliminate the need for complex dispute-resolution procedures. SolarCity also conditioned its obligations to make earn-out payments on the sellers' continued employment with the acquired business, which provides an incentive for the emerging company's management team to stay with the business for the next several years as SolarCity establishes itself in a new international market. The Ilioss deal's earn-out structure also provides SolarCity with security for the sellers' working capital adjustment and indemnification obligations under the purchase agreement by granting SolarCity the right to offset any amounts arising out of those obligations against any earn-out payments that become due.

As with the Branchbird deal, even though the Ilioss deal provided SolarCity with all-or-nothing payment obligations, granted the sellers no right to access or audit the business's books and records, placed no restrictions on SolarCity's right to manage the business as it sees fit and protected SolarCity's right to working capital adjustment and indemnification payments, the Ilioss earn-out provisions did not exhaust options available to a buyer to use an earn-out to its advantage. Most purchase agreements in private M&A deals provide the buyer with the right to indemnification for losses relating to breaches of or inaccuracies in the seller's representations and warranties for one to two years after the deal closes. Since earn-out deals often involve payments to the seller beyond that period, a buyer could find itself with the obligation to make earn-out payments while absorbing losses relating to the seller's misrepresentations. Because Ilioss's stockholder's representations and warranties expire after two years and the earn-out period continues through 2019, SolarCity could very well find itself in this position. Capnia addressed this issue in its September 8, 2015 acquisition of NeoForce Group, a manufacturer of respiratory systems, by providing that NeoForce remains liable for Capnia's losses arising out of inaccuracies in NeoForce's representations beyond the general survival period of 18 months through the deal's 36-month earn-out period but only to the extent that Capnia can offset those losses against earn-out payments.

If the private M&A activity in the third quarter of 2015 is any indication, dealmakers have not yet found contingency contracts to be quite the universal solution that Malhotra and Bazerman make them out to be. On the other hand, third-quarter deal activity does reveal that earn-outs can be industry-agnostic and, with so many variables to negotiate, offer buyers and sellers a wide zone of possible agreement when the uncertainty of future performance threatens the deal.

With any questions, please contact Tony Kuhel or Ben Galea.

M&A – Deal Litigation Settlements

Delaware Chancery Court Turns Against Disclosure-Only Settlements

By Thomas M. Ritzert & Thomas A. Aldrich

Those who follow merger and acquisition litigation know the pattern. A merger is announced. Within days, several plaintiff's firms rush to the courthouse in multiple jurisdictions and file boilerplate strike-suit class action complaints griping about "hopelessly flawed" processes and "grossly conflicted" directors, calling for the court to enjoin the target company's shareholder vote on the proposed merger.

In striking contrast to the inflamed rhetoric and sky-is-falling themes of these plaintiff's lawyer-driven suits, however, within a short period of time and after very limited discovery, the plaintiff's firms agree to settle the class action in exchange for: 1) the target company's agreement to provide additional information in supplemental disclosures before the shareholder vote and 2) the company not opposing the plaintiff's attorneys' request for fees. In fact, as recently as 2014, 79 percent of all M&A litigation was resolved through this type of disclosure-only settlement.[1]

This arrangement results in nominal, if any, benefit to shareholders, and the plaintiff's attorneys are instead the real beneficiaries of such settlements. As such, these settlements have been receiving increasing scrutiny from the defense bar, state legislatures and the courts.

In the latest developments affecting the continued viability of disclosure-only settlements, three recent opinions from the Delaware Chancery Court signal that the days of disclosure-only settlements have effectively come to an end.

In the first case, on Sept. 17, 2015, the Chancery Court begrudgingly approved a disclosure-only settlement in *In re Riverbed Technology Stockholders Litigation*. In *Riverbed*, the plaintiff shareholders sought to enjoin a $3.6 billion merger and obtained supplemental disclosures that Goldman Sachs, the target's financial advisor, had done substantial work for both the target and the acquiring entities. Despite this supplemental disclosure, however, 99.5 percent of the shareholders voted to approve the merger. The Chancery Court concluded that the shareholders' overwhelming approval meant that they did not believe the additional information was of any great importance.

The court noted that the parties negotiated the disclosure-only agreement in reliance on Delaware precedent approving such awards, and therefore awarded a reduced fee award of $300,000 ($500,000 had been requested), but went on to note that, going forward, arguments that disclosure-only settlements gleaned too little benefit for shareholders to support a broad release of all merger-related claims as well as attorneys' fees for plaintiff's counsel may carry the day.[2]

In the second case, on Oct. 9, 2015, in a challenge to Hewlett Packard's $2.78 billion merger with Aruba Networks, the court rejected a disclosure-only settlement. In ruling from the bench, Vice Chancellor J. Travis Laster noted, "I think that we have reached a point where we have to acknowledge that settling for disclosure only and giving the type of expansive release that has been given has created a real systemic problem."

The court then dismissed the case, and also refused to certify a class based on inadequacy of representation, with Vice Chancellor Laster noting, "And I say that because this does look to me like a harvesting-of-a-fee opportunity. It looks to me like it was set up as a harvest case, because there wasn't a basis to file in the first place. Then, once you guys actually had something fall into your lap, in terms of a litigable 'something,' it was just dealt with through the disclosure and the fee."

Most recently, in an opinion handed down January 22, 2016, in *In Re Trulia, Inc. Stockholder Litigation*, Chancellor

[1] Cornerstone Research. "Settlements of Shareholder Litigation Involving Mergers and Acquisitions—Review of 2014 M&A Litigation."

[2] Passarella, Gina. "Chancery Hints Approvals of Noncash Class Accords Won't Be as Easy." *Delaware Business Court Insider*. September 23, 2015.

Bouchard confirmed the reality of the new approach by refusing to approve a disclosure-only settlement, stating that "none of the supplemental disclosures were material or even helpful to Trulia's stockholders, and thus the proposed settlement does not afford them any meaningful consideration to warrant providing a release of claims to the defendants."

Even before the *Trulia* decision, Chancery Court observers had noted a sudden and significant decline in the number of M&A challenges filed in the wake of *Riverbed* and *Aruba* – a trend that should only be strengthened in light of *Trulia*.[3]

Based on these developments, one would expect plaintiff's firms to seek to avoid the effects of these rulings by filing in other states and federal courts outside of Delaware. But with the significant persuasive weight other jurisdictions accord to Delaware Chancery Court rulings on these matters, we expect the movement against disclosure-only settlements to grow further in 2016.

Corporate boards and officers planning for M&A activity in 2016 should be aware that, with disclosure-only settlements increasingly a thing of the past, desperate plaintiff's firms may begin pushing harder for increased deal consideration or post-closing damages, and, from the perspective of merger participants, blanket releases of all merger-related claims may be more difficult to obtain in consequence. Dealmakers should consult with counsel to determine how best to navigate this rapidly shifting landscape.

If you have questions, please contact Tom Ritzert or Tom Aldrich.

The Financial Times Ranks Thompson Hine #1 for Innovation in "New Working Models"

FT FINANCIAL TIMES INNOVATIVE LAWYERS2015 AWARD WINNER

Thompson Hine LLP announced that it was ranked as the top firm in the category "Most innovative North American law firms 2015: New working models" by *The Financial Times*. The firm is recognized for its innovation in developing SmartPaTH®, a service delivery model that incorporates project management, value-based billing, flexible staffing and process efficiency. Thompson Hine created SmartPaTH to better serve clients seeking significant changes in the way their law firms work with them.

The report, *Financial Times North America Innovative Lawyers 2015*, cites Thompson Hine as a firm refocusing its efforts on innovation to increase efficiency, budget more accurately, and manage matters more effectively, noting that "this year, we see firms such as Thompson Hine make smart models of delivering legal services central to their business." SmartPaTH's budget and work plan tool is highlighted in the report as an advance in technology that "integrates everything from billing costs to staffing" and "helps clients improve decision-making."

Managing Partner Deborah Z. Read is also recognized in the report as one of the top 10 "Innovative Lawyers" in North America for being the driving force behind the development of SmartPaTH. The publication attributes Thompson Hine's status as a top firm for client service to SmartPaTH, noting that it "forces a fundamental shift in the way lawyers think about the practice of law" and "not only maximizes the value the firm provides, but also fosters innovation within."

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[3] LaCroix, Kevin. "Delaware Merger Objection Lawsuit Filings Decline in Response to Chancery Court's Rejection of Disclosure-Only Settlements." *The D&O Diary*. November 18, 2015.

Ohio LLCs

"Fix" May Be on the Way for Controversial Ohio Limited Liability Company Act Provision

By David A. Neuhardt

In 2012, the Ohio Limited Liability Company Act was amended, based on proposals by the Corporation Law Committee of the Ohio Bar Association, to specify the fiduciary duties that the members and managers of an Ohio limited liability company owe to the company. A statutory statement of the fiduciary duties owed by the directors of a corporation has long been part of the Ohio corporation law and distinguishes Ohio from some other states, such as Delaware, where those fiduciary duties have been developed by the judiciary rather than the legislature and, therefore, evolve over time, and can vary based on circumstances, yielding less certainty as to how they will be applied.

The 2012 amendments provide that the members of an Ohio limited liability company owe their company two fiduciary duties: a duty of loyalty and a duty of care. The duty of care is defined simply as the duty to refrain from engaging in grossly negligent or reckless conduct, intentional misconduct or a knowing violation of law.

The duty of loyalty is comprised of three parts: 1) an obligation to account to the company for the property, profits and benefits derived from the conduct of the company's business, 2) an obligation to refrain from dealing with the company as, or on behalf of, a party having an adverse interest to the company, and 3) an obligation to refrain from competing with the company in the conduct of the company's business.

It is the last of these duties, the duty to refrain from competing with the company in the conduct of its business, that has caused the greatest concern to practitioners and potential users of the Ohio limited liability company form of organization. In many cases, parties who might otherwise wish to create an Ohio limited liability company have no intention of limiting the ability of the members to compete. For example, the limited liability company form often is used for joint venture real estate projects. The parties come together for a limited purpose – the development of a specific piece of real estate. Often, they are developers who

The combination of the new statutory duty not to compete with the company's business and the inability of the members to eliminate this duty by contract has received a good deal of criticism, and has limited the usefulness of the Ohio limited liability company form of organization for certain types of businesses.

may, in fact, intend to participate in similar projects elsewhere, perhaps even in the same vicinity as the project being developed by the limited liability company.

Prior to the 2012 amendments, the right to engage in other projects—arguably the right to "compete"—could be negotiated by the parties as part of the operating agreement. Unfortunately, the 2012 amendments, which created the express duty not to compete, also provided that the statutory duty of loyalty (including the duty not to compete) may **not** be eliminated by the operating agreement. An exception provides that the operating agreement may identify specific types or categories of activities that do not violate the duty of loyalty, but only if they are *"not manifestly unreasonable"* (a phrase that is not defined in the act). The combination of the new statutory duty not to compete with the company's business and the inability of the members to eliminate this duty by contract has received a good deal of criticism, and has limited the usefulness of the Ohio limited liability company form of organization for certain types of businesses.

Since the members now clearly have a statutory duty not to compete that cannot be eliminated by contract, parties desiring to use a Ohio limited liability company for a business transaction must understand that this obligation is part of the "deal," whether or not it has been expressly agreed to and whether or not it is consistent with their business understanding. If appropriate, careful drafting of the operating agreement may be required to convert the parties' business understanding into a statement of the types or categories of activities that they agree do not violate the duty, but with the ever-present uncertainty of what may, or may not, be "manifestly unreasonable." As a consequence, some practitioners have advised their clients to organize their limited liability companies in a jurisdiction other than Ohio, such as Delaware, which does not impose such a nonwaivable obligation on the members.

Help for this problem may, however, be on the way. Based on "considerable commentary" regarding the default fiduciary duties added in 2012, the Ohio Bar Association's Corporation Law Committee has recommended refinements to the Ohio Limited Liability Company Act to, among other things, eliminate the obligation not to compete from the fiduciary duty of loyalty imposed on the members. In addition, the committee recommended that the freedom to contract be restored, and that members be permitted to waive or eliminate any of the fiduciary duties of the members or managers in writing. Finally, the committee also proposed adding statutory fiduciary duties for officers of a limited liability company (if the company has officers, which are not necessary for a limited liability company), which also may be waived or eliminated in writing. These changes, if adopted by the General Assembly, will give parties choosing to use an Ohio limited liability company the flexibility to once again tailor their organizational documents to fully reflect their business understanding.

The committee's recommendations were incorporated into Senate Bill 181, introduced into the Ohio General Assembly in June 2015. The legislation was unanimously approved by the Ohio Senate in mid-October, and, as this is written, is before the Judiciary Committee of the Ohio House. It appears that sometime in 2016, the Ohio limited liability company likely will be restored to its proper place as the organizational form of choice for private companies in the state.

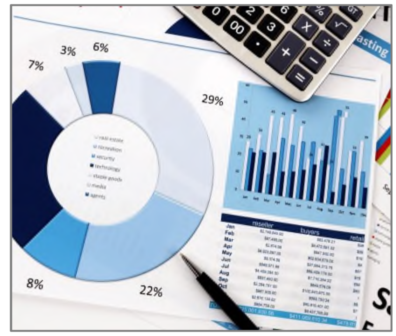
Please contact Dave Neuhardt with any questions.

Corporate Counsel Rank Thompson Hine Nationally for Innovation and Client Focus

Thompson Hine LLP has been ranked among the top 15 U.S. law firms for excellent client service in the *2016 BTI Client Service 30*. This is the ninth consecutive year Thompson Hine has been rated as one of the *BTI Client Service 30* – a survey of corporate counsel that identifies the top 30 law firms delivering superior client service. Ranking in all 17 activities that drive superior client relationships, Thompson Hine is recognized specifically for its "Innovative Approach." In addition, the firm ranked among the top four law firms nationally for "Client Focus" and in the top 20 for "Provides Value for the Dollar," "Commitment to Help" and "Helps Advise on Business Issues."

Clients refer to the firm as "forward-thinking" and report that "Thompson Hine is the only firm asking how we are doing." Thompson Hine has also been named for 14 consecutive years, since the survey's inception, to the BTI Client Service A-Team, of which the BTI Client Service 30 is a subset.

Corporate Governance



Auditor Independence – SEC Enforcement Actions Against Audit Committees

By Tammy P. Bieber

This third and final installment of our auditor independence series discusses actions by the U.S. Securities and Exchange Commission (SEC) against directors when auditor independence has been impaired. As previously noted, the SEC is of the view that independence is a shared responsibility between the company and its auditor, and under the Sarbanes-Oxley Act, it is the audit committee that is charged with oversight for the company.

Given the SEC Enforcement Division's stated position on gatekeepers, including directors, one would expect there to be significant enforcement actions against directors for auditor independence impairment issues. That is not the case, however. Instead, there are a few reported matters, all of which paint a fairly straightforward picture of what, at least to date, the SEC views as violations worth pursuing. Notably, each of these matters was brought against a director who had a personal interest in a venture with the audit firm; none was levied at an audit committee for failure to discharge its auditor independence oversight obligation.

Most recently, the SEC charged a trustee of certain funds, Andrew Boynton, and the funds' administrator with causing violations related to a Big Four accounting firm's independence violations. The independence violation was a business relationship between the consulting affiliate of the audit firm and the trustee who served on the boards and audit committees of three funds audited by the Big Four firm. Boynton agreed to pay disgorgement of $30,000 plus prejudgment interest of $5,329 and a penalty of $25,000.

In 2008, the SEC brought a settled action against Mark Thompson, who sat on the boards of three Ernst & Young (E&Y) audit clients and on the audit committee of another. During that time, Thompson and E&Y collaborated to create audio CDs for business development purposes. By participating in the independence-impairing relationship, failing to disclose the resulting conflict of interest, and signing three annual reports and one audit committee report in which each issuer incorrectly claimed that its auditor was independent, Thompson was a cause of each issuer's resulting reporting violations. Thompson agreed to pay disgorgement and interest of $123,917.

Finally, in 2004, E&Y informed the SEC that one of its nonaudit units had entered into a contract with a company owned by two TIAA-CREF trustees to sell jointly a valuation service for corporate stock options in violation of the auditor independence rules. The two trustees resigned, the SEC's Office of the Chief Accountant required that TIAA-CREF find another audit firm for the next year's audit, and TIAA-CREF received a great deal of negative attention, largely focused on the timing of its internal reporting to its Board of Overseers.

Consistent in each of these cases are two facts: first, the directors personally shared an economic interest with the accounting firm. Second, they failed to disclose that interest on their annual questionnaires (in at least two cases because they did not believe the relationships were reportable).

Although directors must carefully discharge their auditor independence oversight obligations, these cases suggest that the greatest risk to an individual director and possibly the company arises from the directors' own reporting of their relationships. As a result, directors should take care to disclose all relationships that could possibly bear on auditor independence (or clarify that a particular relationship does not) and avoid entering any prohibited relationships while serving on the company's board. Should an independence issue arise, it should be swiftly addressed at the highest levels.

Please visit our website to read the first and second articles in this series. With any questions, please contact Tammy Bieber.

Fair Labor Standards Act

How to Prepare for Potential Changes in the Overtime Regulations

By Nancy M. Barnes

Last March, President Obama directed the Secretary of Labor to update, modernize and simplify the Fair Labor Standards Act's (FLSA's) current white collar exemption standards. According to the Department of Labor's (DOL's) calculations, the proposed rule would result in nearly 5 million workers, who are currently exempt, becoming entitled to minimum wage and overtime protection under the FLSA.

The Fair Labor Standards Act's Current Requirements

By way of background, the FLSA requires employers to pay employees minimum wage and overtime pay (one and one-half times the employee's regular rate for hours worked over 40 in a workweek). The FLSA also provides a number of exemptions from these requirements. With respect to the white collar exemptions, employees who are currently paid at least $455/week ($23,600/year) on a salary basis and whose primary duties consist of certain executive, administrative and/or professional duties, are exempt from the FLSA's minimum wage and overtime requirements. The regulations were last updated in 2004.

Proposed Rule

As proposed, the new rules would more than double the salary basis for employees to qualify for the administrative, executive, professional and computer-related occupation exemptions – raising the salary basis from $455/week ($23,600/year) to an amount "equal to the 40th percentile of earnings for full-time salaried workers," which was $921/week ($47,892/year) in 2013 and is currently projected to be $970/week ($50,440/year) in 2016. The proposed rule also raises the salary basis for the highly compensated employee exemption. Previously, an employee who made at least $100,000 per year and performed at least one exempt duty would be exempt under the highly compensated employee exemption. Under the proposed rule, an employee must now receive a total annual compensation at the "annualized value of the 90th percentile of weekly wages of all full-time salaried employees" ($122,148/year in 2013) to be eligible under the exemption. Outside salespeople would not be impacted by these changes as proposed.

In addition to the change with respect to the salary portion of the exemption test, the DOL also sought comments on the "primary duties" test because it is considering revising those regulations as well. One possibility is that the DOL will require that exempt employees spend 50 percent of their time performing exempt duties – similar to the requirements currently in place in California – as opposed to the current regulations which focus on an exempt employee's "primary duty."

Finally, the DOL requested comments from employers in the computer and information technology industry as to whether changes should be made with respect to the types of positions and duties that should be included as examples of exempt positions/duties in computer-related roles.

The public comment period for the Department of Labor's proposed changes to the overtime regulations ended on September 4, 2015. Over 250,000 comments were received, which represent a high level of interest and concern about these potential changes, especially the steep and sudden increase in the salary level required for exemption.

The two changes are also likely to accelerate an employment litigation trend in the federal court system. Federal lawsuits alleging violations of the FLSA reached 8,160 nationwide in fiscal 2014, up 8.8 percent from the previous year and the highest since 1993, according to data released in March 2015 by the Administrative Office of the U.S. Courts.

No one can be certain when the final regulations will be issued or when they will go into effect. However, the DOL has indicated that the final rule will likely be issued in July 2016, and because this is a major initiative of the Obama administration, most commentators believe that the regulations will go into effect in 2016.

Preparing for the Changes

With that prediction in mind, employers should begin to take proactive steps now to prepare for the effective date of the new regulations. The first recommendation is for the employer to complete an assessment of its current workforce with particular focus on exempt employees who do not meet the salary threshold. For those who are close to the $50,000 salary level, an employer could budget for and be prepared to raise salaries to the necessary threshold to maintain exempt status.

Most employers, however, have a number of employees who meet the duties test but are far from meeting the proposed salary threshold. There are a number of ways to address the handling of these employees once the regulations go into effect. The employer should first assess how many hours per week are actually currently worked by the employee. If the employee regularly works 40 hours or fewer, the overtime requirements should have no budgetary impact. If an employee regularly works more than 40 hours, however, there are a couple of options available. An hourly rate could be calculated that results in the same compensation over the course of the year even though the employee would collect overtime for the hours over 40 worked each week. Another alternative is to restructure the job with fewer duties being performed so that the person who becomes non-exempt can perform their assigned duties within a 40-hour workweek, resulting in no overtime. As a side note, employers are permitted to forbid employees from working more than 40 hours in a workweek without prior authorization.

Second, employers should examine and track the work of all employees who are currently exempt. Tracking is important for a number of reasons. Job descriptions should be updated to accurately reflect work that is actually being performed by the employee in that position. In addition, if the DOL makes changes that require that exempt employees spend 50 percent of their time actually doing exempt functions, an employer will want to assess whether the role will meet that new standard. In some cases, it may be possible to juggle functions and responsibilities between two or more roles such that at least one job will meet the duties requirement even if another one does not. Thus, instead of having two non-exempt positions, one may be exempt and the other not.

For most employers, these new regulations will result in at least some employees moving from exempt to non-exempt status. Formerly exempt employees often see reclassification as a "demotion" and may resent being converted to an hourly position – even if they become eligible for overtime. Employers should consider putting together a communication plan with employees to explain the conversion. Moreover, training may be required for employees who previously did not have to track their time by the hour. Other time-related issues may also have to be addressed, including working outside normal work hours, travel time and other compensable time issues.

While it appears that these changes will go into effect next year, employers currently have significant lead time to prepare for what seems to be inevitable. By putting this issue on the list of New Year's resolutions, employers will be well-prepared to implement and budget for the changes that are expected in 2016.

If you have any questions, please contact Nancy Barnes.

Litigation Avoidance

Facing Lawsuits Head On: Why Preparing for Trial From the Outset Will Keep You Out of the Courtroom

By John T. Bergin

Companies inevitably face legal issues such as demand letters, civil lawsuits and arbitration demands (collectively referenced here as a "lawsuit"). While seemingly counterintuitive, a company should respond to a lawsuit by beginning to prepare a comprehensive Trial Plan to guide it throughout the case, even if the company wants to settle the lawsuit quickly or avoid trial at all costs. A Trial Plan will allow a company to make informed decisions that will get it back to "business as usual" quicker, cheaper and with the least amount of resulting harm to the company. A company's attorneys, however, cannot prepare a Trial Plan alone and must involve the company's management and the employees mentioned and/or targeted in the lawsuit (collectively referenced as the "team") until the end of the case. Without that buy-in, the Trial Plan will be unrealistic and will not be a useful tool for anyone in the organization.

It may seem easier and less costly to approach litigation more reactively, at least in the short term, but developing a thorough Trial Plan is an investment that enables a company to make informed decisions throughout the case and obtain the best possible results.

When preparing a Trial Plan, the team must first realistically assess the allegations and claims in the lawsuit (collectively referenced here as "claims") before turning their attention to a Trial Plan's purely legal components. Companies cannot do so without having their management and relevant employees intimately involved at the outset and may be disappointed in the outcome even if their attorneys "win" the case. Likewise, the company's attorneys may be upset that the management and employees do not understand or value their efforts, much less their "victories."

Having tried more than 60 lawsuits to verdict during two decades as a trial attorney, I have compiled a personal list of issues each team should address in its initial assessment:

Identify Critical Claims. A lawsuit usually contains numerous claims. But, in truth, every lawsuit has only a handful (at most) of critical claims. A company must identify and start assessing them from the beginning of the case. Otherwise, it will spend a disproportionate amount of time and money on the less important claims that will not ultimately make much, if any, impact on potential settlement negotiations or at trial. A company that can pinpoint the critical claims early in the case can focus its efforts on them, thereby saving itself substantial time and money. Doing so also makes it possible to attempt to rationally resolve the lawsuit early in the case when the company's costs are relatively low, internal time spent is minimal and neither party has become entrenched and resolved to fight until the end, regardless of the costs or other impacts.

Realistically Evaluate Critical Claims. Next, a company should evaluate the critical claims and its potential financial exposure. This evaluation starts with a detailed review of the relevant facts (both positive and negative) under the governing law as well as those that remain unknown or uncertain. The factual evaluation must be the first step because only one correct set of facts exists and the legal analysis depends on the precise facts in each case. Further, the ultimate fact finder, e.g., judge, jury or arbitrator(s), will be more likely to bend the law to meet the correct facts than alter the correct facts to fit the applicable law. Simple and straightforward claims and/or defenses almost always prevail, while far-fetched factual scenarios and creative defenses almost always fail to persuade the ultimate fact finder. And while the old adage that there are usually two sides to every story remains true with regard to lawsuits, a company must remember two crucial things: (1) a lawsuit, at its core, is only about money and (2) a company will rarely convince the ultimate fact finder that it is 100 percent right or that a claimant is 100 percent wrong.

Consider Business Impacts. After reviewing the critical claims, the team needs to consider a lawsuit's impact on employees and the continuing operation of the business. While a lawsuit usually requires a company to incur legal fees for outside counsel and face potential financial exposure on the claims, the team must also consider the impact that a lawsuit has on the company's employees mentioned and/or targeted in the lawsuit. Those people will become physically, mentally and emotionally invested in the lawsuit's outcome to the potential detriment of their work. Even if the mentioned/targeted employees can fully perform their work, a lawsuit may require them to spend a significant amount of time as part of the team for the duration of the lawsuit, which can be a long time. In some cases, those employees will undergo the added stress of having to be deposed and/or testify at trial.

Formulate Goals. Finally, the team should use the information from the above analysis to develop realistic goals for the case. In other words, a company must define what constitutes a successful outcome at the end of the case. A company should then make sure that its attorneys, management and employees work closely together throughout the case to ensure that everything they do in the case helps it achieve its goals. The team must also regularly revisit those goals as they may change throughout the course of the case. If so, a company can then timely alter its Trial Plan to make informed and educated decisions throughout the case and obtain the best results possible under the circumstances.

For more information, please contact John Bergin.

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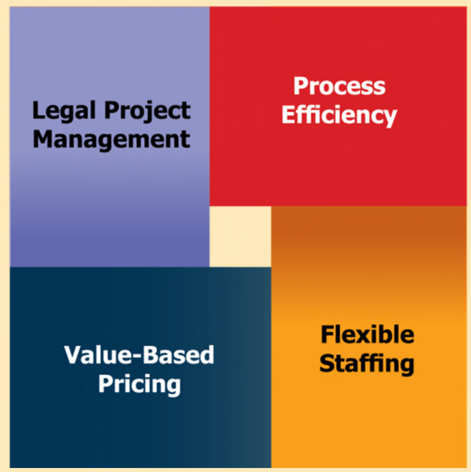

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