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DUE DILIGENCE

"I Thought I-9 Was a Highway. . ." – The Dangers of Ignoring I-9 Due Diligence in M&A Transactions

BY SARAH BUFFETT

Transactional lawyers have to cover a lot of ground in their deals: employment, tax, commercial real estate, intellectual property, and ERISA laws to name a few. So, when I speak to most M&A lawyers about the I-9 and immigration issues that can arise in a transaction, the first question I usually get is, "What is an I-9?"

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The Immigration Reform and Control Act of 1986 (IRCA)[1] requires every employer in the United States verify the employment authorization of each employee they hire by having them complete a Form I-9[2] within three days of hire.[3] The employee completes Section 1 of the Form I-9 and then provides their employer with proof of their identity and work authorization, and the employer records this document information in Section 2 of the I-9.

Are you thinking to yourself right now, "I've been working at my law firm for 10 years and I never had to fill out a Form I-9"? Odds are, you did and forgot it in the haze of new hire paperwork, IRS forms and orientation. Remember having to dig out your social security card from obscurity or bringing your U.S. passport in to Human Resources? That was for your I-9 form.

The Cost of Non-Compliance, a.k.a. "Why Should I Care?"

The Department of Homeland Security, specifically U.S. Immigration and Customs Enforcement ("ICE"), is charged with ensuring employers are compliant with this law. An ICE agent may, at any time, serve a company with a subpoena, called a "Notice of Inspection" ("NOI") that requires the employer to provide ICE with the I-9's for every employee[4] within three days of being served the subpoena. Failing to timely complete an I-9

[1] Public Law 99-603 (Act of 11/6/1986)

[2] *Available at* http://www.uscis.gov/i-9.

[3] Persons hired for less than three days must complete Section 1 and Section 2 of the Form I-9 by the first day of employment, persons hired prior to November 6, 1986 are 'grandfathered" under IRCA and are exempt from the I-9 requirement.

[4] This term is usually defined in the subpoena as all active employees and former employees within the I-9 retention period.

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for employee or doing a really bad job of it can result in fines of $110 to over $1000 per employee for the first infraction.

These fines impact large and small business alike. Last year, information technology staffing giant Infosys agreed to a $34 million dollar fine as part of a settlement agreement with the Department of Justice for their acknowledged I-9 violations.[5] ICE has also issued a $40,000 fine for a 43 person business where every employee was legally authorized to work in the United States but the employer couldn't find their I-9 forms.

When representing the acquirer, I advise on including an indemnification clause in the deal documents to protect my client from I-9 fines for forms they inherit that contain substantive violations. If representing the seller, make sure to add an expiration date for the indemnity clause. After deal close, the buyer can remediate I-9 forms with substantive violations, and you don't want your clients on the hook indefinitely if the acquiring company fails to do so in a timely manner.

For a company looking to acquire an existing business, fines are the least of your I-9 concerns as corporate or transactional counsel. As part of the ICE audit process, the ICE auditor verifies the identity and work authorization of every employee, using the document information recorded on their I-9 form. If any workers are found to have submitted fake documents or lack employment authorization, ICE issues a Notice of Suspect Documents (''NOSD'') and instructs the employer they must terminate every worker on the list in 10 business days[6] or potentially face civil and/or criminal sanctions for knowingly employing an illegal alien.[7]

Recently, I was brought into a deal where the client was acquiring a manufacturing business and one the attorneys noticed they had a lot of facilities in border states and wondered if there might be ''an immigration issue.'' We sent the target's counsel our I-9 and E-Verify due diligence questions, and discovered they were in the middle of an ICE audit. I reviewed the I-9 forms and Section 2 document copies and determined that approximately one-third of their workforce would likely be listed on the Notice of Suspect Documents and would need to be terminated on very short notice. All of the I-9 forms were completed correctly and on time, so ICE would not have issued any fines, but the company did not use the E-Verify program to verify the work authorization of their new hires and had inadvertently accepted fake identity documents from hundreds of hourly employees across seven states.

Transactional attorneys know that sometimes, representations and warranties alone are not enough to address potential issues in a deal. The likelihood of losing hundreds of skilled employees materially affected the price our client was willing to pay for the business they were acquiring. In the end, the deal closed, but the client paid a lot less for the assets of the business than they had originally planned.

[5] *United States of America v. Infosys Limited*, No. 4:13-cv-00634 (E.D.TX 2013); *see* http://www.ice.gov/doclib/news/releases/2013/131030plano.pdf

[6] Employees may challenge their inclusion on the NOSD by submitting new documents and meeting with ICE.

[7] Civil penalties range from $375 to $3,200 per unauthorized alien for the first violation, criminal charges may be brought against the company or individual who continues to employ multiple unauthorized aliens.

I-9 Due Diligence: Better Late Than Never

Have you recently closed a big deal, missed a potential I-9 issue and think it's too late to fix? If ICE hasn't already served a Notice of Inspection, you can add I-9 cleanup to your post-closing checklist. In structuring a deal, the acquiring party can require employees of the target to complete all new I-9 forms within three days of ''hire'' (deal close) or alternatively, the acquiring party can ''step into the shoes'' of the previous employer and acquire all of their I-9 forms and assume liability for its I-9 violations in the process. Most acquiring parties think that completing all new I-9 forms soon after closing is too disruptive to the business, but it is important to know that until ICE shows up, it is never too late to do an internal I-9 audit and remediate the I-9 violations found in the previous company's I-9 file.

A 1996 change to I-9 law[8] allows employers 10 business days to correct any technical or procedural errors on an I-9 after ICE has provided notice of the errors during an audit to avoid fines for technical (nonserious) errors or omissions. Better yet, if you conduct an internal audit of the I-9's you inherited before ICE shows up, you may be able to avoid fines altogether. Substantive (serious) violations of the IRCA I-9 requirements, such as failing to complete an I-9 within three days of hire or failing to complete one altogether has long been viewed by federal courts as ''incurable'' and as such always subject to fine during an ICE audit.

However, ICE has recently taken the position (absent aggravating factors) that an employer with any I-9's containing substantive errors that are brought substantially into compliance with IRCA prior to the NOI being served has demonstrated a good faith effort to comply and will waive the substantive fines for being untimely/incomplete at time of hire.

Bringing I-9 forms with substantive errors into compliance with the law requires showing of a very specific audit trail. Failure to properly document the changes made to I-9 forms during an internal audit may actually create more liability (for example, charges of document fraud) than it cures, so it is wise to conduct internal I-9 audits under the guidance of experienced I-9 compliance counsel. If an I-9 error is improperly fixed or the original erroneous form is not properly preserved, violations can be compounded and aggravating factors can be determined so experienced counsel MUST be consulted on such audit decisions.

I-9's "Plus": All of the Topics to Cover in Due Diligence

In addition to vetting I-9 compliance of a target company during the acquisition due diligence, there are other related topics worth asking a question or two about.

Federal contractors[9] and companies doing business in seven states with mandatory E-Verify laws[10] need to

[8] The Illegal Immigration Reform and Immigrant Responsibility Act (September 30, 1996) creates this ''good faith'' exception to fines for technical or procedural I-9 failures.

[9] Applies to federal contracts issued after September 8, 2009 that include the Federal Acquisition Regulation (FAR) E-Verify clause (73 FR 67704).

[10] North Carolina, South Carolina, Georgia, Alabama, Mississippi, Utah, Arizona

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also check E-Verify compliance of the target company. Companies that are not using the federal E-Verify program to verify the employment authorization of their employees within three days of hire risk losing eligibility for future Federal contracts or the ability to transact business in an E-Verify state.[11]

Federal Acquisition Regulations (FARS) provide for additional punitive measures such as debarment and suspension of the federal contractor. State law may come into play as well.

For example, the South Carolina E-Verify law provides that any company doing business in South Carolina, who is found to have a second instance of failing to use the E-Verify program to verify the work authorization of their new hires in that state, loses their ability to conduct business in the state for a minimum of 10 days.[12]

Banks and other financial institutions, which are not allowed by federal law to be closed for more than three consecutive days, could find themselves in hot water if they lack compliance with this E-Verify law. It is also important to note that the use of E-Verify to verify the identity and work authorization of new hires does not absolve companies of their I-9 obligations, as one business recently discovered.[13] Complete E-Verify records will not mitigate the fines ICE levies for missing or incomplete I-9 forms with substantive errors.

When representing the acquirer, I also like to include an immigration-related due diligence question in my I-9 and E-Verify list. Did you know some work visas are tied to the nationality of a parent company or the existence of an overseas parent or subsidiary? An acquisition that doesn't identify if there are key employees in the U.S. on a work visa prior to deal close may lose the ability to retain those workers. A client may not understand the significance of this until, say, they acquire the U.S. subsidiary of a German manufacturing company and learn the day after deal close that the entire R&D department, made up of German engineers transferred over from the parent, aren't part of their deal.

For this reason, when representing the acquirer, I always recommend including in the definitive agreement a specific immigration law compliance representation and warranty for any transaction that involves a target in a border state, a large number of low-skill employees, or one with key foreign workers. If you represent the target company in the transaction, I suggest you review carefully any such representation and warranty requested by the acquirer. Make sure you communicate with your client's immigration counsel as part of the due diligence process to accurately ascertain the status of foreign workers and how the deal may affect their visas. Note that if your client cannot comply with the immigration representations and warranties requested, the buyer may well ask for a purchase price reduction.

Finally, I-9 and immigration due diligence may help you issue spot other areas of non-compliance. When a foreign national working in the U.S is given access to sensitive technology or data, our export trade laws view this as though it was exported to the foreign national's country of origin and citizenship. There are entire articles written just about the ''deemed export'' rule under U.S. export trade control regulations, so I won't belabor the point, but it is illustrative of the types of issues a little immigration due diligence may help you identify in a transaction when representing the acquirer.[14]

The Final Analysis

If you are a corporate attorney skimming this article, and you take away nothing else, remember this: add ''Form I-9'' and ''E-Verify compliance questions'' to your already voluminous due diligence document and consider adding specific representation and warranties in your deal documents to address these issues. A few more good questions now may save your client millions of dollars in post-close problems. Ignoring I-9 issues in a corporate transaction may mean for your clients the I-9 is a highway. . . to hell. (Sorry, I couldn't resist!) However, I can help you ''map'' the recovery.

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[11] *See* http://www.uscis.gov/e-verify

[12] South Carolina Illegal Immigration and Reform Act (June 27, 2011) Section 41-8-50 (D)(1)(b), exception if first violation did not occur in the three years preceding the second violation

[13] *United States v. Golf International d/b/a Desert Canyon Golf*, 11 OCAHO no.1222 (2014)

[14] *See* http://www.bis.doc.gov/index.php/policy-guidance/deemed-exports