

Early Stage Tech Companies: Navigating Potential Pitfalls

By Benjamin C. Lau & Douglas J. Klein

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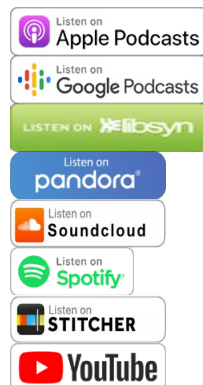
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For early-stage tech employers, rapid business growth can quickly lead to costly employment and immigration law missteps. Risks can be magnified when striving to attract talent.

Jackson Lewis P.C. · Early Stage Tech Companies: Navigating Potential Pitfalls



Transcript

Alitia ([00:06](#)):

Welcome to Jackson Lewis' podcast, We get work™, focused solely on workplace issues everywhere and under any circumstances. It is our job to help employers develop proactive strategies, strong policies, and business oriented solutions to cultivate a workforce that is engaged, stable and diverse.

Our podcast identifies the issues dominating the workplace and its continuing evolution and helps answer the question on every employer's mind, how will my business be impacted?

For early stage tech employers the upside generated by rapid business growth can quickly be eliminated from costly employment and immigration law missteps. Potential risks can be magnified when new business owners strive to attract sought after talent and expand their workforce in today's competitive job market.

On this episode of We get work™ we share practical yet critical steps employers should consider early in the business life cycle of both domestic and foreign national employees to mitigate legal risk and financial exposure.

Our hosts today are Doug Klein, principal in the New York City office, and Ben Lau and Zain Abidi, associates in the Los Angeles office of Jackson Lewis. Running the gamut of legal assistance on this issue, Doug, Ben and Zain all work with large and established Fortune 500 corporations and startups in fintech industries, forging partnerships with employers of all sizes and at all stages of development.

Doug helps employers face multifaceted workforce challenges amid rapid growth and regularly provides labor and employment advice to private equity investors engaged in due diligence and M&A transactions. Ben's practice focuses on inbound immigration, assisting high value employees in navigating the complexities of US immigration law. Zain has worked on US immigration matters for a variety of industries in addition to technology and fintech companies.

Doug, Ben and Zain, the question on everyone's mind today is how can startup employers compete for the talent to help build their business in the face of daunting immigration and other regulations, and if they don't how does that impact my business?

Ben Lau ([02:23](#)):

That's great. So happy I'm able to meet with you, Zain and Doug, today. We're going to talk about some issues we're seeing in recruiting and retaining employees, especially within the tech and startup fields.

To start this off, I think the best way to do it is just let's figure out what the difference between employees and contractors are. If you could help us out with that, Doug?

Doug Klein ([02:44](#)):

Yes. Absolutely. It's something that is commonly confused. Even individuals I work with who they think are employees for a long time will use phrases such as 1099 employees. There is no such thing as a 1099 employee, so let's start from the beginning.

An independent contractor is a standalone business that truly operates independently and maintains all sort of aspects of a unique existence, and an employee is the opposite. An employee is someone who works generally for one single business and the employer controls that individual's work, the means of work, the tools, et cetera.

Right from the beginning we need to have a framework of are we engaging independent contractors or are we employing employees? The distinction can be critical from an employment practices and potential liability standpoint.

Ben Lau ([03:40](#)):

Why is that? Why does it matter whether my employees are contractors or employees I guess when I'm just trying to... You know, I'm trying to get my business going?

Doug Klein ([03:49](#)):

Right. So an independent contractor is not subject to fair employment laws as a general rule. There certainly are exceptions, minimum wage and overtime rules for example.

Right away if you classify someone as an independent contractor, if they're properly classified you don't have to pay that person overtime. Now if they are misclassified and they should have been treated as an employee, then all of a sudden I do owe that person overtime if they work more than 40 hours a week, unless of course they're exempt from overtime, which is a separate issue.

But it's a common misconception, and we see independent contractors or former independent contractors challenge their classification status generally after employment ends... Or, excuse me, the independent contractor relationship ends, and you have a former disgruntled individual who believes they should have been paid more money.

The other area that we're really seeing a lot of activity in is government enforcement, so it's not just an individual who may have an interest in going after a business for misclassification, but the government certainly does.

If somebody is an employee, the business contributes, for example, to unemployment on behalf of that individual. If somebody is an independent contractor they don't. So very often we former independent contractors let go, they go and file for unemployment because they don't know what it is or they think they're entitled to it, or whatever it may be, and all of a sudden the Department of Labor knocks on the employer's door because they looked to see if you contributed on behalf of that individual and you didn't.

Now you have a request for information about how you paid that person and for how long, and also, by the way, who else did you treat like that, because we, the Department of Labor, want to know all about them too? So it's not just necessarily generated by a direct dispute with the former worker, but it can be something that the government becomes interested in.

One other thing I will say, we're certainly seeing this in New York, where I'm sitting, but throughout the country as well, in COVID times, when the governments are broke and unemployment coffers are just drained, the government is looking for assets. They're looking to fill their coffers, so I'm starting to see it, and I have no reason to believe it's going to change.

We will continue to see an uptick from the Department of Labor in terms of independent contractor misclassification and failure to contribute to unemployment, for example, so I think that's only going to continue.

Ben Lau ([06:12](#)):

So if I call someone a contractor, is that not good enough for this? I guess my concern, it sounds like as if the government and whoever I was paying is the one in control of who's a contractor and who's an employee. That's what I'm hearing from you right now.

Doug Klein ([06:28](#)):

It's a good question. Look, a business is certainly in a much better position if you have an agreement, a written agreement, a strong written agreement with an independent contractor, because it would demonstrate that the parties had a meeting of the minds

about what the relationship meant and what the rules were.

But the agreement alone doesn't tell the whole story, and if in fact the person is not an independent contractor then the agreement couldn't say certain things. For example, if the independent contractor doesn't maintain its own workers compensation coverage insurance then that is a strike against the business, because for your employees you have to maintain that, and independent contractors generally have their own workers comp coverage, so the agreement can be telling in that regard.

If the agreement prescribes very meticulous rules about how the work is done and when the work is done, that cuts against an independent contractor classification because, remember, independent contractors don't have the same levels of control over their work like an employee does. As a general rule, independent contractors should perform the work when and where they want to.

So the agreement of the business and the worker certainly matters to some extent, but there's a lot of things that we have to see in an independent contractor agreement to support the classification.

Ben Lau ([07:52](#)):

I see. So when should I contact my attorney? Is there a certain point where either a relationship changes with someone I'm paying that I should be concerned about maybe contacting an attorney to see whether or not I am running into this classification problem?

Doug Klein ([08:09](#)):

What used to surprise me but doesn't anymore is when a company will say to me, "Well, the individual wanted to be treated as 1099, so I did them a favor, so why am I being taken to task for it now?" The answer is it doesn't matter. The government doesn't care what the worker may supposedly requested of you. It's you, the company, that's responsible for properly paying your workers.

So a very important point for any business is if you realize that you are treating some people as independent contractors and others as employees who are doing the very same thing that's a problem, because the government, for example, is going to learn about that if they investigate you, and it's not a helpful fact if you're treating similar people doing the same thing differently.

That's one important time for you to take a pause and say maybe I need to reevaluate how we're paying people and treating them from an employee versus an independent contractor standpoint.

Ben Lau ([09:04](#)):

Got it. That makes sense. To move on over to Zain right now, we'll talk about a little bit some immigration issues we're seeing with recruiting and retaining employees. What's the most common visa, Zain, that we would see employers use when they're trying to bring on talent. They recognize someone doesn't have US work authorization or may need US work authorization, what are the common visas we would see?

Zain Abidi ([09:28](#)):

Yeah. Generally startups and tech companies in their early phases will favor the H-1B visas, TN visas, U3 visas, and to a lesser extent H-1B1 visas. They can be visas for... It's what's called specialty occupations. Those are occupations that require a bachelor's degree in a specific specialty.

The E3 under the regulations is essentially the same visa as the H-1B visa, but for Australians. The TN visa is a little bit more restrictive in the types of occupations that you can hire under, and those are defined by NAFTA.

So with H-1B I think it's important that employers understand the timeline. Generally how employers will pursue the H-1B visa is that they'll have a foreign national who's interning under OPT as a foreign student, and then they realize that that foreign national brings value to the company and they want to sponsor them for something a little bit more permanent or long term.

Generally employers should be aware that the H-1B lottery runs from mid-March to the end of March every year, so if you're going to sponsor someone you should have an idea if you're going to sponsor them by the end of February at the very latest. Generally you should contact your attorney by February 15th. That's what I tell our clients.

From there they'll be entered into a lottery. Last year it ran from March 5th to March 25th. Then from March 25th to April 1st the lottery will run and results will be given out usually on either March 30th or April 1st. From there you have a 90 day filing window to file the H-1B visa.

Ben Lau ([11:00](#)):

I've heard that you need to pay H-1B workers a certain amount of money. Is that true?

Zain Abidi ([11:04](#)):

That's correct. That's generally the biggest issue we see with early stage tech companies and startups, is that they're not aware that there's a prevailing wage. Now the prevailing wage will depend on, number one, what metropolitan area the work site is sitting in, and, number two, the type of occupation.

DOL has what's called the SOC codes, which are umbrella codes that constitute multiple occupations. For example, application developers, so any type of software developer or Java developer, or Python developer will fall under that SOC code, right?

So these prevailing wages differ, based on those factors, so it's important at the early end of the process to kind of determine if the company is willing and able to pay the prevailing wage to the foreign national.

Ben Lau ([11:46](#)):

Got it. One last thing, I mean to kind of tie in the contractors and the visa issues. What if I have a contract worker come up to me and say all of a sudden, "Can you sponsor me for a visa? I don't have US work authorization." Am I required to do anything at that point?

Zain Abidi ([12:04](#)):

First of all, once you have actual or constructive knowledge of a contractor's lack of work authorization you're required to cut ties with that specific contractor or that 1099, quote/unquote, employee or contractor.

Under the I9 regulation, which is how you... I9s are how you verify employment authorization, you're not required to verify contractors, but actual and constructive knowledge of lack of work authorization for a contractor is a finable offense under the regulations.

Ben Lau ([12:36](#)):

Wait, so the I9 is an immigration document?

Zain Abidi ([12:39](#)):

Yeah. People don't realize that I9 is an immigration issue. The enforcement agency that handles I9 enforcement is ICE, which falls under the DHS, or Homeland Security, umbrella. I9 compliance is something most startups don't consider until they're a larger company and once they've hired a few dozen employees.

That's something that startups should take notice of from a very early stage, because ICE audits... Once you hit 20 or 30 employees ICE fines can exceed \$100,000 through I9 issues, so it's important to maintain I9 compliance from the get go.

Doug Klein ([13:12](#)):

Hey, Zain, have you seen any change in the Biden administration's enforcement of I9 compliance as compared to the Trump administration? I know sometimes a change in the political tenor in Washington can affect issues like that.

Zain Abidi ([13:25](#)):

Yeah. Definitely. These are top down policies, so we're seeing nationwide less I9 audits. I think the Biden administration has indicated that they're planning on spending less money on enforcement and more money on clearing immigration backlogs, which is another conversation.

So generally, yeah, we're expecting less I9 audits from ICE, but that can change every four years. We don't know what's coming in 2024, and that's why maintaining compliance in your I9 program is important from the get go.

Doug Klein ([13:55](#)):

And, Zain, I would think that this is a good time to get the house in order so to speak, right, I mean especially if there is a change in office in the future, be it in 2024 or thereafter? Now is the time to focus on these issues, when there may not be enforcement like we have previously seen?

Zain Abidi ([14:12](#)):

Correct. The greatest mitigating factor in a ICE audit is an internal audit, or evidence of an internal audit. I can't stress that enough. Sometimes we have clients who aren't

willing to spend the money on an internal audit and they get audited by ICE and they're slapped with hundreds of thousands of dollars of fines.

You can really bring that down to almost a slap on the wrist if you conduct an internal audit and ICE sees that you acted in good faith to correct your previous I9s and to insure that your future I9s are made in compliance with the program.

Doug Klein ([14:40](#)):

Ben and Zain, a question that I get from clients often is about asking foreign nationals about where they're from, what country they originate from. In certain places with very protective fair employment laws sometimes there's a hesitation about getting into background information like that because they're worried about running afoul of discrimination laws, et cetera. What can employers ask with perspective workers with respect to where they originate from?

Ben Lau ([15:08](#)):

Hi, Doug. This is Ben. Yeah, actually that is an issue that comes up because from an immigration context employers want to know whether or not they're going to incur additional costs to hire this individual, if that's a possibility at least.

So while you're correct, you can't ask somewhere they were born. That's obviously a... National origin is a protected class. Now what we have advised and what is a good strategy or an option is to ask the individual if they require US sponsorship for work, for a work visa. That is not a protected class and it is in fact a question that you can ask to determine whether or not a person would require sponsorship in order for you to hire them and for them to work legally in the United States.

Doug Klein ([15:56](#)):

If a perspective employee answers the question that they would require sponsorship is the employer in safe ground to deny the application of employment and not move forward with employment?

Ben Lau ([16:11](#)):

Yeah. Yeah. Yeah. The employer is not required to incur additional costs simply to hire someone because they don't current have valid US work authorization.

Doug Klein ([16:23](#)):

If a contract worker... So if I have an independent contractor relationship with someone, if they have been working for me and I then learn they don't have work authorization in the US, and we were looking to formalize the relationship for example and have them come on as an employee, are there any pitfalls there? Have I set myself up by engaging them as a contractor that I'll have to sponsor them?

Ben Lau ([16:44](#)):

From an immigration perspective there are some strategies that if the company wants to go through are available to bring that person on as an employee. But as we were... I think Zain addressed earlier, we were talking about it, like from an I9 perspective the company is opening itself up to potential fines for constructively continuing to

employee someone that they know does not have US work authorization.

But I think this dovetails into another issue. Many tech startups and smaller companies are using PEOs mostly to do almost all of their HR work and their I9s.

What are PEOs? This is something that's come up and asked me a lot, Doug. Is this something that you could explain and elaborate on a little bit?

Doug Klein ([17:31](#)):

Yes. I'm encouraged, because a lot of tech startups that I'm working with are coming now with some familiarity about PEOs, and that was not the case five or seven years ago. Foreign based tech companies who are establishing a presence here in the US in particular are more and more familiar with PEO arrangements, but there's a lot of value for small startup companies, tech and otherwise.

PEO stands for professional employer organization. These are large outfits, companies that you, the business, establish a co-employment relationship over the workers, so you and the professional employer organization co-employ your workers.

The benefit for small startup companies to the PEO arrangement is you gain the PEO's resources, payroll resources for example. You also gain their leverage in the insurance marketplace, so where it may be very costly for you to offer health insurance to your workers you want to be competitive in this very competitive tech market you want it for health insurance. PEOs can offer you their leverage for premiums in the health insurance marketplace.

They can do a lot of very onerous housekeeping for you, payroll taxes, administration of benefits, human resources guidance to some extent, so there's a lot of benefits to small startup companies with the PEO arrangement.

Generally as your employee population grows, maybe it's 50 employees, maybe it's 75 employees, the cost savings, so to speak, with the PEO arrangement are not as advantageous to the business, so around the 50-75 employee threshold is when I start to see employers moving away from the PEO model. But, again, it can be a real advantage early on in terms of cost savings and offering employees benefits, et cetera.

Now remember, the PEO is not an employment lawyer and they're not immigration lawyers, right? At the end of the day if there is an issue they're not necessarily going to take the fall, so to speak, so small startup companies are still well advised to seek independent advice on some of these what can be more grainy issues, right, sponsoring foreign nationals, how to pay my people, et cetera. So again, there are pros and cons with everything, but the PEO model can be a real advantage for small businesses.

Ben Lau ([19:54](#)):

From what I'm hearing, both the PEO and I are kind of like both employing this individual? If the PEO did the I9 and I've decided now I'm going to go off the PEO, I'm going to handle all of this stuff on my own, I just take those I9s with me, right? I don't need to do anything else?

Doug Klein ([20:09](#)):

I'm going to defer to Zain on that one.

Zain Abidi ([20:12](#)):

You would inherit any issues or any mistakes done by the PEO on those I9s. Generally what I advise clients is whenever there's a change in who's managing or who's handling your I9s, that's the best time to do an internal audit. Whether they're going from a PEO to in-house or you're a startup that's acquired by a larger company or you merge with another company, to me that's the best time to do an I9 audit, because you can, number one, catch the previous issues and mitigate any future liability from ICE, and, number two, fix those issues internally with the new HR person or whoever is doing your I9s.

Doug Klein ([20:46](#)):

Yeah. That sounds smart.

Ben Lau ([20:48](#)):

On that same note, Doug, if all my personnel documents were developed by the PEO should I have any concerns when I'm doing all this in-house now and not working with the PEO?

Doug Klein ([21:01](#)):

To Zain's point, the time where the company moves to a standalone operation or you're acquired, that's the time to really make sure that we're taking a look at our documents.

This is not a co-employment relationship anymore, so on their face a lot of things that are said in those documents probably don't make sense anymore, so we need to be looking at our employee handbook, our restrictive covenants, wage notices... For example, in places like New York, where you have to provide certain written notice about how employees are paid, those are all going to need to be refreshed because the employer is different now.

Just with respect to restrictive covenants quickly, and this is something that's come up a lot in the tech industry recently for me in my experience, with COVID and remote work we have this phenomenon where employees are relocating all over the place, and oftentimes companies don't even have a complete handle on where their people are physically sitting.

So I encourage anybody who is listening to this to take the time now to make sure we know where our people are physically working for us, including, by the way, outside of the United States. Restrictive covenants in particular, though, are governed by state law as a general rule.

Employers so often have a choice of law provision or have an agreement that was written several years ago. Now our people are located elsewhere. It's really important to make sure that your restrictive covenants are narrow, are focused, have a choice of law provision that makes sense based on their operations and where that person is working for you, because when it comes time to send a cease and desist letter if that employee goes to your competitor, or try to go into court and enforce one of these

things, that's not when we want to be realizing that we should have refreshed our documents.

So it's even more of an issue now because we have people relocating all over the place, again without employers sometimes knowing where they are. But the concept applies not just with restrictive covenant agreements, but we need to make sure we're in compliance with fair employment rules everywhere our people are physically sitting, and with people moving around that's changed recently.

That I assume has similar ramifications, Zain and Ben, with respect to immigration policy, so do you generally recommend that businesses maintain a written immigration policy, and if so what does that look like?

Ben Lau ([23:18](#)):

Yeah. This is Ben. We do recommend that companies develop an immigration policy, and early on is best. While it may not seem like a big deal when you only have five employees, as you start ramping up or as these companies start ramping up their hiring, what we're noticing is that with no standard immigration policy, with this ad hoc approach, they have hiring managers promising green cards to individuals that they've hired.

They have them promising jobs or making job offers to people who are outside the United States without any knowledge of whether or not they're going to actually be able to come to the United States and work, or when that will happen.

So establishing these policies early gets everyone onboard with the same understanding of what actually happens during the immigration process, and if they're promising someone a green card what that actually entails and what they're committing the company to, because no one wants... When you're committing a company to a process that could take up to two years to complete for an employee that hasn't even started working, sometimes you get your employee in a tough situation.

I think one last thing I wanted to ask Zain was to kind of circle back to the remote work. Is it important from an immigration standpoint where my employee is working? They're working at home now. They're no longer in the office. Should I be concerned?

Zain Abidi ([24:34](#)):

Generally no if you take care of these things at the front end. Number one, obviously we have the prevailing wage, and that will vary greatly. We've seen issues of prevailing wage where the office that the employee is reporting to is in Texas but they're staying in Silicon Valley, which is by far the most expensive metropolitan area, the San Jose metropolitan area, so the prevailing wage is considerably higher.

These are considerations the employer should take before employing the remote employee, because sometimes that prevailing wage will be considerably more than what they're willing to pay.

Number two, it's important that you remain LCA compliant. The LCA is an integral

part of both the E3 and the H-1B petitions, which are petitions heavily used by both larger tech companies and startups and early stage tech companies.

On the LCA you have to list every work site, so it's important to list not only the work site that they're reporting to, but all remote work sites.

Doug Klein ([25:30](#)):

A question from the employment lawyer here who's still learning about immigration. Can I I9 new hires remotely, if they're working remotely for me, or does that have to be done physically in person?

Zain Abidi ([25:42](#)):

Yeah. In most states you can use a notary as an agent to complete I9 verification, but some states, like California, do have special rules about that and impose additional restrictions on who can verify those I9s.

Doug Klein ([25:55](#)):

I was hoping to go one day without hearing that there was an exception to the rule based on something in California, and I had almost made it, but of course I didn't.

Ben Lau ([26:04](#)):

One quick thing, Doug, there is... I mean during COVID they did relax the I9 verification requirement somewhat, and that is actually currently in process. The Department of Homeland Security is looking into potentially extending that, so that employers can now verify I9 documents remotely without actually having to see the physical documents.

Whereas right now you need... You know, employers or the notary, or in California the special exception, they actually need to see the physical original document, they are looking into potentially allowing for the verification of documents remotely, without having to see the actual physical documents. So we'll see what that... That's a developing area right now, and hopefully that gives us a little more flexibility in the future.

Doug Klein ([26:50](#)):

And perhaps some of the tech audience listening to this could support the government with developing some technology to facilitate that process.

I think our time is wrapping up here, so I want to say thank you to my west coast colleagues here for educating me certainly on immigration issues, which I continue to learn about and I find to be interesting and developing certainly.

I think just something I've observed in listening today and thinking these issue through is these are sensitive issues for tech companies really because of how competitive the job market is. I hear that constantly from clients who I'm speaking with, is we can't find anyone, or candidates are coming back to us with demands we can't even believe, but we have to give them what they want. We want the talent.

So there's inherent tension I think between recruiting that top talent and growing

your work force and managing against a lot of the risks and considerations we've talked about today.

So I certainly encourage businesses to spend a little bit of time and a little bit of resources right now before you grow the workforce to just get a handle on where are our people sitting, how are we paying them, what immigration promises and visa sponsorship promises are we potentially making, and getting a handle on all of that.

Thank you both for this, and have a great rest of your day.

Ben Lau (28:08):

Thank you, Doug.

Zain Abidi (28:08):

You too. Thanks, Doug.

Alitia1 (28:11):

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