People and Reward

The human face of global transactions.

Overcoming people issues in cross-border M&A.

Freshfields Bruckhaus Deringer

Whatever the industry sector you are targeting, one feature in particular is common to all: people.

Executive summary

Significant HR challenges are present in almost all M&A, spin-off and joint venture transactions. The complexity of 'people issues' increases when the deal is cross-border. Running an international transaction involves a lot of planning and co-ordination.

It is of fundamental importance to carefully assess human resources and labour and employment law matters throughout all different phases of any kind of international transaction, in order to increase its chances of success. Neglecting employment law can threaten otherwise solid cross-border M&A. Therefore you need to think about HR issues, including pensions and benefits plans as well as differences in local labour regulations, to ensure a smooth transaction.

Set your goals

Start by setting your aims for the deal. Do you want to retain employees? If so, you may need to improve their terms and conditions, eg by offering them retention bonuses.

Layoffs do not always reduce costs as employees are generally entitled to severance pay. Business transfer laws such as the EU Acquired Rights Directive (ARD), which all member states have had to transpose into their domestic legislation (often in slightly different ways), can further complicate matters.

Understand the target

To comply with local employment laws and avoid unforeseen costs, you need to understand the target's employment practices, policies and pay:

- Do employees have fixed-term or open-ended contracts?
- Does the target recognise any kind of employee representative body, such as a works council or trade union?
- Have non-compete agreements been signed?

In-depth due diligence – particularly of pensions liabilities – will stop you from paying too much and help you avoid unexpected post-closing HR costs.

Due diligence: prevention not cure

People and reward due diligence should inform the transaction structure, the purchase price, representations and warranties, indemnifications and other conditions and covenants included in the share purchase agreement (SPA) or asset purchase agreement (APA).

Your due diligence should include:

- payroll information, salaries and pay structure;
- benefit schemes, especially accelerated vesting and rollover provisions;
- change-of-control arrangements and transaction bonuses;
- past business transfers;
- pension schemes and exit liabilities;
- collective bargaining agreements;
- restructuring obstacles;
- leased employees, freelancers and contractors;
- incentives to retain employees;
- unusual terms and conditions of employment;
- restrictive covenants;
- union memberships, consultative bodies and industrial relations history; and
- pending or threatened employment disputes or investigations.

Human rights risks and data protection are recent additions to this list.

Human rights due diligence

It's becoming more common for buyers to assess potential human rights-related risks. Businesses that don't may end up associated with worker abuses in supply chains, particularly if components or products are sourced from developing countries.

Data protection in due diligence

Data protection is now a crucial consideration for all businesses. Liability for breaches can be transferred to you at closing. Exposure can be increased by virtual data rooms with personal information about employees.

EU data rules are strict – the processing (ie any review or transfer) of personal data is restricted, especially sensitive information such as trade union membership.

Deal structure

The structure of a cross-border deal – whether a purchase of shares or of assets, or a mixture of both – can have an effect on which employment law issues are relevant.

There are two options:

- buying the shares of the company owning the business (stock or share sale); or
- buying the assets of the target business (business or asset sale).

The main difference between a share sale and an asset sale is that, in the first case, the bought entity essentially stays the same.

Asset sales

For asset sales, there is a distinction between countries where business transfer laws apply, such as EU member states, and those where they do not.

If such business transfer rules apply, you will assume all rights and obligations of employees under existing employment contracts and related benefit schemes. Depending on the country, this could lead to full or joint and several responsibility for pre-transaction employment costs and liabilities. The APA must, therefore, be carefully negotiated and drafted.

In any case, properly rewarding key personnel is critical to ensure a smooth transfer.

Share sales

The target is acquired as a going concern and business transfer laws do not apply. But all employment costs and liabilities remain with the target.

Any liabilities should be reflected in the purchase price, although representations, warranties and indemnification provisions can offer some protection.

Although you may not always have to consult with employee representatives, doing so may help mitigate any employee concerns.

Employment contracts remain unaltered but a target moving out of a group may see changes in pension, bonus and incentive schemes. There may be an exit liability in relation to a pensions trust, accelerated vesting of share options or a need to adapt incentive schemes as they relate to performance indicators of the seller group to mention just the most important changes.

Key features

Asset sales

- Only assets and liabilities that the purchaser agrees to acquire are transferred – 'cherry-picking'.
- The seller is left with the shares in the target and whichever assets and liabilities have not been included in the sale.
- Greater flexibility.
- Diligence can be limited to the transferred assets and liabilities.
- More consents and approvals are required (eg the assignment or novation of existing contracts, consent from suppliers, customers, landlords).
- The process is generally slower and more complex due to the greater number of consents required and the documentation required to transfer each of the assets.

Share sales

- All the assets and liabilities of the target are acquired.
- As all the assets and liabilities are transferred, the seller's ongoing liability is limited to the extent of the warranties and indemnities it gives to the purchaser.
- Diligence is generally more extensive because the target's liabilities will move across to the purchaser.
- The purchaser acquires the target's business as a going concern (ie all the contracts remain in place, subject to any change of control provisions).
- Other than consents resulting from change of control provisions or regulatory/shareholder approvals, it is unlikely that it will be necessary to seek other third-party consents.

Employee transfers

Employee transfers within the EU

Under the ARD, a transfer situation arises if there is a transfer of an economic entity that retains its identity.

A target meets the EU definition of an economic entity if it is 'an organised grouping of persons and assets facilitating the exercise of an economic activity which pursues a specific objective'.

Employees dedicated to the transferred economic entity transfer automatically, ie they don't need to reapply for their jobs, and their employment contracts must remain unchanged post-transfer.

The 'dedication' of employees criteria can be tricky for employees who do not exclusively work for the transferred business (eg shared services). There are no clear rules as to how to determine the 'dedicated employees', but the percentage of working time rule (ie more than 50 per cent) is applied in many EU countries.

Note that in France, in the case of a partial business transfer, the seller has to obtain a prior authorisation from the Labour Inspector for so-called 'protected employees', such as members of the works council and trade union representatives, to transfer them.

The ARD's employee protection rules apply for an indefinite period and cannot be 'signed away' by either party.

In some countries, such as the UK, if an employee believes that changes to their employment contract have left them worse off, they can claim constructive dismissal.

Where terms and conditions cannot be replicated, you must offer an equivalent.

The domestic law in some member states does though allow changes to terms and conditions via a collective agreement with an employee representative body, such as a works council or recognised trade union.

In certain EU countries (eg Germany, UK), employees have a legal right to object to their transfer, but the consequences of such an objection vary from one country to another. For instance, in the UK, employees refusing to transfer with no legitimate reason will be deemed to have resigned. In Germany, employees can refuse to transfer, but have to do so within one month of being notified of the transaction in writing; if they do, they will remain with the seller.

Employee transfers outside the EU

Outside the EU, some countries have laws based on the ARD or similar mechanisms. But many jurisdictions have no business transfer laws at all.

In some places, buying assets can simply leave employees with the seller. But you could offer jobs to those in the target business before the transfer – with the employer's consent.

In a number of Pacific Rim countries (including Australia), the seller must terminate existing employee contracts (and bear any termination costs) and the buyer then offers those employees new contracts.

General aspects of employee transfers

Both the buyer and the seller must inform and consult existing employees who may be affected by the transfer and, in certain circumstances, consult with employee representatives/trade unions.

The parties should co-ordinate communications and comply with any language requirements. Precise information and consultation (I&C) requirements differ by country, as do the consequences for non-compliance.

Understanding the nature and possible impact of these requirements on the deal timetable will be critical (for more details, see the section hereafter).

Overview of an M&A transaction process

The timings and process might change subject to national specificities and the type of transaction (share deal vs asset deal).

Instruct advisers, start process	Initial offer/outline agreement on deal terms	Signing of transaction documents	Closing
Diligence	**Further diligence, negotiation**	**Satisfaction of conditions**	
Signing of NDA (and possible exclusivity/standstill)	On non-competitive deals, non-binding MoU may be signed	Price agreed; warranties and undertakings given; purchaser now legally bound (subject to conditions)	Purchase price paid

Employment law characteristics of an M&A transaction

The timings and process might change subject to national specificities and the type of transaction (share deal vs asset deal).

	Signing	Closing
	Pre-completion	**Post-completion, integration**
• Employee representative information • Press statement (if any) • Advance notice to regulators • Consultation (if required)	• Pre-completion reorganisation (if required) • Discussing employees in scope • Discussing employee retention • Employee consultation	• Reorganisation • Implementation of employee retention • Harmonisation of Ts and Cs of employment

Employee transfer

Information and consultation

Employee representative bodies, such as works councils and trade unions, are common across much of Europe.

Works councils have the right to give advice or 'opinions' on proposed management decisions, and may even have the power to approve/veto proposed changes to pay, benefits and working conditions.

In addition to 'local' (ie country-specific) works councils, many companies operating in more than one European Economic Area (EEA) member state also recognise European works councils (EWCs).

You must consult EWCs on matters with 'transnational significance', eg headcount reductions or transactions affecting employees in more than one EEA member state.

Different obligations and timings mean you must handle I&C processes involving EWCs and local employee representatives carefully. EWC I&C is typically handled first, followed by local consultation processes, although local laws in certain member states may require an alternative approach.

Consultations can take time and deals can sometimes be delayed or even blocked. In the Netherlands and in France, for example, you must consult a works council for an opinion before making any irrevocable decision on the transaction, ie before signing any definitive share/asset purchase agreement. In addition, in the Netherlands, if the works council advises against the transaction, you must observe a one-month waiting period, during which the works council can lodge a court appeal. If the court rules in its favour, you may have to stop the transaction.

To maintain momentum, you may choose to proceed and carve out certain 'difficult' jurisdictions. These jurisdictions will follow their own timetable. Carving out is becoming more and more common as buyers opt for short deal timelines.

Confidentiality

In the early stages of an acquisition, companies (particularly listed companies) are often reluctant to share information with employee representatives. But generally you cannot justify this on the grounds of confidentiality.

In some countries, employee representatives have strict confidentiality obligations but in others the rules (and their enforcement) are limited.

You may prefer to assume that information shared with employee representatives will soon find its way into wider circulation.

Sanctions for non-compliance

If a court or tribunal finds that you failed to comply with your I&C obligations during a business transfer, you could at the very least have to pay a financial penalty.

But in jurisdictions such as France and Finland, company directors can face criminal sanctions (note that imprisonment for the company's legal representative was recently abolished in France though).

Employee benefits

Pension schemes

Pension schemes can cause problems, particularly in the UK, US and Germany. Defined-benefit schemes, which guarantee a certain level of pension on retirement, are expensive to run and often have large deficits. These schemes are less popular nowadays but are still operated by a number of employers in the UK, and to a lesser extent the Netherlands and Spain.

Pension deficits can also be triggered by transactions, eg if a target company leaves the seller group's wider pension scheme.

The involvement of the pensions regulators and pension scheme trustees, who are responsible for ensuring the security of members' benefits, can affect the timing of transactions.

Share schemes

Employers in Europe and the US often offer share-option schemes, which can be an important part of remuneration for key employees.

You should find out what happens when an employee leaves any such scheme operated by the seller, including the tax consequences (forfeiture, accelerated vesting, etc). You may be contractually obliged to replicate the scheme.

If not, you may still wish to do so or could offer a cash-based incentive instead. The rules for such schemes differ across Europe.

Employee data transfers

Annexes of sales agreements and other transaction documents may contain employee data. It is also possible that information on employees required in connection with due diligence will need to be transferred to professional advisers, or to the purchaser itself.

Information concerning transferring employees will inevitably incorporate personal data, and thus will need to be appropriately safeguarded by aggregating or anonymising the data. You can face severe consequences if you fail to comply with data transfer laws.

Do not disclose information that identifies particular individuals unless it is required by law or is necessary for the transaction.

You must not retain personal data for longer than necessary and only process the minimum amount of data required.

Be aware of any potential post-signing data transfer issues, eg from integrating the workforce into group-wide HR tools or benefit schemes.

Recent EU developments

The EU General Data Protection Regulation will enter into force on 25 May 2018, replacing the 1995 EU Data Protection Directive. Unlike the Directive, the new Regulation applies to non-EEA companies processing the data of EEA citizens.

Under the Regulation, you will not be able to transfer personal data to a country outside the EEA without 'adequate' protection.

The EU and the US agreed the EU-US Privacy Shield framework to replace the Safe Harbour framework. The new agreement states – inter alia – that any company handling HR data from Europe must comply with decisions by European data protection authorities.

Retaining and rewarding top talent

Talent continuity can often be a critical part of M&A, having a direct impact on the overall success of the deal. M&A transactions often increase turnover and drag down performance. This is why you should determine whether immediate turnover will be a significant issue, creating the need for a retention strategy.

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- What is the impact of the transaction for key staff? For example, are there change of control provisions for key staff?
- What additional transaction/retention bonuses have been/will be offered to staff? How will liability for such amounts be allocated in the SPA?
- Are any such bonuses conditional on staff transferring/staying through the transition?
- How will tax and social security liabilities be handled?
- Will any ongoing protection for terms and conditions be offered/negotiated?
- What happens if the buyer does not wish to make offers of employment to all in-scope staff?
- What restrictions are there to prevent key staff from leaving either pre- or post-transaction? How will these be reflected in the SPA?

Post-acquisition integration

If you intend to integrate the acquired business (and its employees) into your existing operations (rather than managing it as a stand-alone entity), you will need a coherent strategy.

Try to use your HR function to motivate and retain employees. You need to communicate clearly and show leadership.

Share specific goals with the target's employees immediately after announcing the transaction. Highlighting your corporate values and organisational culture should help assimilate acquired employees.

Start planning post-closing HR integration as early as possible. Consider whether terms and conditions can be harmonised, looking at both individual contracts and existing collective bargaining arrangements. Can changes be implemented unilaterally or do you need consent? The potential for amending collective agreements varies between countries.

All options on company pension schemes should be investigated, including the freezing of existing promises, the handling of vested rights and a changeover from defined-benefit to defined-contribution plans.

Redundancies

If you want to restructure the business and reduce headcount, bear in mind that almost all European countries have rules to protect employees from dismissal post-transfer.

Under the EU Collective Redundancies Directive, you must consult employee representatives if you plan to dismiss:

- over a period of 30 days, at least:
  - 10 workers in establishments with 21–99 workers;
  - 10 per cent of workers in establishments with 100–299 workers;
  - 30 workers in establishments of 300 or more workers; or
- over a period of 90 days, at least 20 workers, whatever the number of workers normally employed in the establishments in question.

There might also be stricter thresholds in some EU countries (eg France).

You must discuss with employee representatives ways to avoid dismissals or reduce their impact, as well as inform national authorities of any plans. The consultation must be duly completed before you give employees their notice of termination.

You may also need the approval of local labour authorities for actions that affect employees. In France, for example, the labour authority must approve any social plan that is put into place; in addition, the dismissal of so-called 'protected employees' such as employee representatives is subject to a prior authorisation from the Labour Inspector – failure to obtain this approval voids the dismissals and you could face compensation and/or reinstatement claims.

In other countries, approval is not needed. Nevertheless, local labour bodies may have a right to be informed and failure to do so can result in fines.

How can we help?

Our experience in big international transactions makes us well placed to help with any people issues. We regularly advise global employers on all HR matters in multiple jurisdictions, as well as project managing all other legal aspects of cross-border transactions.

Our people and reward practice has 22 partners and over 120 other lawyers across the globe. Combining local advice with a strategic overview, we give you a clear and comprehensive game plan.

In places where we do not have offices, we can bring on board trusted local counsel with whom we have a longstanding relationship as part of our Stronger*Together* initiative. This means you will get a consistent, strategic approach to HR issues in any cross-border M&A deal you're involved in.

'It's a team of high-quality experts with great technical know-how. The firm is also very internationally networked, which is important for us in cross-border issues.'

Chambers Europe 2017

'They have excellent employment lawyers located in a lot of countries who provide excellent legal advice when resolving sensitive matters. They understand the nuances and differences of international matters and help us navigate through all problems.'

Chambers Global 2016

'There is never any issue around co-ordination, which is something I have experienced with other firms in the past. They really work as a team. They are great because of the commercial focus and speed of response. They take time to listen and understand what the problem is, and the follow-up is first-class.'

Chambers Europe 2015

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