

Reproduced with permission from Daily Labor Report, 198 DLR I-1, 10/13/2016. Copyright © 2016 by The Bureau of National Affairs, Inc. (800-372-1033) <http://www.bna.com>

Mergers & Acquisitions

Cross-border mergers and acquisitions are challenging, requiring a coordinated approach by experts in tax, securities, capital markets, antitrust, *and* employment law. In this Bloomberg Law Insights article, Baker & McKenzie attorneys Benjamin Ho and Georgia Jolink discuss how employment-related issues can sometimes take a backseat to the corporate considerations driving large global transactions. However, they note, bringing HR to the table early in the game will help avoid or mitigate against major headaches, delay, employee relations issues, and potential exposure for all involved.

Rest Easy: How to Master HR Issues in M&A Deals and Avoid Sleepless Nights

BY BENJAMIN HO AND GEORGIA JOLINK

Cross-border mergers and acquisitions are challenging, requiring a coordinated approach by experts in tax, securities, capital markets, antitrust, *and* employment law. Employment-related issues can sometimes take a back seat to the corporate considerations driving large global transactions, but bringing HR to the table early in the game will help avoid or mitigate against major headaches, delay, employee relations issues, and potential exposure for all involved.

What are some of these HR headaches and why are they so vexing? First, consider that cross-border deals are rife with “people issues”—an issue-spotting playground for employment lawyers. Moreover, the vast majority of the HR-related questions inherent to cross-border deals are most effectively handled sooner rather than later in the life cycle of the deal. Yet, it is not uncommon for deal teams to push off confronting some of

these questions until later in the process when they become more complicated, time-intensive and costly to resolve.

For example, what is the plan for addressing notice and consultation obligations triggered by the transaction, and have the parties budgeted appropriate time to satisfy applicable obligations? Has the acquirer ensured proper harmonization of benefits and certified there will be no gaps in coverage? What has been done to promote employee retention and to ensure that Day 1 post-close goes as smoothly as possible? These are just a few examples of the kinds of persnickety questions that keep in-house counsel and HR professionals up at night. And, if neglected, the late consideration of these issues can delay, or even thwart, successful deal execution.

But there’s good news: Early recognition and management of the complex employment issues germane to corporate deals will lay the foundation for a successful transaction. To cut to the chase, it’s possible to avoid HR nightmares in international M&A and here’s how:

1. What’s under the hood? Conduct a thorough due diligence.

In today’s competitive business landscape, there is immense pressure to move at a breakneck pace. In the rush to sign or close a deal, parties may neglect to conduct a thorough due diligence. However, what companies don’t know *can* hurt them, and an acquiring company could end up inheriting a litany of employment-

Benjamin Ho is a partner in Baker & McKenzie’s San Francisco office and Georgia Jolink is an associate in the firm’s Houston office. They both advise clients on domestic and cross-border employment matters arising throughout the employment relationship, including those from mergers and acquisitions and global corporate reorganizations.

related liabilities if it does not take the time to thoroughly understand what it is buying.

Accordingly, once the structure of the transaction is determined, the next step is a full and thorough due diligence of employment and benefits matters. As a buyer, this may mean examining HR policies, procedures and practices in addition to the more “obvious” matters like pending employee claims or benefits liabilities. While a non-compliant employment policy is unlikely to derail a large-scale transaction, doing a deep dive allows the buyer to better understand the acquired workforce and to advise the deal team on any issues that may impact the price of the transaction.

Due diligence is not without its own legal landmines, however. The European Union, along with an increasing number of other jurisdictions worldwide, has enacted stringent data privacy legislation. Even if both companies are already fully compliant with applicable data privacy laws and take additional steps that might be required to address employee data gathered during due diligence, it is prudent at the very least to redact personally identifiable information before exchanging it as part of due diligence.

2. Analyze employee transfers.

The structure of the transaction at the local level will determine if and how employees transfer from one entity to another. For example, in asset sales in the EU, under the Acquired Rights Directive, employees transfer automatically if the sale qualifies as a business transfer. In the U.S., in an asset sale, employees transfer by way of termination and rehire. By contrast, in stock sales, employees typically do not transfer and remain employed by the local employing entity (except in the case of a forward merger).

The complexity of the transfer analysis should not be underestimated. Even a “simple” automatic transfer may require careful documentation and communication to employees in order to be valid under local law.

3. Consult, consult, consult. Budget time to address works council, employee representative and union requirements.

Regardless of the structure of the local transaction, the parties must watch out for notification and consultation obligations. In many jurisdictions, works councils, employee representative bodies and/or unions groups must be notified and/or consulted regarding the corporate change. This can be one of the most arduous and time-intensive stages of a cross-border deal. And, it can come as a surprise to in-house counsel and HR professionals accustomed to working with U.S. employee populations.

To determine what obligations are triggered, the parties must identify the following: the local transaction structure; the number of employees, legal employer and location; which organizations are present; applicable collective agreements, including company, national, and sector levels; and whether any redundancies are contemplated in connection with the transaction. This should be done as soon as possible as the timing requirements will vary around the globe, and many jurisdictions will require several months to complete the process. For example, in France, a local asset transfer cannot move forward until the applicable works council has rendered an opinion on the transaction. While the acquisition can proceed even without the works council’s tacit approval, the works council has significant power to delay its opinion (and potentially the closing

date of the transaction). As such, it’s wise to build in significant time to address consultation obligations.

4. Understand limitations on redundancies.

The concept of at-will employment does not translate outside of the U.S. If a company intends to reduce headcount as a condition of an acquisition, be aware that most non-U.S. jurisdictions require employers to provide employees with notice (or pay in lieu of notice) and/or severance.

Further, depending on the number of impacted employees and the timing of layoffs, mass reductions in force may trigger additional notification and consultation obligations that can delay a deal. In the U.K., for example, mass redundancies often take up to 3 or 4 months due to the lengthy consultation process, even where the consultation is not contentious.

To avoid lingering employee liabilities post-close, in some cases, the best strategy is to enter into mutual separation agreements. While this often will not waive an employee’s right to severance indemnities, it can be effective in limiting future employment claims as many jurisdictions permit terminated employees to sign release agreements as a condition of a mutual separation.

5. Proactively harmonize terms and conditions of employment.

In most jurisdictions outside the U.S., employers do not have carte blanche to change the terms and conditions of employment. For example, the Acquired Rights Directive requires that EU employees transfer on their existing terms and conditions of employment (subject to limited exception). If employees are presented with different terms and conditions, they may be entitled to cherry pick the terms and conditions that they want, or resign and claim severance. And, in most parts of Asia and Latin America, employee consent is typically required before implementing changes to terms and conditions of employment. If employers implement changes without consent, they may face expensive constructive dismissal claims.

Accordingly, deal teams should partner closely with in-house employment counsel, HR and benefits providers to map current benefits and determine which terms and conditions must be harmonized, and how to effectuate such harmonization.

6. Quantify the impact on benefits and equity.

What happens to employee equity awards that vest over a number of years is a key consideration in any corporate transaction. Where a U.S. company has granted equity to its employees and that company is being acquired, the treatment of the equity awards in the transaction must be sorted out. In an acquisition, change of control provisions in the company’s equity plans may have been triggered or the parties may negotiate an acceleration of vesting, a cash-out of equity benefits, and/or the acquirer may assume the equity awards and convert them to rights over its shares. It is important to understand whether the treatment of the equity awards raises negative tax consequences for the employees or employers prior to the close of the transaction in order to manage the impact of those consequences. There also may be significant securities or exchange control filings or other action items resulting from equity treatment, particularly in countries like China where equity awards are highly regulated and companies need the exchange control authorities’ approval to operate or wind down an equity plan.

Where a U.S. company sells off all or part of its business, employees holding equity awards may be moving to a new company group. Most equity plans make clear that leaving a company group is considered a termination of employment for purposes of the equity award. However, for employees outside the U.S., these equity plan provisions may be overridden by laws intended to protect an employee's rights on transfer of employment or at termination if the termination occurs at no fault of the employee. In Denmark, for example, the Danish Stock Option Act protects employees who terminate employment involuntarily by ensuring that the equity award cannot be forfeited, notwithstanding plan terms to the contrary.

Don't neglect to consider applicable benefit and pension plans. Pension plan liabilities, in particular, can be significant and time-consuming to resolve. It's best to address this issue early during the due diligence phase. The parties should identify relevant pension or benefit plans, determine their timing, funding and structure, and consult with counsel to ensure that a clear strategy to resolve plan issues is prepared.

7. Identify any applicable immigration and mobility issues.

Cross-border M&A can significantly impact employee work permits. During the due diligence process, the parties to the deal should identify the foreign worker population (including locally-hired foreign nationals as well as expatriates on assignment) and confirm the current corporate sponsor of each person's work permit. This helps ensure the continuous work authorization of employees after a significant corporate change, and minimizes exposure for inherited immigration compliance problems.

Many jurisdictions require employers to amend or renew work permits where there are corporate changes that: (i) impact the ownership of the sponsoring employer; (ii) result in a new or different employing entity; or (iii) substantially change the terms and conditions of employment. As a result, employees may need to cease working for a period of time or to remain outside of the host jurisdiction while the amendment is being processed by the immigration authorities. An employer's failure to amend a work permit (or a failure to do so timely) can also result in an interruption or termination of work authorization for a portion of the workforce.

Additionally, many jurisdictions require employers to verify the employment eligibility of the local workforce and to maintain records at the worksite confirming its authorization to employ each worker. The acquiring company may be required to attest that all employees acquired as a result of the transaction have the appropriate authorization to work post-closing. The acquiring entity can also inherit and be liable for immigration violations committed by the target entity. Accordingly, once the structure of the deal is determined, the acquiring company should conduct due diligence on the target company's immigration compliance programs, determine the impact of the corporate change on the employees' authorization to work post-closing, and develop an action plan for amending work permits as necessary. Where the target company will remain the direct employer, meanwhile, it should do an accounting of its foreign workforce and determine whether any work permits or visas should be amended or renewed between signing and closing.

8. Recognize the limitations of restrictive covenants.

The desire to obtain non-compete agreements is common in M&A deals, particularly with a seller's key employees or shareholders. While many states in the U.S., and countries such as Australia and Singapore, permit non-competes as long as they are pursuant to business need and limited in time and scope or in certain limited circumstances, there are unique jurisdiction-specific risks or costs to consider. For instance, in Germany and Spain, consideration during the restricted period is required for a post-termination non-compete to be enforceable. In certain Latin American countries, such as Brazil, the underlying agreement is likely unenforceable in a local labor court, and non-compete agreements are entered into for deterrent effect only. As such, it is critical to appreciate the jurisdiction-specific nuances in the legal landscape relating to restrictive covenants, and buyers should only pursue non-compete agreements that they actually want to enforce.

9. Coordinate internal and external communications.

All parties should coordinate their employee communications regarding the deal, comply with language requirements, and heed local notice and consultation requirements. In some jurisdictions, press releases and other deal communications may implicate labor laws. As such, it's important for employment lawyers to be included in the drafting process. Closely monitored and crafted communications help ensure a smooth transition and encourage employee support for the deal.

10. Include HR in the deal room.

Finally, while it may seem obvious, HR and in-house employment counsel must weigh in on employment matters related to the transaction. So, save a seat for HR, employment, immigration, benefit and equity experts in the deal room. As you can see, their expertise is indispensable to a successful acquisition. Experience shows that the most successful transactions are those in which employment counsel and HR work side-by-side with their corporate, tax, benefits, equity, immigration, and IP counterparts.

Employment-related issues affect the language in the deal documents themselves. In even the most straightforward M&A deals, the parties are required to provide representations and warranties to the other side about the value of the company (for sellers) and the consideration that will be provided (for acquirers). For a seller, this likely means disclosing employment-related liabilities that could have a material impact on the transaction. For an acquirer, this means understanding the potential financial impact of these liabilities. Yet, without getting input from HR and employment counsel, the parties to an M&A deal may fail to adequately assess the costs—both literal and figurative—of these liabilities before it is too late to adjust the deal or the price.

* * *

Cross-border M&A deals are not synonymous with being well-rested. They inherently invite complicated challenges and require precise coordination of numerous moving parts. In particular, the "people" issues weave in a layer of complexity that, if neglected, can cause sleepless nights for all involved. But, adopting these 10 tips will go a long way in preventing HR nightmares and paving the way for deal success.