Spinning Off? Consider These Top 10 HR Issues First

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Companies throughout the world may, at one time or another, elect to spin off a product or business into a wholly owned independent company. Though these types of decisions are often driven by overall business strategy and corporate and tax considerations, the impact on the employees of both the existing company and the "SpinCo" can be significant and require equal amounts of careful planning as other substantive areas. Based on our experience guiding clients through this process, we have identified the following top 10 human resource considerations for companies before, during and after a global spinoff.

1. Due Diligence

First, the employment team should conduct initial due diligence in order to understand the employment landscape. This process will include obtaining an employee census, including the legal employer of each employee; identifying the presence of works council, trade unions and other employee representative groups; reviewing basic employment agreements, confidentiality, proprietary information and restrictive covenant agreements, among others; and notice and severance obligations, among others. All of these components will impact various business considerations, including timing particularly where works council consultations are required, as well as identify potential trouble spots early in the process. Even the most well-organized companies will find surprises throughout the process, and it is better to uncover them sooner, rather than later.

2. Employee Mapping

Once the basic employment landscape is confirmed, it is important to identify which employees are dedicated to which business line. In other words, who must be transferred into or out of certain entities before the spinoff? Classic “shared services” functions can be the most challenging to determine
whether employees should transfer with the business being spun off. These functions typically include finance, human resources and even the legal department — all areas that typically provide services to more than one business within an organization. Other areas of concern with regard to employee mapping include analyzing whether combining employee populations into a single legal entity will trigger any new works council requirements. For instance, companies who wish to avoid a works council may consider not combining two sets of employees in order to stay below mandatory works council threshold numbers of employees (i.e., five employees in Germany or 50 employees in the Netherlands).

3. Works Council, Employee Representative and Union Requirements

Working with these groups can be one of the most taxing and time-consuming stages of a global spinoff. In many jurisdictions, one or more of these groups will need to be notified and/or consulted. To determine which obligations are triggered, the company should identify the local transaction structure; the number of employees/legal employer/location; which organizations are present; applicable collective agreements, including company, national and sector levels; past practice; the existing relationship; and whether any “measures” are contemplated in connection with the spinoff (i.e., redundancies). This should be done as soon as possible once the decision to implement a spinoff is made, as the timing requirements will vary across the globe, and many jurisdictions will require several months to complete the process. For instance, a works council that is disgruntled about another issue may use what would otherwise be a relatively benign corporate change as leverage to achieve its other goals and could even threaten local closing.

4. Analyze Employee Transfers

The structure of the spinoff at the local level will generally determine if and how employees transfer from one entity to another. Transfer methods may include automatic transfers under the Acquired Rights Directive in the EU (asset sales); termination and rehire; and no change of employer (stock sales). This process will require teaming with other functional areas to determine which, if any, assets are transferring with the employees. This exercise is critical in determining whether there is a “going concern” for employment purposes (which may not be the same as for tax or corporate purposes) and the applicability of the Acquired Rights Directive, for example. Employers should note that even a “simple” automatic transfer requires careful documentation and communication to employees in order to be valid under local law and should not be overlooked.

5. Address Harmonization and Synergies

When preparing to integrate employees post-spinoff, employers should be aware that they do not have carte blanche. Many jurisdictions have restrictions on the ability to change benefits (i.e., the EU Acquired Rights Directive) or require employee consent to do so. Further, notification/consultation obligations may be triggered by changes to benefits or other terms and conditions if not otherwise triggered by the local transaction structure. If any synergies (i.e., reductions in force) are contemplated in connection with the spinoff, it is important to understand any limitations on redundancies under local law. For instance, in many jurisdictions the spinoff alone will not constitute cause for dismissing employees for economic reasons, and additional notice and severance may be required if redundancies constitute a collective dismissal under local law. Redundancies also will affect works council and notification and consultation timing.
6. Plan Time for Benefit Transfers

Benefit transfers can cause significant delays. It is important to understand early on what benefits may need to be transferred, realigned or even terminated. Benefit plans sponsored by the parent or another company in the group may stay behind and thus may need to be replicated or replaced prior to the spinoff. The replication process can be time-consuming and require negotiation with providers, which should be factored into the transaction’s timelines. Further, issues of funding and any related liabilities also need to be considered.

7. Notice, Severance and Termination Indemnities

Where the local spin structure is an asset transfer, notice and severance indemnities may be triggered. If any employees need to be transferred to a different legal entity prior to the spin, then these issues also need to be addressed well in advance of the global spinoff.

8. Global Equity Considerations

It is important to consider how equity awards (e.g., restricted stock units, stock options, restricted stock, etc.) and plans will be impacted by a spinoff. To account for the change in value of RemainCo stock upon a spinoff, long-term incentive awards outstanding at the time of the spinoff typically are adjusted to preserve the intrinsic value of the awards. In addition, different alternatives may be used to adjust awards. For example, awards may be adjusted to provide for (i) settlement in shares of the employing entity (RemainCo or SpinCo), (ii) settlement in shares of both RemainCo and SpinCo or (iii) using a hybrid approach. Such an adjustment may trigger tax, securities, exchange control and/or labor law issues, including the following: (i) the adjustment may result in immediate taxation or the loss of tax-qualified treatment; (ii) securities filings may be required; and/or (iii) regulatory approval may be required. New SpinCo plans and award agreements generally will need to be prepared, approved and implemented (requiring new international compliance). Global equity issues and considerations should be analyzed from the date of the spin announcement until the date of the spinoff, and a number of issues will need to be addressed pre- and post-spin.

9. Immigration Matters

It is critical to consider the immigration consequences of a spinoff as early in the due diligence process as possible. Too often, employees’ immigration issues are not addressed until immediately preceding closing (or even after closing), which is often too late to avoid interruption or termination of work authorization for certain foreign national employees and can result in a disruption in the business if key employees are not immediately able to work for the SpinCo due to lapses in immigration status. Keep in mind, many jurisdictions require local employers to maintain evidence of authorization to employ each worker (for example, the I-9 form in the U.S.). Depending on local laws, SpinCo may assume the liabilities of the parent company or may be required to attest that all employees of SpinCo possess the appropriate authorization to work post-closing. Also, many jurisdictions require employers to file amendment petitions to reflect corporate changes to seek continuing authorization to employ a foreign national under the resulting corporate structure. An employer’s failure to file amendment petitions, where required — or failure to do so timely — can result in loss of work authorization. Given this, a prudent company will audit its I-9 and other relevant worksite compliance records, as well as its population of foreign national workers who hold temporary authorization to work, to determine what steps must be taken to ensure compliance post-closing.
10. Employee Communications

It is important to monitor internal and external communications. This is critical to ensure that employees always hear a constant message. Further, communications which suggest that final decisions have been made at a local level, may run afoul of local law where prior consultations are required. Closely monitored and crafted communications can also help to ensure a smooth transition and encourage employee “buy in” for the spinoff.

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