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How to Avoid HR Nightmares in International M&A Deals

Abstract

[Excerpt] What keeps human resources professionals and in-house attorneys up at night? Probably many things, but during a cross-border M&A deal, the nagging questions often revolve around “people” issues: How will the employees transfer from the seller to the acquirer? What are the timelines and gating items to reaching “day 1” with an in-tact workforce to carry out the business? What can be done to ensure employee retention, provide for a smooth transition of services and limit the loss of productivity? Are layoffs an option? Can employees effectively delay or stop the transaction?

While people simply are not predictable in the way that corporate structures and tax solutions can be, there are tried and true methods for recognizing key issues and limiting their potential to become HR nightmares. Companies that have gone through cross-border transactions, whether on the seller or acquirer side, likely will be familiar with these issues, most of which arise during post-acquisition integration, that is, at that stage after close of the M&A on the U.S. level when the acquirer consolidates the newly acquired entity and preexisting foreign subsidiaries.

That said, strategically addressing many of these issues before the U.S. acquisition closes can help avoid HR nightmares. To illustrate the importance of planning, the following is a snapshot of issues arising in, and tips to successfully maneuver through, an international M&A.

Keywords

mergers, acquisitions, human resource management, employee retention, corporate structure, international commerce

Comments

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How to avoid HR nightmares in international M&A deals

By Susan Eandi and Ute Krudewagen

What keeps human resources professionals and in-house attorneys up at night? Probably many things, but during a cross-border M&A deal, the nagging questions often revolve around “people” issues: How will the employees transfer from the seller to the acquirer? What are the timelines and gating items to reaching “day 1” with an in-tact workforce to carry out the business? What can be done to ensure employee retention, provide for a smooth transition of services and limit the loss of productivity? Are layoffs an option? Can employees effectively delay or stop the transaction?

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That said, strategically addressing many of these issues before the U.S. acquisition closes can help avoid HR nightmares. To illustrate the importance of planning, the following is a snapshot of issues arising in, and tips to successfully maneuver through, an international M&A.

■ **Conduct a full and thorough due diligence.**

Unfortunately, employment due diligence is often conducted somewhat superficially, if at all. This can turn into a nightmare if, for example, the acquirer determines after prices already have been negotiated that it has not only inherited various international employees but also several lawsuits. Accordingly, the first step in any international M&A should be a full and thorough due diligence, including an examination of employment and employee benefits matters. One word of

caution, however: Countries that are members of the European Union, along with an increasing number of other jurisdictions around the world, have enacted data privacy legislation. Unless both companies are already fully compliant with data privacy laws and take any additional steps that might be required to address employee data gathered during due diligence, it will be prudent at the very least to redact personally identifiable information before exchanging it as part of due diligence.

■ *HR should be represented in the deal room.*

One of the most significant failures in successfully managing the employment aspects of an international M&A is the lack of coordination between HR and other disciplines involved in the transaction, such as the deal team, corporate, tax, benefits and stock option specialists. In fact, it is crucial that all of these disciplines are coordinated on an ongoing basis in order to avoid HR nightmares due to unfeasible timelines, confusion about what the acquisition agreement requires, lack of understanding about how the corporate structure influences employee transfers and other issues.

■ *Avoid deemed integration issues.*

Closely related to the lack of coordination between various teams is an issue referred to as “deemed integration.” Often, while the corporate and tax teams are still planning if and how to integrate the foreign subsidiaries, the HR and business teams are already informally integrating the local subsidiaries. Unfortunately, this can have significant negative tax consequences. In particular, many foreign jurisdictions offer significant tax advantages if the local transaction is structured as a merger. There is a risk, however, that the tax authorities will not permit the tax-favored integration method once significant informal integration steps have been taken. Accordingly, steps such as co-location, common reporting lines and combined sales structures should be taken with caution and their benefits should be carefully weighed against any potential tax risks.

■ *Address works council, employee representatives and union requirements.*

One of the most emotionally taxing and time-consuming stages in an international M&A involves consulting with works councils, employee representatives and unions, both on the seller and acquirer sides. Various jurisdictions imbue works councils, employee representatives or unions with significant power. In France, for example, a business transfer cannot proceed until the works council, if any, has rendered its opinion. While the acquisition can proceed even if

the works council urges against it, the works council still has significant power to delay its opinion (and thus delay local closing). Furthermore, failure to consult with the works council is a criminal offense. Companies should allow for significant time to understand the works council, employee representative or union situation, prepare for it and fully comply with the consultation process. Spending several months on this phase is not unreasonable in many jurisdictions.

■ *Analyze how employees will transfer.*

As alluded to above, the structure of the transaction on the country level will usually determine if and how employees transfer from one entity to another. It is a common mistake to assume that the U.S. transaction itself will have any impact on the local country level, with the exception of potential stock option implications and the requirement to notify or consult with the works councils, employee representatives or unions.

In the case of a stock sale on the local level, employees simply remain employed with their current employing entity. In the case of a merger, employees transfer to the surviving entity. In the case of an asset sale in Europe, under the so-called Acquired Rights Directive that has been implemented in all European Union member states, employees transfer automatically if the asset sale qualifies as a business transfer, which is often the case but involves a fact-specific analysis. Various jurisdictions outside of the European Union also have automatic transfer principles, including South Africa or Korea. In most parts of Asia and Latin America, however, employees transfer through consensual transfer or through a termination and rehiring process. Each method brings with it various notice, consultation and severance considerations. As such, it is crucial for employment lawyers and members of the HR team to understand the appropriate employee transfer method.

■ *Understand limitations on redundancies.*

At-will employment is virtually nonexistent outside of the United States. Instead, most jurisdictions around the world require not only notice and severance but also cause to terminate an employment relationship. A redundancy triggered by duplication of roles after an acquisition will often not suffice. In Japan, for example, where employment is generally presumed to be life-long, it is generally recommended that voluntary resignation agreements be negotiated, usually in exchange for significant amounts of money. To make matters worse, business transfers in European Union member states are not viewed as grounds for dismissal of employ-

ees. Accordingly, it is crucial to identify other grounds unrelated to the business transfer for dismissal in those countries. This is often difficult to do, particularly against the backdrop of the already stringent requirements for economic dismissals in Europe. Again, the key to handling this issue is good planning. The company should understand its obligations and rights (limited as they may be), negotiate which party will conduct any redundancies and plan and price the transaction accordingly.

■ *Address harmonization of terms and conditions.*

Closely related to redundancies are the difficulties in aligning terms and conditions of employment. With very limited exceptions for pensions and stock options, the European Union’s Acquired Rights Directive requires that employees transfer with their existing terms and conditions of employment. Although it appears that in some jurisdictions employees can validly agree to a change in their terms and conditions of employment, there is a risk in other European jurisdictions that even agreed upon variations would be deemed invalid. Changes in terms and conditions of employment in most parts of Asia and Latin America virtually always require employee consent. In still other jurisdictions, severance can be triggered or conversely avoided if terms and conditions are no less favorable in the aggregate.

■ *Plan in time for benefit transfers.*

Benefit transfers can, and often do, cause significant delay. This is not only due to the legal overlay of often having to maintain the same (or at least comparable) terms and conditions of employment, but also to the existence of various policies and plans, both statutory and contractual, that have to be terminated, transferred, realigned and the like. There have been transactions where employees were without pension or health insurance for periods of time, due to a delay in proper benefit transfers. The legal and HR liabilities in this area are obvious. Careful planning is recommended.

■ *Determine immigration issues.*

Immigration-related issues are yet another area that can cause significant legal liability and delay in cross-border M&A deals. As part of due diligence, it is crucial to identify employees who have work permits or visas and to analyze how to renew, transfer, terminate or otherwise deal with these documents.

■ *Know the limitations on non-compete agreements.*

It is common in corporate transactions for the parties to negotiate non-compete agree-

ments, at least as to key employees. While such non-competes might fall under the very narrow sale-of-business exception found in California Business and Professions Code §16600, international jurisdictions often have different restrictions. In many jurisdictions, including Australia and Singapore, non-competes are generally enforceable to the extent that they are sufficiently limited in

time and scope. In others, including Germany and Spain, consideration is required for a non-compete to be valid. While the latter has the advantage of allowing the party to basically buy a non-compete, numerous companies have been faced not only with the issue of having negotiated an invalid non-compete provision but also with the risk of a court awarding significant consideration to vali-

date a non-compete that the company might not even care about enforcing any more.

In sum, understanding the issues and developing and implementing a realistic HR strategy and timetable are crucial in international M&A deals. Careful attention to these issues will help to reduce HR nightmares and will increase the likelihood of a successful transaction. ■