

# Employment Issues in Mergers and Acquisitions: Planning for Integration and Mitigating Risk

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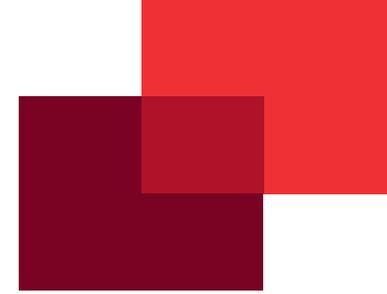
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# Navigating Employment Issues in Mergers and Acquisitions: Planning for Integration and Mitigating Risk

Strafford Live CLE Webinar

Presented by:

Donald C. Dowling, Jr., Shareholder at Littler Mendelson (New York)

Anna Ferrari, Esq., Associate at Morrison & Foerster (San Francisco)

Carole Spink, Partner at Baker & McKenzie (Chicago)

# Overview of M&A Activity, Deal Structures

# M&A trends 2017 and beyond

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- Deal makers have been cautious, particularly given Brexit and the new US administration and what that will entail. Once greater clarity emerges, we expect global M&A activity to pick up to a peak of US\$3 trillion in 2018.
- From a sector perspective, a key driver of global deals will be the tech sector, where M&A is forecast to reach US\$415 billion by 2018 — the highest since 2000.
- Healthcare, particularly biotech and pharma deals, will also fuel the upturn amid greater innovation, less regulatory intervention in the US and a larger role for private health providers in supplying public health services.
- North America will remain the largest market for M&A transactions, accounting for 50% of global M&A values in 2017 and 2018.
- We base our M&A forecasts on the anticipation that EU and UK officials will make progress on establishing a new relationship in 2017, and that the new US administration will adopt a less protectionist stance on international trade and immigration policy, while setting out plans for fiscal stimulus.

# Let's make a deal!

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- There are four "main" deal structures:
  - Asset Acquisition = change of employer, so termination and rehire in U.S. & different treatment outside U.S.
  - Stock Acquisition (Direct Purchase) = no immediate change of employer
  - Stock Acquisition (Merger) = no immediate change of employer (unless forward merger)
  - Carve-Out (Asset/Stock or both) = see above
- Critical to understand what type of deal is happening, including at the local level

# Quick Guide

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## Employment Impact / Type of Transfer in Deals

|                       | <b>Stock deal</b>     | <b>Asset deal</b>  |
|-----------------------|-----------------------|--|
| <b>US</b>             | No change to employer | Termination and hire   |
| <b>Americas</b>       | No change to employer | Generally termination and hire, but country-specific peculiarities |
| <b>APAC</b>           | No change to employer | Generally termination / resignation and hire                       |
| <b>EU/EEA</b>         | No change to employer | Generally automatic transfer                                       |
| <b>Rest of Europe</b> | No change to employer | Termination and hire   |

# Tips for avoiding pitfalls in cross-border M&A

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- Conduct a full and thorough due diligence
- Get HR, employment, immigration, benefit and equity experts in the deal room
- Consider deemed integration issues
- Address works' council, employee rep and union requirements
- Analyze and prepare for how employees will transfer
- Understand limitations on redundancies
- Ensure employment-related IP has been assigned
- Determine if any immigration issues and plan accordingly
- Understand limitations of non-compete agreements
- Address harmonization of terms and conditions
- Determine impact on benefits and equity

# Pre-M&A Employment Due Diligence

# "Big ticket" employment diligence issues

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- U.S.
  - Wage and hour compliance / misclassification
  - Consultant misclassification
  - Benefits liabilities (underfunded pensions)
  - Employee IP
  - Employee entitlements (e.g., retention, severance, change in control)
  - Non-competes
  - Unions
  - Litigation
- **Additional** items outside the U.S.
  - Works' councils or other employee representative groups
  - CBAs & social plans
  - Benefits
  - Payroll (non)compliance
  - Expats
  - Contractual entitlements

# Key Deal Documents

# Deal centerpiece: the Purchase Agreement

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- Key provisions and schedules
  - Representations and warranties
  - Indemnities
  - Disclosure schedules
  - Ongoing obligations
  - Closing conditions

# Key Provision #1: Representations and Warranties

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- Don't rely on due diligence alone.
- "Reps and warranties" = statements of fact made by seller to buyer (and vice versa)
- **If you are the buyer:** the broader the seller rep, the better!
  - "All US employees are properly classified under applicable federal, state and local laws."
- **If you are the seller:** wiggle room is key!
  - "To the Seller's best knowledge, the Seller has properly classified, in all material respects, all US employees under applicable laws."

# Key Provision #2: Indemnities

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- A method for compensating one party for the other party's breach of the purchase agreement
- Two main types:
  - Specific indemnities
  - General indemnification
    - Typically triggered upon reaching a threshold

# Key Provision #3: Disclosure Schedules

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- Carve outs to reps and warranties
  - Reps and warranties: "No severance agreements."
  - Disclosure: "Persons A, B and C have severance agreements."
- Bottom line: seller (or buyer) must disclose exceptions to a rep to make it accurate
- If signing and closing dates are different, update your disclosures prior to closing

# Initial Considerations

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- Identifying the target's workforce
  - Where are employees located?
    - Involve local counsel if needed
  - Who are key employees?
  - Employee census may be the single most important of target's documents
- Successor liability (asset deals)
- Joint employer concerns
- Transition issues
  - Who is coming over? Is human capital a major deal point?
  - Under what terms? Will the buyer require new agreements?
  - Does the buyer intend to close any facilities or lay off employees?
  - Who will pay termination, severance, change of control, retention plan costs?
  - Will the parties enter into a transition services agreement?

# Employment Agreements

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- **Severance and change of control** provisions
  - “Good Reason” usually based on adverse change in job title, reporting relationship, compensation or job duties
  - May be triggered by transaction or create financial incentive for employees to resign post-closing
  - May be necessary to amend or offer additional retention incentives
  - Involve a benefits/tax specialist to analyze tax implications
- **Restrictive covenants**
  - Are existing covenants enforceable?
    - State-by-state analysis
  - Should buyer require same or other restrictive covenants?
- Agreements to protect seller **intellectual property**

# Workforce Classification

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- Employee vs. contractor
- Exempt vs. non-exempt employee
- Exposure
  - Overtime pay
  - Payroll taxes
  - Retroactive application of employee benefits
  - Penalties
- Other concerns
  - Class action lawsuits
  - Private attorney general lawsuits
  - Audit by tax or labor authorities

# Workforce Classification

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- Evaluating classification issues
  - **Common examples:** IT employees, administrative support personnel, inflated “manager” titles
  - Employee/contractor census (e.g., title, compensation, contract term)
  - Job descriptions
  - Handbooks and personnel policies
  - Contractor agreement
  - Management interviews
  - Pending claims or audits
- Remediation
  - Should buyer adopt seller’s classifications?
  - Timing concerns

# Workforce Transfer & Reduction

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- Federal and state WARN laws
  - Require advance notice of plant closings and mass layoffs
  - Generally, if seller terminates and buyer does not re-hire, seller bears WARN responsibility
  - If, after closing, buyer terminates, buyer generally bears WARN responsibility
  - Be sure to analyze cumulative impact under aggregation principle (90 days)
- Severance plans
  - Does seller have one?
    - Unwritten, informal practices can be enforceable
  - Should buyer offer one?
    - Condition on general release of claims
    - Consider structuring as ERISA plan

# Other Wage and Hour Issues

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- Minimum wage
  - Startup “sweat equity”
- Overtime pay
- Meal and rest breaks
- Unpaid interns
- Compensable time
  - E.g., travel time
- Wage statements

# Other Employment Practices

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- Abrogation of at-will employment
- Background check practices
- Employee leaves of absence
- Prior, pending and threatened claims
- Workplace safety and health (if heavy industry)

# Labor Unions

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- Union recognition
  - Generally, buyer is bound by collective bargaining agreements (CBAs)
    - Stock purchase – CBA assumed
    - Asset purchase – Successorship (whether contractual or common law)
- Duty to bargain
  - Unlike other contracts, union relationship survives term of CBA
  - Buyer generally assumes the duty to bargain with the union before changing terms and conditions of employment
- Notice and consent obligations
  - Some CBAs give the union the right to receive notice of or consent to the sale or merger before it happens
- Involving a labor specialist is key

# Labor Unions

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- Evaluating union-related risks
  - Request amendments, MOUs, side letters along with CBA
  - Analyze costly or onerous contract provisions
    - Underfunded defined benefit pension plans
    - Withdrawal liability for multiemployer pension plans
    - Wage/benefit/severance commitments
    - Neutrality and card-check provisions
    - “Zipper clause”
    - Other limits on ability to reduce workforce or operate business
  - Consider management-union relations (e.g., grievances, strikes, organizing activity)
  - Are there pending unfair labor practice charges?

# Immigration

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- Pre-closing issues
  - Assess general compliance with immigration laws
    - Especially industries under ICE scrutiny (e.g., hospitality, agriculture)
  - Termination of employment in asset purchase may impact status of employer-sponsored visas
- Post-closing issues
  - Consider executing new form I-9s for all transferred employees

# Key Takeaways

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- Get a copy of the employee census
- Focal points for diligence:
  - Worker classification
  - Wage and hour compliance
  - Severance and change of control obligations
  - Restrictive covenants
- Involve a benefits/tax law specialist
- Is there a union?
  - Involve a labor specialist
  - Watch out for pension plan issues
- Attend to transition issues and plan layoffs early

# M&A Employee Transfers Outside the US: Vested Rights, Acquired Rights and *de Facto* Firings

*Threshold inquiry: When representing a buyer or seller in an M&A transaction that implicates seller-affiliate employees in one or more jurisdictions, what happens to seller employees upon closing?*

## Pre-closing layoffs

### US context

- Stock (shares) deal and U.S. employee transfers
- Asset-purchase deal and U.S. employee transfers

# M&A Employee Transfers Outside the US: Vested Rights, Acquire Rights and *de Facto* Firings (cont'd)

## Outside-US context

- Stock/shares deal and outside-U.S. employee transfers
  - But: *mandatory consultation jurisdictions*
- Asset purchase deal and outside-U.S. employee transfers

# M&A Employee Transfers Outside the US: Vested Rights, Acquire Rights and *de Facto* Firings (*cont'd*)

## Outside-US context

- Stock/shares deal and outside-U.S. employee transfers
  - But: *mandatory consultation jurisdictions*
- Asset-purchase deal and outside-U.S. employee transfer
  - **Acquired rights jurisdictions**
    - ✓ Brazil
    - ✓ EU (UK “TUPE”)
    - ✓ Bahamas, Malawi, South Africa, Turkey
    - ✓ Singapore
    - ✓ South Africa
    - ✓ South Korea

# M&A Employee Transfers Outside the US: Vested Rights, Acquire Rights and *de Facto* Firings (cont'd)

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    - ✓ Singapore
    - ✓ South Africa
    - ✓ South Korea
  - ***De facto* firing jurisdictions**
    - ✓ Formal employer substitutions and informal employer substitutions
    - ✓ Examples:
      - China
      - India
      - Japan
      - Latin America and Bahamas
      - Puerto Rico
      - Nigeria and the Philippines

# Independent Contractors/Consultants/Freelancers/ Entrepreneurs

- Distinguish employee/executive vs. independent contractor
- Distinguish individual contractor vs. corporate contractor vs. “leased employee”
- Effect of misclassified contractor (*de facto* employee) transferring in:
  - ✓ Stock deal
  - ✓ Asset deal
- *Cf. article in course materials*

# Checklist for *Other* HR Issues in International M&A Transactions

- ✓ Post-merger integration strategy
- ✓ Restructurings/lay-offs
- ✓ Retention
- ✓ Employer entity and powers of attorney
- ✓ Buyer human resources codes and rules
- ✓ Replicating representative bodies
- ✓ Individual employment contracts
- ✓ Benefits delivery, payroll HRIS (and transition services agreements)
- ✓ Expatriates and visas
- ✓ Employee communications
- ✓ Press releases
- ✓ HR integration

# Thank You

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