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

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How To Conduct a Global Human Resources or Labor Compliance Audit—Including Cross-Border Employment Due Diligence

By Donald C. Dowling Jr. | International Employment Partner | New York City
March 2016

Globalization pushes multinationals to align ever more aspects of their internal human resources across borders. Today's multinationals globalize HR programs, workplace policies, employee benefits and staff offerings that back in another era would have been purely local. Think of, for example, global HR policies and handbooks, global codes of conduct, global intranets and HR information systems, global expatriate programs, international benefits offerings, cross-border compensation plans, regional sales incentive plans, global equity plans and supply chain codes of conduct.

Globalizing HR causes ripple effects, and perhaps the biggest ripple is compliance. Headquarters has to stay responsible for, or retain "ownership" over, whatever it has elevated from the local to the regional or global level. As soon as a multinational raises HR policies, codes, initiatives, plans or offerings to a regional or global level, compliance efforts should follow.

Effective cross-border HR compliance checks or assessments—"audit" can be a disfavored term—look into various aspects of employment compliance. A multinational has obvious incentives to verify that its international HR operations adhere to foreign laws and applicable employment agreements as well as to the growing list of "extraterritorial" laws that reach workplaces internationally. In addition, multinationals have compelling business reasons to verify their overseas operations follow in-house handbooks, codes of conduct, international HR policies and corporate values. (*See* "The Return of Global Employment Audit," Law 360, 12/21/09)

This push to review, asses or check human resources compliance across borders comes from various constituencies within a multinational organization, such as: the compliance function (obviously); upper management; the board of directors; the general counsel's office; or human resources. The push can also come from specific business units like industrial safety (assessing global safety compliance and pandemic response); global mobility (assessing visa compliance and duty of care); audit/accounting (assessing global Sarbanes-Oxley and Foreign Corrupt Practices Act compliance) or mergers and acquisition teams (due diligence assessing the human resources compliance of to-be-spun-off or to-be-acquired business units). And the procurement function increasingly needs to assess labor compliance at suppliers and contractors.

International employment compliance audits transcend human resources and implicate operations well beyond HR. For example, no one would call the U.S. Foreign Corrupt Practices Act, U.S. insider trading prohibitions or U.S. trade sanctions (trading-with-the-enemy) regulations "employment laws," but the only way a multinational can ensure it complies with these across borders is to propagate international HR policies requiring compliance, train staff on those HR policies and enforce the polices against workers who do not comply. Checking whether these steps got done right requires an audit of HR functions. All of a sudden headquarters functions with no HR responsibilities (in this case, internal functions responsible for bribery, insider trading and trade compliance) find themselves looking into human resources practices internationally.

Now understanding why multinationals need to audit HR compliance internationally, our question becomes: How? How does a multinational efficiently assess its own ongoing compliance practices across its international HR operations? How does the multinational isolate which rules apply internationally and verify that local foreign human resources operations actually comply? To answer these questions we need to analyze the six stages to a global HR compliance audit: (1) form the audit team and structure the project (2) articulate audit context and scope (3) create a master audit checklist template (4) align local-country checklists off the master (5) conduct the audit and (6) report, and implement remedial measures. After we discuss these six stages, separately we consider the closely-related issue of cross-border HR due diligence in an international M&A or outsourcing deal.

The Six Stages to a Global Human Resources Compliance Audit

In assessing internal cross-border human resources or labor compliance, break the audit project down into six stages:

Stage 1: Form the audit team and structure the project. The first step in any global HR compliance assessment is assembling the audit project team. Consider whom to involve: Consider headquarters, foreign and local human resources staff and the in-house legal and compliance functions. Consider including subject matter experts like industrial safety staff in a health and safety or crisis policy audit, the mergers and acquisition team in a deal-related due diligence exercise or the procurement team in a supply chain labor audit. Involve any corporate audit function. Consider tapping outside counsel who might bring in the attorney/client privilege (recognizing that the privilege can be hard to preserve across borders). Consider involving an outside international HR consultant or specialist labor audit firm, especially for an international supply chain labor audit. Factor in practical issues like audit team members' language fluency, availability and reporting relationships. This said, not all global HR audits enjoy the luxury of a big team—sometimes just a single person needs to assess employment compliance across two or more countries.

International HR audit team in place, consider global project management—how to structure this particular cross-border HR assessment cost-effectively and efficiently. Consider practical issues like timing, budget and the audit team's power to gather data at overseas offices and later to implement recommended fixes. The temptation can be to take a quick-and-dirty approach, grabbing some global HR audit checklist off the shelf, diving in and just doing the audit. But this never works well because there are other steps involved (and because no one ever finds that chimerical one-size-fits-all global HR audit checklist to serve as a sufficiently detailed roadmap for this particular audit project). Each global HR audit spins off in its own uncharted direction with its own specific goals, its own pool of affected countries and its own industry-specific issues: A wage/hour audit in retail is substantially different from a health and safety audit in manufacturing, which is quite different from a bribery audit in government contracting or a contractor-classification audit in the technology sector. All these are very different from a supply chain labor audit. Embrace the fact that your particular cross-border HR compliance audit requires an organic, holistic approach and a number of discrete stages. Shortcuts in managing the project compromise audit results.

Stage 2: Articulate audit context and scope. A team embarking on an international human resources compliance assessment or check should begin by articulating the context and delineating the scope of its particular audit project. This lets you weed out all irrelevant (even if auditable) issues not in play this time.

First articulate *context*. Because HR compliance audits arise in different contexts, they end up going down very different paths. Various audit contexts include, for example: implementing a new corporate structure, preparing for a corporate restructuring, launching a merger or acquisition (spin-off or post-merger integration), responding to a lawsuit/government investigation or simply toughening internal compliance through a robust HR check-up. Some global HR audits focus internally on specific employment law challenges like payroll compliance, health/safety, wage/hour, worker data privacy, contractor classification or—increasingly—corporate social responsibility and ethics including bribery, corrupt practices, insider trading and financial controls. Meanwhile, other global HR audits focus externally on outside supplier compliance, scrutinizing whether labor practices at overseas suppliers conform to the supply chain code of conduct. As mentioned, some HR audits actually focus on employee compliance with issues separate from employment law like employees' compliance with data privacy, bribery, financial controls, trade and securities laws, or like an internal check into staff compliance with a global crisis plan. And as mentioned, international HR audits vary significantly by industry context (an HR compliance audit at an auto manufacturer is a lot different from one at a technology multinational). Consider industry-specific issues like human trafficking in construction and maritime, know-your-customer in financial and professional services and immigration in retail and manufacturing.

After articulating the context of your particular international HR audit, delineate project *scope*—how broad and how deep this HR assessment needs to be. Which countries are involved? Should this global audit focus on compliance with laws, with collective agreements, with corporate policies, with best HR practices, or with all of these? As to legal compliance, should this audit look at local laws, at headquarters-country laws that reach extraterritorially, or at both? What about checking compliance with individual and collective employment agreements? Should this audit confine itself to local host-country employees or should it also include expatriates, contingent staff, consultants, independent contractors and suppliers' employees?

Stage 3: Create a master audit checklist template. Compliance means following rules. Compliance audits focus on vital rules, which is why health and safety audits are a lot more common than dress code audits. Because the vital employment rules differ significantly across jurisdictions, leading a multijurisdictional HR compliance assessment requires isolating which important legal rules HR operations must follow. This means facilitating "apples-to-apples" comparisons across jurisdictions by crafting aligned but localized audit checklists.

Begin by drafting a single master global audit template compliance checklist. Create it organically, tailored for your particular audit project—again, because each global HR compliance audit is unique, an off-the-shelf template from some other project is at best only a starting point, and even a checklist for a similar past audit will need updating. Include in your global audit master template all topics consistent with the audit context and scope, but weed out all other topics. Depending on your audit's context and scope, topics that might merit including in the global template or checklist may include:

- **Corporate, tax and financial laws reaching employment** including employer corporate entity status, employer registrations/corporate form, dual-employer exposure, "permanent establishment" exposure from "floating employees," employee powers of attorney, directors' and officers' liability insurance, and corporate controls on local executive power

- **Payroll laws** including tax and social security reporting and other payroll law compliance, vacation payments to sales staff and others with variable compensation, employee insurance payments, payroll deductions, withholding and contributions, contractual payroll payments like company cars, statutory payroll benefits like meal allowances, union dues check-off and other payroll payments to unions/employee representatives (which are legal outside the U.S.).

- **Local employment laws** including local laws that regulate candidate recruiting, interviewing and "onboarding," wage/hour or "working time" (including overtime and flat caps on hours), holidays/vacation, discrimination/harassment/diversity (including laws requiring hiring and accommodating the disabled), language laws requiring employee communications in the local language, internal HR complaint procedures, internal investigation procedures and termination/release/payout at separation

- **Collective labor laws and agreements** including recognition of, and negotiations and consultations with, trade unions, "works councils" and other employee representatives, union "corporate campaigns" and handling of labor disputes, plus compliance with collective labor agreements including "framework"/union neutrality agreements, collective agreements to which the employer is a party, "sectoral" collective agreements applicable by force of law (employer is not a party), "works agreements" with local works councils and any European Works Council, constitutional documents of employer-sponsored staff representative bodies, "social plans" (past reduction-in-force agreements) and agreements with workplace ombudsmen, staff committees, worker committees and worker forums, health and safety committees and other non-union employee representatives—plus multiemployer bargaining group pacts

- **Headquarters-country laws that reach staff overseas**—that is, as to a U.S. headquartered multinational, "extraterritorial" U.S. laws on audit/accounting fraud, "alien torts," bribery/foreign corruption, Sarbanes-Oxley §301 whistleblower "procedures," securities trading laws, terrorism watch list, trade sanctions and compliance with U.S. discrimination laws as to U.S. citizen staff working overseas

- **Employment claims and litigation** including threatened, pending and past court and administrative "labor claims" brought by employees, employee representatives and government agencies on behalf of employees (breaking out any group or class claims and flagging any particularly high past awards and any court orders with ongoing effect), plus government "labor audits."

- **Benefits and compensation offerings i**ncluding employee benefits, compensation/bonus/sales incentive plans, tuition and expense reimbursement plans, equity plans, company car, housing and meal plans, pension plans/schemes, medical and other employee insurance, statutorily mandated benefits including thirteenth-month pay and mandatory profit sharing, mandatory (inflation-adjusted) raises and severance pay plans— check plan funding and local effects of global plans

- **Human resources policies** including local and global HR policies, local internal workplace "regulations" and posted internal work rules, local and global employee handbooks, global health and safety protocols, crisis/pandemic plans, employee security protocols, global codes of employee conduct or ethics, performance management and succession planning systems, global employee intranet sites, whistleblower hotlines, employer-ratified industry conduct codes and insider trading, conflicts of interests policies, bribery/corruption and trade sanctions ("trading with the enemy") policies—be sure to verify that global policies got properly launched and implemented locally and check the status of any employee policy acknowledgements

- **Individual employment contracts** including local contract/offer letter templates and individual signed employment contracts with current employees, "onboarding" documents, fixed-term, part-time and probation provisions, "zero-hour contracts," restrictive covenants, intellectual property assignments, contract amendments, employee acknowledgements/consents/waivers, releases and "compromise agreements," computer-click intranet assents, "electronic signatures" and paperless execution of HR forms and enrollments—and check compliance with laws requiring written individual employment contracts or "statement of particulars"

- **Data privacy laws reaching employee data** like personnel files, emails and global Human Resources Information Systems, including: employee data notifications and consents, compliance with statutory data retention and data purging requirements, internal HR data processing policies, registrations with government data protection authorities, processing of "sensitive" employee data, employer practices accessing staff emails and computer use, employee data security, employee data breach notification, BYOD procedures, whistleblower hotline compliance with data laws, cross-border HR data transmissions and exports—and check whether data protection and data export clauses in agreements with HRIS providers meet with applicable data law standards

- **Contingent and irregular staffing arrangements** including as to contractor/consultant classification, compliance with local laws regulating outsourcing, secondees/leased/agency employees, secondment agreements with providers of seconded or "leased" employees, co-/dual-/joint-employer exposure as to contractors' staff and non-employee directors—and check compliance of payrolled employees seconded to third parties.

- **Expatriate compliance** including structure of expatriate agreements, "permanent establishment" exposure triggered by expatriates, internal expatriate program and repatriation documents, expatriate payroll compliance and visas/work permits for all non-citizen staff (even those not categorized as company "expatriates")—additionally, check for any so-called "stealth expatriates," look into any "global employment company" that may employ expatriates and check home country "emigration" laws that follow an expatriate on assignment (such as doctrines in Venezuela, Ghana, Brazil and the Philippines), and assess compliance with laws that cap the percentage of immigrants in a workplace (as in Brazil and the Middle East)

- **Duty of care,** that is, business travel safety and personal injury protection of business travelers, expatriates and regular employees in jurisdictions that allow staff personal injury claims (regular employees pose little threat of personal injury claims against the employer in jurisdictions like the United States that offer a robust "workers compensation bar" defense, but employer personal injury exposure is a real risk in jurisdictions like England that do not offer this defense)

- **Supply chain labor and monitoring labor conditions at overseas suppliers:** All the above topics address internal employment compliance auditing an organization's own staff employed on its own (worldwide) payroll, or contractors who might claim to be de facto employees. Completely separate is the additional challenge of a cross-border external employment compliance audit—monitoring labor conditions at an organization's worldwide suppliers, contractor companies and business partners even where there is no viable threat of co-/dual-/joint-employer liability. Do not confuse or conflate these two very different labor audit "constituencies."

  Three types of organizations should monitor external (supplier) labor conditions internationally: (1) those that have issued "supplier codes of conduct" or adopted industry supplier codes, (2) those subject to the [California Transparency in Supply Chains Act (Cal. Civ. Code, § 1714.43)](), the [UK Modern Slavery Act 2015]() and similar laws that require attesting to suppliers' labor conditions, and (3) those party to high-risk overseas contracts like construction projects in the Middle East, or sourcing arrangements with plantations or mines in Africa or in the global shipping or fishing sector.

  - *Not always an issue:* This said, keep supply chain human rights issues in perspective and discount advice from certain consultants and activists that the United Nations Guiding Principles on Business and Human Rights, International Labor Organization declarations and other aspirational labor rights protocols somehow impose binding legal obligations on supply chains. For the most part, they do not. Most of the world's companies have not tied themselves to any supplier code of conduct or taken other proactive steps regarding supply chain or contractor labor conditions, and do not necessarily need to audit labor compliance in their supply chains.

  Every organization that has issued an international supplier labor conduct code needs a proactive plan for monitoring compliance. The alternative—issuing a supplier labor code but then ignoring whether anyone bothers to follow it—all but invites non-compliance. By definition, an organization that issues a supplier labor conduct code is just a customer that does not employ the workers its code protects. As a mere customer, a code-issuer has no regular (extra-contractual) right of access either to audit supplier employment records or to inspect supplier workplaces. This "privity of employment contract" challenge complicates supplier code compliance far beyond the internal HR audits we discussed. Think through how to audit any international supplier labor code or overseas contract arrangement early on, at the conduct-code-drafting and contracting stage. Do not expect access to supplier or contractor HR records or workplaces unless suppliers and contractors had previously granted audit rights in the purchase order or contract. Monitoring supplier codes in poor countries becomes more of a challenge, and gets tougher down each successive link in a supply chain. Indeed, specialist outsourcers and software providers have emerged in the niche business of monitoring international supplier labor codes:

Stage 4: Align local-country audit checklists off the master. Master audit checklist template in hand, we arrive at the trickiest stage: Localizing the master by spinning it off into a set of tailored but aligned local audit checklists, one for each jurisdiction subject to the audit project, anchored in local legal and contractual standards. For example, if the global master template includes "overtime pay," then each local country checklist should set out that jurisdiction's overtime hours threshold, its overtime pay rate (time-and-a-half is not universal) and address any enhanced overtime hours thresholds or enhanced overtime pay rates that in applicable collective bargaining agreements may require. If, for example, the global master template includes "public holidays," then each local country audit checklist should list that country's statutory public holidays plus any extra holidays the employer may give are required under collective labor pacts. As another example, if the global master template includes "statutory benefits," the local Venezuela checklist (for example) should address Venezuela's cestaticket mandatory meal coupon program as well as (for example) Latin American checklists should address mandatory thirteenth month pay (agüinaldo, in Mexico) and mandatory profit sharing. If the global master template includes vacation laws, the local Brazil checklist (for example) would address that Brazilian employees must get 30+ vacation days per year and draw down vacation either in a 30-day uninterrupted chunk or a 20-day uninterrupted chunk plus a 10-day vacation time sell-back; meanwhile, the local France checklist (for example) would addresses both France's minimum vacation benefit and France's ban on vacation year-to-year roll-over.

Failing to make the local checklists this granular would leave the auditors ignorant of the standards they need to check compliance against. Needless to say, this stage requires both local legal research and a familiarity with local employment and labor agreements.

Beyond localizing topics from the master checklist for each affected jurisdiction, add into each local audit checklist all quirky local rules that, because they are inherently local, have no counterpart on the master audit checklist template. This requires involving a local lawyer or HR expert competent to issue-spot and fill gaps under local employment law. As a few random examples, a local HR audit checklist:

- for England should address employee-signed overtime opt-outs (overtime opt-outs will not be on the master audit checklist template because few other countries allow them)
- for Brazil should address funding local employee unemployment fund bank accounts ("FGTS")
- for Canada should address contractually quantifying pre-dismissal common law notice and also executing English-language communication consents in Quebec
- for Italy, Germany or Poland should address whether the internal email system and intranet platform trigger local telecommunication laws
- for South Africa should address mandatory affirmative action plans
- for Saudi Arabia should address mandatory workplace gender segregation
- for Indonesia or Korea should address the awkward issue of mandatory monthly menstruation leave

Stage 5: Conduct the audit. At last we get to the actual audit—time to go out and conduct the global HR assessment. Take the local checklists into the field and do the global HR compliance check, gathering compliance information in each jurisdiction corresponding to each item on each local checklist. Do this by addressing five topics.

First, decide how on-site audit process logistics will work. Will auditor inspections be announced or surprise? Will local management and HR cooperate? Will headquarters auditors travel onsite, or can they conduct the field piece remotely or delegate local data gathering to local HR staff? What technological solutions are available to help? Will auditors interview individual employees? How to handle local HR staff who say they will help but then fail to respond adequately? How to handle local rank-and-file staff who refuse to cooperate? Relying too heavily on local staff can compromise the integrity of the audit if local staff is unskilled in doing audits or if the audit scope includes sensitive topics that the local office might conceal from headquarters.

Second, decide how deep to plow. How granular will the audit be? Will auditors look only at policies/protocols/agreements or will they study specific employment agreements, employee-signed acknowledgements, minutes of union/works council meetings, paycheck stubs, timesheets, safety logs and the like? Will translations of local HR documents be necessary? Will auditors get access to local outside providers like payroll outsourcers and benefits administrators?

Third, address how the international audit process itself will comply with local employment and data protection laws. Should local management-side labor liaisons notify works councils or other employee representatives about the audit? Omnibus data privacy laws restrict an audit team's ability to "export" personally identifiable audit response data to U.S. headquarters. Europeans, for example, are quick to argue that their data privacy laws block many aspects of foreign headquarters' internal investigations—and in this regard, an internal audit is a form of internal investigation. So craft a strategy for exporting HR audit data legally.

Fourth, decide how to apply appropriate metrics in the audit. As an obvious example, any assessment of minimum wage compliance must account for locally applicable statutory and collectively bargained minimum wage rates. And any assessment of overtime pay or vacation compliance needs to factor in statutory and collectively bargained local overtime rates and vacation allowances. If the audit looks into workplace health and safety, decide whether to apply global health and safety standards or local workplace health and safety regulations. If the audit looks into diversity, it would be foolish to apply U.S. EEO-1–style diversity metrics to employee populations in, say, South Africa, Argentina, Japan or Finland.

Fifth, draw the line between this audit and a stand-alone investigation. Where the audit uncovers a specific act of wrongdoing that merits its own discrete investigation, stop and spin that internal investigation off as a separate project. Conducting a cross-border internal investigation into a suspicion or allegation of a discrete wrongful act is completely different from doing a cross-border HR audit.

Stage 6: Report, and implement remedial measures. The field part of the international HR audit complete, summarize the findings. The summary report should avoid identifying specific employees (to minimize data protection and defamation exposure) and account for any attorney/client privilege and evidentiary admissions issues. Think about how the report might later get used against the organization as evidence of willful noncompliance, and craft a strategy to minimize that risk. One strategy might be to avoid committing sensitive audit findings to writing. Another strategy is to involve a lawyer who confers attorney/client privilege. At least limit distribution of the audit report.

The audit team needs to propose specific remedial measures—recommended fixes—for any diagnosed compliance shortcomings. It is pointless to undergo a compliance audit to identify non-compliant shortcomings but then to take no action as to the findings. That said, be careful about how to memorialize remedial measures recommendations. Again, avoid generating documents that might later get used against the employer.

After recommending remedial measures, monitor that the team's proposed fixes actually get implemented locally. Too many audits get done right but then the audit report languishes in a drawer without ever improving compliance. An audit like that is pointless (perhaps even dangerous), because the report proves the organization knew about a non-compliant situation it did nothing to fix.

And consider how to leverage lessons learned from this audit to use commercially available technologies to enhance ongoing compliance assessment going forward. According to one forensic consultant, "companies under-utilize data analytics to support their anti-bribery and corruption compliance and monitoring activities. Only 27% of respondents at U.S. listed companies use data analytics to identify potential [anti-bribery and corruption] violations." (Inside Counsel, Nov. 2015, pg. 37)

Cross-Border Employment Due Diligence in an International M&A Deal

We saw that international audit projects spin off in their own different directions. One specific context of a global HR compliance audit or assessment is the employment due diligence piece to a cross-border spin-off, merger, acquisition or outsourcing transaction. Cross-border employment due diligence is just a specific context or application of the international employment assessments we have discussed.

Any multinational seller preparing to divest its entire operation or spin off or outsource a line of business employing staff in more than one country—that is, any seller doing a cross-border spin-off or outsourcing deal—anticipates that prospective buyers will launch a due diligence process to audit the seller's compliance with laws, policies, agreements and business practices. The buyer needs to assess what it is and is not buying and whether the purchase is worth the price. "Due diligence" is the process by which the buyer verifies that, at closing, it will acquire compliant operations (or at least it will acquire non-compliant operations sold at a discount commensurate with the costs of getting up to compliance). An M&A seller, therefore, begins the divestiture, spin-off, sale or outsourcing process by conducting a sort of internal audit assembling the materials prospective buyers will demand to see related to seller legal and business practices compliance. M&A due diligence looks into a wide range of business and legal compliance including tax status, corporate registrations, antitrust analysis, accounting practices, intellectual property rights, real estate titles, environmental compliance plus threatened, pending and past business lawsuits involving the seller.

One key part of any thorough due diligence process, but only a part, is the staffing piece—workplace due diligence into the seller's labor practices, employment law compliance and employee benefits offerings. That is the part we address here. Employment due diligence is particularly vital outside the United States because other jurisdictions tend not to recognize employment-at-will, and outside employment-at-will an M&A buyer tends to get locked into perpetuating the seller's employment conditions going forward after closing, whether by vested rights in a stock purchase, by acquired rights in an asset purchase or by some contractual arrangement amounting to a so-called "employer substitution." Further, law in all countries shifts pre-closing employment liabilities to a stock shares buyer after closing and law in many countries outside the U.S. shifts pre-closing employment liabilities to an asset buyer after closing. So prospective buyers and outsourcers need to understand and get comfortable with the to-be-acquired worldwide workforces they will inherit upon consummating the deal.

The due diligence process exists to root out noncompliant problems, so the due diligence process itself cannot afford to cause its own compliance breach. Many jurisdictions including most of Europe plus Argentina, Canada, Hong Kong, Israel, Japan, Korea, Mexico, Philippines, Singapore, South Africa, Uruguay and a growing number of others impose broad data privacy ("data protection") laws that can have unexpected consequences in the cross-border due diligence context. Electronic due diligence data rooms raise exposure under these laws if the data room offers bidders personal information about identifiable seller employees, especially where the seller hosts the data room on the cloud or otherwise makes HR data accessible across borders (even if password-protected). Bidders cannot shrug this off as the seller's compliance problem, because a seller's liability for breach of data protection laws can transfer to a buyer at closing, particularly in a stock deal. Compliance steps may require "anonymizing" data room employee information, entering into "onward transfer agreements" with bidders, entering into cross-border "model contractual clauses" agreements, collecting signed employee consents or other steps. Jurisdictions including Argentina, Hong Kong, Japan, Korea, the United Kingdom and some other omnibus data protection law jurisdictions have issued data law guidance specific to the M&A due diligence context. Follow it.

Because employment due diligence in a cross-border M&A or outsourcing deal is essentially the same exercise as the cross-border HR compliance audits we discussed, a global employment due diligence exercise involves the same six stages as a global HR compliance audit: (1) form the employment due diligence team (part of the M&A deal team) (2) delineate the scope and depth of the employment due diligence (3) create a master employment due diligence template checklist (4) align local employment due diligence checklists for all countries at issue off of the master (5) conduct the employment due diligence and (6) report back to the deal team and use the employment due diligence results to negotiate a better deal. In addition, after closing the deal the buyer or outsourcer should leverage employment due diligence results as a resource for post-merger integration.

Of these six stages, the second and third stages—scope of employment due diligence and crafting the master employment due diligence checklist—require some further discussion anchored to the due diligence context. As to the second stage (scope), prospective business buyers in an M&A deal and prospective outsourcers will not care about immaterial aspects of the seller's staffing operations. International HR due diligence in any merger or acquisition should therefore always be subject to some defined materiality threshold. Find out what that materiality threshold is and then focus HR due diligence only on compliance problems that could exceed it.

The third stage (crafting a due diligence checklist for a specific cross-border M&A deal) helps a prospective business buyer or outsourcing provider identify what data to scrutinize and also helps a prospective business seller or outsourcing principal anticipate the categories of data prospective buyers or outsourcers will ask to see. Here is an international human resources due diligence checklist template paralleling the global HR audit checklist template above, tailored to the cross-border M&A context. From this global HR due diligence template, tailor a master human resources due diligence checklist focused on your specific cross-border M&A or outsourcing deal. (Then—stage four—align local-country due diligence checklists off of the master; next—stage five—conduct the HR due diligence; finally—stage six—report back to the deal team.)

- **Census and organization chart of employees and contingent staff.** Get a census of seller employees and directors worldwide who will transfer as part of this deal, including part-time staff and anyone out on leave. Include employees who work for the target entity and target-entity employees "seconded" out to service other organizations. Ideally this census should include dates of hire, compensation rates and job category. Identify any "shared services" employees who serve both the target unit and non-acquired units and identify the seller's contingent staff: independent contractors, consultants, agents, "leased employees" and other secondees, sales representatives, "business partner" staff dedicated to this business and anyone working from home or remotely, even overseas. Separately, get an organization chart and verify that only the employees who actually serve the target unit—regardless of title or designation—will transfer as part of the deal. (The buyer needs to avoid taking on extraneous staff.) Conversely, verify that all key workers who should transfer will indeed come over as part of the deal. (The buyer needs essential staff.)

- **Corporate employer issues.** In each affected country, identify the seller's local affiliated corporate entities that employ staff. Learn the relationships among the seller's operating entities and any "services companies" that may employ people. Be sure staff work for the correct affiliates.

- **Payroll and government filings.** Check the seller's payroll processing compliance as to deductions, withholdings, reporting, compliance with dues check-off, mandatory payments to worker representatives and remittances to agencies including government payroll tax, social, unemployment and housing funds, and government-mandated insurance analogous to U.S. workers and unemployment compensation insurance. How does the seller issue payroll? What about vacation payments to variable compensation and sales staff? Does the seller pay statutory benefits? What payments are being made directly to staff on leave, including "garden leave"? Are any employees out on leave getting state benefits charged to the employer?

- **Employee claims, liabilities and exposure.** Is the seller subject to any pending, threatened or potential unasserted employment-related grievances, claims, lawsuits, appeals, disciplinary proceedings, government agency proceedings, investigations, inspections, government workplace audits, administrative charges, unfair labor practice charges, criminal proceedings or unpaid employee judgments? What is the employment claims history over the last few years, including settlements and judgments? What is the exposure for the seller's past noncompliance with labor/employment, payroll, safety, and HR data privacy laws? What are the seller's cash reserves set aside for these claims?

- **Wage/hour compliance.** Verify compliance with wage/hour ("working time") laws, cap-on-hours laws, vacation and holiday mandates, overtime payments, travel expense reimbursements, exempt-status designations, mandatory meal breaks, toilet breaks and rest periods. Check that vacation, leave and severance payouts get calculated correctly.

- **Health and safety; duty of care.** Check compliance with health and safety laws including recordkeeping mandates. Get accident records. Get information on duty of care/safety/evacuation and other protocols for hazardous-duty work and occupational health/safety law compliance—particularly for business travelers and expatriates but also as to regular employees in jurisdictions like England that do not offer an employer workers' compensation bar defense to staff personal injury lawsuits.

- **Language laws.** Do employee communications comply with local laws in jurisdictions like Belgium, France, Mongolia, Quebec and Turkey that require HR communications be in the local language?

- **Discrimination/harassment.** Verify compliance with local discrimination/diversity/harassment laws including laws on pay equity, mandatory training and bullying. Check compliance with affirmative action laws as in South Africa and disability quota laws as in Austria, Brazil, Germany and elsewhere. Verify compliance with the seller's own discrimination/harassment policies. Does the seller impose mandatory retirement in violation of a no-age-discrimination provision in its own code of conduct? As to harassment, check compliance in countries like Brazil and France that prohibit "abusive work environment" harassment separate from protected group status.

- **Compliance with local HR policies.** Identify and check compliance with the seller's own internal employment policies, written and unwritten. Look at employee handbooks, written work rules, workplace internal "regulations," employee handbooks and health/safety guidelines. What special terms and conditions (beyond legal minimums and above market) does the seller extend to employees? The buyer will likely have to replicate these special terms after closing.

- **Global code of employee conduct or ethics.** Check compliance with the seller's internal ethics code of conduct or ethics and social responsibility programs including any commitment to an industry code, corporate social responsibility program or so-called "framework" (global union neutrality) agreement. Do the seller's HR practices comply? If the seller's codes of conduct incorporate International Labor Organization standards by reference—rarely a good idea—be sure the operations actually comply. Will the seller's current practices align with the buyer's practices and comply with the buyer's policies and codes? Check seller practices regarding government procurement, payment procedures to government officials and compliance with anti-bribery laws and audit/accounting rules. Verify that any seller whistleblower hotline complies with Europe's tough data protection law mandates specific to hotlines.

- **Compensation and benefits.** Using a separate compensation/benefits checklist, check the seller's benefits and compensation offerings including bonus and sales incentive plans. Are these above market? Do they comply with legal minimums? Look into the seller's compensation philosophy, compensation/benefits "schemes" or plans, severance plans, retirement plans, retention plans (which are particularly relevant in an M&A deal) and perquisites like meals, housing and expatriate benefits. How do they dovetail with local mandates? For example, are severance plans cumulative with local severance benefits? Check individual pension promises, special agreements, grandfather clauses, death/disability benefits, cafeteria plans, service awards, profit-sharing and savings plans, tuition and adoption reimbursement plans, employee assistance programs, employee loans and guarantees and any unusual expense reimbursements. Understand the interplay between foreign pension plans and foreign social security in each affected country. Check compliance with local laws that mandate extra payments and benefits (like thirteenth-month pay and profit sharing in Latin America and paid meals in Venezuela). Get an accounting of any transferring plans, and study funding—unfunded, underfunded, and "book reserve" plans raise huge problems and occasionally even kill deals.

- **Equity.** Look at seller stock options, stock grants, restricted stock units, phantom stock and other equity plans as well as employee ownership programs, officer/director stock ownership and employee ownership in affiliates and entities doing business with the seller. Were grants to overseas plan participants done legally? (Expect compliance shortcomings here, because cross-border equity grants are complex.) What will happen to equity plans, awards and unexercised or unvested options after closing? Often the buyer will not or cannot replicate seller equity plans. What will it need to do instead?

- **Employee insurance coverage.** Study the employment-related insurance cover the seller provides like employee life/health/accident and medical insurance, hazardous duty/kidnap insurance for business travel, payments to state-mandated insurance funds (workers' compensation and state social security insurance), expatriate coverage and "key man" policies naming the employer as beneficiary. Consider analogous insurance needs post-closing. In an asset or outsourcing deal, consider logistics—how to replicate insurance packages by the closing date.

- **Performance management.** Study the seller's performance management and succession planning systems. Focusing on key employees, collect data on job evaluations, performance appraisals and problem employees. Where the performance management system is global, does it comply with data protection laws? Consider how to integrate seller and buyer performance management approaches after closing.

- **Labor organization relationships**. What labor organizations represent the seller's workers—trade unions, independent unions, in-house unions or employer dominated "white unions"? What about pending employee requests for union recognition or organization? Separately, collect organizational data on the seller's non-union in-house or company-sponsored labor organizations like local/national works councils, any European Works Council, health/safety committees, staff consultation committees, worker committees, workplace forums, labor/management committees and ombudsmen. How cooperative or contentious are they? Collect meeting minutes and records memorializing labor disturbances and days lost to strikes. Will the buyer have to replicate any labor groups after closing an asset or outsourcing deal?

- **Collective agreements.** Look at applicable collective bargaining agreements, "industrial awards," "work agreements," "social plans" and other written agreements with employee representatives—not only union agreements but also labor accords with local works councils, and with any European Works Council, with worker committees, health and safety committees, ombudsmen and the like. Avoid the common mistake of due diligence requests for only seller "collective bargaining agreements" (a phrase usually interpreted to include only formal union agreements, excluding informal one-off accords and arrangements with works councils). Get "social plans" (collective agreements from past lay-offs) and expired collective agreements with terms that still apply. Identify all industry ("sectoral") collective agreements that bind the seller even as a non-signatory. Does the seller participate in any multiemployer bargaining associations?

- **Individual employment agreements**. Look at individual employment contracts with staff including employment agreements labeled "offer letters," "statements of particulars," restrictive covenants, non-competes and confidentiality agreements, employee indemnification agreements, invention and intellectual property agreements, resignation letters and releases. At least check these for key executives and look at form/template agreements for rank-and-file employees. (Again, be alert to data protection law compliance.) Find out whether any parts of the workforce lack written agreements or "statements of employment particulars" where law requires them. Pay special attention to contracts with contingent workers—service providers like "temps," independent contractors, consultants and agents.

- **Employee consents.** Check individual employee consent forms, which come in many flavors. In jurisdictions like the UK and Korea, employees may have consented in writing to work overtime and in Quebec employees may have consented to receive communications in English. European employees may have (revocably) consented to employer processing of sensitive personal data, and employee data processing consents are vital India, Mexico and certain other jurisdictions. Employees worldwide may have executed payroll consents or acknowledged a code of conduct or work rules in writing. If these consents are electronic, do employee assents comply with electronic signature protocols?

- **Change-in-control clauses.** Check change-in-control, golden parachute, and other transfer-related clauses in individual and collective employment and agency agreements, including M&A-ratification provisions in any labor union contracts and European Works Council agreements, as well as HR services contracts. Find transferability clauses in independent contractor agreements. These are vital.

- **External agreements.** Do any external agreements (with third parties) limit staffing flexibility? For example, in a stock purchase, are there acquisition agreements or "social plans" from earlier seller deals that limit reductions-in-force? Has the seller signed onto any supplier codes of conduct of its customers? Is the seller a government contractor that has taken on staffing-related public procurement obligations? In the United States, for example, a buyer of a government contractor can take on big "affirmative action" obligations after closing—analogous issues might arise abroad. What about "leased employee" and secondment agreements the seller may be a party to? What about independent contractors? Separately, look at the seller's outsourcing agreements with HR service providers like payroll providers, "temp" agencies, benefits providers and whistleblower hotline providers.

- **Recent layoffs and divestitures.** What layoffs or "collective redundancies" have happened in the last few years? What divestitures of business units have occurred? Did these comply with applicable laws? What lingering obligations exist in old "social plans" or accords with government labor agencies? Any recall rights?

- **HRIS**. Look into the seller's employee data-processing and human resources information systems (HRIS). Check how HRIS and email systems comply with data protection laws, especially as to cross-border data exports. Has the seller made all required notices/communications to employees about HR data processing and collected necessary employee consents? What so-called "sensitive" staff data does the seller process? Do data protection clauses in agreements with HRIS providers meet applicable data law standards? Look at the seller's contracts with HRIS providers and consider the effect post-closing. Are the seller's routine HR data exports compliant? What about staff communications regarding whistleblower hotlines? What about BYOD? Verify that seller HRIS and email systems do not trigger telecommunications laws in countries where this is an issue like Italy, Germany and Poland.

- **Powers of attorney.** Find out what powers of attorney the seller's employees, officers and directors hold. (These are particularly critical in Latin America, where there can be different levels of powers, some of which include the power to dispose of company assets.) Consider how these powers will need to work after closing. In an asset deal the buyer will need to reissue these. What controls does the seller's headquarters use to monitor local management's compliance with laws and corporate policies?

- **Expatriates and immigrants.** Gather information on the seller's expatriate and immigrant populations and programs. Who are the overseas secondees and other posted expatriates? Which corporate entity employs each expatriate? Identify any "stealth expatriates" outside the formal expatriate program working outside their home countries. Check that expatriate employment arrangements comply with both host and home country laws (home countries may impose employment laws with "extraterritorial" reach). Does the seller employ any expatriates through a global employment company structure? Expatriates can be very expensive, so verify that packages are not above-market. Also do an "international I-9" exercise to check the visa or work permit status of non-local-citizen employees worldwide (regardless of whether categorized internally as expatriates or local hires). Does the seller comply with laws (as in Brazil and the Middle East) capping the percentage of immigrants in a workplace? How might the structure of this M&A or outsourcing deal affect visas after the deal closes? If the seller employs staff in countries where it is not registered to do business, how does it comply with host-country payroll obligations? And check "permanent establishment"—are there "floating employees" doing business in countries where the buyer is unregistered, not paying taxes, and flouting local payroll mandates?

- **Supply chain and human rights.** Beyond due diligence into the seller's own employees, decide whether to assess employment law compliance at the employees of the seller's suppliers. Where this is an issue, get both the buyer's and the seller's supplier code of conduct, if any, and collect reports from any past social/human rights audits. Is the seller's supplier code too sweeping in scope? Collect data on labor practices in the supply chain particularly as to components and products sourced from poor countries and look at overseas construction projects. Go as far down the supply chain as necessary. Look at seller disclosures under supply chain disclosure laws like the California Transparency in Supply Chains Act and the UK Modern Slavery Act 2015. Consider post-closing exposure to workplace-context human rights claims. Consider whether the seller's supply chain practices might, after closing, breach any buyer supplier code.

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As today's multinationals globalize ever more aspects of human resources across national borders, they take on "ownership" of, or responsibility for, verifying that international HR offerings comply with laws, labor agreements and workplace policies and norms. This gives rise to a need for doing global HR compliance audits or assessments. In addition, specific scenarios like preventing corrupt practices, overseeing supply-chain compliance and conducting due diligence in cross-border M&A or outsourcing deals spawn special breeds of international employment compliance verification projects. Cross-border HR audits can be complex and can take a number of stages to complete, but are increasingly vital to today's globalized business operations.

2015 EMPLOYMENT LAW UPDATE

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CHAPTER 8

EMPLOYMENT LAW TOOLKIT FOR CROSS-BORDER M&A DEALS

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§ 8.01 Introduction

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§ 8.01 INTRODUCTION

Some years ago a leading London corporate lawyer told the *New York Times* that in "merging two regular companies . . . you just do it and sort out the people issues afterwards."[1] If that was ever true, it no longer is. In any merger or acquisition between two employers, especially in the cross-border context, human resources and employment law compliance have grown particularly vital.

In today's knowledge-based economy the driver for a growing number of mergers and acquisitions is talent acquisition. It stands to reason that employment issues could actually *predominate* in deals driven by employment factors. Employee matters can be persistent and bedeviling over the entire course of a cross-border transaction, from deal structuring to due diligence to acquisition-agreement drafting to closing, and then especially during post-merger integration.

But actually, employment issues do *not* predominate in the merger and acquisition process. If we break down the mechanics of how M&A deals are structured, workforce issues are at best peripheral to the M&A process. Human resources leaders rarely get a "seat at the table" in planning acquisitions and divestitures. Employment and even employee benefits lawyers usually play, at most, a supporting role and sometimes little to no role.

Yet employment and benefits and compensation issues in cross-border mergers and acquisitions can get fairly complex. Businesses need expert guidance focused on cross-border staffing challenges. One law firm has noted that "although M&A projects tend to be driven by corporate or tax lawyers, in many cases labour law issues have significant influence on whether . . . the deal is successful."[2]

Our discussion here amounts to a toolkit for U.S. human resources professionals and lawyers responsible for the workforce issues in cross-border M&A deals (transactions where the seller employs staff in more than one country). We focus on the multinational buyer and seller as they account for the seller's outside-U.S. staff that, at closing, will transfer over to the buyer. Our discussion breaks down into three stages: (1) staff transfers outside the United States (vested rights, acquired rights, de facto firings), (2) international M&A employment due diligence checklist, and (3) checklist of workplace issues in international mergers and acquisitions.

[1] A. Sorkin, "A Lawyer's Lawyer: Bridging Borders," Mar. 26, 2000.

[2] http://www.cmslegal.com/CMS-Guide-to-Employment-Issues-in-an-MA-Transaction-09-04-2013.

§ 8.02 M&A EMPLOYEE TRANSFERS OUTSIDE THE U.S.: VESTED RIGHTS, ACQUIRED RIGHTS, AND DE FACTO FIRINGS

In most multi-jurisdictional business deals, a single threshold employment-law question predominates and permeates every other question about employment and human resources: *After the closing, what will happen to the seller's personnel?* In some way or other, every workforce issue that arises during a merger or acquisition plugs back into this one central question.[3]

[A] Post-Acquisition Employment Status

- *Pre-closing layoffs*: Rarely but occasionally the answer to the central question of the fate of seller employees at the moment before closing is *there will be no seller employees at closing*—the seller will first have laid them all off. That is, occasionally, and more often in small local deals than in big international ones, the parties negotiate for the seller to lay off or "make redundant" all employees before closing, so the seller can turn over the business with no staff at all.

  Any pre-closing complete lay-off or "collective redundancy" needs to comply with each affected jurisdiction's reduction-in-force and notice/severance laws, including local labor laws that require information/consultation/bargaining with employee representatives. However, in jurisdictions including the European Union and Turkey, the fact of a merger or acquisition deal "shall not in itself constitute grounds for dismissal."[4]

  But because lay-off laws are not unique to the merger and acquisition context, at least outside Europe, Turkey, and other jurisdictions that prohibit M&A-motivated layoffs, a *pre-closing* complete reduction-in-force is largely the same as any other layoff, except that any unsatisfied severance liabilities might reach a buyer after closing.[5]

In the vast majority of cross-border transactions, at closing the seller employs staff in more than one country. In those deals, the answer to our central question of what happens to seller staff at closing differs from jurisdiction to jurisdiction, particularly if the transaction is an asset purchase and not a stock purchase. The issue of what happens to seller's staff at the moment of closing gets particularly complex *outside* the United States because overseas jurisdictions

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[3] Indeed, anyone who is not quite sure what will happen to the seller's staff after a merger or acquisition closes is in no position to answer any personnel-related questions in a particular deal.

[4] EU Transfer of Undertaking Directive 2001/23/EC at art. 4(1); *see* Turkey Labour Law 4857/2003, art. 6.

[5] For our purposes, the point is that only in those rare deals where the seller has no staff at the moment of closing are there no employment law issues for the deal parties to worry about.

strive to protect sellers' employees more paternalistically than under laissez-faire U.S. employment-at-will. To explain the various ways employee transfers work overseas in mergers and acquisitions, we begin by looking at how *U.S. law* treats sellers' staff in a merger or acquisition deal. Then we contrast the very different scenario of what happens to a sellers' workforce in an M&A deal *abroad.*

[B] U.S. Context

In addressing the fate of a seller's stateside workforce at the moment of closing a merger or acquisition, the key distinction to draw is whether the deal structure has the buyer buying the seller's *stock* (in Europe and elsewhere called "shares") or its business *assets.*

- *Stock (shares) deal and U.S. employee transfers.* A stock sale (including a merger by acquiring stock) does not change employees' status at closing. If we look through the lens of employment law, a stock transaction appears invisible: The buyer, at closing, *becomes* the employer entity. The employer entity itself stays the same. Therefore, employer/employee relationships, employment liabilities, and individual and collective bargaining arrangements stay exactly the same—except of course to the extent staff have change-in-control clauses written into employment, compensation, or collective agreements. In short, putting contractual change-in-control provisions aside, a stock purchase (or merger by stock) in most countries of the world does not implicate employee transfers and so usually does not trigger any legal issues as to transferring staff. In the words of the classic rock song, employees on the morning after the closing of a stock deal come into work and "*meet the new boss, same as the old boss.*"[6]

  Then, after closing, the acquirer of a business's stock enjoys genuine flexibility as to its newly acquired *American* employees because of the unique U.S. doctrine of employment-at-will. If for example some stock buyer acquires the shares of a business and decides to lay off some or all of its newly acquired U.S. staff, the new boss (the stock acquirer) is free to do the lay-off without paying any severance pay or separation charges.[7]

  Going beyond lay-offs, U.S. employment-at-will also grants stock buyers almost complete operational flexibility as to newly acquired staff, because U.S. law imposes no *vested rights* obligation to maintain work

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[6] "Won't get Fooled Again," lyrics by Pete Townshend.

[7] This assumes that: neither a severance pay plan nor the stock purchase agreement restricts lay-offs; none of the U.S. staff enjoys contractual, quasi-contractual or union contract dismissal rights; the lay-offs are not for an illegal discriminatory or retaliatory reason; and any mass downsizing complies with notice mandates under U.S. W.A.R.N. law.

conditions after closing. That is, a stock buyer immediately after closing is generally free to reduce American employees' existing terms and conditions of employment, to demote American employees, to discontinue American employees' benefits, to reduce their pay, to change their job titles, and otherwise to restructure its new American workforce however it wants to.[8]

- *Asset-purchase deal and U.S. employee transfers.* The analysis differs markedly as to the effect on a seller's American employees when a merger or acquisition gets structured as an *asset purchase.* U.S. labor union law imposes doctrines of "alter ego" and "successorship" on the six percent of U.S. non-government workforces represented by labor unions. But otherwise, in the asset-purchase context where there is no U.S. labor union—the other 94% of the time—American workforces get no statutory job protection when their boss sells the business. This leaves the buyer of a business's assets free not to offer the seller's U.S. employees any jobs at all. An American asset buyer that decides to offer jobs to seller's staff is free to offer worse or tougher jobs at lower pay and at a new and distant workplace. An asset buyer of a business that decides to hire any of the seller's U.S. staff is free (unless it contractually committed otherwise) to offer whatever terms and conditions it wants—even terms materially lower than what the seller provided. And an asset buyer is free to start American employment fresh, with no credit for years of service with the seller.[9] In short, where there is no labor union, U.S. employment law imposes no concept of so-called "acquired rights."

[C] Outside-U.S. Context

Outside the United States, what happens to seller's staff in a merger or acquisition plays out completely differently. And yet we can analyze how M&A-context employee transfers work overseas using the same structural distinction—stock transactions versus asset purchase transactions. At that point, though, everything differs.

[1] Stock (Shares) Deal and Outside-U.S. Employee Transfers

As in the United States, in a merger or acquisition by stock purchase overseas, the buyer also *becomes* the employer entity at the instant of closing. Therefore, existing employer/employee relationships, employment contracts, and employment liabilities all stay the same after closing. Overseas (as in the United

[8] This is subject to any contractual or quasi-contractual restrictions and subject to benefits continuity rules under U.S. ERISA law (29 U.S.C. § 1001 *et seq.*).

[9] Outside the union context, seniority credit is often meaningless in U.S. employment, anyway.

States), a stock transfer M&A deal is invisible from an employment law standpoint—with the technical exception that a few European jurisdictions like Belgium, France, Hungary, and Romania (and arguably Austria, Denmark, and Germany) impose obligations of "information and consultation" with worker representatives before a seller can commit to or close even a stock shares sale of a business.[10]

This said, outside of U.S. employment-at-will, from the moment of closing a stock buyer slams into a rigid legal hurdle that does not exist stateside: The doctrine of *vested rights*. Because of vested rights, stock buyers enjoy less flexibility to change the terms and conditions of employment of their non-U.S. staff. Outside-U.S. jurisdictions impose a regime usually called "indefinite employment," but in the Philippines known by the more descriptive label *security of tenure*[11] Indefinite employment regimes regulate, restrict, or prohibit no-cause employment terminations by granting fired employees a cause of action for dismissals without notice, without good cause, or without following mandated dismissal procedures. Because the vested rights principle follows a stock transfer deal through closing, a stock buyer after closing cannot lay off any of its newly acquired outside-U.S. employees unless it complies with these employment law restrictions, pays legally imposed severance costs, and follows local notice/termination/severance pay and lay off mandates. In short, as to staff outside the United States, a stock shares buyer that closes an M&A deal on a Tuesday evening wakes up Wednesday morning shackled to the new business's staff by the very same chains that had shackled the seller on Monday.

And the tentacles of these vested rights rules reach well beyond restrictions against lay-offs. An implicit corollary of any functional doctrine limiting no-cause *employment dismissals* is that legal restrictions against firings also restrict *constructive dismissals*. Otherwise an indefinite employment regime's prohibition against unfair dismissals would become meaningless—an employer could freely "fire" workers, without cause, by demoting them, cutting their pay, and assigning them intolerable tasks until they quit. The upshot is that vested rights rules outside the United States severely restrict the power of an employer stock buyer, after closing, unilaterally to reduce employees' material employment terms and conditions. This means that after closing, a stock buyer outside the United States faces tough obstacles if it wants to restructure, transfer workers to new office locations, realign job titles or discontinue bonuses, benefits, or equity plans (absent employee consent—which often requires making substantial concessions).

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[10] And of course any contractual change-in-control clauses apply by their terms.

[11] Labor Code of the Philippines art. 279.

[2] Asset-Purchase Deal and Outside-U.S. Employee Transfers

The vested rights doctrine we just discussed does not reach a buyer of business *assets*, because an asset buyer is a distinct legal entity—a new and separate employer. This fact alone sometimes tempts business buyers to structure their acquisitions as asset purchases just to maximize flexibility in staffing operations by sidestepping vested rights (and also sidestepping the seller's accrued liabilities). This strategy is particularly common stateside, where many business sales, especially purchases of smaller businesses, get structured as asset purchases to free up the buyer to decide which of the employers' staff, if any, it may want to hire.

But the strategy of structuring a deal as an asset purchase to sidestep the seller's employment liabilities is much less attractive to parties doing mergers and acquisitions *abroad*. Jurisdictions outside the United States tend to close the perceived vested rights loophole in one of two very different ways: either by imposing an *acquired rights* rule or else by imposing what we might call a *de facto firing* doctrine. Both models make the asset purchase structure much less attractive to a business buyer outside the United States.

- *Acquired rights jurisdictions.* If the buyer of a business could skirt the seller's vested rights obligations to its staff simply by structuring its acquisition as an asset purchase, this would threaten the public policy outside the United States that underlies the vested rights doctrine: safeguarding employees' security in their existing jobs. Many countries see an asset sale transaction as a potential loophole that threatens to let the asset seller compromise its employees' vested rights. Many of those jurisdictions close this perceived loophole by legislating in a doctrine usually called *"acquired rights."* Acquired rights laws are statutory mandates that force an acquirer of the assets of a business—in Europe called an "undertaking"—to assume the transferor's existing workforce along with the seller's vested rights obligations.[12]

  In an acquired rights jurisdiction, the vested and acquired rights concepts together add up to a strict but fairly simple rule that reaches all mergers and acquisitions: Regardless of whether parties structure their transaction as a purchase of stock shares or assets, at the instant of closing the buyer steps into the seller's shoes as employer of record and assumes a legal obligation to perpetuate the staff's existing jobs, pay, employment terms, conditions, and seniority.[13]

[12] Indeed, acquired rights laws in Europe are so broad that they reach not only asset sales but also outsourcings and other business transfers in addition to asset sales. But here we focus on acquired rights laws in the sale-of-business-assets context.

[13] Unless employees consent otherwise—which they have little incentive to do unless granted concessions.

But to the seller of business assets, the other side to this coin looks a lot shinier. The quid pro quo of any coherent acquired rights mandate is that when staff transfer in an asset sale with their terms, conditions, and seniority intact, the transferor (the seller) walks away from its workforce without having to lay anyone off—free of severance pay, notice, and "collective redundancy" (lay off) obligations. Yes, some acquired rights laws keep an asset seller jointly and severally on the hook with the buyer for employment claims for a while after closing—e.g., in Turkey the post-closing employment claims joint liability period runs for two years[14] and in the United Arab Emirates the post-closing joint liability period runs for six months.[15] In any event, the buyer usually makes good on employment liabilities during this post-closing window period. Either way, in acquired rights jurisdictions, asset sales trigger no severance pay obligations, and this ends up helping both parties: A seller with no severance pay burden does not pass severance pay costs onto the buyer in the form of a higher sales price.

This summarizes acquired rights laws generally. But in their particulars, acquired rights laws work in different ways depending on the jurisdiction. Here are some examples:

- **Brazil.** The Brazil Labor code[16] is a blunt acquired rights rule, but it reaches only asset sales when an entire line of business transfers. In those deals, the staff transfers as a matter of law. But article 448 does not reach sales of *partial* lines of business.
- **EU.** Each EU member state imposes a sophisticated and strict acquired rights law under which an asset seller's employees automatically transfer to an acquirer with their pay, terms/conditions of employment, and service credit intact. EU member state acquired rights laws adopt ("transpose") the amended European Union "acquired rights" or "transfer of undertakings" directive.[17] These same laws require information and consultation (like mandatory union bargaining) with employee representatives over the asset sale.[18] Colloquially (if inaccurately) these local European acquired rights laws often are referred to by the local British acronym "TUPE." Member

[14] Labour Law 4857/2003, art. 6.

[15] Labour Law art. 126.

[16] Art. 448.

[17] EU directive 2001/23/EC.

[18] Examples of these laws include: France labor code article L 122-12; Italy law 428/1990 as amended; Malta Employment and Industrial Relations Act XXII of 2002 article 38 as amended by Act IX 2003.124; and the UK Transfer of Undertakings (Protection of Employment) Regulations [TUPE] as amended.

state laws implementing the EU acquired rights directive are particularly robust and well-enforced—Austria's and Germany's acquired rights laws, for example, actually let employees refuse the transfer, at least in some circumstances. That said, the EU acquired rights directive lets European states except pension plans—so some EU jurisdictions except pension rights as not acquired rights.[19]

- **The Bahamas, Malawi, South Africa, and Turkey.**[20] The Bahamas, Malawi, South Africa, and Turkey are all examples of jurisdictions with acquired rights laws meant to work more or less like laws under the EU reject an asset transfer.
- **Singapore.** Under the Singapore Employment Act,[21] only low-level employees (staff *other than* managers, executives, and those in confidential positions) transfer by operation of law to an asset buyer with their pay rates, terms, and conditions of employment and seniority intact. A Singapore seller must notify these non-exempt employees (and any union) of the transfer before closing. Employment contracts automatically transfer, too, unless employees agree with the buyer on new terms.
- **South Korea.** South Korea imposes acquired rights restrictions on many asset transfers. Transferring employees must get reasonable notice and must consent to (or, at least are able to reject) the transfers. Parties may execute an "Employment Transfer Agreement" confirming that consent. South Korea requires ETAs if the buyer will change terms or conditions of employment.

- *De facto firing jurisdictions.* We said that in most jurisdictions outside the United States there are vested rights jurisdictions that protect the vested rights of a seller's staff, and we said that in one way or another all vested rights jurisdictions end up safeguarding employee vested rights if the employer sells its business assets. The first and more "elegant" way that some vested rights jurisdictions protect vested rights in an asset sale is the method just discussed, legislatively imposing acquired rights obligations. But not all vested rights jurisdictions impose acquired rights laws. The second—the blunter and less elegant—way that other vested rights jurisdictions end up safeguarding vested rights when an employer

[19] *See* EU directive at art. 3(4). *See also Pension Issues in European Mergers and Acquisitions*, EuroWatch (Nov. 15, 2007).

[20] Bahamas Employment Act 2001 section 72, Malawi Employment Act number 6 of 2000 at sections 32(2) and 42, South Africa Labour Relations Act section 197; Turkey's Labour Law 4857/2003 article 6 plus Turkey's Commercial Code 6102/2012 art. 178.

[21] Section 18A.

sells its business assets is a model we might call the *de facto firing doctrine*.

De facto firing jurisdictions bluntly presume that an asset seller's employees continue on as *seller* employees even after an asset sale closes—unless and until the seller lawfully dismisses them and pays them all the notice and severance pay they are entitled to. After all, the seller, the employer of record, may decide to sell its business assets, but its sale of things does not exempt the seller from its ongoing responsibilities to its staff. In a de facto firing jurisdiction, a worker whose job relates to transferring business assets either keeps right on working for the seller even though the business assets have now disappeared, or else he gets fired and paid out accordingly—even, in many cases, where the asset *buyer* agrees to hire him after closing.

Of course, in practice a seller of business assets has no jobs for its staff to work after it closes its asset sale. The legal system considers the asset seller still to be the employer, but what is that seller to do now that it no longer has work to keep its people busy? Obviously the seller has to do a *layoff*—funding severance pay, notice, and all other obligations of a mass firing. While severance costs fall on the seller in the first instance, because it is the asset sale itself that triggers those costs, a smart seller factors severance pay liabilities into the asset sales price. And so the asset buyer ultimately, if indirectly, ends up paying.

The good news for the parties is that there is a shinier side to this coin, too. There is a quid pro quo to the de facto firing doctrine, the opposite of the quid pro quo of the acquired rights doctrine. In a de facto firing jurisdiction, the asset buyer is free to ignore the seller employees' old vested rights. Ex-employees of the seller, having been fully "cashed out" in severance pay, get no right to a job with the asset buyer. If the asset buyer *does* hire a seller's staff anyway, it is free to offer lower pay, reduce terms and conditions, and without offering retroactive seniority credit.

De facto firing regimes work particularly smoothly in those deals where the buyer does not want any of the seller's workforce. But in many merger and acquisition deals the buyer seeks a "turn-key" operation complete with experienced staff ready to work. Indeed, sometimes a fundamental reason motivating a buyer to do the deal is that the buyer wants to acquire the seller's "human capital." In other deals, the asset buyer may not be too eager to hire the seller's workforce but the *seller* may insist the buyer take on its staff to minimize human resources problems and costs.[22] The challenge in these scenarios is that even when the buyer

[22] Sometimes a benevolent seller wants to walk away from its old business knowing it "took care of its people."

in a de facto firing jurisdiction agrees to hire seller employees at closing under identical terms/conditions, and seniority, that commitment does not necessarily relieve the seller of its severance pay obligations. This creates a potential double-dipping scenario that employees in these jurisdictions often seek to exploit: In de facto firing jurisdictions, expect staff in an asset transfer to maneuver so they get both a full severance pay-out from the seller plus a good job from the buyer. This double-dipping often happens because in these systems an asset seller that chooses to sell only its business assets has no right to expect the law to credit the asset-buyer's post-closing job offers toward the seller's pre-closing severance pay obligations. In the eyes of the law, what happens here is exactly the same as the lucky guy who gets laid off one day, cashes a huge severance pay check the next day—and the following day finds a great new job somewhere else.

This said, the parties to an asset deal in a de facto firing country might save a lot of money if they think ahead. In an asset deal where the buyer is willing to hire seller staff on mostly similar terms and conditions of employment (ideally if the buyer is even willing to recognize service or seniority credit with the seller), both parties have a keen financial incentive to save severance money.[23]

In short, in asset deals where the buyer will take on some or all of the seller's staff, de facto firing jurisdictions shift the burden to the *deal parties* to structure their transaction in a way that saves severance payments that, in all fairness, would be an underserved windfall—unjust enrichment—to transferring employees.

- *Formal employer substitutions.* The law in some de facto firing jurisdictions—Mexico, for example—lets a buyer and seller affirmatively structure a so-called "employer substitution" by which the buyer steps into the shoes of the seller as employer with all terms and conditions transferring. An employer substitution shifts vested rights obligations to the asset buyer, relieving the seller of its severance pay liability. Usually the employees or their trade union must affirmatively accept the employer substitution. To nudge employees toward accepting—remember, the sellers' staff will want both severance pay from the seller and new jobs from the buyer—the buyer might commit to the seller that it will not hire (say, for a year) any seller employee who rejects the employer substitution.[24]

[23] Again, a smart seller inevitably passes severance pay costs onto the seller in the form of a higher asset sale price.

[24] By law under an employer substitution, if some employment liability arises after closing, the seller remains jointly and severally liable for employment claims during a fixed period (six months,

- *Informal employer substitutions.* Even absent a formal employer substitution vehicle, parties to an asset sale might forge a sort of private employer substitution by agreeing that the buyer will offer jobs to seller staff on same pay rates, terms, conditions, and service credit—but only in exchange for each employee's agreement to *resign* from the seller (or otherwise to waive and release severance pay claims). Under this scenario, the buyer and seller, in effect, team up and present the seller's staff with a choice: *Either get a full severance package from the seller or get a comparable job with the buyer—but pick one, because you cannot have both.* This strategy stops "double dipping" and saves the seller severance pay costs that the seller would otherwise pass onto the buyer. And this approach ensures the buyer takes on only those of the sellers' employees who really value their jobs. This said, though, in practice informal employer substitutions do not always work: Sometimes the asset buyer and seller agree on a purchase price too early, before they hammer out the details of staff transfers. By the time this staff transfer issue arises deep into deal negotiations, the buyer decides it wants the freedom to hire any of the seller's staff—even employees who may insist on a seller severance pay check. In this situation, the employees who end up with both severance pay from the seller and good jobs from the buyer are very lucky people indeed.

Examples of de facto firing jurisdictions include:

- *Australia.* Australia's Fair Work Act 2009[25] address the transfer of collective bargaining agreements in an asset deal, paralleling the U.S. successorship and alter ego doctrines and focused on "the transfer of rights and obligations under [collective] enterprise agreements, certain modern awards and certain other instruments if there is a transfer of business from an old employer to a new employer."[26] Otherwise, though, Australian employees themselves do not transfer to an asset buyer, even if most collective employment agreements do. Also, some social security ("National Employment Standards entitlements") transfer when an asset buyer hires a seller's staff and retains them for three months.
- *China.* An asset seller in China that fires staff associated with transferring assets is subject to notice and severance pay obligations. China's lay-off ("massive workforce reduction") law kicks in where a seller fires at least 20 employees or 10% of its workforce. Employees can insist on

in Mexico). Therefore a smart buyer and seller will address pre- and post-closing employment liabilities in their purchase agreements.

[25] Arts. 307-20

[26] Art. 310.

getting severance pay or they can agree to a transfer (such as where jobs with the buyer depend on transfer consent). The mechanics of an agreed transfer (effectively an informal employer substitution) are either resignation-plus-buyer-hire or else executing a mutual termination agreement plus a new employment agreement with the buyer, which can be structured as a three-party contract. Or course, Chinese employees will not likely agree to a transfer like this unless the buyer perpetuates terms/conditions/seniority.

- *India.* Indian law distinguishes unskilled low-wage manual-laborer "workmen" earning up to US$34 per month from non-workmen, who are usually managers, administrators, and supervisors. Where an asset seller does not intend to retain workman associated with transferring assets, the buyer can decide whether to hire these workmen on the same terms, conditions, and seniority. Where an asset buyer declines to hire a seller's workmen on replicated terms, there is a de facto firing and the seller owes the workmen notice and severance pay. Indian law is similar as to *non-workmen*, except that a non-workman might transfer onto the payroll of an asset buyer even if the seller pays no severance pay and even if the buyer does not replicate the seller's terms/conditions/seniority (unless employment agreements require otherwise).
- *Japan.* An employer (and hence a seller) in Japan cannot unilaterally lay off staff without cause, even when the employer is willing to give notice and tender severance pay. This means that Japanese employees affected by an asset sale (called a *jigyoujouto*) enjoy a right to keep working for the seller even after closing, even if the buyer and seller contractually provide for an employment transfer and even if continued employment proves impossible because no seller business remains. Needless to say, this presents a conundrum to an asset seller—and also to a buyer that needs the seller's "human capital." Where buyer, seller and employees all agree, they can forge an informal employer substitution by which the buyer assumes the seller's employment contracts, or by which the seller and its employees agree on separation terms or negotiated retirement agreements with releases. When employees consent to a cash-out, the buyer is free to hire seller's staff on new terms/conditions without respecting seniority (unless, of course, the buyer contractually committed to another arrangement).
- *Latin America and The Bahamas*. Argentina, The Bahamas, Mexico, and most of Latin America[27] constitute de facto firing jurisdictions where employees who lose their jobs in an asset sale are deemed to have been dismissed, and so enjoy a right to full notice and severance pay unless

[27] Note 16, *supra*, and accompanying text.

they consent to some other arrangement, like an "employer substitution." In some Latin American jurisdictions a buyer and seller will be held jointly liable for severance payments (legal systems fear the buyer who sells all its business assets and then flees the jurisdiction before satisfying severance pay obligations).[28]

- *Puerto Rico.* Puerto Rico Labor Law[29] sets out a mandate that statutorily imposes the de facto firing rule, with a refinement regarding service/seniority credit: "If the new acquirer continues to use the services of the employees who were working with the former owner, such employees shall be credited with the time they have worked . . . under former owners."
- *Nigeria and the Philippines.* Nigeria and the Philippines are examples of straight de facto firing jurisdictions. Unless some labor agreement requires otherwise, an asset seller is liable for severance obligations to employees it lays off.

§ 8.03 INTERNATIONAL M&A EMPLOYMENT DUE DILIGENCE CHECKLIST

Having addressed the central employment question in every merger or acquisition transaction—what happens to a seller's employees at the instant of closing a merger or acquisition deal—we turn now to process, the staffing issues that lawyers need to address in any international merger or acquisition. And the first "people" issue in any M&A deal is always *human resources due diligence.* Every prudent buyer of a business undergoes an investigation or discovery process to find out what it is and is not buying, and whether the purchase will be worth the price. The seller, therefore, first needs to be ready to "show its hand" to the buyer.

Thorough due diligence involves a wide range of business and legal issues including antitrust analysis, accounting principles, intellectual property rights, environmental compliance, tax requirements, and an analysis of the pending and potential lawsuits against the seller. One part of any thorough due diligence process is the *staffing* piece—workplace due diligence into the seller's labor practices, its employment law compliance and its employee benefits offerings. Due diligence into workforce issues *outside the U.S.* is particularly vital, because as discussed, business operations away from employment-at-will in effect inherit the

[28] This said, though, as mentioned an exception in Latin America is Brazil—a sale of the assets of an entire line of business can in effect trigger a sort of acquired rights rule. Brazil Labor Code art. 448.

[29] § 185(b) Indemnity for Discharge without just cause—just cause for discharge.

seller's human resources status quo—whether by vested rights in a stock purchase, by acquired rights in an asset purchase, or else by some contractual commitment amounting to some sort of employer substitution. Also, because law in many places shifts pre-closing employment liabilities to the buyer after closing, any prospective buyer of a business needs to study the seller's global personnel operations and get familiar with the to-be-acquired worldwide workforce.

Using a thorough due diligence checklist helps a prospective business *buyer* figure out what data to scrutinize and also helps a prospective business *seller* anticipate what data that prospective buyers will expect to see. But conducting due diligence into human resources across borders is tricky because employment is inherently local, rooted in issues indigenous to each affected country.[30] An employment due diligence checklist can account for inherently local workplace and employment law issues only if it gets tailored for all the jurisdictions in play in the present deal.

This international human resources due diligence checklist here focuses on staffing issues that tend to arise *across various* jurisdictions. And so this checklist is merely an outline that needs tailoring for each local jurisdiction where a seller in a given deal employs staff. In doing cross-border workforce due diligence, always account for these issues:

- **Data protection laws in due diligence**. The due diligence process exists to root out non-compliant problems, so the due diligence process itself should never cause its own compliance breach. Many jurisdictions, including the European Union as well as most of the rest of Europe plus Argentina, Canada, Israel, Japan, Korea, Philippines, South Africa, Uruguay, and a growing number of others impose broad data privacy ("data protection") laws that inevitably have unexpected consequences in the due diligence context. Electronic due diligence data rooms raise exposure under these laws if they offer up to bidders personal information about identifiable seller employees. Bidders cannot shrug this off as the seller's problem because liability for breach of data laws can transfer to a buyer at closing, particularly in a stock deal. Compliance steps may require "anonymizing" data room information, entering into "onward transfer agreements" with bidders, entering into cross-border "model contractual clauses" agreements, collecting signed employee consents, and taking other steps. Jurisdictions including Argentina, Hong Kong, Japan, Korea, and the U.K. have issued legal guidance specific to the M&A due diligence context. Follow it.

[30] For a few random examples, Hong Kong imposes unique social security and pension compliance requirements, Mexico imposes strict profit-sharing mandates, Brazil imposes an unusual employer-financed unemployment regime, Saudi Arabia imposes unique workforce gender-segregation rules, and South Africa imposes unique diversity plan obligations.

- **Materiality threshold.** Prospective business buyers do not care about *immaterial* aspects of the seller's staffing operations. International HR due diligence in any merger or acquisition therefore needs to be subject to some *materiality threshold.* Find out what the threshold is, and then focus HR due diligence only on issues that could exceed that.
- **Claims, liabilities and exposure.** Is the seller subject to any pending, threatened, or potential employment-related grievances, claims, lawsuits, appeals, disciplinary proceedings, workplace inspections or audits, government complaints or investigations, administrative charges, unfair labor practice charges, criminal proceedings, or unpaid employee judgments? What about claims disposed of over the last few years, be they settlements or judgments? What is the exposure for the seller's noncompliance with labor/employment, payroll, safety, and HR data privacy laws? What are the seller's cash reserves for these claims?
- **Corporate employer issues.** In each country, identify the seller's local affiliated corporate entities that employ staff. Learn the relationships among seller's operating entities and any "services companies" that employ people.
- **Census and organization chart of employees plus contingent staff.** Get a census of seller employees (and directors) worldwide, including part-time and contracted-out employees. Include both employees who service the target entity and target-entity employees "seconded" out to service other organizations. Ideally this census should include dates of hire, compensation, and job category. Separately, get an organization chart and verify that only the employees who actually serve the target unit—regardless of title or designation—will transfer as part of the deal. Conversely, verify that all essential staff that should transfer will come over as part of the deal. Identify any "shared services" employees who work for both the target unit and non-acquired units. Next, identify seller's contingent staff.[31]
- **Expatriates and immigrants.** Collect information on the seller's expatriate and immigrant populations and programs. Who are the overseas secondees and other posted expatriates? Which corporate entity employs each expatriate? Identify "stealth expatriates" outside the formal expatriate program who nevertheless are working outside their home countries. Check the visa status of non-local-citizen employees worldwide. How might this deal affect these visas?

[31] Independent contractors, consultants, agents, secondees, sales representatives, "business partner" staff dedicated to this business, and employees working from home or remotely, even overseas.

- **Compliance with policies and laws.** Identify (and check compliance with) the seller's own employment policies, written and unwritten. Look at employee handbooks, written work rules, health/safety guidelines. Separately, check whether the seller complies with legally mandated terms and conditions of employment. What special terms and conditions (beyond legal minimums) does the seller extend to employees? The buyer may have to replicate terms after closing.
- **Code of conduct.** Check compliance with the seller's internal ethics code of conduct and social responsibility programs, including any commitment to an industry code, any corporate social responsibility program, and any so-called "framework" (global union neutrality) agreement. Are these translated into local languages and compliant with overseas language laws? Do the seller's HR practices comply? Will the seller's current practices align with the buyer's practices and comply with the *buyer's* policies and codes? Check seller practices regarding government procurement, payment procedures to government officials, compliance with anti-bribery laws and audit/accounting rules. Verify that any seller whistleblower hotline complies with Europe's tough data protection law mandates.
- **Supply chain and human rights.** Get the seller's *supplier* code of conduct, if any, and collect compliance data like social/human rights audits. Collect data on labor practices in the supply chain, particularly as to components and products sourced from poor countries, including construction projects. Consider post-closing obligations on the buyer under California's Transparency in Supply Chain Act 2010.[32] Consider post-closing exposure to workplace-context human rights claims. Consider whether the seller's supply chain practices might, after closing, breach the *buyer's* supplier code of conduct, if any.[33]
- **Compensation and benefits.** Using a separate compensation/benefits checklist, check the seller's benefits and compensation offerings, including bonus plans. Are they above market? Do they comply with legal minimums? Look into the seller's compensation philosophy, compensation and benefits "schemes" or plans, severance plans, retirement plans, bonus plans, and perquisites.[34] Check sales compensation. Check individual pension promises, special agreements, grandfather clauses, death/disability benefits, cafeteria plans, service awards, profit-sharing and

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[32] Cal. Civil Code § 1714.43; Cal. Revenue and Taxation Code § 19547.5.

[33] This said, keep human rights issues in perspective. Discount advice (from certain consultants and activists) that the United Nations Guiding Principles on Business and Human Rights and other aspirational declarations somehow impose binding legal obligations relevant to international mergers and acquisitions. For the most part, they do not.

[34] Such as meals, housing, and expatriate benefits.

savings plans, tuition and adoption reimbursement plans, employee assistance programs, employee loans and guarantees—even unusual expense reimbursements. Understand the interplay between foreign pension plans and foreign social security in each affected country. Check compliance with local laws that mandate extra payments and benefits (like thirteenth-month pay and profit sharing in Latin America). Get an accounting of any transferring plans and study funding—unfunded, underfunded, and "book reserve" plans can raise huge problems and occasionally even kill deals.

- **Equity**. Look at seller stock options, stock grants, phantom stock, and other equity plans, plus employee ownership programs, officer/director stock ownership, and employee ownership in affiliates and entities doing business with the seller. What will happen to these after closing? If the buyer will not or cannot replicate them, what will it need to do instead?
- **Employee insurance coverage.** Look at the employment-related insurance the seller provides, like employee life/health/accident insurance, hazardous duty/kidnap insurance, payments to state-mandated insurance funds (workers' compensation and state social security insurance), expatriate coverage and "key man" policies naming the employer as beneficiary. Consider analogous insurance needs post-closing, and in an asset deal, consider the logistics of setting insurance in place by the closing date.
- **Performance management**. Study the seller's performance management system. Focusing on key employees, collect data on job evaluations, performance appraisals, and problem employees. Consider integration after closing.
- **Labor organization relationships.** What labor organizations represent the seller's workers? Are these independent unions, in-house unions, or so-called "white unions"? What about pending employee requests for union recognition or organization? Separately, collect organizational data on the seller's *in-house or company-sponsored* labor organizations like local/national works councils, any European Works Council, health/safety committees, staff consultation committees, worker committees, workplace forums, labor/management committees, and ombudsmen. How cooperative or contentious are these groups? Collect meeting minutes and records memorializing labor disturbances and days lost to strikes.
- **Collective agreements.** Look at applicable collective bargaining agreements, "industrial awards," "social plans" and other agreements with employee representatives—not only union agreements, but also accords with works councils, worker committees, health and safety committees, ombudsmen and the like. Avoid the common mistake of asking only for

"collective bargaining agreements"—a phrase usually interpreted as meaning only formal union agreements, excluding informal one-off accords and arrangements with works councils and the like. Get expired agreements with terms that still apply. Identify all industry ("sectoral") collective agreements that bind the seller even as a non-signatory. Does the seller participate in any multi-employer bargaining associations?

- **Individual employment agreements**. Look at individual employment contracts with employees, including employment agreements labelled "offer letters," "statements of particulars," "restrictive covenants," "non-competes and confidentiality agreements," "indemnification agreements," "inventions and intellectual property assignments," "expatriate arrangements," and "resignation letters and releases." At least check these for key executives and look at form/template agreements for rank-and-file employees. Be sure to look at contracts with contingent workers—service providers like independent contractors, consultants, agents.
- **Employee consents**. Check individual employee consent forms. Employee consents come in many flavors: In jurisdictions like the U.K. and Korea, employees may have consented in writing to work overtime. European employees may have consented to employer processing of sensitive personal data. Employees may have acknowledged a code of conduct or work rules in writing. If these consents are electronic, do signatures comply with electronic signature protocols?
- **Change in control clauses.** Check change-in-control, golden parachute, and other transfer-related clauses in employment and agency agreements, including M&A-ratification provisions in any labor union contracts and European Works Council agreements. Of course, dig out every change-in-control clause in every executive employment agreement and find all transferability clauses in independent contractor agreements. These are vital.
- **External agreements**. Do any external agreements (with third parties) limit staffing flexibility? For example, in a stock purchase, are there acquisition agreements from earlier deals that limit reductions-in-force? Has the seller signed onto any supplier codes of conduct of its customers? Is the seller a government contractor that has taken on staffing-related public-procurement obligations?[35] Separately, look at outsourcing agreements with HR service providers like payroll providers, "temp" agencies, benefits providers and whistleblower hotline providers.

[35] In the United States, for example, a buyer of a government contractor can take on big "affirmative action" obligations after closing; analogous issues can arise abroad.

- **Payroll and government filings.** Check the seller's payroll processing compliance as to deductions, withholdings, reporting, compliance with mandatory payments to unions, and remittances to agencies including government tax, social, unemployment, and housing funds. How is payroll issued? Are there any extra deductions (such as for charitable contributions or employee loan repayments)? Does the seller pay mandated benefits like premium-pay vacation, profit sharing, and thirteenth-month pay? If the seller employs anyone in countries where it is not registered to do business, how does the seller comply with host country payroll obligations? Be sure to check "permanent establishment" issues—are there "floating" employees doing business in countries where the seller is unregistered, not paying taxes, and flouting local payroll mandates? This is a too-common scenario.
- **Wage/hour compliance.** Verify compliance with wage/hour laws, cap-on-hours laws, vacation and holiday mandates, overtime payments, payments during business travel, exempt-status designations, mandatory meal breaks, toilet breaks, and rest periods.
- **Health and safety; duty of care.** Check compliance with health and safety laws, including recordkeeping mandates. Get information on duty of care/safety/evacuation and other protocols such as for hazardous-duty work and occupational health/safety law compliance, particularly for expatriates.
- **Discrimination/harassment.** Verify compliance with local discrimination/diversity/harassment laws including laws on pay equity, affirmative action, mandatory training, and bullying. Verify compliance with the seller's own discrimination/harassment policies. For example, does the seller impose mandatory retirement in violation of a no-age-discrimination provision in its own code of conduct? (That, unfortunately, is a common problem.) Indeed many international discrimination/harassment policies go well beyond local laws, and many employers blatantly violate their own policies.
- **Recent layoff and divestitures.** What layoffs or "collective redundancies" have occurred in the last few years? What divestitures of business units have occurred? Did these comply with applicable laws? What lingering obligations remain in "Social plans," like for example *recall rights*?
- **HRIS.** Look into the seller's employee data-processing and human resources information systems [HRIS]. Check how HRIS complies with data protection laws, especially as to cross-border data exports. Has the seller made all required notices/communications to employees about HR data processing, and collected necessary consents? What so-called "sensitive" data about staff does the seller process? Beyond HRIS, verify

compliance with data protection laws in the HR context, including as to routine HR data exports overseas, and as to global whistleblower hotlines.

- **Powers of attorney**. Find out what powers of attorney employees, officers, and directors hold. These are particularly critical in Latin America, where there can be different levels of powers, some of which include the power to dispose of company assets. Consider how these powers will need to work after closing.
- **Management oversight**. What controls does the seller's headquarters use to monitor local management's compliance with laws and corporate policies?

§ 8.04 CHECKLIST OF WORKPLACE ISSUES IN INTERNATIONAL MERGERS AND ACQUISITIONS

Understanding what happens to a multinational seller's staff when an international merger or acquisition closes, and understanding the employment law issues to check for in preliminary deal due diligence, we are now ready to inventory all the other employment law issues that can come up during the course of a cross-border merger or acquisition transaction. Be sure to account for all of these when they come up in an international merger or acquisition:

- **Post-merger integration strategy.** A buyer structuring a merger or acquisition first needs to account for post-closing *employment integration*. Vital issues relating to the deal from the outset inevitably turn on the extent to which the buyer intends after closing, to integrate its existing workforces with its new ones. Too often the transaction lawyers pushing the deal along operate under incorrect assumptions about the buyer's post-closing integration plans. This leaves the deal team prone to mistakes that could compromise the buyer's position later. For example, sometimes M&A lawyers assume that the buyer will continue to employ the acquired workforce, but the buyer client meanwhile is planning a huge "restructuring." A buyer structuring an international merger or acquisition should articulate from the beginning where it will fall on the spectrum between managing the new operation as a stand-alone versus fully integrating all acquired workforces into existing buyer operations, or doing a post-closing layoff. And does the buyer need a transition period after closing but before integration, with the seller continuing to employ staff under a transition services agreement?

- **Restructurings and lay-offs.** We mentioned that in some jurisdictions a business sale itself is not legal grounds for firing staff.[36] That said, some buyers may insist that the seller do a pre-closing lay-off. In other deals a buyer will plan lay-offs or a "restructuring" for *after* closing. If there will be lay-offs or a restructuring after closing, lay the groundwork when structuring the transaction itself.[37]

- **Retention.** The flip side of the lay-off coin is *retention*, often a challenge after a merger or acquisition. A buyer that will need workforce or leadership continuity should implement, well before closing, strategies like proactive communications, incentives and retention or "stay bonuses." To start thinking about retention after closing is usually too late.

- **Purchase agreement drafting.** Employment issues factor into a number of the key provisions in any thorough international M&A agreement. Even in an asset sale in de facto firing countries where a buyer does not intend to employ any of the seller's workforce, a merger or acquisition purchase agreement's representations, warranties, covenants and schedules should account for employment issues across the seller's worldwide operations, accounting for the scenario of paid off seller employees suing the buyer under various theories. Of course, the details—what the purchase agreement says about employment—differ from deal to deal. The parties usually agree in principle that pre-closing employee-related liabilities lie with the seller while post-closing liabilities lie with the buyer. But as already mentioned, local laws in many jurisdictions can hold both parties jointly and severally liable for employment claims that accrue in the months before or after a deal; the purchase agreement needs to reapportion those liabilities.

  And of course there are plenty of other employment complications that parties typically iron out in the purchase agreement's representations and warranties. What if the buyer, after signing the agreement but before closing, grants pay raises or takes other steps that raise the buyer's post-closing employment costs? What if an asset buyer fails to match employment terms and conditions, triggering imputed firings by the *seller*? What if the seller concealed vital HR information in due diligence or in the purchase agreement schedules? How will the parties transfer pension rights, and address unfunded liabilities? Clarify these and other personnel issues in the purchase agreement. Consider using indemnities or setting aside a basket of funds to cover post-closing employment claims between the parties.

[36] *See* EU Transfer of Undertakings Directive, 2001/23/EC, at art. 4(1).

[37] For example, if the buyer anticipates doing layoffs after closing, severance provisions in the seller's employment contracts and information/consultation obligations with employee representatives may actually get triggered *before* closing. Be sure to comply.

- **Employer entity.** The buyer in an asset deal may need to set up new corporate entities in certain countries to employ local staff after closing. Factor employment issues into entity structure. Forming a new local corporate entity implicates issues not only of corporate and tax law, but also *employment* law.[38] Also, work out who will get powers of attorney to act on behalf of these entities.
- **Buyer human resources codes and rules.** The buyer in an international M&A deal should factor in *its own* global code of ethics, human resources policies, diversity programs, commitments to industry or customer codes, and any "framework" (global union neutrality) agreement. Do any *seller* practices run afoul of these? Will the buyer be able to impose these commitments on newly acquired workforces after closing? Do the seller's sourcing practices comply with the buyer's supplier code of conduct?
- **Worker representative consultations and irrevocable offers ("put options").** Because employee representative bodies like trade unions, works councils, health and safety committees, worker committees, and ombudsmen are so much more common outside the United States than stateside, *collective employee representation abroad ends up playing an outsize role in mergers and acquisitions.* Even before a seller commits to sell a business (particularly an asset sale), many countries impose a mandatory subject-of-bargaining duty of "information and consultation" and (in Germany) "participation" involving worker representatives in the ultimate sale decision. For example, the French Labour Code[39] requires active collective consultations in a business sale while Japan's Demerger Act requires some, albeit rather minimal, information obligations. Across Europe, even *buyers* bear pre-closing employee representative consultation obligations with their own workforces.[40]

  Compliance with consultation obligations in the business sale context is vital—as we have seen, liability for a seller's pre-closing labor law violations often passes, at closing, to the buyer. But merger and acquisition context employee consultation mandates are particularly tough to follow in practice while a deal still needs to stay under wraps and where the bargaining obligations arise at remote overseas outposts far from headquarters and only peripheral to the deal. This conundrum leads to

[38] For example, German "AG" corporations bear stricter employee-involvement burdens than "GmbH" entities. In some parts of Latin America multinationals set up a "services company" to employ staff separate from their "operating" entity, to control liabilities under local profit-sharing mandates. And "Representative Offices" in some countries are limited as to what their staff is empowered to do.

[39] Article L 2323.

[40] EU directive 2001/23/EC, art. 7(1), final sentence.

complex and creative workarounds like (particularly in France and the Netherlands) the buyer and seller downgrading their initial merger or acquisition purchase agreement to a mere "irrevocable offer"—essentially a "put option" that the seller commits to accept only after it completes deal-mandated labor consultations.

Some examples of jurisdiction-specific challenges relating to worker representative consultations and negotiations in overseas mergers and acquisitions:

- In some jurisdictions, failing to consult with worker representatives about a deal is a crime.[41]
- In France, Germany and elsewhere, a works council that has not been fully informed and consulted over a deal can win an interim injunction holding up the closing. This happened, for example, in the 2014 Printemps deal.[42]
- Information and consultation obligations in the merger and acquisition context get particularly strict as to *European Works Councils*—the pan-European employee bodies that exist inside large employers separate from local national works councils. EWCs are sleeping giants that can lie rather dormant in day-to-day European human resources operations but spring to life in the context of an acquisition or divestiture. In any deal involving an EWC, get on top of EWC consultation obligations from the beginning.
- France's new *Florange* law imposes particularly heavy consultation obligations on mergers and acquisitions that the seller cobbles together after originally intending to shut down.[43]

- **Replicating employee representative bodies**. Under U.S. law, employer-dominated labor organizations are flatly illegal. But outside the United States, many employee representative bodies owe their very existence to their employer sponsor.[44] A buyer of assets may need to arrange to transfer and then host (or to replicate) the seller's non-union employee representative bodies upon closing.[45] Where a seller spins off less than its entire workforce, employees may transfer without their employer-hosted staff representative bodies, forcing the buyer to scramble to

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[41] *E.g.*, France Labour Code arts. L. 2328-1, L.2346-1.

[42] Printemps, Court of Appeals of Paris, Mar. 10, 2014, case no. 13-17082, ch. 6-1.

[43] Law no. 2014-384 of Mar. 29, 2014.

[44] Examples include: works councils and EWCs in Europe, labor-management councils in Korea, company unions in Latin America, health and safety committees, staff consultation committees and ombudsmen around the world.

[45] *See* EU Transfer of Undertakings Directive, 2001/23/EC at art. 6(1).

launch its own worker bodies upon closing. Parties to mergers and acquisitions too often overlook this problem in the pre-closing rush.

In some asset deals the buyer may have a strategic reason to invite in a so-called "white" (employer-friendly) union right after closing. And any deal that will push the buyer's combined post-closing EU employee population over the 1,000 mark will make an EWC a possibility for the first time. The buyer needs to be proactive, or the EWC might get established in an undesirable way.

- **Individual employment contracts.** We discussed that when employees transfer over to a buyer either by contract or by operation of law, the buyer often assumes an obligation to maintain their terms and conditions of employment and seniority status quo as they were with the seller. As to the mechanics, the buyer often inherits the existing individual employment contracts, as written, even though those contracts have the seller's name on them as the "Employer." As a housekeeping matter, buyers may want to substitute their own individual form employment contracts naming the buyer as the employer, and making permissible (non-material) tweaks to employment terms and conditions to align HR offerings with the buyer's actual codes, policies, programs, and offerings. Employees who sign new employment contracts with the buyer should always unambiguously revoke the previous employment agreements with the seller (the ones that transferred). Too often this step gets overlooked.
- **Payroll, benefits delivery, transition services agreements, and HRIS.** At closing the buyer needs to be in full gear, ready to issue payroll in each country, make government withholdings and contributions, and provide payroll-linked benefits that replicate seller benefits. This requires taxpayer identification numbers and government filings. Some benefits plans automatically transfer to a buyer (such as in a stock transaction), but others do not. And so a buyer in an international deal, particularly an asset deal, almost inevitably has to scramble to issue legal payrolls around the world and to implement programs and structures that replicate seller offerings, starting the day after closing. Indeed, replicating *equity plans* can be effectively impossible where the buyer is not publicly traded. Be sure a global payroll provider is in place at closing.

  Separately, the buyer needs to figure out a compliant way to "migrate" acquired employees onto its human resources information system [HRIS].

  Often these payroll, benefits delivery, and HRIS issues prove impossible to resolve by closing. In those deals parties work out *transition services agreements* that keep staff payrolled by the seller for a while after closing.[46] In structuring transition services, be alert to the threat of co-/dual/joint employer claims by the transition staff.

- **Expatriates and visas.** A seller's expatriates pose a challenge in a deal where the buyer must employ the expatriates, must reconcile (or replicate) their compensation packages, and must account for the problem of an asset transfer nullifying visas and work permits. Separately, a buyer that will dispatch its own expatriates into new overseas operations right after closing should apply early for its own new visas and work permits.

- **Employee communications.** Employees will be hungry for information about the deal. A buyer and seller should coordinate their employee communications. In Europe and some other jurisdictions, the seller may have to tell its employees, before closing, about the *buyer's* post-closing integration or layoff plans.[47] In making staff communications about a deal, remember to comply with workforce language (translation) laws.

  Never get into the position of issuing an internal announcement to employees about a merger or acquisition that betrays that the employer just did an end-run around its consultation and bargaining obligations with its worker representatives. That employee communication will end up as "Exhibit A" in the unfair labor practices case.

- **Press releases.** When the buyer and seller get together to issue their joint press release announcing their deal to the world, they better first think through the ramifications of *overseas labor laws*. Never get into the position of issuing a press release about a deal that betrays that one or both parties just did an end-run around its consultation and bargaining obligations with its worker representatives—that press release will be compelling evidence later in a labor case.

- **HR integration.** Following through on HR issues after a merger or acquisition is vital to business success, but successful post-merger integrations in the international context can be slow, expensive, and risky. Work out a coherent post-merger HR integration strategy. Learn the lessons of the famous mergers between publicly traded companies that later broke apart because of flawed post-closing staff integrations.[48] Be careful, thorough and smart when combining global workforces after a merger.

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[46] For example, German Federal Employment Court decision no. 8 AZR 826/11 (Sept. 27, 2012) authorizes these transition services agreements in Germany.

[47] This is one reason, as already mentioned, a buyer should articulate early its post-merger integration strategy.

[48] *E.g.*, the AT&T/NCR merger.

Contrary to the assertion of a London corporate lawyer, parties to an international deal can never afford to "just do it and sort out the people issues afterwards."[49] Outside the United States, a stock (shares) transaction, merger, or asset purchase that affects staff across a number of countries confers significant rights on employees. Precisely what these rights are, though, differs by country and depends on the transaction structure. Address the fate of overseas employee populations head-on. Handle employee due diligence proactively. Account for all the other employment issues in each affected country.

[49] *See* note 1, *supra*.