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

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

Strafford Live CLE Webinar

Presented by:
Donald C. Dowling, Jr., Partner at K&L Gates (New York)
Anna Ferrari, Esq., Associate at Morrison & Foerster (San Francisco)
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Overview of M&A Activity, Deal Structures
M&A trends from 2015

- M&A up 32% worldwide – strongest year ever
- More than 42,300 deals announced in 2015
  - Valued at $4.7 trillion, with 71 deals worth $10+ billion
  - Cross-border M&A = 1/3 of all deals
- US targets led the way; APAC region close behind
- Leading industries: healthcare/pharma, energy, tech
- 2016: expect more of the same
Let’s make a deal!

There are four “main” deal structures:

- Asset Acquisition = change of employer, so termination and rehire in U.S. & different treatment outside U.S.
- Stock Acquisition (Direct Purchase) = no immediate change of employer
- Stock Acquisition (Merger) = no immediate change of employer (unless forward merger)
- Carve-Out (Asset/Stock or both) = see above

Critical to understand what type of deal is happening, including at the local level
Quick Guide
Employment Impact / Type of Transfer in Deals

<table>
<thead>
<tr>
<th></th>
<th>Stock deal</th>
<th>Asset deal</th>
</tr>
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<tbody>
<tr>
<td><strong>US</strong></td>
<td>No change to employer</td>
<td>Termination and hire</td>
</tr>
<tr>
<td><strong>Americas</strong></td>
<td>No change to employer</td>
<td>Generally termination and hire, but country-specific peculiarities</td>
</tr>
<tr>
<td><strong>APAC</strong></td>
<td>No change to employer</td>
<td>Generally termination / resignation and hire</td>
</tr>
<tr>
<td><strong>EU/EEA</strong></td>
<td>No change to employer</td>
<td>Generally automatic transfer</td>
</tr>
<tr>
<td><strong>Rest of Europe</strong></td>
<td>No change to employer</td>
<td>Termination and hire</td>
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Tips for avoiding pitfalls in cross-border M&A

- Conduct a full and thorough due diligence
- Get HR, employment, immigration, benefit and equity experts in the deal room
- Consider deemed integration issues
- Address works’ council, employee rep and union requirements
- Analyze and prepare for how employees will transfer

- Understand limitations on redundancies
- Ensure employment-related IP has been assigned
- Determine if any immigration issues and plan accordingly
- Understand limitations of non-compete agreements
- Address harmonization of terms and conditions
- Determine impact on benefits and equity
Pre-M&A Employment Due Diligence
“Big ticket” employment diligence issues

- **U.S.**
  - Wage and hour compliance / misclassification
  - Consultant misclassification
  - Benefits liabilities (underfunded pensions)
  - Employee IP
  - Employee entitlements (e.g., retention, severance, change in control)
  - Non-competes
  - Unions
  - Litigation

- **Additional items outside the U.S.**
  - Works’ councils or other employee representative groups
  - CBAs & social plans
  - Benefits
  - Payroll (non)compliance
  - Expats
  - Contractual entitlements
Key Deal Documents
Deal centerpiece: the Purchase Agreement

- Key provisions and schedules
  - Representations and warranties
  - Indemnities
  - Disclosure schedules
  - Ongoing obligations
  - Closing conditions
Key Provision #1: Representations and Warranties

- Don’t rely on due diligence alone.
- “Reps and warranties” = statements of fact made by seller to buyer (and vice versa)
- If you are the buyer: the broader the seller rep, the better!
  - “All US employees are properly classified under applicable federal, state and local laws.”
- If you are the seller: wiggle room is key!
  - “To the Seller’s best knowledge, the Seller has properly classified, in all material respects, all US employees under applicable laws.”
Key Provision #2: Indemnities

- A method for compensating one party for the other party’s breach of the purchase agreement
- Two main types:
  - Specific indemnities
  - General indemnification
    - Typically triggered upon reaching a threshold
Key Provision #3: Disclosure Schedules

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

• Identifying the target’s workforce
  • Where are employees located?
    • Involve local counsel if needed
  • Who are key employees?
  • Employee census may be the single most important of target’s documents

• Successor liability (asset deals)

• Joint employer concerns

• Transition issues
  • Who is coming over? Is human capital a major deal point?
  • Under what terms? Will the buyer require new agreements?
  • Does the buyer intend to close any facilities or lay off employees?
  • Who will pay termination, severance, change of control, retention plan costs?
  • Will the parties enter into a transition services agreement?
Employment Agreements

• Severance and change of control provisions
  • “Good Reason” usually based on adverse change in job title, reporting relationship, compensation or job duties
  • May be triggered by transaction or create financial incentive for employees to resign post-closing
  • May be necessary to amend or offer additional retention incentives
  • Involve a benefits/tax specialist to analyze tax implications

• Restrictive covenants
  • Are existing covenants enforceable?
    • State-by-state analysis
  • Should buyer require same or other restrictive covenants?

• Agreements to protect seller intellectual property
Workforce Classification

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

• Evaluating classification issues
  • Common examples: IT employees, administrative support personnel, inflated “manager” titles
  • Employee/contractor census (e.g., title, compensation, contract term)
  • Job descriptions
  • Handbooks and personnel policies
  • Contractor agreement
  • Management interviews
  • Pending claims or audits

• Remediation
  • Should buyer adopt seller’s classifications?
  • Timing concerns
• Federal and state WARN laws
  • Require advance notice of plant closings and mass layoffs
  • Generally, if seller terminates and buyer does not re-hire, seller bears WARN responsibility
  • If, after closing, buyer terminates, buyer generally bears WARN responsibility
  • Be sure to analyze cumulative impact under aggregation principle (90 days)

• Severance plans
  • Does seller have one?
    • Unwritten, informal practices can be enforceable
  • Should buyer offer one?
    • Condition on general release of claims
    • Consider structuring as ERISA plan
Other Wage and Hour Issues

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

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

• Union recognition
  • Generally, buyer is bound by collective bargaining agreements (CBAs)
    • Stock purchase – CBA assumed
    • Asset purchase – Successorship (whether contractual or common law)

• Duty to bargain
  • Unlike other contracts, union relationship survives term of CBA
  • Buyer generally assumes the duty to bargain with the union before changing terms and conditions of employment

• Notice and consent obligations
  • Some CBAs give the union the right to receive notice of or consent to the sale or merger before it happens

• Involving a labor specialist is key
Labor Unions

- Evaluating union-related risks
  - Request amendments, MOUs, side letters along with CBA
  - Analyze costly or onerous contract provisions
    - Underfunded defined benefit pension plans
    - Withdrawal liability for multiemployer pension plans
    - Wage/benefit/severance commitments
    - Neutrality and card-check provisions
    - “Zipper clause”
    - Other limits on ability to reduce workforce or operate business
  - Consider management-union relations (e.g., grievances, strikes, organizing activity)
  - Are there pending unfair labor practice charges?
• Pre-closing issues
  • Assess general compliance with immigration laws
    • Especially industries under ICE scrutiny (e.g., hospitality, agriculture)
    • Termination of employment in asset purchase may impact status of employer-sponsored visas

• Post-closing issues
  • Consider executing new form I-9s for all transferred employees
Key Takeaways

• Get a copy of the employee census
• Focal points for diligence:
  • Worker classification
  • Wage and hour compliance
  • Severance and change of control obligations
  • Restrictive covenants
• Involve a benefits/tax law specialist
• Is there a union?
  • Involve a labor specialist
  • Watch out for pension plan issues
• Attend to transition issues and plan layoffs early
Threshold inquiry: When representing a buyer or seller in an M&A transaction that implicates seller-affiliate employees in one or more jurisdictions, what happens to seller employees upon closing?

Pre-closing layoffs

US context

• Stock (shares) deal and U.S. employee transfers
• Asset-purchase deal and U.S. employee transfers
M&A Employee Transfers Outside the US: Vested Rights, Acquire Rights and *de Facto* Firings (cont’d)

**Outside-US context**

- Stock/shares deal and outside-U.S. employee transfers

  ➤ But: *mandatory consultation jurisdictions*

- Asset purchase deal and outside-U.S. employee transfers
M&A Employee Transfers Outside the US: Vested Rights, Acquire Rights and de Facto Firings (cont’d)

Outside-US context

- Stock/shares deal and outside-U.S. employee transfers
  - But: *mandatory consultation jurisdictions*
- Asset-purchase deal and outside-U.S. employee transfer
  - **Acquired rights jurisdictions**
    - Brazil
    - EU (UK “TUPE”)
    - Bahamas, Malawi, South Africa, Turkey
    - Singapore
    - South Africa
    - South Korea
M&A Employee Transfers Outside the US: Vested Rights, Acquire Rights and *de Facto* Firings (cont’d)

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    ✓ Singapore
    ✓ South Africa
    ✓ South Korea

  ➢ **De facto firing jurisdictions**
    ✓ Formal employer substitutions and informal employer substitutions
    ✓ Examples:
      • China
      • India
      • Japan
      • Latin America and Bahamas
      • Puerto Rico
      • Nigeria and the Philippines
Independent Contractors/Consultants/Freelancers/Entrepreneurs

- Distinguish employee/executive vs. independent contractor
- Distinguish individual contractor vs. corporate contractor vs. “leased employee”
- Effect of misclassified contractor \( (de facto\) employee) transferring in:
  - Stock deal
  - Asset deal
- \textit{Cf. article in course materials}
Checklist for *Other* HR Issues in International M&A Transactions

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

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