Mergers and Acquisitions: The Role of HR in UK and EU Transactions


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Client Alert

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Last year the UK had the second largest share of the global mergers and acquisition market. In this article we consider the role of the HR director in a merger or acquisition and look at the range of people issues involved in the early structuring of the transaction, the transaction process itself and the post-transaction activities in the context of the transaction’s legal framework.

Whilst the media frenzy continues around the level of city bonuses resulting from such a record year, those of you who deal with the HR and employment law aspects of such deals know that HR strategy and the practical management of the people issues involved in them can result in headaches that are definitely not champagne-fuelled.

The Structure

A key early stage issue to be determined is whether the acquisition is to be structured as a share purchase, an asset purchase or both, since the answer to this question has a fundamental legal effect on the employees’ rights and the purchaser’s obligations. The purchase of assets (but not goods and services) or the merger of two companies to form one, or a third, may constitute a “relevant transfer” for the purposes of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (“New TUPE”). Provisions relating to employment rights on the transfer of an undertaking are contained in New TUPE and the Employment Rights Act 1996, whereas collective issues are covered by the Trade Union and Labour Relations (Consolidation) Act 1992.

If New TUPE applies, it has the following three-fold effects:

The employees automatically transfer;

1. there are information and consultation obligations; and
2. there are special protections against dismissals and changes to terms and conditions of employment connected with the transfer.
3. there are special protections against dismissals and changes to terms and conditions of employment connected with the transfer.

Summary of the Changes Introduced by New TUPE

So much has already been written about New TUPE, but focusing on the extent to which New TUPE has changed practices for those involved in mergers and acquisitions, the key points to bear in mind are:

• Definition of a Relevant Transfer: This now consolidates the relevant case law, i.e. a transfer of an economic entity which retains its identity.
• **Requirement to Provide Employee Information:** There is now a requirement on the vendor to provide the purchaser with "employee liability information".

• **New Allocation of Liability for Failure to Inform/Consult:** The vendor and the purchaser will now be jointly and severally liable for a protective pay award for a failure to inform/consult.

• **Limited Flexibility to Change Terms and Conditions Post-Transfer:** Changes to terms and conditions of employment post-transfer are now valid if they are for an "economic, technical or organisational reason" entailing changes in the workforce.

• **Clarification on Transfer Related Dismissals:** Dismissals will be automatically unfair if they are by reason of the transfer or for a reason connected with the transfer unless there is an “economic, technical or organisational reason” entailing changes in the workforce.

• **Easier to Claim Constructive Dismissal:** Employees can now resign and claim constructive dismissal in connection with a transfer if there is a substantial change in working conditions to their material detriment. They no longer need to show that there is a breach of contract.

As well as the sanction for failing to inform/consult employee representatives under New TUPE which remains at up to 13 weeks' actual pay per employee, a vendor may also now be liable for failing to provide employee liability information to a purchaser. The minimum sanction for such a failure is £500 for each employee in respect of whom the information was not provided. There is no maximum so watch out and make sure that you are not that first test case.

**The EU Perspective**

New TUPE implements the 2001 EC Directive (the “Directive”) which replaced the 1977 Acquired Rights Directive. Those involved in cross-border or EU mergers and acquisitions should be aware that the Directive, like its predecessor, has been implemented and interpreted differently in different EU Member States. For example, regarding the sanctions for failing to inform and consult, in France you could be facing one year’s imprisonment, there are criminal penalties in both Belgium and the Netherlands and in Germany the deal could be void. You will find that highlighting these possible sanctions to your commercial colleagues will focus their attention on this issue! Given this range of possible sanctions, the early instruction of local counsel to advise on the application of local law to an EU-wide transaction is a must.

**What if New TUPE Does Not Apply?**

Although the specific obligations under New TUPE will not apply to a share purchase, it would be wrong to think that, from a people point of view, a share purchase has few legal consequences. As the purchaser will stand in the vendor’s shoes and take on all past and current employment-related liabilities, HR still has a key role in the transaction.

**Takeovers**

The Takeovers Directive (Interim Implementation) Regulations 2006, which came into force on 20 May 2006, place a larger emphasis on providing information in a takeover situation. As a result, HR may be required to play a greater role in making documents available to employee representatives, including on issues such as the likely impact of the bidder’s plans on the target's employees (and, where relevant, on its own employees); any proposed material changes in conditions of employment; and any opinion prepared by the employee representatives on the effects of the offer. Board-level HR directors should also be aware of the criminal offences for non-compliance with the rules of the Takeover Code.

**Pensions**
If the transaction is a “relevant transfer” for the purposes of New TUPE, the Transfer of Employment (Pension Protection) Regulations 2005 will apply. These regulations require purchasers to make some form of pension provision available to employees who transfer in certain circumstances. If the transaction could result in changes to pension provision, there is an additional layer of consultation required by the Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006. Pensions are not only a highly sensitive issue for most employees; they are also expensive benefits for employers. HR should ensure that the pensions aspect of any transaction and any proposed changes to pension provision are carefully handled by specialist advisors and actuaries and that the associated costs are factored into the transaction early on. Recently, deals have been known to falter due to pensions issues so this really is one to watch out for.

**Due Diligence**

Although you may have significant input into the structure of the deal, your “to do” list will fill up very quickly with action items once you start on the due diligence process. HR directors take a key role in overseeing the collation of due diligence information and facilitating answers to the endless queries on it on a sale, or review of it on a merger or an acquisition. Irrespective of the structure of the deal, conducting a thorough HR due diligence exercise is essential for the purchaser and mitigates the risk of warranty claims against the vendor. For a purchaser, it is also one of the first opportunities HR will get to find out about the people whom it will manage going forward. Take the time to identify risks, liabilities and the solutions in preparation for your integrations activities. As a minimum, you or a member of your team should collate or review the following key documents and information:

- employment contracts (including amendments);
- handbooks and policies;
- benefits plans and schemes provided to employees;
- equivalent information regarding temps/agency employees and other “workers”;
- Union recognition and collective agreements;
- other information/consultation bodies’ documentation;
- other relevant details, such as absent employees (i.e. on sick/maternity/paternity/adoption/parental leave, on secondment), outstanding disciplinary actions and grievances, recent levels of industrial action and recent work accident rates; and
- past and existing employee claims.

**The Red-Flags**

When reviewing the above, particular attention should be given to the following areas where problems can arise in the future:

- notice entitlements;
- change of control provisions;
- any previous TUPE transfers;
- pension, share and share option schemes;
- employee/industrial relations issues;
- restrictive covenants;
- recent dismissals and claims; and
- arrangements by “custom and practice”.

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Additional Pre-Transaction Activities for a Purchaser

HR is also likely to be asked to step in to assist with deciding whom the business wishes to retain from the vendor’s senior management team and devising a strategy to ensure their buy-in. Practical tools for these purposes include long fixed-term contracts, extended notice periods, golden handcuffs, loyalty bonuses, restrictive covenants and lock-in periods. Conversely, where staff will be exited, HR will need to ensure it briefs the business on the costs and risks associated with the terminations and have an updated standard compromise agreement to hand.

The Deal Documentation

Whether HR takes an active role in the actual negotiation of warranties, representations and indemnities will vary from organisation to organisation. However, with their knowledge of the workforce and of the likely risks identified during the due diligence process, they can and do add value at this stage.

Post-Transaction Activities

This final stage of the process is often the key to ensuring a successful integration and transaction from an HR perspective. Typical post-transaction activities include merging HR systems, restructuring and redundancies and changing or harmonising terms and conditions and policies.

In the context of a share purchase, there are no special statutory limitations on a purchaser’s ability to vary terms and conditions post-transaction, although the general principles regarding changing terms and conditions will apply. However, in an asset purchase, New TUPE gives employees greater protections against changes to their terms and conditions.

Although New TUPE was billed as offering greater flexibility to harmonise terms and conditions of employment, unless there is an economic, technical or organisational reason which entails alterations in the number of employees employed or the functions performed by the employees, changes related to the acquisition could be invalid. In the real world most organisations do seek to modify or harmonise terms and conditions at some stage. However, you should tread very carefully. In particular, bear in mind that the passage of time does not offer any protection as there is no set period of time post-transfer after which it is safe to change terms and conditions. Evidentially it may be harder to establish a causal link between the transfer and the changes after a significant passage of time.

Summary

As illustrated above, HR plays a key role in the merger and acquisition process from inception to completion. In particular, you should ensure that HR is involved at the earliest stage, to get things on the right footing from the start. The HR director will truly add value where they guide the business through the legal pitfalls to completion whilst ensuring that when the ink is dry on the deal documentation, the resulting organisation is not only integrated but is ready to achieve its next business goals.