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Labor law considerations when making a European acquisition or divestiture: A long way from U.S. law

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Regardless of whether they are the buyer or seller, U.S.-based companies involved in mergers and acquisitions with a European element are often surprised by labor law aspects they face in connection with the transaction.

There is little doubt that the transaction structure will raise European Union labor law issues. While many of the issues will be the same in all European countries, they will usually be less profound if the European entities are sold as part of a stock transaction rather than as a sale of assets.

During the transaction cycle, deal teams must focus on a number of labor-related items. While some of these items can be addressed during due diligence, others may affect the entire deal structure and timetable.

Before we deal with them, it is worth introducing Europe's central legal labor concepts, which may be unfamiliar to Americans.

THE TRANSFERS OF UNDERTAKINGS DIRECTIVE OF 2001

The Transfers of Undertakings Directive of 2001, a law that applies to transactions in all European countries, is hugely significant in both asset and stock sales with carve-outs or spinoffs when businesses are transferred between owners.

Under EU law, each European member state must implement certain principles into local country law. Accordingly, in all EU jurisdictions, there are local law implementations of the directive. This means the same basic principles apply in all EU countries, although there are local variances.

The U.K.'s local implementation is called the Transfer of Undertakings and Protection of Employment, and it is so well-known that attorneys refer to transfers there simply as TUPE transfers.

The underlying principle is that if there is a "transfer of an undertaking" — a business is transferred from one entity (the transferor) to another (the transferee) and that undertaking retains its identity through the transfer — then all employees who are employed by the transferor automatically become employees of the transferee under the same terms and conditions of employment. Employees cannot be terminated because of the transfer of undertaking.

The application of the TUPE transfer directive is legally and commercially so significant that there is much case law both at the European Court of Justice — and indeed at all local country courts — as to when the directive is triggered.

If there is a TUPE transfer, the transferee not only must employ all the transferor's employees on the same terms (including recognizing all service with the seller), but it is also restricted in changing benefits after closing.

Further, the transferee must inform and consult with the transferor's employees and their representatives prior to the transfer, and the employees have the right to object to the transfer.

An asset sale (or a stock sale with a carve-out) is therefore usually considerably more complex than a stock sale, as the directive creates layers of complexity that raise commercial and labor legal issues.

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UNIONS AND WORKS COUNCILS

There is a widespread culture of employee representation in Europe. Employee representative bodies, whether works councils (consisting of employees of the company) or unions (usually external to the company) are prevalent in many European jurisdictions and are vested with considerable powers. These powers can have a material impact on a transaction, particularly in France, Germany and the Netherlands.

Employee representative bodies in those countries generally have their own attorneys (often financed by the employer!) and frequently conclude collective agreements themselves with employers or employers' associations.

These agreements contain a wide array of terms and conditions of employment, and occasionally they also include restrictions relevant to a transaction.

EMPLOYMENT CONTRACTS AND TERMINATION

Nearly all workers in Europe are employed under written employment agreements that employers can terminate only with notice (usually of at least a month, and frequently longer) and only if there is a legally acceptable reason for that termination, such as redundancy or proven breach of contract. Otherwise, affected employees invariably will be able to gain reinstatement and/or financial compensation.

Each deal presents its own distinct elements and challenges. There is no set pattern. From our experience, there tend to be a few items that constantly surprise and sometimes burden the parties to the transaction.

INFORMATION AND CONSULTATION OBLIGATIONS

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Most of these obligations — and their potential impact on the transaction structure and timing — depend on a few elements, including which employee representative bodies are in place (one should assume a landscape of works councils and unions, but there may not be any), any applicable collective agreements, previous practices at the local business, the state of labor relations, any plans of the purchaser for the business after the sale, and above all, the jurisdictions in which the operations are located.

The onus to inform and consult primarily will be on the seller's management. Nonetheless, the seller will be at least an interested observer, and more often than not will be required to divulge the plans for the business. It is often in the seller's best interest to open up a direct dialogue with its employees and/or their representatives.

At a minimum in most cases, the seller will need to inform employee representative bodies about any transaction affecting the relevant business. Whether the bodies need to be consulted with, which may entail gaining their written consent to the transaction or some aspect of it, will depend on the deal structure.

Share sales tend not to require consultation. A notable exception is sales in France and the Netherlands, where failure to inform and consult with the relevant employee representative bodies (works councils) could lead to a delay in signing or closing the transaction — and invite even more serious consequences.

Asset sales usually constitute TUPE transfers, which generally include a statutory requirement to consult with employees or their representatives before the transaction is completed and the employees are transferred.

COMPANY PENSIONS

In many European countries — most notably Belgium, Germany, the Netherlands and the U.K. — employers provide varying pension benefits. These benefits are sometimes funded by employer payments into an external fund (so-called defined contributions) and sometimes by the employer's promise to employees that it will pay a particular pension benefit (so-called defined benefit).

In the context of a TUPE transfer, the defined benefit scheme can require expert attention in a transaction setting. In some European jurisdictions, such as Germany, pension liabilities will automatically transfer to the purchaser. However, the funding does not. This means that the funding and implementation of pension commitments are often a material issue when considering and negotiating transaction terms.

ASSIGNING EMPLOYEES

With respect to share sales, it is clear which employees are within the transaction perimeter — since the entire employing entity is being sold, all its staff will be "sold" too. With respect to asset sales, on the other hand, issues can and do arise.

Assuming the asset sale is a TUPE transfer with only parts of a business being sold, there can be legal and practical uncertainty about which employees are being assigned to the respective business and thus are being transferred to the purchaser.

This can lead to legal and commercial ambiguity about which employees will transfer with the business and which will be left behind.

A common way to deal with this is for both parties to agree upon a list of employees they intend to transfer. The documentation should address how to treat employees who are on the list but claim they should not be.

Conversely, it should spell out how to deal with employees who are not on the list but claim a right to employment with the purchaser.

Companies are often surprised to learn that each employee who falls within the TUPE transfer regime can refuse to transfer to the purchaser. Employees who do so either are automatically terminated or remain employed by the seller.

OTHER COMMON ISSUES

Many other issues may arise, including issues relating to employee representation on boards, limitations on changing terms of employment, and contractual and statutory restrictions on incentivizing and changing management.

BEST PRACTICE

All in all, labor lawyers and HR professionals cannot become involved too soon, whether on behalf of the seller or purchaser, when preparing for a transaction or bid.

It is good practice to draw up an employee communication timeline that focuses on which entity and individuals are to inform and/or consult with which employees and employee representative bodies.

Parties to a transaction often fail to recognize that the seller and purchaser will be required to exchange information.

The seller has the obligation to inform and consult with its employee representative bodies, and the purchaser must provide information to the seller about its future plans for the business.

The purchaser will be well-advised to be transparent so as to make a positive first impression on the employee representative bodies the purchaser will need to work with post-closing.

An emphasis on the timely provision of accurate information is vital not only to facilitate the transaction process but also to maintain good labor relations.

Transactions can be challenging from a labor and employment perspective, but with adequate planning and communication, they are rarely delayed — let alone completely thwarted.

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