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M&A employment law support – post completion integration, changes to terms and redundancies

Inside

This Inbrief examines some of the legal challenges a buyer may face once the deal is done and integration is the number one focus – whether across its simple day to day operations, or in relation to more drastic steps such as restructuring and dismissals.

Who is the legal employer?

In a share purchase, the identity of the employer remains the same before and after the sale – it is simply ownership of the target company which changes hands. By contrast, in a business purchase, employees may become employed by the buyer itself under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) as a result of the transaction. Deals may be achieved through a combination of the two - a share purchase in the first instance, followed by a TUPE transfer of the newly acquired subsidiary's staff to the buyer's own entity on or shortly after completion.

Determining the legal employer is the number one question before embarking on an integration exercise, because it will impact the way communications are framed, documents are drafted and processes are followed.

Integration – share purchase and avoiding an inadvertent TUPE transfer

In some situations, TUPE can arise after a share purchase even where there is no intention to transfer employees' terms and conditions to the buyer. This can happen if the buyer becomes responsible for carrying on a new subsidiary's business, takes on the obligations of the employer, or takes over the day-to-day running of the business.

This can be problematic because the buyer may have no intention of being the actual employer, but becomes it by law – with all of the resulting employment and tax liabilities.

Further, an unexpected TUPE transfer can lead to claims for failure to comply with the relevant rules, especially for failure to inform and consult about the transfer.

There have been various tribunal and court cases in recent years examining the risk of an inadvertent TUPE transfer. A TUPE transfer was found to have occurred in each of the following cases, and we have set out a brief summary of the key risk factors.

In *Millam v The Print Factory*:

- both separately registered entities held combined board meetings;
- the buyer handled the subsidiary's sales function;
- a single sale representative moved from the subsidiary to the buyer;
- the buyer paid the wages and administered the payroll of the subsidiary's employees (the subsidiary did not have its own payroll).

In *Jackson Lloyd Ltd and Mears Group plc v Smith*:

- board members of the subsidiary resigned with immediate effect and were replaced with members nominated by the buyer;
- the buyer told the subsidiary's employees that the buyer had acquired the subsidiary and the employees would be transferring to the buyer;
- the buyer sent a team of integration managers to the subsidiary's site to examine working methods and oversee integration;
- the buyer sought to revive the subsidiary's brand using all of the buyer's own systems, methods and policies/procedures.

In *Guvera v Butler*:

- one of the buyer's directors became the sole director of the subsidiary;
- when that director resigned, the CEO of the buyer sent his chief technical officer to the subsidiary with specific instructions on how to deal with the business going forward;
- the CTO influenced a number of key business decisions, such as in relation to making (or not making) payments to creditors, discussing renewal of licences and determining redundancies (both numbers and who would go and stay).

Drawing from these cases, a buyer should be mindful of how its involvement will appear and seek to draw a distinction between its own operations and those of its subsidiary. The more the subsidiary appears as a self-standing entity responsible for its own decisions, the less risk there is that staff will be deemed to have TUPE transferred to the buyer. The subsidiary should, as much as possible:

- utilise its own processes and policies – such as redundancy policies, family rights and any enhanced payments linked to these;
- maintain its own branding – for example, on staff communications/PowerPoint presentations;
- direct its own personnel day-to-day and be seen to do so, such as ensuring a leader of the subsidiary signs off on communications on its behalf or attends meetings with staff;
- hold its own board meetings.

Both the buyer and subsidiary should take care in how they present the integration to employees, to avoid giving the impression that employment has transferred to the buyer in practice.

Changes to terms

A buyer's integration efforts are likely to involve some restructuring. This can mean different things. Commonly there will be alignment across Group policies and benefits, changes to scope of roles, changes to reporting lines, possibly some new hires and potentially some dismissals.

Changes can be made after a **share purchase** where TUPE does not apply, but the process is not necessarily straightforward.

Where changes are envisaged which mean variation of the employment contract, the starting point is that employee consent will be required, unless: (i) the terms of the employment contract expressly permit the employer to make the variation they wish to make (typically given a narrow interpretation by the courts); and/or (ii) the change is to a discretionary, rather than contractual, provision.

Whether something is discretionary or contractual will hinge on the precise wording in the agreement. For example, an employee may have a contractual right to participate in a private medical scheme, but the terms of the contract may specify that the insurance provider and scope of cover are discretionary and may be varied. This would mean that changing the subsidiary's provider to align it to the group's own offering may not require employee consent.

Changing the scope of roles and reporting lines is another common occurrence during post-completion restructuring. Buyers may want some employees of the subsidiary to take on work within its wider group structure, or to report to the buyer's own managers, such that teams are spread across the group. Care needs to be taken not to trigger an inadvertent TUPE transfer (as above).

Where no job description is contained in the contract, and the clause governing the employee's role gives their title only, it may be difficult for an employee to argue that they have contractual rights to their existing scope of work and management and so no change can be made without their consent (save for certain senior roles, such as execs). However, even then, the question is one of reasonableness. Is it reasonable for the employer to make this change, or could it amount to a breach of the implied duty of trust and confidence, entitling the employee to resign and claim constructive dismissal? That will all depend on the details of the change, such as whether it amounts to a demotion, and whether it is brought about in a reasonable manner by giving the employee fair warning.

Changes are more difficult in the case of an **asset purchase** where TUPE applies. At a high level, TUPE provides that any variation to a transferring employee's contract is void if the sole or principal reason for the variation is the transfer – even if the employee consents to the variation – unless there is an economic, technical or organisational reason for making the change which entails changes in the workforce (known as the "ETO" exemption). This exemption is rarely made out where a buyer simply wants to harmonise the terms of the incoming employees with its existing workforce.

Nevertheless, in practice, harmonisation exercises after a TUPE transfer are common. Where a buyer has a more advanced employment offering than the seller (often true because it is larger), the overall package to employees may be more favourable and therefore attract less complaint (although not less legal risk). Alternatively, a buyer could try to package the changes as being unconnected to the transfer – such as by linking them to a promotion or discretionary bonus payment, linking them to some other reorganisation, or even waiting a couple of years before making any changes.

More information about changing terms and conditions following a TUPE transfer can be found in our previous Inbrief here.

Redundancies

A buyer's integration planning may also involve making redundancies, sometimes as a way of creating efficiencies across the group.

Share purchase

Sometimes a buyer will require the target to make the redundancies before completion occurs, in the knowledge that post completion, the buyer won't need the roles within its group structure. This is risky, as the target must have its own need for redundancies at the point of making the dismissal. Otherwise the dismissals are likely to be unfair. Pre-completion, the target is likely to need the roles identified to continue with its own daily business operations. A good way to tell whether the redundancy rationale belongs to the target or buyer is to ask whether redundancies would be needed if the deal fell away.

Given the legal risk involved here, the seller will often seek an indemnity from the buyer should it face any claims from the employees it makes redundant. The seller is also likely to seek a contribution towards, or potentially full payment of, redundancy costs.

Even following completion, for a redundancy to be fair, the newly acquired subsidiary must still have its own redundancy rationale. It is possible to look at the requirement for particular roles across the group. However, making roles redundant in the subsidiary, on the basis that there is already someone doing the work in the parent, may risk an inadvertent TUPE transfer (as discussed above) if effectively the two businesses are merging. It should clearly be the subsidiary's own management making announcements, leading the consultation, confirming dismissals etc (even if some of this is done in conjunction with the buyer).

There is a duty to look for suitable alternative roles for an employee at risk of redundancy. A buyer should remember that this may also cover any vacancies elsewhere within the buyer itself and the rest of the group, and not just the subsidiary.

Asset purchase/TUPE

In an asset purchase, employees who have transferred under TUPE have enhanced dismissal rights (although they still require two years' qualifying service to bring an unfair dismissal claim). TUPE protects employees from dismissal where the sole or principal reason is the transfer and where there is no ETO reason entailing changes in the workforce. Redundancy may be a legitimate reason for these purposes.

However, a buyer should remember that any process still needs to be fair in the usual way. The timing of the redundancy is important. A transferor/seller cannot rely on the transferee/buyer's redundancy rationale in order to make redundancies before completion. Even if the buyer will not need all of the employees it is due to inherit, legally it must inherit them anyway (noting the likely redundancy as a measure during the TUPE consultation phase), and then carry out its own redundancy procedure post completion. Otherwise it will face claims of automatic unfair dismissal, which would pass from the seller to the buyer under TUPE. To mitigate its risk, the buyer may wish to require the seller (under the asset purchase agreement) to make redundancies under a settlement agreement, which contains a TUPE opt out given by the employee – although it should be noted that the validity of such an opt out is open to challenge.

Where a buyer has inherited employees under TUPE, a fair redundancy procedure could entail the buyer pooling its existing employees with the inherited ones and applying selection criteria to determine who is potentially selected for redundancy. This is often an unattractive proposition. It is often a practically difficult one as well, given that the buyer does not yet know the new employees and must rely on whatever information it has received through the purchase to determine performance or suitability when carrying out the selection scoring. For this reason, it is not uncommon for buyers to seek to frame the transferred role as a unique one, which does not require pooling with other employees. This approach is likely be open to contest if the role is not genuinely unique.

Collective consultation

Finally, buyers should remember that where a business proposes to dismiss 20 or more employees within a (rolling) period of 90 days at one establishment, this will trigger the duty to carry out collective redundancy consultation. Because of the extended definition of "redundancy" under the legislation, this obligation also arises in mass dismissal and re-engagement exercises (often known as "fire and rehire"), where significant changes to terms are made.

It is not uncommon for buyers to seek to avoid the collective consultation duty, by staggering dismissals so that no more than 19 fall within a period of 90 days. This takes careful planning, and is inherently open to suspicion from employees. A buyer should remember that the duty to carry out redundancy consultation legally arises where there is a "proposal" to make redundancies. This does mean something more concrete than a mere contemplation. A buyer should ensure that it marks its redundancy planning documents as drafts for consideration only, and uses the language of possibility, rather than firm decision, in its internal communications during the planning stage.

This is a complicated area. Please get in touch with your usual Lewis Silkin contact if you need any support in understanding whether TUPE applies and its effects in any acquisition context.

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