

# M&A employment law support — top ten questions



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## Introduction

In mergers and acquisitions (M&A) navigating the legal requirements and ramifications of the deal can be tricky. This Inbrief sets out the top ten questions that sellers and buyers need to consider in relation to employment law in M&A transactions. We also offer some insights and tips, from our extensive experience, on how to get the deal done.

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### 1. Is this a share purchase or an asset purchase?

On a share purchase, the default position is that the identity of the target company remains the same before and after the sale - it is simply ownership of the target that changes. This means the employing entity remains the same and employees stay where they are.

On an asset purchase, employees may become employed by the buyer, under the Transfer of Undertakings (Protection of Employment Regulations) 2006 (TUPE).

TUPE provides that where there is a transfer of assets amounting to "an economic entity which retains its identity", any of the seller's employees who are assigned to that economic entity will transfer with it. This would include a business sold as a going concern (including after a share purchase). Employees transfer on their existing terms and conditions, which means that rights and liabilities also transfer to the buyer. This has important ramifications for process and documentation.

TUPE is modified where a business is bought out of formal liquidation or administration, allowing a buyer greater flexibility.

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### 2. What due diligence do we need?

A robust due diligence process can help a buyer to expose any key areas of potential employment law liability within the target company/business. An up-to-date and thorough due diligence questionnaire is crucial for this.

Key areas of focus include:

- *Terms and conditions:* Are service agreements and employment contracts fit for purpose? Clauses regarding notice periods, post-employment restrictions, intellectual property and confidentiality are particularly important. Check for change-of-control clauses which could result in sizeable payments. Do any policies/handbooks include contractual terms?
- *Incentive schemes and benefits:* Are there any bonus schemes, equity award schemes or benefits, and can these be easily changed if needed?
- *Enhanced payment rights:* Are employees contractually entitled to enhanced

redundancy payment, for example, whether expressly or impliedly through custom and practice?

- *Claims/disputes:* Are there any existing/likely employment claims against the company?
- *Employment status and tax:* Is there a risk that individuals labelled as self-employed are employees, potentially leading to potential employment rights and tax claims?
- *Collective agreements:* Is there a trade union or works council?
- *Pensions:* Is the company compliant with its pensions auto-enrolment obligations? Are there any defined benefit schemes in place? Rights relating to early retirement or redundancy under an occupational scheme may transfer under TUPE.
- *Covid-19:* Is the company compliant with the latest health and safety requirements, such as to carry out risk assessments? Has any claim under the government's furlough scheme (Coronavirus Job Retention Scheme) been lawfully made?

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### 3. Which employees do we want to acquire and how do we get there?

If you are a buyer, you should identify early on who the critical or key individuals are in your purchase. You need to confirm that they are employed by the company in question and not by an entity outside of scope for purchase. If the important people are not in the correct entity, a buyer should get the seller to move them to the right place, with both parties bearing in mind that this is likely to trigger TUPE (even where the ultimate acquisition is a share purchase).

In an asset purchase, there is an additional question of whether employees are permanently "assigned" to the target business. This test should be met easily where an employee devotes the whole of their time to the business, but the position may be less clear where they work in other areas too.

Employees have the right to object to the transfer. A buyer can make it a condition for completion of the deal that particular employees, or a specified percentage of employees, must transfer.

Self-employed individuals and agency workers are not usually covered by TUPE and their

contracts do not transfer to the buyer. If they play an important part in a target business, the buyer may wish to enter into new contracts to take effect post-completion. In a share purchase, no change of contracting party is needed, but a buyer should review whether the terms of engagement provide ample protection to the company against employment status and tax claims.

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#### **4. What should be included in the purchase agreement?**

Buyers should give careful thought to warranties that capture all relevant areas of employment law (and trigger any further “flushing out” of important information later in the seller’s disclosure letter). A buyer should have certainty over which employees are being acquired, what terms they are employed under and the sums to which they are entitled (including any promises made).

A general warranty of compliance with employment law is needed, but a buyer may wish to include specific warranties confirming that holiday pay has been calculated correctly (given complexities in the case law) and the national minimum wage has been paid. A warranty should also be sought confirming compliance with IR35 tax legislation, including that the seller has provided any status determination statement required.

Indemnities are particularly valuable where specific risk has been identified, such as employment litigation – especially discrimination and whistleblowing claims, which attract uncapped Employment Tribunal awards.

An asset purchase agreement should contain provisions dealing with which employees will transfer under TUPE, any TUPE liabilities and apportionments, and potentially how the parties will work together during the TUPE information and consultation process. Indemnities might ordinarily address failure of the seller to provide employee liability information, any unintended transferring employees, and failure to inform and consult (on both sides). The latter can attract punitive damages of up to 90 days’ gross pay per employee, and liability is joint and several between the transferring company and the buyer – so a buyer could potentially face potentially extensive liability. It is not legally

possible to get employees to waive these rights

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#### **5. What process do we need to follow with employees?**

In a share purchase, while there is no legal requirement to inform employees that ownership of their employer will be changing hands, companies generally prefer to communicate positive messaging on their own terms.

In an asset purchase which triggers TUPE, there is a prescriptive information and consultation process to be carried out “in good time” before completion with employee representatives of any affected employees. This may involve an election of employee representatives.

Information to be given to representative includes: when and why a transfer is taking place; the legal, economic and social implications of the transfer; any measures that the target or the buyer proposes in connection with the transfer (or if none, a statement to that effect); and information relating to agency workers (easily overlooked).

Where there are proposed measures, the employer must consult with representatives with a view to reaching agreement with them. “Measures” has been interpreted broadly as any “action, step or arrangement” taken in connection with the transfer. This could include dismissals, variation of terms and conditions, reporting line modifications, changes to benefit providers, alteration of pay day, and so on. Consultation must be genuine, though agreement need not be reached.

In the UK, it is possible to consult after the deal is signed and before completion, but this may not be permitted in other countries.

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#### **6. Can we integrate the acquired business into our own?**

If you are a buyer, you will most likely turn your attention to integrating the new business into your existing activities following completion.

A buyer should be aware that even in a share purchase, certain acts post-completion can trigger an intra-group TUPE transfer of the acquired employees. These could include a parent company taking over the day-to-day running of the business, employees reporting

directly to employees of the parent company, or (more obviously) the acquired employees signing an employment contract with the parent company.

Where a buyer acquires a business and after completion splits its activities among companies in its group, that may trigger additional TUPE transfers. In practice, it is often advisable for a buyer to present such post-completion plans as a “measure” in the first TUPE transfer process from the seller to the buyer.

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#### **7. Can we change employee terms and conditions?**

As a general rule, contractual changes can be implemented by obtaining employees’ consent. However, where employees have been acquired in an asset purchase, TUPE states that their terms and conditions cannot be changed if the sole or principal reason for the change is the transfer. The only exception, rarely applicable, is where there is an economic, technical or organisational (ETO) reason entailing changes in the workforce.

In practice, employees may agree to the changes, but the changes risk being technically void. 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, wrapping them up with some other reorganisation, or even waiting a couple of years or so to implement them.

It may be desirable to hold an off-the-record discussion, particularly with more senior individuals, where changes to terms and conditions are sought (or dismissal is required). To ensure an employee has waived their statutory rights - including those under TUPE - they need to sign a settlement agreement that meets certain requirements, including that the employee has obtained independent legal advice.

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#### **8. Can we dismiss employees we have acquired?**

Ordinarily, provided that an employer has a fair reason and follows a fair process, it is

entitled to dismiss employees. In an asset purchase, however, that becomes more difficult. 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, although a buyer should remember that any process still needs to be fair in the usual way. This could mean pooling its existing employees with newly acquired ones when selecting roles for redundancy – a potentially unattractive proposition.

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### **9. Do we need a transitional services agreement?**

Sometimes following the purchase of a business, a buyer requires the seller company to provide services and know-how to it for a limited duration to provide operational continuity. This can be done under a transitional services agreement (TSA). The parties should be mindful that commencing and ending the provision of services may trigger TUPE transfers, depending on how the acquisition and TSA are structured.

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### **10. Is a cross-border acquisition any different?**

Due diligence, contractual protection, employment processes and post-completion abilities in a cross-border acquisition will vary depending on the jurisdictions involved. Many countries across Europe operate their own versions of TUPE (derived in each case from the EU Acquired Rights Directive) so, in an asset purchase, similar considerations to those in the UK are likely to apply. Where TUPE does not apply (e.g. in the U.S.) a “fire and rehire” process is normally needed to transfer employment to the buyer.

Both seller and buyer should ensure someone internally has central management of the timeline on a cross-border acquisition. This is particularly important where consultation is required, to avoid communication or action in one country being deemed as evidence of pre-determination elsewhere. It is typically advisable to obtain local advice on the nuances of other legal frameworks.

For further information on this subject please contact:

**Richard Moore**

Partner

+44 (0) 20 7074 8387

[richard.moore@lewissilkin.com](mailto:richard.moore@lewissilkin.com)

**Lee Nair**

Managing Associate

+44 (0) 20 7074 8275

[lee.nair@lewissilkin.com](mailto:lee.nair@lewissilkin.com)