Practical Tips For Dealing With The European Acquired Rights Directive

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In the last edition of The Metropolitan Corporate Counsel, we focused on the scope of the Acquired Rights Directive ("Directive") and the way it and similar local laws affect additional layers of employment-related complexities to European business transactions. Under the Directive, all rights, duties and liabilities of the employer ("Seller") relating to the transferring employees' contracts of employment transfer to the incoming employer ("Acquirer"). This includes rights under the employment contract and statutory rights, including employees' rights to bring claims for unfair dismissal, redundancy and discrimination. For this reason, it is essential that an Acquirer ascertain all pertinent information about the employees it might inherit when considering whether to buy a business or enter into an outsourcing agreement in some Member States.

Due Diligence And Pre-Closing Phase

As the Directive transfers contracts of employment and related rights and liabilities automatically to the Acquirer, it is essential when buying a business (or taking on contracts in a transaction context) to conduct a thorough audit of the Seller’s business and to have access to all pertinent information relating to the Seller’s employees who will transfer and their terms of employment. Where acquisition involves only part of the business, the Acquirer should seek indemnity against claims from any employees retained by the Seller who may claim that they should have transferred.

The Directive also provides transferring employees with certain rights pre-transfer. Where there is a delay between signing the sale and purchase agreements and the actual transfer, employees who are treated as a discrete, ring-fenced part of the Acquirer’s business – such that it does not retain its identity, then the Directive does not apply.

Due diligence efforts to manage the workforce and, in particular, employees who are transferred must be undertaken before closing.

Post-Closing And Integration

After the deal closes, the Acquirer’s efforts to manage the workforce and, often, integrate the employees begins. The Directive and local laws often impact this.

The Directive’s starting point is that harmonizing terms and conditions post-transfer – including compensation changes or transfers to working hours – are permitted with employee agreement.

In Germany, any substantial changes to working conditions occurring by the transfer – including compensation changes or transfers to working hours – are permitted with employee agreement. In Germany, what happens to terms and conditions of employment post-transfer largely depends on the source of those terms. If pre-transfer they were contained in collective bargaining agreements or works agreements, the terms and conditions are treated as transferred after the transfer if they were part of the individual employment agreements and may not be altered to the employees’ detriment for a period of two years. If the terms and conditions of employment were based on individual agreements, they may be altered even to the employee’s detriment, provided by collective agreements or works agreements.

Stock options are one particular area of difficulty. Often, options in the Seller are exercised out or substituted with options under the Acquirer. Where the Acquirer does not have its own scheme, however, matters are less straightforward.

In the UK, the courts have established the principle of “substantial equivalence” where there is an express or implied contractual right to receive equity. Recognizing that it is impossible for the Acquirer to exchange the stock options with the current stock options for a cash payment. The Acquirer’s obligations to provide a benefit of “substantial equivalence” to the lost options. Under German law, transferred employees have no rights in relation to the options they have lost, as long as they were individually informed of this consequence pre-transfer. They cannot claim any compensation in excess of the current stock options. In Germany, stock options are not affected by the transfer if they are an integral part of the employment contract of the employer (or another group company) and if the employer itself has not taken on any obligations with regard to the options. In this case, the transferred options do not transfer to the Acquirer. If the options are granted by the Seller itself, however, they are part of the employment conditions and can, in principle, transfer. That said, the law in this area remains uncertain, and it is clear that any change in employee means that options are cancelled automatically with the transfer.

What if the Acquirer needs employees to sign new protective contracts, such as non-solicitation, non-compete or non-circumvent? Often contracts that the Seller’s employees signed are inadequate. This would constitute a variation to the contract of employment that, by reason of the transfer, would be void. In the UK, France, and Germany, the Acquirer would be well advised to seek to update these provisions of all employees’ contracts (not just those who have recently transferred) at once, perhaps in response to the changing needs of the Acquirer’s business further down the line (therefore, the Acquirer’s business) should consider how the Directive may affect the contemplated transaction.

The Directive and local laws often impact these matters, including the transfer of pension rights and the protection of pensions. The Employer (or another group company) is a labor and employment partner in the firm’s Seattle office. She advises clients on employment-related matters.

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