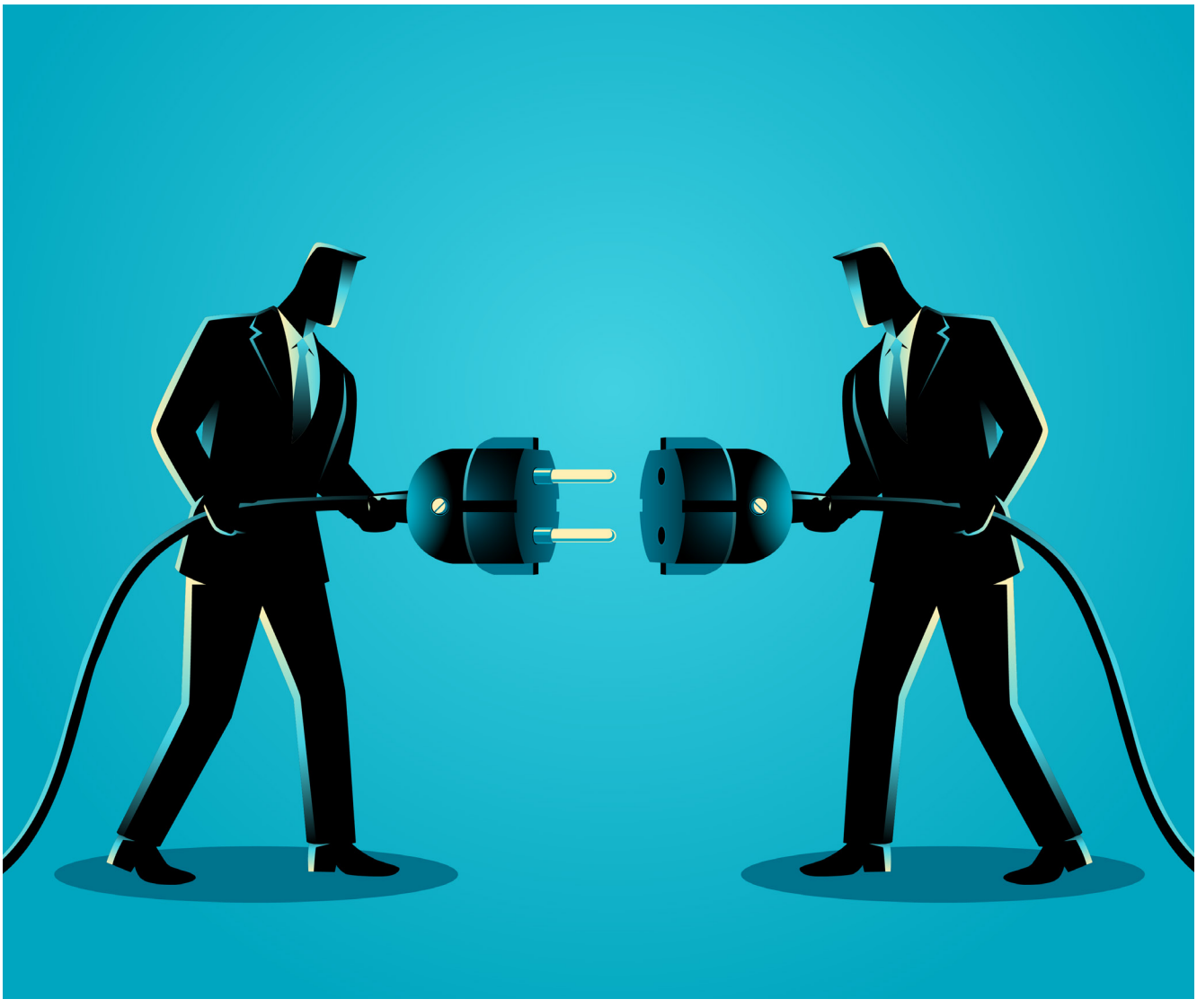

HR Integration Issues in M&A Transactions

When a merger and acquisition (M&A) transaction is carried out, the human side to mergers is often overlooked. However, the acquirer/purchaser must address the concerns and demands of the employees while balancing it with the needs of the company in order to close the deal successfully. Read on to find out what are the major issues that organisations need to address for a successful M&A transaction.

> *In order to make a smooth transition, it is advisable that the term of service and seniority of an employee should be taken into account and the conditions of service should not be any less favourable than those prior to the transfer.*

Mergers and acquisitions (M&As) are instruments which cause the inorganic growth and expansion of a company. Any M&A transaction has a significant impact on the human resource of the company/ business being acquired. This article aims to discuss the issues faced by the employees as well as the acquiring and selling entities while undergoing such a transition and the possible implications under Indian Laws. The different types of M&A transactions include:

- Court Approved Mergers
- Acquisition of Shares Resulting in a Change in Control
- Sale of Business Division in a Slump Sale

1. Fundamental Issues for Employees

Amidst the transformation and growth of the acquirer company, the concerns and sentiments of the employees are often forgotten and remain unaddressed. The employees are often anxious due to the perceived job insecurity and uncertainty of their position in the acquiring company. Some of the key concerns of the employees which the acquirer needs to estimate are:

A. Continuity of Employment Benefits

Indian laws provide various benefits that the employer has to give its employees including maternity benefits, gratuity, provident fund, etc. An employee is eligible for some of these benefits, such as gratuity and maternity benefits, only after they have worked with the employer for a minimum period of time. One of the major concerns of the employees in cases of mergers and acquisitions is loss of time period with the previous employer and its impact on the continuity of service. In order to make a smooth transition, it is advisable that the term of service and seniority of an employee should be taken into account and the conditions of service should not be any less favourable than those prior to the transfer. Such conditions must be specifically mentioned in the employment agreement with the new employer.

In the case of Bombay Garage Ltd vs. Industrial Tribunal, disputes pertaining to dearness allowance and gratuity arose between the acquiring entity and the workmen, the acquiring entity contended that the gratuity should be calculated from the day of acquisition and not past service. However, the Bombay High Court held that the workmen cannot be deprived of the benefits which have accrued on account of past services in cases where the business is transferred to another person or company. It is, therefore critical that when the entity acquires the business, the benefits of the employees flow through and employees' right to such benefit is based on the length of the employment regardless of the acquisition. This principle has been upheld and applied in other cases as well, and is one of the most important factors to consider vis-à-vis the workforce when undertaking an M&A transaction. It is now one of the good practices of acquisitions to ensure that the services of employees are not broken or interrupted for the purposes of bonus, provident fund, gratuity or other statutory benefits and for all purposes are calculated from the date of their respective appointments with the old employer.

Treatment of employee stock options is also an important subject which ought to be dealt with prior to the company being acquired. Either the employee should exercise the option before the acquisition or an accelerated vesting period

should be discussed in case of an acquisition.

B. Nature and Quality of the Acquiring Entity

There may also be cultural compatibility issues wherein the employees might find it difficult to assume the culture of the acquiring entity. The degree of misalignment of the values and beliefs of the target company and the acquiring entity are major contributing factors to the challenges of an M&A transaction. Further, in case the target company has a better reputation and name in the market compared to the acquiring entity, the employees may not be in favour of the transaction.

C. Lack of Communication

One of the major issues that the employees face is the lack of communication with their current or proposed employers. This lack of communication creates distrust and uncertainty, leading to lower employee retention. It is critical that the human resource is kept in the loop and is periodically informed about the decisions that may affect them. This would lead not only to a smoother transition but will also build transparency and trust leading to employee retention.

2. Challenges for the Acquirer/Purchaser

Human resources is one of the most crucial assets in any M&A transaction. It, therefore, becomes imperative for the acquirer to address the concerns and demands of the employees while balancing it with the needs of the company since unresolved issues may result in the failure of the transaction.

A. Address Employee Concerns on Retention

Prior to the M&A transaction, the acquiring entity should conduct due diligence to check for any red flags including the ones in the human resource sector. The acquiring company should also look into analyzing the employment contracts of the top management for any "change of control" clauses as well as the stock options that are given to the employees and have a plan in place to effectuate a seamless integration. Several cases which come up before the courts often highlight the importance of due diligence for an acquiring entity in an M&A transaction from the perspective of the transition of employees.

In Odeon Cinema v. Workers of Sagar Talkies, the Madras High Court, while discussing the duties

and obligations of the acquiring company held that where there is a transfer of a business of one management to another, the rights and obligations which existed as between the old management and their workers continue to exist vis-à-vis the new management, after the date of the transfer. Accordingly, proper due diligence at the time of acquisition is of paramount importance.

The Supreme Court in the case of McLeod Russel India Limited vs. Regional Provident Fund Commissioner, Jalpaiguri and Others, has held that the transferee entity will be liable for any default on part of the transferor entity even if there is an agreement to the contrary stating that the transferor will be liable. This decision of the Supreme Court further highlights the importance of due diligence which must be undertaken by the acquiring entity to ascertain the liabilities of the transferor entity towards various employee benefits and seek such remedies as may be required prior to such acquisition.

During the process of integration, it is imperative that the acquiring entity communicates with the employees as well as clarify the leadership roles and structures. It is essential that the entity also try and resolve any cultural misalignment as well as streamline the talent that the entity wants to retain. It is at this stage that any negotiations will likely take place. These negotiations depend on the value of the employee as well their skill set and replaceability factor while keeping in mind the risk of other employees also raising similar demands.

After the completion of the acquisition, the entity has to take care of the implementation of a uniform HR policy, retention of the key employees as well as their compensation (including any accrued employee benefits). Given the fragile condition of the newly integrated company, it is important that the entity continues to address the concerns and grievances of the employees.

“During the process of integration, it is imperative that the acquiring entity communicates with the employees as well as clarify the leadership roles and structures. It is essential that the entity also try and resolve any cultural misalignment as well as streamline the talent that the entity wants to retain.”

B. Address Issues Arising from Golden Parachute/ Poison Pill Provisions in Top Management Contracts

At times the acquisitions are hostile and the acquiring entity doesn't have the support of the management of the target company. In such a situation, the target company often tries to fortify itself by using the defences of the golden parachute or the poison pill method. While these methods have not been very popular in India, there have been some instances of these mechanisms being used. The impact of a golden parachute or a poison pill mechanism is largely dependent on the ability of the acquiring entity and the concerned employee to negotiate with each other.

With reference to the golden parachute, the target company guarantees a huge compensation to the top management in case of termination or change in control. This results in deterring the acquiring entity from engaging in a hostile acquisition since they would be responsible for paying out the huge compensation in the event of taking control.

With reference to the poison pill method, the target company creates securities which provide their holders with special rights exercisable only after a period following the occurrence of a trigger event such as a tender offer for the control or the accumulation of a specified percentage of target shares. This makes the shares of the target company unfavourable.

3. Issues Under Indian Laws

Human resources in India can be bifurcated into two main categories, “workmen” and “non-workmen”. One of the most critical features of M&A in India in the treatment of “workmen” by the acquiring entity, are their working conditions, compensation, service rules etc. are the subject matter of various labour statutes in India.

Section 2(s) of the Industrial Disputes Act, 1947 defines a workmen as any person (even including an apprentice) who is employed in any industry to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire or

reward, regardless of whether the terms of employment are express or implied and doesn't include a person who may be employed primarily in a managerial or administrative capacity or a supervisor drawing wages in excess of INR 10,000.

However, Indian courts have not restricted themselves to a literal reading of Section 2(s) when determining whether an employee is a "workman" or not. The Supreme Court in Ananda Bazar Patrika (Private) Ltd. vs. Its Workmen, held that the principle which should be followed in deciding the question whether a person is employed in a supervisory capacity or in clerical work is that if a person is mainly doing supervisory work but incidentally or for a fraction of the time also does some clerical work, it would have to be held that he is employed in supervisory capacity, and, conversely, if the main work done is of clerical nature, the mere fact that some supervisory duties are also carried out incidentally or as a small fraction of the work done by him will not convert his employment as a clerk into one in supervisory capacity. This judgment of the Supreme Court has been relied upon by various High Courts and the Supreme Court itself, where the nature of work is examined to determine whether an employee will be treated as a 'workman' or not for the purposes of the Industrial Disputes Act.

Therefore, in an M&A transaction, the first determination has to be whether an employee is a 'workman' or not. If an employee falls within the purview of 'workman' as provided under Section 2(s) of the Industrial Disputes Act and as interpreted by the various judicial precedents, the old employer as well as the new employer have to ensure that compliance under all applicable labour legislations, including but not limited to those under the Industrial Disputes Act, 1947, Industrial Employment (Standing Orders) Act, 1946, etc. have been met with regard to the employees.

Section 25FF of the Industrial Disputes Act, 1947 provides that

> *The Supreme Court has further strengthened the position of workman by holding that a workman cannot be forced to work under a different management and even where there has been no change in the terms and conditions of service, the old employer is under an obligation to take the consent of the workman prior to such transfer.*

if the ownership or management of an industrial undertaking is transferred, whether by agreement or by operation of law, every workman who has been in continuous service for not less than one year in that undertaking immediately before such transfer shall be entitled to notice and compensation in accordance with the provisions of Section 25F, as if the workman had been retrenched.

The proviso to Section 25FF states that a workman is not entitled to any notice or compensation if the following conditions are fulfilled:

1. The service of the workman has not been interrupted by such transfer.
2. The terms and conditions of service applicable to the workman after such transfer are not in any way less favourable to the workman than those applicable to him immediately before the transfer.
3. The new employer is under the terms of such transfer or otherwise, legally liable to pay to the workman, in the event of his retrenchment, compensation on the basis that his service has been continuous and has not been interrupted by the transfer.

However, the Supreme Court has, in Sunil Kr. Ghosh vs. K. Ram Chandran, further strengthened the position of workmen by holding that a workman cannot be forced to work under a different management and even where there has been no change in the terms and conditions of service, the old employer is under an obligation to take the consent of the workman prior to such transfer. If the workman does not accord his consent, he is entitled to retrenchment compensation in accordance with the Industrial Disputes Act, 1947.

Even though the employment agreement governs the employer-employee relationship for a non-workman it is recommended that consent of the employee in case of transfer to a new entity be taken in order to avoid scrutiny by courts since the labour laws in India are pro-employees. As stated previously, it is also good practice to provide non-workman continuity of service and employee benefits when transitioning them to a new employer or management as part of an M&A transaction.

Conclusion

The success or failure of an M&A deal is dependent on various contributing factors in which human resource integration can be substantial. A positive strategy while dealing with human resource issues is fundamental for seamless integration. The acquiring entity must keep in mind the concerns of the human resource as well as the legal compliances while planning the acquisition in order to judge the viability of the transaction.

Ms. Medha Srivastava is a Partner with Atlas Law Partners and has an experience of over 12 years in the Banking & Finance, General Corporate, Private Equity and M&A practice. She has represented various domestic and international clients in M&A and Private Equity transactions.

Ms. Neha Sahgal is an associate with Atlas Law Partner in the General Corporate and M&A team and has recently completed her B.B.A LL.B from Symbiosis Law School, Noida in 2019.