# Introduction to employment law

This section introduces some of the common areas of employment law which are relevant to corporate transactions

# Introduction

The employees or workers of a business or a company can be its most important assets, particularly in businesses which depend on the skills, knowledge and goodwill generated by key personnel. Key individuals can often represent the brand – or the business - itself.

In the context of an acquisition, the buyer will want to ensure that:

* it retains all the key employees it needs to carry on the business; and
* the contracts of employment do not contain onerous conditions or allow key employees to leave and set up in competition.

The buyer may also, following completion, plan to make changes to the employment structure and so may require this to be considered in due diligence

As a corporate lawyer you will need to be able to:

* identify potential employment law issues;
* know when to consult an appropriate colleague for specialist advice; and
* understand the nature and relevance of the solution being suggested to your client and how this will impact on the transaction or the work that you are undertaking.

# Due diligence relating to employment issues

The buyer (whether on a share sale or an asset sale) would expect to receive information from the seller in relation to key employment issues, in particular those set out below.

* Details of any employees who are on long term sick leave or other leave of absence.
* Details of any employees who only work partly for the business being transferred. For example, where the employee works in the division being sold, and the division being retained by the seller.
* Copy contracts, directors’ service agreements, consultancy agreements and other agreements for services and staff handbooks.
* Details of any active or pending litigation or disciplinary proceedings.
* Full anonymised details of all employees and directors, in particular details of any key employees.
* Notice periods. For example, are there any unduly long periods or other onerous termination provisions?
* Full details of salaries, bonuses and any commission arrangements (if applicable) and other fringe benefits, (such as company cars, medical insurance or pensions).

# Employees, workers and independent contractors

For employment law purposes, it is very important to determine whether someone is an **employee, an independent contractor** or a **worker** in their relationship with the target company.

This will determine who qualifies for certain employment rights - and who does not.

Correct identification of classes is important as additional rights could lead to increased costs and liabilities to the employer.

All categories have some rights under the Employment Rights Act 1996 (ERA) in relation to protection from discrimination.

Workers and employees have rights to:

* limited working time; and
* a minimum wage.

Employees alone have:

* Unfair dismissal rights;
* Statutory redundancy rights.

An individual may be labelled as an independent contractor or a worker in their contract but they may be an employee with enhanced rights.

The definitions of worker and employee are complex and governed by constantly developing case law.

As a corporate lawyer if there are workers or contractors working for the target it is advisable to refer this to employment specialists to confirm if the correct classification has been applied.

# Dismissal

Where an employee’s contract is terminated by their employer (**dismissal**) the employee may be able to make a claim against their former employer. There are a number of different claims an employee might bring as shown on this slide.

In due diligence, identifying a claim may mean a liability of the target, but identifying a pattern of dismissals and claims may indicate wider issues in the target business.

**Wrongful dismissal** and **unfair dismissal** are the two main claims that an ex-employee may bring against their former employer on dismissal.

**Unfair dismissal** is a statutory claim that can only be brought by employees who also satisfy certain other qualifying criteria. To successfully defend an unfair dismissal claim, the employer must have: (1) a fair reason for the dismissal (for example, capability or conduct); and (2) the dismissal must have been fair in all the circumstances.

A claim for **wrongful dismissal** arises where the employer has dismissed the employee in breach of the terms of their employment contract. Wrongful dismissal claims can be brought in the Employment Tribunal or court. The remedy for wrongful dismissal is damages (and the general duty to mitigate applies).

The term ‘dismissal’ also encompasses ‘**constructive dismissal’**. This occurs where it is the employee who leaves the job, but they are compelled to do so by the conduct of the employer.

**Statutory redundancy** is a fair reason for dismissal. Following a statutory procedure for redundancy allows an employer to dismiss a number of employees who are no longer required in the business without the dismissal being unfair.

# The employment contract: Restrictive covenants

To protect its business, an employer may put **restrictive covenants** in the employee’s employment contract to restrict what they can do after their employment has ended. These can be broadly categorised as follows:

* **Non-competition:** This prevents the ex-employee from working for a competitor or setting up a competing company.
* **Non-dealing:** This prevents any dealings between the ex-employee and the employer’s customers.
* **Non-solicitation/poaching:** This prevents the ex-employee soliciting business of customers or prevents the ex-employee poaching members of the employer’s team to join a new business.

A buyer will want to ensure that the employment contracts of key employees include restrictive covenants that are **enforceable**.

Restrictive covenants are void and unenforceable unless…

…they protect a legitimate interest of the business…

… and they go no further than is reasonably necessary to protect that legitimate interest

**Reasonableness factors to consider:**

How long? How far? Needs of business / Duties of employee?

If the employer dismisses an employee in breach of contract - or if the employee resigns as a result of a constructive dismissal - then any restrictive covenants will be **void and unenforceable**.

**A review of simplified restrictive covenants from a director’s service contract**

*The Executive undertakes that they will not (without the previous consent in writing of the Company) for the period of 6 months immediately after the Termination Date\* directly or indirectly:*

1. *carry on or be engaged, concerned or interested in, any business which is similar to and competes with the business being carried on by the Company as at the Termination Date;*

The time period should only be as long as necessary. There are a broad range of factors that may be considered but a common trend is a period of 3 months to one year

1. *negotiate with, solicit business from, or endeavour to entice away from the Company the business of any person who was a customer, client or supplier of, or supplier to, the Company during the period of 12 months immediately preceding the Termination Date; or*
2. *interfere with, solicit, or endeavour to entice away from the Company any person who was, at the Termination Date, or within the period of 6 months immediately preceding the Termination Date an employee of the Company.*

Is it appropriate to apply non-solicitation to all employees, should this be limited to senior managers or key employees?

Geographic restriction? This clause does not limit the actions to a particular geography. The reasonableness of this restraint is highly dependent on the facts.

*\* Termination Date means the date of termination of the Executive’s employment with the Company.*

# Post-completion issues: Changes to terms and conditions

After completion, the buyer may want to make changes to the terms and conditions of employment of some or all the employees. This may be because the buyer wants to:

1. cut costs; and / or
2. put the new workforce on similar terms and conditions to its existing workforce (often referred to as '**harmonisation**’); and/or
3. ensure that key employees are bound by new restrictive covenants and/or confidentiality provisions.

An employer cannot make unilateral changes to the terms and conditions of employment of its employees without the risk that the employees will leave and claim that they have been **constructively dismissed**. Buyers may offer **incentives** to employees, in order to obtain their consent to any proposed changes.

On an **asset sale**, certain changes may be **invalid** even if the employees' agreement was obtained, because of the effect of TUPE. You will consider this in later Topics.

# Post completion: Removal or retention of employees

Where individuals are surplus to the buyer’s requirements, the following should be considered:

* **Compensation** may be payable to an employee if termination is midway through a fixed term contract or full notice is not given.
* Do the service contracts contain effective **restrictive covenants** following termination? Remember that even enforceable restrictive covenants will not survive a breach of contract by the employer.
* In order to avoid issues arising, particularly with senior employees, the buyer may consider entering into a **settlement agreement** with the employee.

If there are certain people that a buyer is keen should stay, at least for a short period post-completion, the following should be considered:

* The buyer will want to ensure that the notice periods of key individuals are long enough.
* Check for any ‘**golden parachute’** clauses during due diligence. These allow individuals to treat themselves as dismissed, without notice, on a change of control. The clause will also entitle such individuals to receive a specified (and often very generous) payment from the company in these circumstances.
* It may be that the buyer needs to offer a whole new **package of incentives** to the key individuals it wishes to retain on completion.

**Summary**

* The distinction between employees, workers and independent contractors is important as it determines the level of employment law protection the individual benefits from.
* There are a number of dismissal claims an employee may be able to make which could give rise to liability for the employer.
* Restrictive covenants must protect a legitimate business interest and go no further than reasonably necessary to do so.
* Reviews of employment due diligence can be wide reaching.
* Employment due diligence should consider the buyer’s intentions to make any changes to terms and condition or to remove or retain key employees.