How does an employer change terms and conditions of employment following a transaction? This is the current position in the UK and certain other key EU jurisdictions.

For a purchaser of a business, often one of the key post-closing employment issues is harmonising employment terms and benefits. In the UK, this raises significant legal issues, particularly in the context of asset deals to which the Transfer of Undertakings (Protection of Employment) Regulations 2006 ("TUPE") apply. This briefing looks at the key legal and practical issues that a purchaser will face in implementing such a harmonisation exercise in the UK and other key EU countries following both asset and share deals.

UNITED KINGDOM

A: Asset deals – TUPE

In general terms, TUPE will apply where a business is sold as a going concern. The principal effects of TUPE are as follows:

- All employees assigned to the business being sold will transfer automatically to the purchaser on the completion date by operation of law. There is no termination and re-hire and the employees’ continuity of service is deemed to be preserved.

- The transferring employees will transfer over with their existing contractual employment terms unchanged (apart from the identity of the employer and some pension rights).

- The purchaser will inherit all existing employment liabilities relating to the transferred employees.

Regulation 4(4) – invalidity of TUPE-related changes

Regulation 4(4) of TUPE provides that, in respect of any employment contract that is or will be transferred on a TUPE transfer, "any purported variation of the contract shall be void if the sole or principal reason for the variation is (a) the transfer itself; or (b) a reason connected with the transfer that is not an economic, technical or organisational reason entailing changes in the workforce" (an "ETO reason"). There are two key points to note:

(i) The fact that the employee may have consented to or been given consideration for the variation does not prevent the employee from subsequently alleging that the variation is void (although consent and consideration are not wholly irrelevant (see below));

(ii) The "ETO reason" exception is relatively narrow. UK courts have held the words "entailing changes in the workforce" mean that there must be some changes in the numbers or functions of the relevant employees.
Recent case law – only detrimental changes prohibited

Regulation 4(4) appears comprehensive in that it specifically prohibits "any" purported variations, whether detrimental or beneficial to the employee. Nevertheless, recent UK caselaw\(^1\) has indicated that this regulation may now have to be interpreted so that it only renders void those variations which the employee considers detrimental. The problem this presents for the purchaser is twofold.

Firstly, this may effectively allow a transferred employee to "cherrypick" which of his original terms to enforce.

Secondly, the criterion for deciding whether a change can be challenged as void is whether the employee considers the change to be detrimental, rather than whether objectively that is so. This leaves the purchaser in an unenviable position, not least because some contractual changes may be viewed by some employees as detrimental, but viewed by others as beneficial. For example, it is not uncommon for a purchaser to want to tie in certain key staff for a particular period following closing. This is sometimes done by a combination of retention bonuses and alteration of employment contracts to be on a fixed-term basis for a certain period following closing. If the employment contracts of senior management were changed to be on a fixed-term basis for 12 months following closing, some employees might view this as beneficial (since it might be viewed as providing security of employment) whilst others might view it as detrimental (since it might be viewed as preventing them from joining a new employer in that time). Although it could be argued that an employee would never agree in the first place to a variation which is to his or her detriment, this argument becomes more difficult to sustain where the employee has agreed to a package of changes, some of which are potentially detrimental and others potentially beneficial.

---

How should a purchaser act in practice?

The first step is to consider the extent to which a proposed change is already authorised by the employee's contractual terms. Many benefits are provided under policies that do not form part of the employee's contractual terms of employment. In addition, it is increasingly common to find drafting in employment contracts that permits the employer to vary or withdraw certain benefits on notice to employees.

If, however, the proposed changes do require variations to the contractual terms of employment and TUPE applies to the transfer, the purchaser has the following three options to implement the variations:

1. **Break the link with the TUPE transfer**

   The obvious way to avoid the issue presented by regulation 4(4) is to ensure that the variation is not connected to the TUPE transfer. Employers can try to achieve this by (i) ensuring a substantial period of time between the TUPE transfer and the contractual variation; and/or (ii) implementing the contractual variations as part of a wider reorganisation/restructuring programme that affects not only transferring staff but other personnel as well. It is, however, difficult to say with certainty when a change will no longer be connected to a prior TUPE transfer. UK courts have found that contractual variations implemented even two years after a TUPE transfer were still connected to the prior transfer.

   It should be borne in mind that, even if a contractual variation can be 'de-linked' from the TUPE transfer, in order for the variation to be validly implemented it will need to comply with normal rules under UK contract law (see below).

2. **Termination and re-hire**

   It is always open to an employer to dismiss the relevant employees and then immediately offer re-employment on the amended terms. Assuming the employees accept the offer of re-employment, they will then be employed on the new terms that cannot be challenged as void. Nevertheless, this option is rarely used in practice not

---

\(^1\) Power – v – Regent Security Services Ltd [2007] IRLR 226
least because there is a significant risk that employees may choose not to accept the offer of re-employment and instead seek compensation for dismissal in an employment tribunal. In addition, dismissing the entire workforce immediately after acquisition may not be the best start for employee relations.

3. Consult with and obtain the consent of employees

The safest option open to a purchaser to implement TUPE-related variations is to implement the changes after a comprehensive exercise of consulting with, and obtaining the consent of, the relevant employees. Although neither the consultation nor the individual consent of employees will provide a legal defence if the variations are challenged as void, it should nevertheless result in employees viewing themselves as having voluntarily bought in to the process and lessen the likelihood of any employees pursuing claims. Clearly, it will also assist if the purchaser can genuinely assure employees that financially the varied terms will leave the employees better off or at least no worse off in the aggregate.

B: Share deals and non-TUPE situations

Where a purchaser is implementing changes that are not connected to a TUPE transfer (e.g., on a share sale or where the changes have successfully been 'de-linked' from the TUPE transfer as discussed above), it is important to bear in mind that the variation must comply with the normal rules of UK contract law to be valid, i.e., it will require consent and consideration. The consent of the employee will be required for the variation otherwise the employer runs the risk of the individual either claiming breach of contract or resigning and claiming constructive dismissal.

The variation must be supported by valid consideration (i.e., the employee is given some benefit for agreeing to the change). If the variation is beneficial to the employee that will be sufficient consideration. Where the change is detrimental UK courts are often willing to accept that continued employment by the employer is valid consideration, although less so where the changes relate to matters that do not have immediate impact (e.g., changes to termination provisions or post-termination restrictive covenants). In those circumstances, it is advisable either to give the employee some obvious consideration (e.g., a payment/benefit for agreeing to the change) or ensure the variation is recorded in a document executed in the form of a deed.

Other EU countries

Similar issues exist in other key EU countries, although not perhaps with the same degree of restrictiveness as the UK.

In Germany, a purchaser in an asset transaction can harmonise the employment terms of transferring employees by obtaining their individual consent. Where, however, employment conditions derive from collective or works agreements, these cannot be amended to the employees’ detriment within one year of the transfer, even with the employees’ consent. The only exceptions to this rule are: (i) if the collective or works agreement expires within the one-year period, detrimental changes with employee consent are permitted; (ii) if the purchaser and the employees agree that the employment contracts should be governed by another collective or works agreement which implements changes to the employees’ detriment, this later collective agreement will substitute the former one; and (iii) where a different or new collective or works agreement is deemed to apply to the purchaser’s business by law.

Following expiry of the one-year period, a purchaser can implement contractual changes by obtaining employee consent or unilaterally if it has objective justification to do so (e.g., to maintain jobs). Following share sales in Germany, the terms and conditions of employees of the acquired company can be changed with employee consent or unilaterally if the employer has objective justification (as above).

In Italy, the purchaser in an asset sale must afford the transferring employees the same economic and contractual employment terms to which they were entitled under collective agreements applied by the seller. It is possible to replace such agreements if they
expire or if a new collective agreement is put in place by the purchaser. In the latter case, the replacement agreement must be of the same “level” as the previous collective agreement - in Italy collective agreements are effectively categorised into different levels, depending on whether they are drafted at an industry, national, territorial or company level. A purchaser in Italy does not have the option of dismissing and re-hiring the workforce on amended terms and conditions since a dismissal by reason of the transfer will not be considered a lawful dismissal under Italian law.

Following a share sale in Italy, the employer may amend the employment terms of employees provided that it obtains their consent (or, if the terms are contained in a collective agreement, the consent of the relevant trade union).

In France, following either an asset or share sale, an employer can amend the contractual terms of employees provided that it obtains the explicit consent of the relevant employees to the changes.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

For more information on the topics covered in this issue, please contact:

Paula Holland
London
+44.20.7655.5909
paula.holland@shearman.com

Sam Whitaker
London
+44.20.7655.5954
sam.whitaker@shearman.com

Georg Jaeger
Mannheim
+49.621.425.7208
gjaeger@shearman.com

Doreen Lilienfeld
New York
+1.212.848.7171
dlilienfeld@shearman.com