EMPLOYMENT AND EXECUTIVE COMPENSATION ISSUES IN MERGERS AND ACQUISITIONS-AN ANALYSIS

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ABSTRACT

In today's business world, Mergers and Acquisitions (M&A) are tools used for the growth of business and optimization of resources and this process have an impact on the employees as well as the target entities. The Merger and Acquisition becomes successful and will be effective only when there is a healthy environment between the two companies and a fair balance between employees and security and business interest.

The term 'merger' is not defined under the Companies Act, 2013, in general it is a business collaboration between two or more companies where in they agree to operate their business jointly as one entity, it takes effect by transferring the agreed assets and liabilities to the transferee company. On other hand, Acquisition in broader sense includes merger wherein only after acquisition merger can take place. In acquisition, one corporate entity acquires equity stake whether majority or minority of another corporate entity. In simple terms, it can be stated the acquisition of a company means acquiring the share, the acquired company will become a subsidiary company.

Section 25FF of the ID Act, 1947 talks about the Compensation to workmen in case of transfer of undertakings[1]. As per this provision, the workmen should be given prior intimation regarding such transfers and the compensation should be provided for such act and their exceptions to it.

During M&A transactions the acquirer or the resultant entity implements employment related restructuring which may include changes in the designation of the employees, their remuneration, prerequisites and other benefits that were given to the employee and before taking such action the company is mandated to follow the due process of law wherein all the legal conditions and the due diligence criteria, must be made in the context of

[1] Section 25FFF of The Industrial Disputes Act, 1947

employment safety.

This Article gives a Bird's Eye View on the rights of the employees during M&A transactions, whether the company can go for the M&A without prior approval from the employees, what are the measures that need to be taken care by the company prior to M&A with regard to employees and their compensation and also, the Impact of M&A transactions on the employees of the companies.

Keywords: Merger, Acquisition, Employees, Compensation, Due diligence

INTRODUCTION:

The Employment is the most affected and unnoticed part during the M&A transactions because the entities mostly concentrate on the synergies and the level of competition but often forget about the employees who are the strong pillars for any company's success. The employees plays crucial role at each and every phase of the company wherein they work for the company continuously directing to the company's growth and also to the economy of the country. So, in order to secure the employees during the process of due diligence both the companies should take all the reasonable and necessary measures in order to safeguard the employment and consider it as one of the most essential ingredients during any M&A transaction.

TYPES OF MERGERS AND ACQUISITIONS AND THEIR IMPACT:

The mergers and acquisition are also known as Combinations under the Competition Act, 2002 and as amalgamations under the Companies Act, 2013. There are various types of mergers that are in practice across the globe like Horizontal merger, Vertical merger, Congeneric merger, Conglomerate merger, Cash merger etc... among which Horizontal and Vertical merger are the widely used.

i. Horizontal Merger:

A merger occurring between companies in the same industry is referred to be Horizontal Merger. A horizontal merger is a business consolidation that takes place between companies that compete in the same market and often provide the same commodity or service. A merger between Sprite and the Thumsup beverage division, for example, would be horizontal in nature.

ii. Vertical Merger:

A merger between two companies producing different goods or services for one specific

finished product is referred to be Vertical Merger. A vertical merger occurs when two or more firms, operating at different levels within an industry's supply chain, merge operations. A vertical merger brings joins two businesses that may not be in direct competition but are nevertheless connected by the same supply chain. A prominent example of Vertical merger could be the merger between Pixar and Walt Disney wherein Pixar was an innovative animation studio and had talented people and Walt Disney was a mass media and entertainment company[2].

iii. Conglomerate Merger:

A merger between firms that are involved in totally unrelated business activities is referred to be Conglomerate merger. A merger between a shoe company and a pencil manufacturing company, for example, would be conglomerate in nature as they are totally unrelated businesses.

iv. Congeneric Merger:

A merger that takes place between two business organizations that deal in products that are related to each other and operate in the same market is said to be congeneric merger, which is also known as product extension merger. A merger between Thomas Cook India Limited and Sterling Holiday Resorts (India) Limited is an example of a congeneric merger as both the companies were involved in the tourism industry but their customer-bases and process chains were unrelated[3].

The Companies Act, 2013 majorly focuses on two types of amalgamations that is Horizontal and Vertical. So, it is necessary to understand the impact of these amalgamations on the employees in holistic point of view.

The Competition Commission of India severely evaluates Horizontal mergers within the same industry under Section 6 (1) of the Competition Act, 2002, as the combination of two competitive industries reduces market competition and moves the industry closer to monopoly status.

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[2] Divi Dutta Indraneel Godsay Mohna Thakur, Mergers And Acquisitions In India – A Brief Overview, Mondaq, https://www.mondaq.com/india/corporate-and-company-law/1210798/mergers-and-acquisitions-in-india--a-brief-overview, (23rd Feb 2023, 10:14pm)

[3] Divi Dutta Indraneel Godsay Mohna Thakur, Mergers And Acquisitions In India – A Brief Overview, Mondaq, https://www.mondaq.com/india/corporate-and-company-law/1210798/mergers-and-acquisitions-in-india--a-brief-overview, (23rd Feb 2023, 10:14pm).

A result of a horizontal amalgamation is the amalgamation resulting in twin departments, i.e., the same type of department or team is present in both businesses as they are from rivalling industries. Employees of the amalgamated organization may be at risk of losing their jobs if the amalgamated body chooses to keep only one of the two twin departments, which is one potential drawback of a horizontal amalgamation. Also, it puts more pressure on workers to put up more effort and outperform their coworkers in order to avoid being fired.

Further, the company's vision will determine the answer regarding whether employees shall be terminated after an amalgamation. If it is envisioned by the amalgamated company to increase its volume of work it takes on, it will implement the corporate strategy of integrating the twin departments with one another so they may collaborate easily and contribute to the company's objectives. The proposed amalgamation plan frequently reflects this vision, but it must first receive mandatory approval from the relevant authorities in order to be put into effect.[4].

As already stated earlier, When there is an amalgamation between two companies producing different goods or services for one specific finished product, then it is known as a 'vertical amalgamation'. An example of a vertical amalgamation would be wherein one entity is into the business of making pencils, and another entity would be into the business of making the lead. An amalgamation of these two entities would result in 'vertical amalgamation'. In horizontal amalgamations, the same types of roles or departments are doubled, therefore in most of these situations, there is a likely likelihood that the additional set of employees will be fired on the basis of certain criteria like favorite branch, experience, and amalgamation adaptability.

However, this is not the case with vertical mergers because there are no overlaps in the departments or responsibilities of the firms, the situation is different when two companies with distinct roles in the supply chain unite vertically. Instead, the departments of the firms would complement one another, and the Board of the combined company would work on a corporate strategy that would involve all employees in achieving the commercial objectives of the combined company.[5]

[4] Shauree Gaikwad,Employees right Arising Out of M&A: The Indian Judiciary Perspective,The HNLU CCLS blogs,Spetmeber 4, 2020. https://hnluccls.in

[5] Shauree Gaikwad,Employees right Arising Out of M&A: The Indian Judiciary Perspective,The HNLU CCLS blogs,Spetmeber 4, 2020. https://hnluccls.in

STATUS OF EMPLOYERS RIGHTS ARISING OUT IN M&A IN OTHER COUNTRIES

In the United States, a federal act known as the Worker Adjustment and Retraining Notification Act, ('WARN Act') 1988, mandates an employer to provide a 2 months' notice to employees if the employer is going to either layoff more than 50 employees or shut down. Therefore, if an amalgamation results in fifty or more employees' employment to be terminated, a US company shall be obligated to inform the employees two months in advance under the WARN Act. However, there are no other obligations of the employer to inform the employees regarding a merger if the thresholds under the WARN Act are not met.

In the United Kingdom, the Transfer of Undertaking (Protection of Employees) Regulations, 2006, ('TUPE Regulations') mandates the employers to retain all employees during an amalgamation, inform the employees prior to the amalgamation, and also provides the employees a choice to terminate their employment in case the employee objects to being employed by the transferee company. Therefore, the TUPE Regulations serves as employee friendly law which aims to safeguard the rights of employees and lay out the obligations of employers during an amalgamation.

PROTECTION OF EMPLOYEES DURING M&A IN INDIAN PERSPECTIVE

The Industrial Disputes Act, 1947 (ID Act) deals with settlement of Industrial disputes, provides statutory protection to workmen in the matters of termination, transfer and closure of the establishments and also deals with the transfer of business undertakings in relation to workmen. Section 2(s) of the Act defines the term workman as any person (including an apprentice) employed in any industry to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire or reward, whether the terms of employment be express or implied, and for the purposes of any proceeding under this Act in relation to an industrial dispute, includes any such person who has been dismissed, discharged or retrenched in connection with, or as a consequence of, that dispute, or whose dismissal, discharge or retrenchment has led to that dispute[6]. The following categories of employees are excluded from the definition of workmen are persons employed in an administrative or managerial capacity; and persons employed in supervisory work and earning more than 10,000 Indian rupees per

[6] Section 2(s) of The Industrial Disputes Act, 1947

month. Non-Workmen means all the employees other than workmen namely performing managerial and supervisory functions will fall under this category.

The protection that is been given to the employee under the ID Act, 1947 in cases where the ownership and management of an undertaking is to be transferred by an agreement or through the operation of law , every workmen who has been in continuous service for not less than one year immediately before such transfer is entitled to give a notice one month or payment of wages in lieu of the notice and compensation equivalent to 15 days average pay for every completed year for continuous service or any part thereof over 6 months, this will not apply to for the workmen employees as per the following conditions: the service has not been interrupted by such transfer or change in ownership or management of the undertaking and the terms and conditions of employment after such transfer are the same or more favorable than those applicable immediately before the transfer; and

The benefit of continuity of service for the services performed for the transferor entity: employees earn certain benefits such as leave, maternity benefits, gratuity benefits (see 'Due diligence' below), and severance pay benefits only after they have worked for a certain specified minimum period, which varies for different statutes. The continuity of employment provisions ensures that a person's length of employment with the transferor entity flows through to the purchaser of the business or the new entity. This helps to ensure that the new employer or management, upon consummation of the transaction, is liable to pay compensation on the condition that the service of the workman has been continuous and has not been interrupted by the transfer[7].

These requirements under the ID Act clearly apply in respect of workmen for any merger, slump sale acquisition and asset purchase acquisition. The provisions of the ID Act discussed above would not apply in the case of a share purchase acquisition, because change in the shareholding pattern of the employing entity does not result in change of employer.

The rights of non-workmen in M&A transactions are governed primarily by the employment contract and a review of the employment contracts of non-workmen employees is important to understand the incentives and compensation that may be triggered pursuant to an M&A transaction.

[7] Section 25FF of the Industrial Disputes Act, 1947

In the case of ***Sunil Kr Ghosh Vs. K Ram Chandran***[8] the Supreme Court has introduced new jurisprudence on the right of employees in a merger and acquisition where by the transferor entities are now required to obtain consent from workmen before effecting any change ownership or management of the establishment and also supreme court held by applying the principals of natural justice than an employer should consider treating non-workmen at least on issues relating to consent.

The Supreme court of India also held that the workmen who refuses to be transferred before any merger or acquisition will have to be paid Severance compensation. The Severance compensation in respect of workmen is equivalent to 15 days average pay for every completed year of continuous service or any part thereof over 6 months. The consent should be taken 30 days prior of the effective date of the transaction failing which the workmen may also be entitled to payment of wages in lieu of notice. The Severance compensation of non-workmen will depend on the terms of the employment contract. In addition to severance compensation employees that is both workmen and non-workmen will be entitled to other occurred employment benefits such as gratuity leave encashment and other contractual benefits that may have accrued before severance of employment.

In the Case ***Maruti Udyog Ltd. Vs. Ram Lal and ors. On 25 January, 2005***[9] the Supreme Court has clarified that Section 25FF of ID Act envisages payments of compensation to a workman in case of transfer of undertaking the quantum whereof is to be determined in accordance with the provisions contained in Section 25F as if the workmen have been retrenched.

In the Case of ***Gurmail Singh Vs. State of Punjab and Ors.*** The Supreme Court interpreted section 25FF of ID Act and said that the industrial law however safeguarded the interests of the employee by inserting section 25FF and giving them a right to compensation against former employer on the basis of a national retrenchment except in cases where the successor under the contract of the transfer itself terms safeguarded them by assuring them of continuity of service and of employment terms and conditions. In result they can get compensation or continuity but not both[10].

[8] Sunil Kr Ghosh Vs. K Ram Chandran (2011) 14 SCC 320
[9] Maruti Udyog Ltd. Vs. Ram Lal and ors. On 25 January, 2005
[10] Gurumali Singh Vs State of Punjab and Anr On 7 Jan 2022

CONCLUSION:

By analyzing all the provisions and procedures it is clear that the company or any other industry, if it wants to do merger or the acquisition it need to follow all the rules and regulations by taking the employees into consideration. The main procedural aspect before the merger or acquisition is the Due Diligence, it is a critical step before acquiring or merging entities to understand the practical challenges that may be faced by the parties either to proceed ahead with a proposed transaction or not. In this process, the companies should estimate all the difficulties that could probably arise regarding the employment and certainly should take proper and reasonable measures in complying with compensation providence. In India there is necessity of a reform like U.K. TUPE regulations, in order to safeguard the rights of the employees and provide them the assurance of security during the M&A.