Employees: Private Acquisitions (Germany)

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A Note considering German employment law issues when acquiring a private company or a business in Germany.

This Note sets out the key employment law considerations when acquiring or disposing of a private company (share purchase) or a business (asset purchase) in Germany, including:

- Any obligation to inform and consult employees in connection with the share or asset purchase.
- The costs, formalities and rights relating to the dismissal of employees impacted as a result of the share or asset purchase.
- What to consider when undertaking due diligence in relation to the employees of a business and the common employment warranties and indemnities sought in such share and asset purchases.
- Visa requirements.

Obligation to Inform or Consult Employees

Employees' consent is not usually required for share or asset purchases (unless a specific contractual agreement has been made between the parties or with employee representatives to consult employees or representatives and seek their consent, which rarely is the case).

However, in an asset purchase which qualifies as a transfer of undertaking (or part of it) under the *Acquired Rights Directive (2001/23/EC)* as implemented into German law by section 613a of the *German Civil Code* (*Bürgerliches Gesetzbuch*) (BGB), employees must be informed of the transfer before it takes place, and they can elect not to be transferred with the business (the right to object). In this case, the employees will remain employed by the transferor (that is, the seller) despite the business and the jobs in the business having transferred to the buyer.

Consultation Procedure

If a part of a business is sold, where the transferring part of the business needs to be carved out from the remaining business in the context of the purchase, or where the transferee (that is, the buyer) intends to merge the transferring business with an existing business, there is a mandatory obligation to conduct a pre-transfer consultation with the respective employee representatives (works council) under section 111 of the *Works Constitution Act* (*Betriebsverfassungsgesetz*) (BetrVG). In addition, the economic committee (*Wirtschaftsausschuss*) (where one exists) must also be consulted if the buyer becomes the majority shareholder in case of a share deal (*section 106, BetrVG*).

Works councils do not have a veto right as regards the sale or purchase, but they can delay the acquisition until the consultation process for the business carve-out or merger has been completed.

Unlawful Dismissal: Employee Rights

In a share purchase, the legal entity transfers to the purchaser at closing (of the acquisition). The normal rules for dismissal and protection against dismissal continue to apply post-closing. Liability for dismissals pre- or post-acquisition remains with the employer (that is, the legal entity) and is not affected by the purchase.

In an asset purchase, the employment contracts of transferring employees continue with the transferee after closing. Employees are credited for their years of service with the seller which are now considered years of service with the purchaser. Therefore, any dismissal by the transferor will have to comply with the applicable unfair dismissal rules. Employees must not be dismissed because of the business acquisition (*section 613a, BGB*). That is, the acquisition alone is not a valid reason for dismissal, whereas conduct, personal and redundancy dismissals remain possible.

Where the transferor dismisses an employee pre-transfer, it will need to comply with the usual pre-transfer unfair dismissal rules. If closing of the acquisition occurs before that employee's effective date of termination, they still transfer to the transferee together with the business. If any severance (or other dismissal compensation) is due, the purchaser will also become liable to pay this to the employee. For employees who object to the transfer and therefore remain with the transferor, the unfair dismissal rules at the transferor apply, and the transferor is liable for any dismissal of those employees.

It is standard market practice for the parties to a share purchase and (in particular) an asset purchase to agree on rules with respect to dismissal execution and liability (covering notice period salary and benefits, and severance or unfair dismissal litigation costs) in the purchase agreement.

In asset purchases, sellers seek to transfer liability for the dismissal costs of employees objecting to the transfer to the purchaser, with purchasers typically rejecting these requests. The parties often then agree to share these costs. In addition, the parties will negotiate on the costs of more employees transferring to the purchaser under section 613a of the German Civil Code than originally planned, and also on what happens if fewer employees transfer than planned.

Employee Dismissals: Costs

Dismissals in the context of a business reorganisation (whether pre- or post-acquisition) will usually be mass dismissals, requiring collective consultation in businesses with a works council as well as additional formalities with the Employment Office. The *Unfair Dismissal Act* (*Kündigungsschutzgesetz*) (KSchG) will usually apply and require the dismissals to be justified, for example for reasons of redundancy. Dismissed employees' notice periods will have to be acknowledged.

There are no specific rules in Germany for dismissal costs because German dismissal law provides for reinstatement as the primary remedy in case of an invalid dismissal. Dismissals compensated by severance payments are not acknowledged under German law. However, in practice, employers and employees often enter into a termination or termination settlement agreement to avoid unfair dismissal litigation, and these agreements usually provide for a severance payment to the employee.

In dismissal cases, severance is typically calculated using the following rule of thumb: 0.5 to 1.5 gross monthly salaries per year of employment. Severance would be over and above salary and benefits payments owed until the expiry of employees' notice periods.

If a works council exists in the respective business, consultation and negotiation of a reconciliation of interests agreement with the works council must be undertaken before the reorganisation can proceed and dismissals be undertaken. The lead time required for this increases the total reorganisation costs.

Social Compensation Plan

In addition, where there is a transfer of the whole or part of a company, a merger or a split-up of businesses, a social compensation plan must be agreed between the employer and the works council (*sections 111 and 112, BetrVG*).

The social compensation plan serves to mitigate the disadvantages employees suffer from the reorganisation. It will typically include severance payments (using the calculation formula above or other more sophisticated variations) to dismissed employees as well as additional benefits such as outplacement or relocation payments. The total social compensation plan volume is subject to negotiation with the works council and will be affected by the industry, location of the business (high or low unemployment rates), insolvency or crisis scenario as opposed to normal reorganisation, number and type of jobs affected and bargaining power of the works council.

Collective Redundancies

If the business is subject to collective bargaining, the trade union may request that a collective bargaining social plan is entered into in addition to the social compensation plan with the works council, which will also include dismissal benefits such as severance. In negotiations, employers will seek to ensure that collective bargaining social plan benefits are set off against works council social compensation plan benefits.

Employee Rights on a Share or Asset Purchase

Employees usually do not have any other rights on a share or asset purchase (unless a specific contractual agreement has been made between the parties or with employee representatives, which is rarely the case).

Collective Agreements

On a share purchase, collective bargaining agreements or works agreements will usually remain unaffected, as they will have been entered into by the legal entity (that is, the target). They can be changed following the normal rules and formalities for changing collective agreements, which require the consent of the parties to the agreement. Carve-out exceptions may apply where collective agreements applicable to the target are seller-group agreements. They may either continue to apply as target-specific collective agreements (for example in an intra-group acquisition), or they may need to be changed or adapted in the context of the purchase. However, neither group nor target can do this unilaterally; consent of the contracting parties is required.

On an asset purchase which qualifies as a transfer of undertaking under the *Acquired Rights Directive (2001/23/EC)* the situation is different, as the legal entity, not the transferring business, will have entered into the collective agreements. As a general rule, collective bargaining agreements with trade unions will not transfer to the purchaser, while works agreements with the works council in the target business may survive the acquisition and continue to apply post-closing if the business transfers without any material changes.

The purchaser, together with the works council, may change these agreements post-transfer. Should the purchaser integrate the target business into an existing business, the works agreements in the existing business may supersede the transferring works agreements going forward.

This is a very complex area of German law with little guidance in statute or case law, so a thorough prior review of the application of collective agreements post-transfer (in particular expensive agreements, such as pension schemes) is recommended. As a back-up solution, where collective agreements do not continue to apply collectively to the purchaser, the employees' rights and duties from these agreements will be transposed into those employees' employment contracts and will continue to apply to the purchaser on this individual level (*section 613a, BGB*). This makes it more difficult for the purchaser to change these terms of employment as the purchaser is under an obligation not to change these terms in the first year following the transfer of the business (*section 613a, BGB*).

Post-Transfer Changes to Terms and Conditions of Employment

A transfer or business sale is not a valid reason for the employer to change the terms and conditions of employment. Automatic changes are rarely triggered by a transfer. As a result, the employer must review the legal basis of the respective terms (for example, whether they have been collectively agreed with a trade union or individually in the employment contract) and determine whether and how they can be changed.

Typically, changes cannot be implemented unilaterally by the employer, but only with consent from trade unions, works councils or employees (depending on the legal basis of the respective terms).

Post-transfer, most employers will offer their (standard) employment contract to transferred employees, to align compensation and benefits and facilitate HR administration. Where pre-transfer benefits are more generous (for example, company car entitlement), cash compensation is offered to mitigate the loss. Many benefits can however be translated into the new employer's schemes post-transfer.

In any event, post-transfer changes of terms and conditions require thorough due diligence and planning.

Share Option Schemes

It is neither common nor compulsory for employees to participate in share option schemes in Germany, except in new economy and digital industry companies and start-ups. In addition, banks or other financial institutions that are subject to statutory remuneration rules (for example, those stemming from the *Capital Requirements Directive (2013/36/EU)* (CRD IV)) use share option schemes as an optional means for sound and effective risk management, and to provide an incentive for prudent and sustainable risk taking. Share option schemes also exist in larger companies or groups and in listed companies. Typically, the management board (C-level) and employees on level C minus 1 and C minus 2 are offered scheme participation as an additional part of their compensation package. Virtual share option schemes are more common than actual share option schemes.

Share Options: Tax Benefits

Tax benefits are available where options are offered to all employees in the company and are not offered as a remuneration to compensate for the employment services provided. Options provided as remuneration are taxed at the employee's personal tax rate, but in certain cases tax relief is available, essentially leading to a lower total tax on these options. This also applies to virtual share option schemes.

Group Companies

Options can be granted to employees of group companies. This has been a trend in the last couple of years where international groups have moved from domestic company targets to group targets or consolidated top co-targets. Whether or not the employer legal entity is involved in granting or administering the options will determine which set of legal rules will apply to group share option schemes.

Transferability

By law, where the employer (as opposed to a group company) owes the share options (or remuneration in a virtual option scheme) to the employee, the obligation will transfer automatically to the purchaser in a business acquisition qualifying as a transfer of undertaking under the Acquired Rights Directive. However, options that can already be exercised can only be claimed from the previous employer (that is, the transferor) and not from the transferee.

In practice, as the transferee is rarely able to continue a transferor share option scheme, the purchase agreement will cover how the transferor will settle and close the share option scheme for transferring employees until completion and who (transferor or transferee) will assume the related settlement costs.

Due Diligence and Warranties: Employees

A market standard employment due diligence request list would typically include the following information, which sellers in Germany would commonly provide (with limits regarding HR compliance information, for example on internal investigations):

- **Workforce data.** Number of employees broken down by location, whether they are temp agency employees, freelancers, consultants, interns or other types of worker, and their status (full-time, part-time, fixed-term). This would also include attrition rates and sickness and accident statistics.
- **Key employees.** Number of key employees, their roles, terms of employment (in particular, notice periods) and post-termination restrictive covenants.
- **Employee representation.** The system and bodies of employee representation, details of the most recent elections, copies of agreements with works councils and trade unions.
- **Reorganisations.** History of the last five years, existing agreements (in particular, reconciliations of interest/social compensation plans) and limitations with respect to future reorganisations.
- **Important HR contracts.** For example, with suppliers, outsourcing agreements and HR software agreements, and sample employment contracts for all employee groups, consultants, freelancers and temp agency agreements.
- **Compensation and benefits.** Details of compensation and benefits, type of plans and legal basis of plans.
- **Company pensions.** Funding levels, types of pensions scheme and member information, scheme history. In particular, reorganisations, freezing and closing of schemes.
- **HR compliance.** Compliance management system information, policies and procedures, whistleblowing systems and investigations undertaken.
- **Employee data privacy compliance.** Information on what employee personal data is being processed, for what purpose and on which basis, data deletion/retention concept, controller-processor agreements and data exports (EU/non-EU).
- Litigation by or relating to employees and works councils (in particular, litigation relating to benefit and pension plans).
- Details of audits by public authorities (in particular, health and safety and working time).
- Employment tax and social security audits in the past five years.

In an asset acquisition, in addition to the above, due diligence should identify any issues which result from the transferring business being severed from the employer legal entity. For example, this could relate to the post-transfer applicability of collective bargaining agreements, pension scheme agreements with external parties such as insurance companies, group benefits plans, stock option plans, post-termination restrictive covenants and key HR-related third party contracts (for example, payroll, digital personnel files and e-signature software).

Where only a part of a business is transferred, due diligence needs to identify the corresponding carve-out issues, so as to identify which employment rules and agreements will apply post-transfer.

Data Protection Considerations

The *General Data Protection Regulation ((EU) 2016/679)* (GDPR) substantially affects the due diligence process. In a physical or virtual data room, the seller (by providing employee information), the data room provider (by setting up the data room) and the buyer (by accessing employee information in the data room) will process personal data as regulated in the GDPR, if data room information contains personal data (that is, any information relating to an identified or identifiable natural person, for example names, contact details or signatures). The data processing needs to be compliant with GDPR, that is:

- It must be done on a lawful basis.
- Data subjects must be informed about data processing.
- There must be appropriate technical and organisational measures to protect the data.

Sellers and buyers must evaluate data privacy compliance before setting up the data room and starting the due diligence. In addition, the seller must ensure that a state-of-the-art data processing agreement is in place with the data room provider. Due diligence agreements between seller and buyer must address data privacy and related representations and warranties.

Practically, redacting data room information and making personal data available on a very limited basis (that is, in the late stage of due diligence in a "red room" to a special "clean team") is now the standard approach to due diligence.

Employment Warranties and Indemnities

The purchase agreement will reflect the due diligence findings, in particular the risks related to employees. Representations (including disclosure schedules) will commonly describe the target company or business, and set out:

- The number of employees working in the business.
- Employee representatives and collective agreements.
- Key individual employment contracts, compensation and benefits schemes, pension schemes.
- HR compliance, employee data privacy compliance and litigation related to employees and their representatives.
- Tax and social security compliance.

The representations are backed up by corresponding warranties. Where a legal risk has already materialised, the buyer will request an indemnity from the seller (for example, where more employees than intended have claims from a stock option scheme based on a breach of the equality principle committed by the seller).

Evaluation and discharge (until closing) of short-term and long-term employment liabilities will also be addressed in the purchase agreement (for example, discharge of stock-option claims, holiday, jubilee or bonus liabilities, as well as contributions to external occupational pension schemes). Since there is no general funding obligation for direct employer occupational pension schemes, the purchase agreement will need to address whether and how funding will be provided or how and in what amount the buyer will be compensated for the pension liabilities assumed on closing. Payment can be set out as a payment from seller to buyer, or it can be a line item (typically as a financial liability) in the purchase price clause.

Finally, the purchase agreement will provide for restrictions on the seller's ability to run the business pending completion. In particular, these will ensure that no (new) material employee liabilities are being created, for example by changing occupational pension scheme rules.

Directors

Only a natural person of full legal capacity who is permitted to exercise a profession and who has not been convicted of specific business offences (including insolvency offences) can be a director of a private company. Directors can, but do not need to be shareholders.

These restrictions do not exist for members of a private limited company's supervisory board (which in any event is generally not mandatory).

Requirements as to Nationality or Domicile of Directors/Management and Foreign Directors

Nationality and domicile (Germany, or at least within the EU) have in the past been eligibility requirements for directors of private companies in Germany. However, this is no longer the case. As a precaution however the existence of these requirements should be checked in advance with notaries and relevant public authorities.

Directors' Liability

As a general rule, directors are not liable for liabilities incurred by the company or acts of the company. Directors of a company can however become personally liable for any damage caused as a result of a breach of directors' obligations, such as day-to-day management, compliance with shareholder resolutions or rules regarding capital maintenance and liquidity protection of the company. A director can be held personally liable by tax or social security authorities.

Directors owe their duties to the company they are managing. As a result, there is no general liability for parent company directors with respect to the acts of a subsidiary.

Visa and Work Permit Requirements

Non-EU nationals require a residence or work permit to live and work in Germany. There are different types of permits depending on status. The application process is quite bureaucratic and can take several months, although costs are reasonable.

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