Aspects of Labor Law in Cross-Border M&A

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A cross-border M&A transaction, just like any other complex project, multi-stakeholder project, requires careful planning to be properly implemented. Aspects of labor legislation will often be present, and clients should be well advised to think about those early in the process, and plan accordingly. Ukrainian labor laws are historically pro-employee and quite prescriptive; failure to take legal requirements into account can lead to last-minute hick-ups in the process of implementing a transaction.

Certain labor law aspects that commonly arise are outlined below. These are examples of what may be relevant, depending on the individual circumstances of each cross-border M&A transaction.

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Obtaining work permits and residency permits

When a foreign investor acquires a Ukrainian business, it may be necessary to relocate some overseas personnel to the Ukrainian business. This does not necessarily require entering into employment relations but, where employment is the most suitable option, the overseas personnel will first need work permits and residency permits. This rule equally applies to overseas secondees; so foreign workers who will maintain their employment with a foreign company but who are seconded to a Ukrainian company will also need work permits and residency permits.

As a general rule, a foreigner arriving legally in Ukraine may temporarily stay in the country on the basis of their passport and relevant entry visa. But their employment with a Ukrainian company generally requires a work permit issued by the relevant state employment centre. Certain limited exceptions apply, such as with respect to the staff of foreign missions registered on the territory of Ukraine in accordance with procedures established by legislation. An application for a work permit is filed by the employer with regard to a specific position/ role, and the employer is required to substantiate why a non-resident should be employed instead of a Ukrainian resident.

Certain changes were made to work permit rules as recently as September 2017 (see the Law of Ukraine *On Amendments to Certain Legislative Acts of Ukraine on Elimination of Barriers to Attracting Foreign Investment*, effective from 27 September 2017). The amended rules are meant to be more investor-friendly.

Replacing corporate officers with the buyer's nominees

There is quite a process to have the incumbent corporate officers (such as directors) replaced by nominees of the new owner of the business, especially at a joint stock company. This usually involves calling (in advance of closing of the transaction) and holding (at closing or shortly after) a general meeting of the participants or shareholders, respectively. For a joint stock company, a general meeting of the shareholders will be required to replace the supervisory board, and potentially directors as well (unless directors of that joint stock company are appointed by decision of the supervisory board, in which case a meeting of the supervisory board will also be needed). A general shareholders meeting will have to be called at least 30 days in advance, a considerable timing issue which will need to be borne in mind.

Under Ukrainian law, a limited liability company and a joint stock company may be managed by either a sole executive (for example, a general director, director or Chief Executive Officer) or an executive board (for example, a directorate, board of directors, or management board). In either case, no corporate directors are allowed, i.e. all must be individuals only.

Persons to be appointed as directors will need to be advised on their duties under the law. Those statutory duties include complying with organisational documents and other internal company documents, maintaining confidentiality of commercial secrets and other confidential information of the company, acting in the company's interests, and not exceeding their powers. Directors may be liable to the company for losses caused by their actions or inaction. Since relatively recently, an action on behalf of the company against a director may be brought by a shareholder with 10% or more of all shares (or a number of minority shareholders holding in aggregate 10% or more of all shares). Directors may also be criminally liable for money laundering, forgery, tax evasion, among other things), or face administrative liability, usually in the form of a fine, for less serious offences, such as a failure to file statutory accounts. Directors also have duties in connection with labor relations at the company, such as ensuring labor discipline.

In the event that the incumbent director will retain his/her office after closing the transaction, the investor may want to put in place certain safeguards to protect interests against potential abuse. This can be done by adding certain provisions into the company's organisational documents, like the following:

1. The right of a second signature on all documents to be signed on behalf of the company, which is given to a trusted person (often, a foreigner employed by the investor elsewhere); or

2. A monetary limit on the powers of the director, so that without the prior approval of the new owner of the business the director may only sign contracts not exceeding a certain value; for contracts above that monetary limit, prior approval of the shareholder(s)/participant(s), respectively, will be required.

The new owner of the business may also add additional signatories with respect to the company's bank accounts in Ukraine.

An important statutory right for the owner of the business which, until relatively recently, was not available, is the ability to dismiss corporate officers at any time at the owner's discretion (though the owner may have to make severance payments in such case of at least the equivalent of six months of salary).

Employee rights in the context of an M&A transaction

As noted, Ukrainian employment laws are generally pro-employee. This is manifested, in particular, in the limited right of the employer to dismiss an employee; this can usually be done only for a cause. At the same time, there is good news that employees will not normally have any consultation or consent rights in connection with an imminent M&A deal, and a resulting change in the ownership of the business. That said, any major reorganisation of the work force (such as redundancies or changing material terms of the employment), will require certain procedural steps. One procedural requirement to follow is giving employees notice of planned redundancies or, for instance, salary cuts or full-time/part-time regime (which would qualify as a change in the financial terms of their employment) at least two months in advance. If an employee refuses to continue working on the new material terms and provided it is not possible for the previous conditions to remain, their employment agreement will be terminated.

The *Labor Code of Ukraine* provides that a change in the company's ownership or a company's reorganisation does not automatically cause termination of employment agreements with the employees. At the same time, in the event of an asset deal, employees remain employed by the selling company and can be transferred to a new entity subject to their consent (so no automatic transfer is possible).

Investors need to be aware of their duties, and the target's duties, in connection with any existing collective agreements in respect of the target. Collective agreements are regulated by the *Labor Code of Ukraine* and the Law of Ukraine *On Collective Agreements and Arrangements*. Collective agreements are concluded in all companies with trade unions or other employees organisations in order to regulate production, labor, and social and economic relations and to coordinate the competing interests of, on the one hand, the employees and, on the other hand, the employer. A collective agreement is signed between the employer and one or several trade unions or another labor organisation, and will contain certain mutual obligations of the parties.

In case of change of the company's owner, the existing collective agreement shall remain in force for the term for which it was concluded but not more than one year. During this period, the new owner is required by law to commence negotiations on conclusion of new, or amended, collective agreement. The collective agreement shall remain in force in the event of a change in the composition, structure, name of the authorised body on behalf of which this collective agreement was concluded. In case of company reorganisation, the collective agreement shall remain in force for the period for which it was concluded, or may be revised if the parties agreed so.

A few words on payroll taxes

Under the law, the employer acts as a tax agent and is, in this capacity, obliged to pay taxes on behalf of the employee before remitting his/her salary. The following payroll taxes apply at the moment:

1. Personal income tax — at a rate of 18%, deducted from the employee's salary, deducted at the expense of the employee;

2. Military tax — at a rate of 1.5%, deducted from the salary, so paid at the expense of the employee;

3. Social Security Tax — at a rate of 22%, payable on the top of the salary and hence paid at the expense of the employer; but the taxable amount to which this tax applies is subject to a cap, effective from 1 December 2017, of 44,050 Ukrainian hryvnias.

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