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**M&A - due diligence from an
employment law perspective**

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Issues that are identified during an employment due diligence can have a crucial impact on the business transaction as during M&A the buyer also acquires the human capital of the target company. Human capital is considered an intangible asset of the company. Besides that, the employment issues and disputes can be extremely costly. As such, prior to M&A, the employment lawyer should assess the potential administrative and criminal risks that might lay on the target company. It is, therefore, essential for the buyer to review all employment-related files and documents.

Before acquisition, the purchaser must ascertain whether there have been any claims against the seller and whether such claim has been resolved. If it is unresolved, how can it affect the acquisition? This is one of the topics that is discussed during due diligence. Some companies, of course, may choose different priorities or additional areas of focus. The essential considerations upon conducting the employment due diligence include:

(a) Compliance of the Employment Agreements with the requirements of the Labor Code

Employment agreements, amendments to the employment agreements and other related documents must be reviewed during due diligence. The employment lawyers must check whether the content of the employment agreements complies with the requirements of Article 43.2 of the Labor Code. Article 43.2 of the Labor Code provides the list of the information that must be included in the employment agreement.

Lack of any information as stipulated in Article 43.2 may lead to invalidation issues. Additionally, it is necessary to check whether the information stated in the employment agreement matches with the information that appears in the e-gov.az portal. Sometimes, it is observed in practice that the companies make amendments to the employment agreements; however, they do not register such changes in the e-gov.az portal. Such inactions might cause a headache to the new owner as the changes to the employment agreements get into legal force after their appropriate registration in the e-gov.az portal. To prevent adverse outcomes, the acquirer must pay detailed attention to such issues.

(b) Classification of the employee as an independent contractor

The rule regulating the misclassification issues found its reflection quite recently in the Law on the Amendments to the Labor Code of the Republic of Azerbaijan effective from 8th of May 2021. In order to conduct a misclassification audit, the buyer has to obtain the target company's employees and independent contractors list along with the subsequent agreements. Afterward, it is necessary to assess whether the independent contractors fall under the requirements of Art. 7.2-3 of the Labor Code. In the event it is detected that an employee is misclassified as an independent contractor, the penalties must be evaluated.

(c) Vacation Pay

Paid leave-offs must also be examined during merger and acquisition. Following the requirements of the Labor Code, during termination of the employment agreement with the employee, the last payment including the compensation for the unused time must be made to him/her. Failure to pay the compensation for the unused vacation or failure in the calculation of the vacation payment can lead to administrative penalties. Therefore, it is important to be aware of whether the statutory payments are made or duly made to the employees or not.

(d) Employee's compensation and benefit plans

Any comprehensive due diligence should include a detailed review of the target company's compensation and incentive/ bonus plans. Especially, the buyer should pay attention to whether the seller fulfilled their obligations under the plans. Last but not least, the new owner should be attentive to whether such plans include any obligation on the payments of leave offs.

(e) Labor Safety

The buyer must ensure that all existing policies of the target company concerning occupational health and safety comply with the local legislative requirements and the requirements related to occupational health and safety are met. Otherwise, administrative and criminal sanctions can be applied to the new owner.

(f) Immigration Considerations

Change in ownership can affect foreign employees. Employees might need new work permits and/or temporary residence permits. Therefore, it is principal for the acquirer to evaluate the number of foreign employees, their holding positions, and the type of documents under which they remain in the country. If, after the corporate transaction, foreign employees carry out the labor activity under the old immigration documents, the administrative sanctions might be imposed for non-renewal/cancellation reasons.

(g) Legal Consideration of the employee's dismissal/transfer

A key issue to be considered under any M&A transaction is the status of the employees and adherence to the procedural requirements.

Under the local law, should the owner of the enterprise change, the employment agreement signed by and between the former owner and the employees must be kept in effect by the new owner. An exception to the general rule applies. Pursuant to the Labor Code, the new business acquirer may terminate employment agreements with the employees under Articles 70, 73, and 75. In the light of Art. 63.2 of the Labor Code, a new owner, can also terminate the employment agreements with the employees holding managerial positions such as deputy directors, chief accountant, and other division managers. The local law also allows modifying the terms and conditions of the agreements with the above-mentioned employees under Article 56 of the Labor Code.

Although the termination might seem straightforward concerning the employees who meet the prescribed criteria, it can be more complicated with regard to the protected employees. The Labor Code provides the list of the employees with whom the employment agreement cannot be terminated except for the reason of the expiration of the term of the contract or upon liquidation of the enterprise, which is not applied to M&A transaction. Therefore, it is advisable from the acquirer company's viewpoint to request and analyze personal files of the questioned employees to decide whether to keep or dismiss them; if the decision on dismissal was reached, what is the applicable ground to cease the employment relationship.

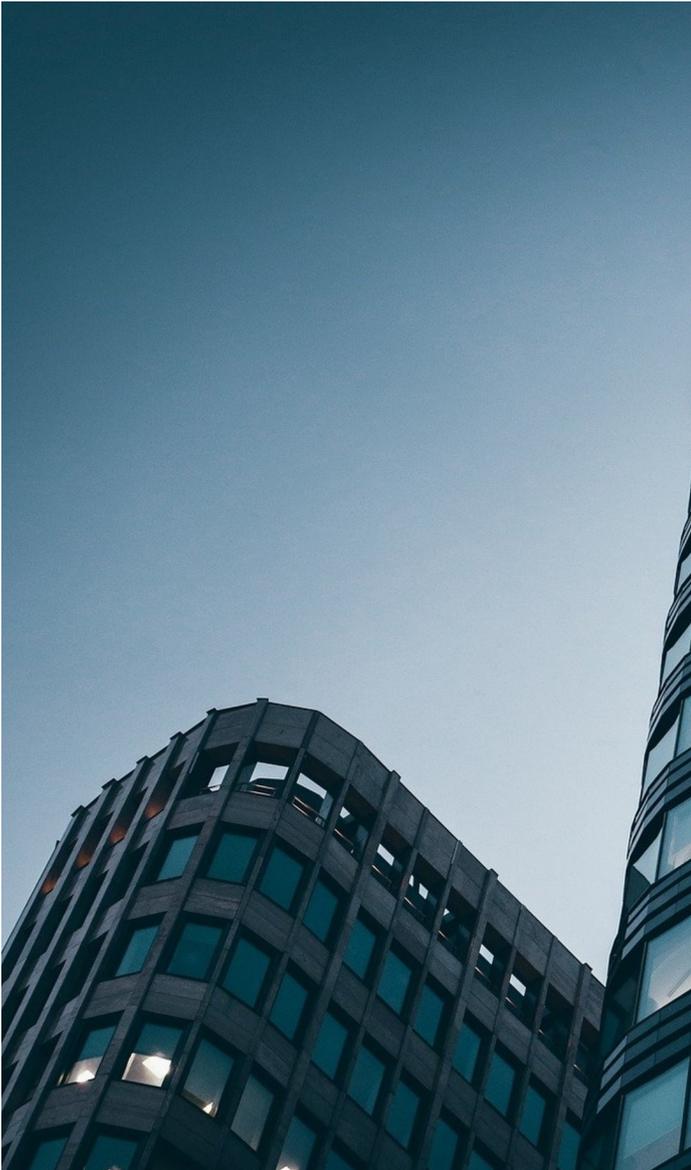
Another issue that might require attention in the course of M&A deal: whether and how to transfer the employees of the affected business to the new owner. In some jurisdictions, transfer of the employees is allowed by the law, whereas the concept of the "transfer of the employees" under the local legislation does not exist in Azerbaijan.



(h) Labor disputes

Existing claims that have been raised against the target company by the seller company's employees must be reviewed. This can include not only the active litigation but also the cases where the employees sent the complaint letters to the Ministry of Labor and Social Protection of the Population of the Republic of Azerbaijan, to the State Employment Agency and etc. The new business acquirer must be aware of any current, pending, or future litigation concerning unlawful dismissal and other issues.

All in all, the new business acquirer should not underestimate the necessity of conducting employment due diligence. An employment law due diligence plays a substantive role in deciding on acquisition or merging with another business. The results of the due diligence can affect the purchase price and terms.



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