Ireland

The treatment of employees in takeover situations

by Blanaid Clarke

The most obvious group to be affected by a takeover offer is the shareholders of the target company. Fortunately a plethora of regulation exists to ensure fairness and equality of treatment of shareholders in such situations. Another group that is likely to be substantially affected is the employees of the target company who will be concerned that the successful bidder will engage in cost-saving measures and that jobs will be lost. Even if employees retain their jobs, they may be concerned that their jobs will not be secure or their conditions of employment altered.

The latest draft 13th Directive on Company Law Concerning Takeover Bids (COM(97)565 final, OJ 1997 C378) strengthens the position of employees and imposes greater duties on directors to act in employees' interests and to provide them with information on the takeover. This article sets out to examine the current legal treatment of employees during corporate takeovers in Ireland with a view to determining whether implementation of this directive in Ireland would involve significant legislative or policy changes.

TAKEOVER BIDS

The general purpose of the draft directive is to co-ordinate certain safeguards which member states require of companies for the protection of shareholders during takeover bids. Article 5(1) sets out five general principles which must be respected in the rules introduced by member states to implement the directive. One of these principles imposes a duty on the board of the target company 'to act in all the interests of the company, including employment'. The Company and Commercial Law Committee of the Law Society of Ireland have noted that this principle may cause difficulties where there is a conflict between the interests of the shareholders and the interests of the employees. Such a conflict would arise for example where a generous offer had been made to shareholders but in circumstances where the bidder made clear its intention to dismiss a large portion of the workforce following the acquisition. Modern corporate theory would appear to suggest that the claims of the shareholders should be paramount. Furthermore the committee point out that as the main focus of the draft directive is on protecting shareholders theirs would appear to be the overriding interest.

on the internet

http://www.parliament.the-stationery-office.co.uk/pa/cm/cmhansrd.htm

The Irish Law site provides visitors with a vast array of different sources of Irish law, including the constitution, legal associations, information on the legal system and the courts, and the peace process.

Article 6 sets out the informational requirements to be complied with by member states in their rules. This article imposes obligations on member states to provide employees with certain relevant information. Article 6(1) states that as soon as the bid has been made public, the target's board must inform the representatives of its employees, or the employees themselves if there are no representatives. In addition art. 6(2) requires that, when the offer document has been made public, the board communicate it to the employees' representatives or, where there are no representatives, to the employees. Article 6(3) sets out the minimum informational requirements to be included in the offer document. This document should contain inter alia details of the bidder's intentions with regard to the future business and undertakings of the target, its employees and its management. The latest proposal requires that the document should also include any change in the conditions of employment.

THE IRISH TAKEOVER PANEL ACT & RULES

The Irish Takeover Panel, a statutory body established by the *Irish Takeover Panel Act*, 1997, regulates all takeover offers for companies resident in the Republic of Ireland whose shares were listed or dealt in on the Irish Stock Exchange. The act sets the Irish panel two principal objects:

(1) to develop rules governing the conduct of takeovers and other relevant transactions; and

(2) to monitor and supervise takeovers and other relevant transactions in order to ensure compliance with the provisions of the act and the rules.

The act also sets out twelve general principles which apply to the conduct of takeovers. The Irish panel fulfilled its rule-making duty by introducing the *Irish Takeover Panel Act 1997 (Takeover) Rules* 1997 and the *Irish Takeover Panel Act 1997 (Substantial Acquisition) Rules* 1997. These rules mirror substantially the City Code and Rules Governing Substantial Acquisitions of Shares.

General principle no. 8 of the act states that when giving advice and furnishing information in relation to the offer the directors of the target company shall be bound 'to consider the interests of the shareholders as a whole'. General principle no. 9 of the City Code upon which this principle is based, states that in giving advice to shareholders directors should 'consider the shareholders' interests together with those of employees and creditors'. It would appear that the requirement to consider the interests of employees has been deliberately omitted from the Irish principles. Yet even the City Code does not go as far as the directive in requiring the directors of the target company to act in the interests of their employees. The City Code refers to considering employees' interests only when giving advice to shareholders. The difference could potentially be important. However, because the London Panel insists upon compliance with the spirit as well as the letter of the City Code, and given the flexibility involved in a self regulatory code, it is always open to the London Panel to require directors to act in the interests of employees. Such flexibility is clearly absent in the Irish statutory framework.

According to r. 24.1 of both the Irish Rules and the City Code, the bidder should include the following information in the offer document:

- its intentions regarding the continuation of the business of the target and its subsidiaries;
- its intentions regarding any major changes to be introduced in the business, including any redeployment of the fixed assets of the target and its subsidiaries;
- the long-term commercial justification of the offer; and
- its intentions with regard to the continued employment of the employees of the target and of its subsidiaries.

Clearly when an offer document has been published, the employees will have direct access to the information contained therein. It will not be important that this information was not passed to them directly by the directors as required by the directive but was obtained by the employees independently. For this reason, Alistair Defriez, the Director-General of the London Panel, has described the provision in the directive as a 'somewhat mystifying development'. It should also be noted that the informational requirements in r. 24 are not quite as far-reaching as those stipulated in the directive. Article 6(3) involves notifying employees of 'any change in the conditions of employment'. Such information would not necessarily be substantial enough to come under the heading of 'any major changes to be introduced in the business' and may not therefore be included in the offer document. Similarly, unless the changes in working conditions are so severe as to constitute constructive dismissal they are unlikely to require inclusion in the offer document under the heading 'the continued employment' of the employees. The Company and Commercial Law Committee of the Law Society of Ireland have made the valid point that it would be difficult, if not impossible in the case of a hostile bid, for the bidder to give any indication of any changes in the conditions of employment in the target company as it is unlikely to be aware of such conditions.

EUROPEAN INSTRUMENTS

The introduction to the City Code states that:

'the Code and the Panel operate principally to ensure fair and equal treatment of all shareholders in relation to takeovers.'

Similarly the whole focus of the Irish Rules, implementing the general principles set out in the act, is on the protection of shareholders. When the then Minister of State at the Department of Enterprise & Employment, was questioned in the Irish Parliament about the lack of protection afforded by the act to workers, he pointed to 'its relatively narrow scope'. Interestingly, the Minister then went on to say that there was already existing legislation including European instruments which deal with the protection of the workers' interests in takeovers.

The transfer of undertakings directive

The Minister referred specifically to 'European instruments such as the transfer of undertakings'. The transfer of undertakings directive (No. 77/178, OJ 1977 L61/26) provides for the safeguarding of employees' rights in the event of the transfer of undertakings, businesses or parts of businesses. Although the original proposal dealt with 'the harmonisation of the legislation of member states on the retention of the rights and advantages of employees in the case of mergers, takeovers and amalgamations', the directive, as introduced, only applies where there has been a transfer of an undertaking or part of an undertaking. It does not apply therefore where a limited company is taken over by the acquisition of its share capital. In such circumstances, the regulations which implement this directive into Irish law will be of no use to employees.

The collective redundancies directive

The *Protection of Employment Act* 1977 implements in Ireland the directive on the approximation of the laws of member states relating to collective redundancies (Directive 75/129, OJ 1975 L48/29). The act provides certain informational benefits to employees, where dismissals of a large proportion of the workforce in any period of 30 consecutive days are effected, for certain reasons stated in the act. A dismissal on the grounds of redundancy is included. The act stipulates that where an employer proposes to create collective redundancies it shall, with a view to reaching an agreement, consult with employees' representatives and supply them with all relevant information. This information should include the reasons for the proposed redundancies, the number of employees to be made redundant and the period during which it is proposed to effect the proposed redundancies. The consultations should include the possibility of avoiding the proposed redundancies, reducing the number to be made redundant or otherwise mitigating their consequences.

A number of problems render this legislation less than potent in safe-guarding employees' interests in a takeover such as:

- insider dealing restrictions may prevent the communication of information to employees at an early stage;
- consultation with the target company's management may be futile as they are unlikely to be in a position to control redundancies; and
- the maximum penalty for failing to initiate consultations is a fine of £500. This is unlikely to act as an adequate deterrent. In any case, the employer is offered a possibility of mitigating this penalty by pleading 'substantial reasons related to his business which made it impracticable for him to comply with his obligations'. The necessity of maintaining the confidentiality of certain information may provide such an excuse.

The European Works Councils directive

The *Transnational Information and Consultation of Employees Act* 1996 implements in Ireland the European Works Councils directive (Directive 94/95, OJ 1994 L254/64). The directive requires the establishment of European Works Councils in large enterprises operating across two or more EU countries. It also provides for the establishment of special negotiating bodies comprising representatives from the undertakings' operations in the countries concerned. The objective of the directive is to ensure that undertakings operating in more than one EU country inform and consult representatives of employees affected by their decisions. Although there is no specific reference to takeovers, decisions on the future prospects of the business could obviously be categorised as decisions affecting employees. Apart from the limited application of this act to employees in general, other difficulties would stem from the confidential nature of the information to be disclosed and the fact that, while the act ensures that employees are informed of major changes in employment, their ability to affect the decisions being made would seem slight.

COMPETITION LEGISLATION

Domestic competition law is covered by two pieces of legislation: the *Mergers, Takeovers and Monopolies (Control) Act* 1978 and the *Competition Act* 1991. The 1978 act requires the prior approval of the Minister for Enterprise & Employment for takeovers of companies where at least one of the enterprises concerned carries on business in Ireland. Unless the Minister deems otherwise, the act only applies to companies which exceed certain size and turnover thresholds. Upon notification, the Minister may decide to refer the matter to the Competition Authority for investigation. The latter must state its opinion:

'as to whether or not the proposed merger or takeover concerned would be likely to prevent or restrict competition or restrain trade in any goods or services and would be likely to operate against the common good.'

In assessing the effect of the acquisition on 'the common good', the authority must give its views in respect of a set of listed criteria which includes the likely effect of the acquisition on the level of employment and on employees. However it must be noted that the question of the common good must be considered in terms of the promotion of competition. Once the Minister receives this report, he or she makes a decision based on his or her assessment of 'the exigencies of the common good' which must again include the criteria listed in s. 8. It would thus seem that the Minister is obliged to balance the interests of the employees against other issues such as improving competition. Such protection may not be sufficient to allay the concerns of employees.

The *Competition Act* 1991 may also be relevant to takeovers. The purpose of the 1991 act is to prohibit anti-competitive agreements and practices and to prohibit the abuse of a dominant position. Unlike the 1978 act, there are no minimum size thresholds and title in the shares may pass to a bidder notwithstanding that the parties have not notified the Competition Authority of the acquisition. Section 4(1) prohibits agreements which have as their object or effect the prevention, restriction or distortion of competition in trade in any goods or services in the state. The Competition Authority has confirmed that before a merger or takeover can be found to have offended against s. 4(1):

'it must be shown that it would, or would be likely to, result in an actual diminution of competition in the market concerned.'

It would be difficult to see how a takeover agreement would fall within the scope of the s. 4(1) prohibition purely because it is contrary to the best interests of the employees. Similarly an argument that a company was abusing a dominant position contrary to s. 5(1) by acting contrary to the best interests of their employees would not appear sustainable.

One sense in which the interests of the employees may be indirectly protected under the 1991 act is indicated in the *Barlo Group plc/Kingspan Group plc* case. In a submission to the Competition Authority, the Minister for Enterprise and Employment indicated his concern that jobs should not be lost in the target company. He stated that the target had been losing money and that if the takeover did not proceed the jobs would be lost. The Competition Authority itself referred to the 'failing firm defence' noting that there was little prospect of the plant continuing in operation unless the acquisition proceeded. Its point was not that it was concerned by the potential job losses per se. Rather it felt that if the plant were to close the degree of market concentration would increase anyway and thus the takeover itself was not leading to a diminution in competition.

COMPANIES LEGISLATION

The only section in Irish company legislation which expressly requires companies to consider the interests of their employees is s. 52(1) of the *Companies Act* 1990. This section provides that the directors 'are to have regard in the performance of their functions [to] the interests of the company's employees in general' as well as the interests of its members. Although this would seem to be an extremely valuable right of employees, s. 52(2) minimises the benefit considerably. It states that the duty imposed on directors by this section:

'shall be owed by them to the company (and the company alone) and shall be enforceable in the same way as any other fiduciary duty owed to a company by its directors.'

This means that the employees cannot themselves enforce this duty. The company alone is the correct plaintiff in any action.

COMMON LAW

The power of directors to consider the interests of their employees is severely limited at common law. In *Hutton v West Cork Railway Co* (1883), Bowen LJ clearly stated that 'there are to be no cakes and ale except such as are required for the benefit of the company'. Unless there is a specific object in the company's constitution sanctioning relevant non-commercial activities, it is necessary to establish that the activities are reasonably incidental or conducive to the carrying out of the company's business. Another limiting factor is that a director, in order to fulfil his or her fiduciary duty, must believe that the costs of non-commercial activities are in the interests of the company, i.e. in the long term interests of the shareholders. In *Parke v Daily News* (1962) Plowman J rejected the idea that directors, in having regard to the question what is in the best interests of their company, are legally entitled to take into account the interests of the employees irrespective of any consequential benefit to the company. This principle was applied most recently by the Irish Supreme Court *In The Matter Of Greendale Developments Ltd (In Liquidation)* (1997). In *Heron International Ltd v Lord Grade* (1983), the Court of Appeal had to consider the nature of directors, duties in the context of a takeover situation. The court stated that where directors are assessing rival bids in a takeover situation, they must make a decision based on the best interests of the company. In such a case, 'the interests of the company must be the interests of the current shareholders'. No mention was made of the interests of the employees.

CONCLUSION

From the foregoing analysis, it is clear that implementing the provisions of the draft 13th directive safeguarding the rights of employees in Ireland would require further legislative change. It would also require a change in the current acceptance of the domination of the interests of shareholders in corporate decision making. Whether such a change is desirable remains to be determined.

Blanaid Clarke
University College Dublin.
Lecturer in Corporate Finance Law.