



# U.S.-South Africa Business Alert

## Recent legal developments in the United States-South African business community

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### **Doing business in the United States and South Africa: Labor and employment law**

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#### **The United States: Dispelling misconceptions**

Labor and employment lawyers from outside the United States often have misperceptions about the nature of our laws. In the United States, there is a general presumption of “at-will” employment. At-will employment means that either the employer or the employee may terminate the employment relationship without notice or cause. Thus, many foreign employers believe that employees may be dismissed with impunity.

But this is far from the case – the employment relationship in the United States is heavily regulated, on federal and state levels. Laws prohibit discrimination, harassment, and retaliation, and the penalties are unmatched in any jurisdiction, with juries permitted to award punitive damages, as well as damages for “emotional distress,” so that even a “garden variety” claim of discrimination may result in a multi-million-dollar award. Moreover, class (or “collective”) actions for failure to pay proper wages or for allegedly discriminatory practices also result in highly publicized settlements in the tens of millions of dollars, and higher.

Nevertheless, as a general rule, it is fair to say that the rules in the United States are generally more flexible than elsewhere, and companies generally find a welcome environment here. This article will address a few questions directed to labor and employment law issues surrounding corporate transactions in the United States.

#### **What are the key issues involved in establishing a manufacturing facility in the United States?**

(A) Employment contracts: Who receives them and what must they include?

There is no general obligation in the United States for the employer to issue employment contracts. As the at-will employment is only a presumption that may be rebutted by other circumstances, it is generally recommended that the employer use caution when drafting an employment contract, as this may imply more protection than available under the at-will doctrine.

Fixed-term contracts are generally considered only to be terminable “for cause.” It is therefore advisable to phrase such agreements carefully, to avoid unintended employee protection.

Alternatively, they may provide for termination at will, and set forth the employee's specific rights in those circumstances – which may include payment of less severance than would otherwise be implied by the term of the contract.

(B) Hiring managerial employees

Managerial and supervisory personnel are excluded from the protection of the National Labor Relations Act (NLRA) and, most often, also from federal statutes such as the Fair Labor Standards Act (FLSA). This gives the parties more freedom to determine the terms and conditions of the employment.

When hiring managerial employees, it is more common to draft employment contracts, as the need for special provisions is likely to be higher. Examples of such provisions could be restrictive covenants, conflict-of-interest clauses, arbitration agreements, and confidentiality provisions.

Restrictive covenants, such as non-competition clauses, are generally enforceable in most states. However, overbroad clauses may be denied enforcement by the courts. Therefore, it is important when drafting such provisions to consider the reasonable necessity of the imposed restrictions in regard to the duration and the geographic scope.

**How does a foreign employer acquiring an existing business in the United States assess the existing workforce and consider changes?**

Generally, there are no U.S. federal statutes regulating transfer of business as known in other countries. In most situations, the courts have developed certain protections for employees in target companies, but the general rule is still at-will employment, which entitles both seller and buyer to terminate employees without notice or cause.

(A) Making changes to key managerial positions

As a result of the at-will employment doctrine, the buyer is generally not required to hire the employees in the target company if the sale is carried out as an asset deal. In a stock deal, the buyer generally assumes all liabilities as a successor employer, and any change in management must be done through terminations. The NLRA does not protect managers and supervisors. In addition, individual contracts and employment policies may protect the managerial employees from termination due to change of ownership.

Any discussions with senior management regarding their role in the company going forward should be carried out with care to avoid an implied protection against termination. When contemplating termination of senior management, it is important to avoid conflicts with the Age Discrimination in Employment Act (ADEA), which protects employees over 40 years old; Employee Retirement Income Security Act (ERISA), which protects employees from termination close to vesting of employment benefits; and Older Workers Benefit Protection Act (OWBPA), which protects older workers from losing their retirement benefits.

(B) Carrying out a workforce reduction

As most employees are subject to at-will employment, the buyer is generally free to carry out a work reduction in the acquired company, regardless of whether it's an asset or a stock deal, provided that the buyer is not acting in bad faith or violating anti-discrimination statutes. Unless otherwise agreed,

the employees are generally not entitled to special notice or severance, with the exception of particular federal or state notice statutes as discussed below.

The Federal Workers Adjustment and Retraining Notification Act (WARN) applies to reductions that result in plant closing or that exceed 50 employees within a 90-day period in companies with (1) 100 or more fulltime employees or (2) 100 or more full- or part-time employees, who work in aggregate at least 4,000 hours per week, exclusive of overtime.

Under WARN, the employer is required to give a minimum of 60 days' notice before terminating the employment relationship, unless the lay-offs were caused by unforeseeable events, natural disaster, or similar exception in the Act. Unlike the NLRA, WARN also covers management and supervisors.

According to WARN, the employer's obligation to provide 60 days' notice is transferred to the buyer at the date of sale.

Violation of the employer's duties under WARN may result in civil penalties for each day of violation. In addition, the employer may be forced to pay back pay and benefits to the affected employees for the 60-day period. Some states have enacted their own WARN statutes, which may provide for better protection of employees.

In a stock deal where the employees are represented by a certified union, the buyer may be forced to recognize the union and bargain over the effects of the contemplated reduction in workforce. This may also be the case in an asset deal, if the majority of employees in the target company is transferred to the buyer. If the target company has entered into a collective agreement, this may prevent a reduction in workforce.

Aside from the general concerns regarding termination of employees in protected groups, no employees enjoy special protection against workforce reductions. Union-represented employees are not immune from termination, but the collective agreement may require the employer to show legitimate business reasons for the terminations and some collective agreements may expressly prevent reductions in workforce.

### (C) Reorganizing the workforce

There is generally no statutory protection against the buyer's unilateral changes in employment terms and conditions.

In a stock deal, the buyer should carefully consider the existing employment contracts and employment policies, to determine whether unilateral changes are permitted. If the employees are covered by a collective agreement, the employer will be required to follow the special procedure for renegotiating the terms with the union. If no collective agreement has been reached but a certified union exists, the employer may be required to recognize the union as the exclusive bargaining agent and may have a duty to bargain in good faith about the proposed changes.

In an asset deal, the employer is generally not required to offer the same terms of conditions, but, should the employees be covered by a collective agreement, the buyer may be expressly required to assume the seller's obligations under the agreement.

Relocating the workplace generally does not require acceptance from the employees. However, there exists the risk that relocating the workplace would be challenged as an unlawful excuse to eliminate employees in a particular preferred group, e.g., age, race, gender, etc.

(D) Changing the wage-and-benefits structure

Unlike reorganizations of the workforce, the wage-and-benefit structure may be considered contractually protected terms. The employer may be required to give proper notice to change the wages and employment benefits. If the employees are protected against dismissal, this may prevent unjustified changes in the employees' compensation. Employers may, however, lawfully reserve to themselves the right to make unilateral changes in compensation or benefits.

In a stock deal, this means that the buyer is advised to ensure that proper notice is given before changing wage-and-benefit plans. If the employees are covered by a collective agreement, the same issues arise as with reorganizations. Consent, however, is implied by the employees' decision to remain employed after notice is given.

(E) Consulting with labor unions or works councils

There is generally no special requirement that the buyer must consult with the unions or employee representatives due to the purchase of assets or stock in a target company.

In an asset deal, collective agreements do not transfer automatically unless expressly provided in the collective agreement. However, the buyer may be required to recognize the union and bargain in good faith over the terms and conditions if a majority of the seller's employees is transferred. If the buyer contemplates major restructurings or reductions in workforce, the buyer may be required to bargain over the effects of these changes.

In a stock deal, the buyer is generally obligated to assume all obligations of the target company and any change in collective terms and conditions must be bargained over with the union.

(F) Consulting with government

There is generally no obligation to consult with the authorities regarding the employees in connection with the transfer of business, irrespective of whether it is a stock or an asset deal.

Should the transfer of business result in reductions in workforce, the buyer may be required under WARN to give notice to the local government where the layoffs take place.

**South Africa: Employment law obstacles are more imagined than real**

There is a perception in some minds that the legislative regime in South Africa creates a legal minefield for those wishing to do business there, especially in regard to employment issues. The reality is that, in many respects, the law facilitates transactions and permits for a degree of flexibility that can assist parties in their commercial endeavors. This article considers some of the most critical questions usually asked by parties wishing to do a deal in a foreign jurisdiction and shows that the law in South Africa is not an insurmountable obstacle. In fact, an understanding of the legal environment and possibilities can help parties structure their deals in ways that allow them to take advantage of those areas in which the law can assist and to minimize risks by following the correct procedures where consultation or negotiation is required.

## **Is employee consultation or consent required for transactions such as acquisitions, disposals, or joint ventures?**

One of the first questions asked by a company seeking to do business in a foreign jurisdiction is whether employee consultation or consent is required for transactions such as acquisitions, disposals, or joint ventures. In South Africa, an employer is obliged to consult with employees when it contemplates the possibility of dismissals by reason of its operational requirements. If it is contemplating a disposal of assets that might result in job losses and the need to retrench, it would have to consult. However, where the employer contemplates disposal of all or a part of the business as a going concern, no consultation is required, because Section 197 of the Labor Relations Act of 1995 (the LRA), the South African transfer of undertaking provision, says that, in such circumstances, employees transfer automatically to the purchaser with the business. As there is no implication of job losses, there is no need to consult. The provisions of Section 197 thus not only serve to protect employees in sale of business situations but also facilitate such transactions for the seller and the purchaser. Let us examine how Section 197 works in a little more detail.

Where the whole or part of any business is transferred as a going concern in South Africa, all employees of the seller (the old employer) transfer automatically by operation of the provisions of Section 197 to the purchaser (the new employer). The practical consequences of this are as follows:

- The new employer is automatically substituted in the place of the old employer in all contracts of employment existing immediately before the date of the transfer;
- All rights and obligations between the old employer and the new employer as at the time of transfer continue in force as if they had been rights and obligations between the new employer and the employees;
- Anything done by the old employer before transfer (including dismissal of employees or the commission of any unfair labor practice) is considered to have been done by the new employer; i.e., the employees can enforce their rights against the new employer; and
- Transfer does not interrupt continuity of employment.

The only condition for the transfer to take place automatically is that there must factually be a transfer of the business as a going concern. There does not have to be an offer from the purchaser or a release from the seller for the employment to be effective. There are no consultation requirements for implementing a transfer under the circumstances where a business is transferred as a going concern. Consultation (with a view to concluding an agreement) would only be required where the parties seek to avoid the automatic consequences of Section 197 of the LRA. What is recommended, however, is effective communication with transferring employees, to ensure a smooth transition from one employer to the next and to avoid disputes that can arise where employees are uncertain about their positions and how the deal will affect them.

## **Does the new employer have to honor the exact terms and conditions of employment that existed with the old employer?**

No, it does not, because the LRA provides a measure of flexibility. Under the provisions of Section 197, the new employer complies with its obligations if it employs the transferred employees on terms and conditions on the whole no less favorable than the terms previously enjoyed by them with the old employer. Section 197(4) further specifically provides that employees may be transferred to a new

pension, provident, or similar fund provided the criteria set out in Section 14 (1) (c) of the Pension Funds Act are complied with (this section requires the Registrar of Pensions to be satisfied that any scheme to amalgamate or transfer funds is reasonable and equitable, and accords full recognition to the rights and reasonable benefit expectations of the persons concerned in terms of the fund rules, and to additional benefits which have become established practice).

**Is there any liability for transferring employees for a severance payment when they leave the old employer and start working for the new employer?**

• Transfer does not give rise to an obligation to make severance or other payments to transferring employees, because there is no termination of employment. However, some requirements regarding the valuation of existing rights and benefits must be dealt with as part of the transaction. In summary, the old employer must:

- agree with the new employer to a valuation as at the date of transfer of accrued leave pay, severance pay that would have been payable to transferred employees in the event that a dismissal for operational requirements had taken place (even though there is no dismissal but, rather, a transfer), and any other payments that have accrued to the employees but not been paid as at date of transfer (e.g., bonuses);
- conclude a written agreement that specifies which employer is liable for payment of any of the amounts referred to above, or if there is to be an apportionment; the terms of the apportionment; and what provision has been made for the payment of these amounts if/when any employee becomes entitled to payment;
- disclose the terms of the agreement contemplated above to each transferring employee who will be employed by the new employer after the transfer;
- take any other measure that may be reasonable to ensure that adequate provision is made for any obligation on the new employer that may arise from the above.

A valuation agreement that is separate from the Business Transfer Agreement can be useful to deal with the Section 197 issues, although this is not a requirement – it could be done as part of the Business Transfer Agreement. However, since its terms have to be disclosed to employees, it usually makes practical sense to have these issues detailed in a separate agreement. Employees should be afforded the opportunity of verifying that the information in relation to their individual benefits/accrued rights has been accurately recorded. This includes days of accrued leave and length of service on which severance payments would be based. Identifying all these liabilities upfront is useful, as the amounts involved could be material to the transaction.

If the old employer does not comply with the requirements set out above, then it will remain jointly and severally liable with the new employer for a period of 12 months after the date of transfer for any severance benefits that may arise if employees are dismissed for operational requirements. The old and new employer remain jointly and severally liable for any claim concerning a term or condition of employment that arose before the date of transfer.

Again, it can be seen that, while ensuring a measure of protection for employees in a business transfer situation, Section 197 contains flexibility for the parties to agree between themselves about who will be liable for which payments to employees or how these liabilities will be apportioned.

Understanding these obligations also helps direct the parties to consider the insertion of appropriate warranties or indemnities in their Business Transfer Agreement.

**Are there any restrictions on the new employer if it wishes to rationalize or restructure the business after transfer and to run the newly acquired business in a way it considers commercially sound and rational?**

There is no prohibition against rationalization or restructure. However, if it proposes doing so in a way that will have an effect on existing jobs, i.e., where job losses are contemplated, consultation would be required. This consultation would have to take place in accordance with Section 189 or Section 189A of the LRA (depending on the number of employees who might be affected). Section 189A contains minimum consultation and notice periods. *Forecourt Express (Pty) Ltd v SATAWU & Others* is a recent decision of the South African Labor Appeal Court where the new employer wanted, immediately after purchase of the business of the old employer, to restructure that business along the lines that had worked for it in its existing business. This meant using subcontractors and labor brokers to supply staff, rather than employing people itself, and that it had to retrench most of the existing staff. The union objected and took the new employer to court. The LAC confirmed that an employer is entitled to run its business as it sees fit provided that it does not change the terms and conditions of employment of its employees without their consent, and that, if it contemplates dismissals, it complies with its obligations under Section 189 of the LRA. The court held that Forecourt had explained its reasons for why it wanted to operate the business differently and that it was not for the court to tell it that it had to continue running the business on the old basis for a period of time before deciding to change. Forecourt was entitled to choose the way it saw as less risky to run its business, i.e., by using labor brokers and sub-contractors and integrating the purchased business with its existing business, thus achieving a competitive edge. Having proposed this model, it was clear that there was no longer any work for the former employees of the old employer and this provided a fair reason to dismiss them.

One word of warning: Parties engaged in a transaction should be wary of terminating employees before the transfer takes place, because such a termination could well be construed as a dismissal where the reason for dismissal is related to a transfer of a business as a going concern, which is prohibited under Section 187(1)(g) of the LRA. What this means is that a purchaser cannot say to a seller, “You must get rid of employees before we do the deal or as part of the deal.”

**Knowing the legal environment gives you the advantage**

Doing business in South Africa has to be approached with a proper understanding of the legal environment but, once parties know the playing field and the rules of the game, they can strategize and plan accordingly. There are no insurmountable obstacles and, in many instances, the law can facilitate a smooth transaction. What is demonstrated in this article is the need to consider the employment issues from an early stage so that, when consideration is given to how the deal should be structured, the parties know and appreciate the employment law implications. In some cases, the employment law consequences can be a determining factor in the decision on how to structure the deal.

## Contact us

For more information on the relevant employment law issues when doing business in South Africa, readers are invited to consult the chapter written by Susan Stelzner for the *2006/07 PLC Cross-border Handbook on Labor and Employee Benefits*, which can be accessed via the ENS website ([www.problemsolved.co.za](http://www.problemsolved.co.za) [go to “news” and click on “Susan Stelzner’s employment law Q&A – November 2006”]). Ms. Stelzner is in the process of updating this chapter for the *2007/08 Handbook* and has also written a similar chapter for the IBA publication *Getting the Deal Through*, which has recently been published and is available on the ENS website.

Ms. Stelzner is currently vice-chair of the IBA’s Discrimination and Gender Equity Committee and has been involved, over the last three years, in the IBA international employment law conferences, including co-chairing a session in 2006 in Barcelona.

Philip Berkowitz is former chair of the American Bar Association Committee on International Labor and Employment Law, International Law Section. He is also co-editor of *International Labor and Employment Law: A Practical Guide*, published by the ABA as part of its International Practitioner’s Deskbook Series.

In June 2007, Ms. Stelzner and Mr. Berkowitz were co-chairs of a session at “Attracting and Retaining Talent: The Role of HR and Employment Conditions,” the 2007 IBA employment law conference in Copenhagen.

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We welcome your comments and questions. For more information and discussion regarding the topics covered in this Alert, please contact:

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