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Mergers and acquisitions in the Middle East: The case for continuity of service

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All GCC countries have labor laws and provisions for the treatment of nationals and expatriate labor at managerial, professional, skilled, and unskilled levels. As a general rule, nationals are entitled to and contribute to a retirement pension scheme with contributions made by both the employee and employer. These arrangements are not impacted by any merger and acquisition (M&A) activity that may affect the employer or employee. Expatriates are entitled to an end-of-service gratuity based on the duration of their employment with their sponsoring or legal employer. Since employers can change as a result of M&A activities, the length of service with the new employer, and consequently, the gratuity entitlement of expatriate workers, can be impacted negatively.

This article puts forward the case for how labor laws across the GCC might evolve to regulate the treatment of expatriate labor impacted by corporate M&A activity and proposes an interim approach to be considered by any company contemplating an M&A transaction.

Historically, family enterprises across the GCC were in portfolio "build" mode. Diverting any part of the family portfolio was not a conversation founders were willing to entertain. More recently, there has been a shift in the discourse, and sometimes behavior, as governments have started to carve-out and sell portions of state-owned enterprises via initial public offerings (IPOs). This has encouraged private and semi-government organizations to follow suit. Many have started to consider the benefits of focusing on their "core" business and to package and shed peripheral activities. As a result, Deloitte has seen an uptick in the number of IPO readiness assignments and M&A activity with the intent to redistribute the IPO or sale proceeds to shareholders and/or reinvest in developing and growing the core and related ventures.

Organizations specializing in M&A integrations and separations often come across business units designated for carve-out that lack a full complement of management and staff. The business unit in question may or may not be part of a ringfenced legal entity. Often employees are employed by the "Group" or sometimes a combination of Group, the business unit itself, and/or a shared service center entity owned by the Group.

The reasons are varied and largely historic, regardless of company size. People may have been employed by the Group at the time the activity was launched. The same people and their successors continue to be employed by the Group while performing tasks for new business units even after those business units mature and are carved out into new legal entities. Over time, some Groups may have set up shared services to take advantage of operational synergies across the portfolio for support functions such as HR, IT, or Finance. Shared service staff could be deployed across several portfolio entities or dedicated solely to one business unit. Staff in shared service centers are inevitably impacted when the business unit or activity they support is carved-out.

So, what is the impact on employees who are caught up in such M&A transactions?

It is common for employees to be asked to change legal employers, either because the acquirer of the target employing the staff wants to integrate them into one of their existing legal entities or for other reasons. This is either because the business unit they support needs to be packaged with a full complement of staff in order to be sold as "stand-alone" or because the acquirer wants to integrate them into one of their existing legal entities. The process is relatively straightforward. In both scenarios, the employer making the request owns both legal entities. The HR department develops a simple three-way agreement to be signed by the employee and directors from both the selling company and the acquiring company to transfer the existing employment contract.

There is an added complication in the Middle East due to expatriate employment visas linking to their legal employer. However, this is changing with the introduction of new visa categories such as the Golden visa in the UAE, where employees are no longer beholden to their employers. It is worth noting that Golden visas remain the exception rather than the norm and certain criteria need to be met to qualify for application. When transferring to a new legal entity, the residency visa for the employee must be transferred to their new sponsor. Aside from the cost (no GCC government offers a discount or refund for the unused portion of the existing visa), there is also a small risk that certain transfer requests will not be approved, creating unnecessary stress to the affected individuals and to the value of the transaction if these are key personnel.

GCC citizens who change legal employers do not require employment visas and are not impacted in the same way. In their case, the HR department has a grace period to inform the relevant social security authorities of the employer change so that contributions to their retirement fund can be drawn from the correct employer's bank account.

Typical EOSB rules

Following at least 12 months of service as of the date of termination, EOSB is calculated based on:

1. 21 days of basic pay per year for the first five years of service;
2. 30 days of basic pay per year for any additional years; and
3. Benefits are pro-rated for partial years and capped at two years' total salary.

In the case of expatriate workers, there is no equivalent social security contribution or retirement fund. Instead, every employer is obligated to provision for end of service benefits (EOSB). This is gratuity that is paid to the employee when they terminate their employment.

The payout of the EOSB is linked to each employee's length of service and their final salary. One consequence observed is that some employers pay out the EOSB when employment is terminated under one legal entity and restarted with a new legal entity. The joining date for the employee is then reset to the date they joined their new legal employer. Most employees in this situation are happy to receive a lump sum and few have questioned or challenged their new starting date. For staff with more than five years of continuous service, there is potentially a negative financial impact over the long-term, although there have been no reported cases of expatriates challenging their employer to pay out EOSB and reset the joining date.

Other employers, particularly multinational firms engaging in cross-border transactions, apply a different policy, one aligned with policies that exist in their home markets. The new employer or acquirer assumes no changes to the joining date, thus giving all affected employees the full benefit for their length of service based on their initial joining date with their original employer. When agreeing to such deals, the seller is expected to transfer to the acquirer the EOSB provision on their balance sheet for the staff included in the transaction perimeter.

In EU member states, there is a concept relating to the safeguarding of employee rights during M&A transactions: "The transferor's rights and obligations arising out of a contract of employment or from an employment relationship shall be transferred to the transferee"; in other words, the employment contract is transferred with no changes to the joining date or length of service and without the employee being required to sign additional paperwork. Although in practice, a courtesy letter is sent to the impacted employees, either as a welcome letter from the new employer or as a letter drafted by the transferor, explaining the transaction and the transfer.

Given the current absence of GCC regulations relating to the rights and obligations of employers and employees in the event of M&A or transfers of businesses or parts of businesses, what should HR and M&A advisors recommend to their GCC clients?

The purpose of M&A is to create value. For the seller, it is about focus: releasing tied-up capital to reinvest and focus on core activities. For the buyer, it is about accelerating growth relative to an organic growth strategy. A starting point for any buyer is to retain, integrate, and incentivize newly acquired staff alongside existing staff in a merit-based remuneration structure. To that end, all employers should avoid creating different classes of workers within their expatriate staff population: those who will receive their full EOSB entitlement upon leaving based on continuous employment and others who may receive less due to being impacted by an M&A transaction. Instead, they should look to safeguard employee rights during the M&A process by:

1) Assuring continuity of service to all affected staff.
2) Placing an obligation on the original employer to transfer the EOSB provision on their balance sheet to the new employer for all affected staff.

Much like newly introduced bankruptcy laws in some GCC countries have provided some degree of protection for employees, GCC labor laws must evolve to recognize the prevalence of M&A and the necessity to protect workers impacted by corporate transactions. In the interim, companies and their advisors should plan to transact on the basis that impacted employee contracts are not terminated (although in practice they often are), and ensure that continuity of service is recognized from the date of first employment.

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