

Legal Alert

Due diligence: The value of examining employment documentation before acquiring a business

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Before buying an enterprise, the cautious investor will check its condition by conducting due diligence. The scope and degree of detail of due diligence vary enormously in practice. Sometimes every document is checked, but sometimes only the most vital issues, where the risk exceeds a certain defined amount. Then it is easy to overlook entire fields of activity of the target where it seems unlikely that the risks will exceed the threshold amount. One example is employment. If social insurance contributions are up-to-date, there are no pending disputes concerning overtime, and the salaries do not appear inflated, it may seem to the buyer that there is no danger. But appearances can be deceiving.

Employment matters are a varied field which is worth examining even if a cursory review of the documents supplied by the seller suggests that the risk is below the buyer's threshold value for materiality. For companies from the service industry, human capital is a particularly valuable asset of the enterprise, and any disruptions affecting a group of employees or key personnel can generate significant confusion and cause measurable financial losses to the enterprise. It is impossible to list all situations creating potential risks, but if:

- A significant proportion of employees have a task-based working time and records of their working time are not maintained, the risk of potential claims and disputes surrounding overtime is greatly increased
- Employees are accruing unused annual holiday leave, they may also be exceeding the permissible limits of working hours, thus increasing the risk of potential overtime claims

- There are pending disputes over mobbing or discrimination, it is worth determining whether the suspected offender is a key employee or important specialist and how difficult it would be to part with that person
- Managers, including board members, are at an advanced age, it may be impossible or very costly to remove them because of pre-retirement protections
- The enterprise employs staff mainly under contracts for a definite period providing for the statutory two-week termination notice period, this does not necessarily mean that the termination notice period will be two weeks, because it may turn out that the employment must be treated as a contract for an indefinite period and the termination notice period is actually three months.

The trained eye of a specialist should catch information suggesting what problems exist or may exist and be able to assess the relevant level of risk. While the risk of potential employee claims or disputes cannot be entirely excluded in this way, this can provide the investor with a basis for conducting appropriate negotiations with the seller, for example seeking the right representations and warranties to cover claims that may be asserted against the buyer.



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