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Employment Issues Loom Large in Japanese Mergers

By Michael Chang

In light of the sustained downswing in Japan's economic cycle and the availability for purchase of relatively inexpensive corporate assets, merger and acquisition activity has been on the rise.

In Japan, where lifetime employment is a social norm, the stringent labor laws may not allow for the flexibility of achieving the goals of the intended merger or acquisition. This lack of flexibility may impede, if not frustrate, deals, particularly in the service or retail industries, in which employment-related issues often are the focus.

American and Japanese management philosophies differ fundamentally regarding employment systems. The American at-will employment system provides for labor flexibility by permitting employers to hire employees during times of business expansion and lay them off during recessions. In Japan, by contrast, businesses adopt the social norm of lifetime employment by hiring graduates out of college and retaining them until their retirement.

Under Japanese law, an employee who is not employed under a contract for a specific, fixed period is deemed an employee under a contract for an indefinite term. Most employees of Japanese corporations, or the *Kabushiki Kaisha*, fall into this category, while members of management are likely to hold individual employment contracts. Because the concept of an at-will employment arrangement, where an employer can terminate regular employees at any time without cause, doesn't exist in Japan, the flexibility of personnel movement is severely restricted. Employers cannot terminate employees absent a strong showing of "just cause."

Because of an entrenched set of employment laws that reinforce these norms, employment issues should be evaluated far in advance of a contemplated deal, ideally as part of the structuring of the investment (acquisition of shares, purchase of assets or

establishing of a joint-venture entity). Counsel should raise awareness regarding the treatment of personnel and assist in determining the potential costs incurred as a result of labor issues. In the event of a shutting down of the acquisition target, for example, all employees would need to be transferred, or encouraged to relocate, to the acquiring company.

Counsel should focus on how to assist the acquirer not only to perform due diligence but also, from a business perspective, to spend as much time as possible getting to know the target business, its assets and its management. Trying out a small business deal with the target to test the waters may reveal its attitudes and its culture. Retaining bilingual counsel also helps to reduce misunderstandings and to breed trust with the target management across cultural norms.

The ability to organize post-acquisition employment structures and personnel goals depends largely on the relevant provisions of the target company's employment policies, commonly referred to as "work rules." Work rules are mandated by the Labor Standards Law, and companies must regularly file copies and make them available to employees. Typical work rules define company and personnel policies ranging from the length of the probation period - typically three months - to when an employee must retire and how much retirement allowance an employee is entitled to receive.

Any changes to the work rules should be communicated clearly to the employees. In companies in which the work force is unionized, work rule changes may be conditioned on the union's consent. The process may be subject to significant delay or even rejected by the local labor bureau, which oversees labor relations, if the changes result in a significant reduction of entitlements and benefits.

In a September 2000 case, for example, the Japanese Supreme Court declared invalid

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a work rule change that significantly lowered employee salaries of a specific category of employees, despite the fact that the employer had obtained the consent of a majority of labor union whose membership comprised 73 percent of all the employees.

While a seller's work force may be the main attraction to the potential buyer and, therefore, the buyer may choose to assume altogether the obligations of the target company (including its employment agreements, collective bargaining agreements and work rules), there must be thorough and careful planning so as to allow for maximum future flexibility.

Once the acquirer determines that a division of the target business should be shut down, it has a choice of transferring the employees in that division to another division or making them redundant. While the work rules may provide the flexibility in permitting a supervisor unilaterally to reassign an employee to a different job location, an argument could be made under the Labor Standards Law that a termination without just cause has occurred. The analysis would focus on how far the employee (or his or her family) has to move, the financial inducements offered (such as a relocation package) or the nature of the new position compared to the existing position.

The first step for an employer seeking to reshuffle the target work force would be to explore alternatives such as creating similar jobs with similar working conditions and identical pay and benefits. To avoid running afoul of the Labor Standards Law, the employer should suggest that acceptance of the package is entirely voluntary. Although the government has no notification requirements for offering a voluntary retirement program, failing to conform to procedural requirements will expose the company to government and judicial scrutiny.

Finally, a buyer should examine its obligations under the Health Insurance Act and Welfare Pension Insurance Act to determine its obligations under any company-sponsored pension plans. While investment instruments such as 401(k) and IRA are not widely available in Japan, most Japanese employees are covered under a national pension system that provides coverage for health and medical services in exchange for premiums contributed by way of salary deduction.

The disruption to the work force arising from mergers and acquisitions and the exposure to potential liability (and the ensuing loss of reputation) is a major impediment to a successful merger or acquisition. In any industry in which the work force is an integral part of the business, careful planning and preparation are essential to enable the parties to focus on the benefits of the deal - particularly the human side - and to ensure continued post-deal success in the business operations.

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