Spain

By Yoko Takagi, Javier García Cueto and Juan de Navasqües

The economic crisis has destroyed Spain’s labor market, with the rate of unemployment reaching 19.4 percent at the end of 2009, compared to just 8.3 percent in 2007, and to an average rate across the 16 eurozone countries of 10 percent.

In order to boost the Spanish labor market and to rebuild its credibility, the Spanish government has proposed reforming Spanish labor law so as to encourage employers to use alternatives to dismissal when seeking to reduce the cost of its workforce. This reform proposal is based on the approach taken by Germany in its reform of June 2010, and seeks, among other things:

- To enable employers to reduce employee working hours
- To reduce the burden of severance payments on employers by providing for a state contribution to those costs
- To reduce the use of fixed term contracts
- To increase employers’ flexibility to amend employment terms applicable to their workforces
- To create more opportunities for the unemployed

On June 22, 2010, the Royal Decree-Law 10/2010 (Real Decreto-Ley 10/2010, de 16 de junio, de medidas urgentes para la Reforma del Mercado de Trabajo, or the
The RDL (Real Decreto Legislativo) was approved by the Spanish Parliament. The most significant changes made by the RDL include:

(1) Duration of Fixed Term Contracts
When the RDL comes into force, it will establish a maximum duration for fixed term employment contracts. All fixed term contracts for a specific role or service will be subject to a maximum duration of three years (which may be extended by agreement in certain circumstances by a further 12 months). This does not apply to fixed term contracts that are entered into to deal with specific market conditions, such as seasonal work.

(2) Successive Fixed Term Employment Contracts
Spanish law currently provides that employees who, within a 30-month period, enter into two identical employment contracts with the same employer, each for a term of more than 24 months, automatically become permanent employees. The RDL extends this to employees with contracts for different roles entered into with two entities within the same corporate group.

(3) Severance Payments Due on the Termination of a Fixed Term Contract
The RDL will increase the compensation payable to employees on the termination of a fixed term contract gradually from eight days’ pay (as it is currently) to 12 days’ pay by 2015. This will apply to all fixed term contracts other than training posts or roles providing temporary cover where the temporarily absent employee has a right to return to the role (e.g., maternity cover).

(4) Collective Redundancies
The RDL also changes the grounds on which collective redundancies may be made, and Article 51.1 of the Spanish Employee Statute (Estatuto de los Trabajadores) has been amended accordingly. This amendment defines what is meant by economic, technical and organizational reasons, and a sufficient reduction in productivity, which entitle the employer to make redundancies.

(5) Collective Suspension Schemes and Working Time Reductions
The RDL permits reductions to employees’ working hours for economic, technical and organizational reasons, or due to the reduced productivity of the employer by between 10 and 70 percent of the working time of any given employee calculated on a daily, weekly, monthly or annual basis. This is designed to enable employers to reduce labor costs without having to make redundancies.

(6) Changes in the Dismissal Procedure
The RDL decreases the notice period required to dismiss an employee on objective grounds from 30 to 15 days from the date a termination notice is served. In addition, it is worth noting that a failure on the part of an employer to comply with a fair dismissal procedure will no longer render the redundancy null and void, but will instead make it unfair. This means that an employer will not be forced to continue to employ the employee, but may instead elect to pay them damages.

(7) State Redundancy Payments
The desire to enhance job creation and reduce unemployment has also meant that the Spanish Salary Guarantee Fund will now pay employees a portion of the severance payment which, until now, the employer was liable for. This compensation is equivalent to eight days’ salary per year of employment, provided that the employment contract was entered into after June 18, 2010 and that it was for an indefinite term or, in the case of a fixed term contract, the term was for 12 months or more.

(8) Others
Some other changes brought about by the RDL include:

- Reducing the amount of social security contributions payable by an employer in Spain in certain specific situations (e.g., in relation to young employees or those who were previously unemployed)
- Increasing certain equal opportunity obligations on employers, including the introduction of paternity leave for fathers or same-sex partners of new mothers
- Extending the protections afforded to temporary agency workers in accordance with the requirements of EU law, including by establishing subsidiary liability of the company receiving their services for severance payments, and limiting the use of temporary agency workers in sectors with especially hazardous health and safety concerns (e.g., where a worker may be exposed to ionizing radiation or carcinogenic or toxic agents)

The Spanish Government hopes that these measures will enable employers to think more laterally about their response to the difficult economic climate in Spain, and in particular, that they will be encouraged to think about both alternatives to dismissals and hiring in a downturn. The purpose of the RDL is to improve employers’ confidence in the Spanish labor market, in particular, by increasing the flexibility of labor law, whilst still protecting categories of employees thought to be vulnerable to discriminatory cost-cutting measures.

There are a number of other measures implemented by the RDL, but they are too numerous to be described in this article.
Greece

By Dr. Ilias Mikrouleas of DPIM Papagiannakis Mikrouleas & Associates

Recent labor law reform in Greece has been designed to address both the results of the international financial crisis and Greece’s own fiscal problems. Since October 2009, there has been a loss of market confidence, a widening of yield spread, an increase in financing costs and other challenges to growth and employment. Labor market reform is just one of many structural reforms included in the “Memorandum of Economic and Financial Policies” and the “Memorandum of Understanding on Specific Economic Conditionality”, which have been adopted by the Greek Government and Parliament (Greek law 3845/2010, Government Gazette A 65/6-5-2010) in response to these difficulties and, in the context of the European Union/European Central Bank/International Monetary Fund Stand-By Arrangement with the Greek Government of May 2, 2010, under which a three-year support program was put in place for Greece, providing for as much as €110 billion way of financial support.

Some of the individual labor law amendments have been already enacted through law 3863/2010 (Government Gazette A 115/15-7-2010), lessening the level of employee protection afforded by employment legislation, in particular in relation to collective dismissals, minimum wages, overtime premia and collective agreements. Further amendments are planned. The most significant changes are described below.

(1) Wage Bargaining and Employment Disputes

Changes to the collective bargaining and arbitration systems have been among the most controversial issues of the agenda for labor market reform. The only legal change made in this area so far has been to permit the adoption, at a later stage, of a presidential decree making the required amendments.

The following measures have been proposed:

- Regional agreements would be able to set lower wage increases than the relevant sectoral agreement.
- Employer-level agreements would override regional agreements, which in turn would take precedence over sectoral agreements, and these employer-level agreements may introduce variable pay linked to the employer’s productivity.

The Greek government also plans to improve the legal framework for arbitrating employment disputes. At present, a trade union may unilaterally request arbitration if an employer does not accept the preceding mediator proposal. In this case, the decision of the arbitrator will bind the employer even if it has not taken an active part in the arbitration proceedings. The proposed reform would mean that both the trade union and the employer could seek arbitration following an unsatisfactory mediator proposal.

Minimum Wages, Overtime Premia and Collective Dismissals

The agenda for labor market reform introduces some exceptions to the minimum wage rules, providing for lower minimum wage levels for categories of workers thought most at risk by rising levels of unemployment, such as those under the age of 25 and the long-term unemployed. This is designed to increase their employability.

Overtime rates have also been reduced and collective dismissal thresholds (above which dismissals are prohibited) have been raised, in both cases for all employees, in an effort to boost employment rates.

Legislation for Employment Protection

The amendments to employment protection legislation extend the maximum period of probationary employment for new employees in Greece to one year, facilitate greater use of temporary and part-time contracts and enhance employer flexibility in the management of working time. The overall level of severance payments is to be reduced for both blue and white collar employees. The minimum notice period employers in Greece are required to give employees has been shortened.

In addition, the Greek government has made a commitment to fix the current minimum wages for the next three years (although this requires the agreement of respective parties to Greek collective bargaining agreements which govern wages).

Social Safety Net

The Government plans to reform the welfare state so as to improve its protection for those deemed most vulnerable in the current economic
climate, including the young and the long-term unemployed. The Government is also seeking to reduce the level of undeclared work by amending the registration requirements that apply to employees when they first start working.

The Greek government hopes that these measures will promote growth and competitiveness. The philosophy behind the reforms seems to be that "unleashing growth potential requires pursuing a genuine competition culture and ensuring collective bargaining institutions that deliver wages commensurate with productivity" (as stated in the revised Government Memorandum of Economic and Financial Policies of August 6, 2010). Implementation of the labor market reform agenda in Greece is just beginning — the coming months will be crucial in assessing the impact and success of the steps already taken and in planning the next ones.

The UK

By Stephen Brown and Kathryn Donovan

The UK Government's austerity measures to date have focused on pay and benefits in the public sector:

(1) Capping Civil Servants’ Redundancy Pay

The Civil Service Compensation Scheme is a statutory scheme which provides compensation for compulsory and voluntary redundancies affecting civil service employees. At present, payments equivalent to up to six years' pay can be made under the scheme, an arrangement which one UK government minister has described as "untenable" in the current economic climate.

Under proposed new legislation due to be enacted in November, payouts for compulsory redundancies would be capped at 12 months’ pay and those for voluntary redundancies at 15 months’ pay. This new legislation would effectively override a recent High Court decision in which one civil service trade union successfully challenged attempts by the previous government to reduce civil service redundancy benefits without their agreement. Unions have threatened strike action if the new plans go ahead.

(2) Public Sector Salary Freezes and Publication

A two-year pay freeze beginning in April 2011 was announced in the June 2010 Budget, though low paid public sector workers (those who earn £21,000 or less) will get a flat rate pay increase of £250 a year.

The UK government also plans to publish details of every public sector employee paid more than Pay Band 1 of the Senior Civil Service Pay Scale (around £60,000), and any public sector employee paid more than the Prime Minister (currently £142,500) must have their salary signed off by the Treasury.

(3) Reducing Defined Benefit Pension Entitlement in Public Sector Pension Schemes

In June 2010, the government announced that an independent commission will undertake a fundamental structural review of public service pension provisions in the UK. At present, a number of those plans provide members with a defined benefit, based on years of service and salary at retirement. These plans are exceptionally expensive for the public sector employers, who bear the performance risk of the plans' investments i.e., if the pension is not sufficiently funded to pay the pension, the employers are liable for the shortfall.

It has been suggested that public sector organizations will need to follow the lead of private companies, many of which have altered their arrangements for both future and existing members, such as closing their final salary plans and setting up defined contribution plans in their place (where the employer’s liability is fixed).

A report published in July this year gave a series of recommendations including:

• Pensions should accrue benefits at one 80th of final pay for every year employees belong to the scheme, not one 60th. This would cut the cost to the public purse by £10bn a year
• Increasing the plan pension age from 60 to 65 for all members, saving £5bn a year
• Increasing employee contributions by 2 percent, raising up to £2bn a year
• Considering amendments to the plans so that they provide for a mixture of defined benefits and defined contributions, rather than just defined benefits

The government has also proposed amending the basis on which benefits are revalued to take account of inflation, so as to use a lower (and less expensive) basis.
The US

By Linda Inscoe

Some federal agencies and state and local governments in the United States have responded to the economic downturn with a combination of measures, including wage and hiring freezes, furloughs and layoffs. In addition, public employee salaries and benefits are coming under increased scrutiny, and governments are under pressure to negotiate concessions that lower pension benefits for new employees and increase employee contributions toward their retirement savings and other benefits.

(1) Public Sector Hiring Freezes and Salary Increase Restrictions

In August, the US Postal Service announced a freeze, until further notice, on hiring and promotions for management-level positions at post offices, field offices and the Postal Service’s Washington headquarters. The move impacts about 8,000 positions, including 2,000 vacancies. The Postal Service estimates that the freeze will save up to US $30 million per quarter.

In May 2010, the Federal Workforce Reduction Act was introduced in the House of Representatives by Republican lawmakers. If enacted, the bill would establish a federal hiring freeze (with exceptions for national security agencies, the Department of Defence, the Department of Human Services and the Veteran’s Administration) in every year in which the Director of the Office of Management and Budgets projects a Federal budget deficit.

A majority of states have already adopted temporary hiring freezes in an effort to manage spending or balance state budgets; and a number, including Washington, Pennsylvania, Louisiana, Montana, Nebraska and North Carolina have taken steps to freeze or limit salary increases for state workers.

(2) State Furloughs and Layoffs

In a recent report, the National Governors Association and the National Association of State Budget Officers noted that 22 states furloughed government employees, and 25 laid off workers during fiscal periods from 2009-2010. So far in 2010, 13 states have furloughed employees, and 19 have undertaken layoffs.

Perhaps the greatest furor has been over furloughs ordered by California governor Arnold Schwarzenegger, in an effort to tackle a US $19 billion State budget deficit. Governor Schwarzenegger has imposed nearly 50 unpaid furlough days, affecting hundreds of thousands of state workers, since February 2009. The controversial furloughs have reportedly saved California US $2 billion to date, but they have also generated a storm of litigation. Some 40 lawsuits have been filed challenging the Governor’s authority to order the furloughs under the terms of applicable collective bargaining agreements, and without authorization from the California legislature. One trial court upheld a challenge to the furloughs filed by unions representing State workers, a decision that was upheld on appeal but overturned by the California Supreme Court earlier this month.

(3) Increased Scrutiny and Negotiation of Public Employee Salaries and Benefits

Public employee pay and benefits are coming under increased scrutiny by taxpayers and cash-strapped government employers. Some analysts have concluded that Bureau of Labor Statistics (BLS) data regarding salaries received by employees of the federal government, show that these public sector employees earn significantly more than their private sector counterparts. The differential is even more dramatic when comparing the value of health, pension and other benefits received by Federal and private sector employees. The BLS data shows that, in 2008 (the most recently year for which data is available), the average value of employee benefits was US $40,785 per federal employee, and less than US $10,000 per private sector employee. State and local government employees on average also earn more than their private sector counterparts when the value of benefits is included; and many state and local governments have promised their employees pensions that are grossly underfunded.

Legislators in a number of states have reacted to increased scrutiny of public sector pay and benefits by passing legislation that:

• Requires public sector employees to contribute a portion of their salaries toward healthcare benefits (New Jersey)

• Reduces public pensions for new hires (including Colorado, Illinois, New Jersey and New York)

In California, bills have been introduced that, if passed, would require increased disclosure of local government employee pay, limit pension-spiking by existing employees (a process whereby public sector employees receive significant raises or otherwise artificially inflate their earnings in the years immediately preceding retirement in order to increase their pension entitlements), and scale-back pensions for newly-hired government employees.

Finally, many government employers are negotiating concessions with public sector employee unions, as the less attractive alternative to closing the budget gap is, in many cases, layoffs.
Bonuses and Other Variable Pay Components: A Comparison

By Norma Studt, Sarah Dunkley, Lionel Vuidard and Carol Samaan

With the year-end fast-approaching, many employers are turning their attention to bonus arrangements for 2011. Latham & Watkins’ attorneys in Germany, France, the UK and the US consider some key concepts and drafting issues applicable to bonus agreements.

1. What are bonuses? How do they differ from commission?

The term “bonus” does not have a prescribed legal meaning, and may be used to refer to a number of different incentive arrangements. There is a distinction in all of the jurisdictions discussed here between a bonus (which often takes the form of a cash payment made in recognition for good performance over a particular period) and commission (which usually refers to an incentive arrangement where employee is paid a percentage of the profit that is earned by his employer as a direct result of his work).

In Germany, the term “commission” has its own legally-defined meaning, and there are rules governing its payment with which employers often fail to comply. These rules do not apply to bonuses.

In France, in addition to bonuses and commission (neither of which are defined in French law), employers are encouraged, and sometimes bound, to offer collective profit-sharing schemes to their employees. Unlike regular bonuses and commission, these schemes are exempt from social security contributions.

2. What is the degree of employer discretion permitted in bonus plans or arrangements?

As stated above, bonuses are usually performance-related, but employers often provide for at least an element of discretion in the value of bonus payments. For instance, an employee may have qualitative bonus objectives — to improve client relationships, for example — as well as quantitative ones, such as ensuring turnover exceeds a set target during the performance period. In a number of jurisdictions, case law and regulations have developed to restrain the level of employer discretion in these circumstances.

In Germany, the purpose of a bonus affects the degree of an employer’s flexibility and the extent to which the German labor courts will interfere with an employer’s assessment of the bonus award. In particular, performance-related bonuses are regarded as an essential element of remuneration, and there are strict rules derived from case law concerning them.

In France, employers traditionally have enjoyed wide discretion as to whether to pay occasional bonuses, to determine the amount and to select who will be eligible for bonuses. The ambit of that discretion has since been reduced by terms in employment contracts, collective bargaining agreements and employer initiated bonus plans. When a bonus is paid pursuant to a plan, it must be paid pursuant to the plan’s terms and conditions, which must be objective and precise.

Moreover, according to recent French case law, each employee must be able to verify that the calculation of their bonus is compliant with the terms and conditions of the bonus plan, and so must be provided with the bonus calculation formula and details of any individual or group performance targets. If this is not provided, then the conditions will not be enforceable, and 100 percent of the target bonus will be payable.

In the UK, a bonus may be described as being entirely discretionary, in which case an employee will have difficulty proving a contractual right to the bonus. In practice, however, bonus plans are often only partly discretionary, allowing employees to dispute the way in which an employer’s discretion is exercised. For example, if an employer has expressly reserved an element of discretion in the UK and Germany, when determining if performance targets have been met or the value of bonus that a particular level of performance will trigger, that discretion must exercised in good faith, and not in a manner that is perverse or irrational. The UK courts may award damages to an employee for the amount that the court considers likely to be payable on the fair and rational exercise of discretion, however, there is no requirement for the exercise of the employer’s discretion to be “reasonable,” and the English courts are generally reluctant to substitute their judgment for that of the employer.
In the US, an employer can design a bonus to be entirely discretionary, with or without specific performance conditions set out in the bonus award and if so, an employee generally will not have a contractual right to receive it. However, if a bonus is guaranteed upon achievement of certain criteria, the employee may have a contractual right to it if the terms of the award are fulfilled. State wage and hour laws may also apply in determining whether a bonus has been earned and must be paid, in whole or as a pro-rated basis.

In France, the UK and the US, custom and practice may limit the ambit of an employer’s apparent discretion as to how performance is measured. If an employer has consistently used a particular method to assess performance over a number of bonus cycles, and with does not reserve discretion to do otherwise, then its employees may argue that they have an implied right to have their performance measured in that way. In Germany, if an employer has paid a discretionary bonus without reserving sufficient right not to, then the employees may argue that they have an implied right to be paid a bonus in the future.

3. Can an employer clawback or cancel a bonus?

In Germany, performance-related bonuses may be cancelled if: (a) there is specific language entitling the employee to do so in the contract or bonus plan, (b) the employer’s cancellation right concerns no more than 30 percent of the total remuneration value, and (c) the exercise of the right of cancellation is lawful and fair in all other respects. It is therefore difficult for employers in Germany to enforce a cancellation right. Though discretionary bonuses can be subject to clawback in certain circumstances, there has been no case law to provide guidance on whether even performance-related bonuses may be clawed back.

In the UK and the US, as set out in previous edition of The Working World, and in France, including language in a bonus plan or clause of an employment contract which purports to entitle the employer to “clawback” or reclaim some or all of a bonus in specified circumstances is controversial, and the enforceability of such a clause may be challenged by employees on a number of grounds. In the UK and in France, these include challenges on the basis that the clawback provision may be an unenforceable penalty or an unreasonable restraint of trade. In the US, such a clause may be challenged on the basis that a clawback provision is an unenforceable recoupment of wages under certain state laws. Additionally, in the US, the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act (see Article on page 11) may cause a company that fails to adopt a clawback policy providing for the recovery of incentive compensation from executive officers in the event of an accounting restatement due to the company’s material noncompliance with financial reporting requirements to be prohibited from listing the company’s securities on a national securities exchange in the US.

4. What is the impact of garden leave on an employee’s bonus entitlement?

In Germany and France, where an employer puts an employee on garden leave during the employee’s termination notice period, the employee is entitled to the same amount of bonus as if he had worked during his notice period.

In the UK, this depends on the drafting of the bonus and garden leave provisions in the employee’s contract of employment. A well-drafted contract will make it clear that an employee will not be eligible for a bonus if he is under notice on the bonus payment date. Alternatively, if an employee is entitled to a pro-rated bonus, such as when employment terminates part way through the bonus year, the garden leave clause should specify that while the employee is on garden leave, he will not accrue service for that bonus.

In the US, garden leave is rarely imposed upon an employee and instead, employers tend to rely on non-competition covenants in the employment contract (although in recent times the use of garden leave by employers has increased, and generally upon similar terms to the UK).

5. What is the impact of the termination of the employee’s employment on his bonus entitlement?

In Germany, employers were historically only permitted to pro-rate a bonus if an employee’s employment was terminated before the end of the bonus performance period. However, recent developments suggest that German employers may be able to stipulate in the bonus plan that the entire bonus will be forfeited if the employee is not employed for the entire performance period.

In the UK, the US and France, ideally the bonus clause or plan will specify that a bonus will only be payable if the employee is currently employed and has not given or received notice to terminate their employment on the bonus payment date, or alternatively that a pro-rated bonus is payable in these circumstances. In France, however, even with provision for non-payment/pro-rated payment of a bonus, an employee would be able to claim back the bonus if the termination is without cause.
In the UK, if this is not provided for clearly in the bonus provision, an employee may argue that he is entitled to receive a bonus equivalent to what he would have been paid if his employment had not been terminated by the employer part way through the bonus year.

In France, particular attention must be paid to the statutory prohibition on the implementation of “monetary sanctions” on employees.

6. How do equal treatment principles impact on bonuses?

German, French, the US and the UK labor laws apply the principle of equal treatment, with the result that the different treatment of comparable employees is prohibited unless it can be objectively justified. In these jurisdictions, as with all employment-related pay and benefits, bonuses should not be awarded, designed or applied in such a way that could be discriminatory on the grounds of sex, race, disability, sexual orientation, religion or belief, or age. In particular, care should be taken when determining bonus eligibility for employees who have been absent for part of the bonus year due to maternity leave as the risk of a sex discrimination claim in relation to this is high. In addition, employers should be careful of inadvertently discriminating against fixed term and part-time workers when designing and implementing bonus plans.

7. Are there any rights of unions or employee representatives with respect to bonuses or bonus schemes?

In Germany, many collective bargaining agreements provide for the payment of Christmas and vacation allowances, and some also provide for performance-related allowances (particularly in the manufacturing and piece-work sectors). Otherwise, performance-related bonuses are normally granted on company level, which is, without the works council’s co-determination right (if there is a works council), only possible where there is no bargaining agreement which covers, or typically covers, this.

A works council’s co-determination right may be relevant where a bonus arrangement applies to more than one employee, particularly in relation to the introduction or modification of such arrangements. This co-determination right applies to, among other things, performance assessment standards and their application, and the distribution of a fixed bonus pool among a number of employees. Any agreement between the employer and the works council must be recorded in writing, and if they cannot reach agreement, the matter must be referred to the reconciliation board whose decision will be binding. An employer must allow time for bargaining on bonus arrangements, which may take a number of months. It is common practice for both the employer and the works council to have legal counsel throughout this process, and an employer would be well-advised to do so.

In the UK and the US, unless a collective agreement specifically states that it governs the terms of employees’ bonuses, bonus rights are simply contractual between the employee and the employer. In the UK, it is generally more common in the public sector to find collective bonus agreements than in the private sector.

In France, the works council may need to be informed and consulted before collective remuneration schemes or structures are implemented or substantially modified. In addition, companies with trade union representation must conduct annual negotiations on remuneration, including bonuses, with those unions, during which time an employer is prohibited from making any unilateral decisions that would impact collective terms of remuneration, such as bonus plans.

8. How are bonuses regulated in these jurisdictions?

In Germany, while there are strict legal obligations regarding when an employee becomes entitled to a bonus and limiting an employer’s discretion in relation to adjusting performance targets, there are no legal requirements capping the value of bonus payments. Pursuant to the 2009 German Act on Board Member Remuneration, the remuneration of a board member must be “appropriate,” not only in relation to the company’s performance and sector, but also with regard to the board member’s individual performance.

In the UK, there are broadly two forms of employee whose bonus arrangements are subject to regulation: (i) board directors and (ii) employees of financial institutions whose activities influence the risk profile of those institutions.

In the first case, there are a number of disclosure and reporting obligations set out in the Companies Act 2006, the Listing Rules (applicable to companies listed on the Main Market of the London Stock Exchange) and the Combined Code (a code of good corporate governance practice). The more stringent obligations apply to companies listed on the Main Market, including that they are required to explain, in their annual report and accounts, the extent to which their remuneration practices comply with the Combined Code, and to explain any non-compliance. The Combined Code requires that executive remuneration must be sufficient to attract, retain and motivate the
executives but that companies should not pay more than is necessary. Furthermore, a significant proportion of the directors' pay must link individual and company performance to reward, and be "designed to enhance shareholder value."

As for the second group of employees, the UK Financial Services Authority's Remuneration Code applies to the largest banks, building societies and broker-dealers in the UK (currently 26 entities) and requires that their remuneration policies be consistent with effective risk management. This is both a rules and a principles-based code, and it applies to the remuneration of employees who perform significant influence functions and whose professional activities could have a material impact on the company's risk profile. Draft revisions to this code are currently being considered, and these could significantly expand its scope and application. For example, the new proposals include rules on deferring 40 percent of bonus payments, with that percentage increasing to 60 percent for bonuses of £500,000 or more.

In the US, bonuses may be subject to a number of rules, including rules that affect the employer's ability to deduct bonuses for tax purposes and the timing of bonus payments.

Section 162(m) of the US Internal Revenue Code generally imposes a US $1 million limit on a publicly-traded corporation's tax deduction for compensation paid or accrued for each of the corporation's "covered employees," which include the corporation's "principal executive officer" and the three most highly-compensated executive officers (other than the principal financial officer). This limit does not apply to "qualified performance-based compensation," which, in the case of a bonus, means that the bonus is payable solely upon the attainment of performance goals and meets certain other requirements under Section 162(m). If, however, the facts and circumstances indicate that an executive would have received all or part of the bonus regardless of whether the performance goals are attained, the bonus will fail to be qualified performance-based compensation.

Under the recently enacted Patient Protection and Affordable Care Act, bonuses payable to officers, directors and employees of certain health insurers may be subject to additional deduction limits under Section 162(m).

As discussed in the January 2009 edition, additional compensation standards, disclosure requirements and deduction limits apply to bonuses payable to certain executives of financial institutions participating in Troubled Assets Relief Program.

As considered in the June 2009 edition, Section 409A of the US Internal Revenue Code imposes rules relating to when deferred compensation, which may include bonuses that are earned and vested in one year but payable in a following year, is paid. Deferred compensation that fails to comply with Section 409A generally is subject to US federal income taxation at the time the compensation vests, including an additional tax. Many bonuses are structured to be paid in a manner that satisfies the "short-term deferral" exemption under Section 409A, so that compensation will not be treated as deferred compensation so long as it is paid on or before the 15th day of the third month of the year following the year in which the employee's right to the compensation vests.

State wage and hour laws may impose additional requirements on the payment of bonuses.

In France, the amounts payable under bonus plans are not usually capped, though there are some industry specific regulations. As in the UK, risk management obligations pertaining to remuneration policies have been imposed on banks and financial institutions pursuant to an order of the French Ministry of November 3, 2009.

9. How should bonus provisions be drafted?

In Germany and France, bonus arrangements are normally set out in the employment contract or in a rider to that agreement. In Germany, bonuses are afforded the protections which the law accords to all employee remuneration, including the assumption that they should be drafted precisely and clearly, and a failure to do so will mean ambiguities are interpreted in the employee's favor. In France, documents relating to bonus arrangements should generally be drafted in French or a French version should be provided.

In the US and the UK, the content of the bonus clause is more important than its location. However, prudent employers include only minimal bonus provisions in an employment contract — for example, a clause stating that the employee may be eligible for an annual bonus at the board's discretion. Any specific terms such as performance targets or maximum/minimum bonus amounts could then be set out in a separate bonus plan updated annually to give the employer more flexibility over the terms of the bonus entitlement from year-to-year, and prevents the need for employee consent to revise the terms of the employment contract.

As a general rule, the less specific the provision, the less likely it is to create a contractually binding obligation on the employer to pay a bonus to the employee. However, if a bonus provision is too vaguely drafted it may not be sufficient incentive for employees.
Latham & Watkins’ attorneys Jane Ng in Hong Kong, and Yoko Takagi and Javier García Cueto in Spain, share observations below on the legal regimes concerning bonuses in their jurisdictions:

**In Hong Kong**, employees are not legally entitled to a bonus unless it is specifically provided for in the employment contract. However, it is common for Hong Kong employers to provide for an “end of year” payment to employees — sometimes referred to as a “13th month payment” or “double payment” — which is often paid around Chinese New Year. Employers are free not to provide for an “end of year” payment, but if they do, then the Employment Ordinance regulates the amount and timing of that payment. When employment terminates, the employee is entitled to the “end of year” payment on a pro-rated basis.

**In Spain**, there is no specific regulation of bonus schemes, which gives welcome flexibility to employers. The key points are:

- Bonuses may be set out in employment policies, collective bargaining agreements and/or individual employment contracts.
- Spanish law prohibits discrimination on the basis of sex, race, disability, sexual orientation, religion or belief, or age. Employers are therefore well-advised to use clear, objective bonus targets, and to avoid using bonus arrangements that depend entirely on their discretion.
- Where a bonus arrangement provides for an employer to determine applicable performance targets, an employee will not be entitled to the target bonus if he disputes the fairness of the bonus objectives. However, if his employer fails to set the bonus criteria or the target bonus value, the employee is entitled to receive the bonus, and the Spanish court will determine the appropriate amount.
- A bonus forms part of an employee’s “salary” for both labor law and social security purposes, and so must be taken into account in the calculation of severance payments unless the employee leaves voluntarily or was fairly dismissed before the bonus accrual period ended.
- Spanish practice allows for complex remuneration schemes in which a bonus may be linked to other incentives. Such schemes are common in management buy-outs, where bonuses may be combined with debt and equity-linked participation programs, sometimes based on envy ratios or ratchets (otherwise known as “sweet equity”, whereby management have a right to purchase equity at a discount so as to encourage them to improve the value of the equity on exit).
The Dodd-Frank Act: An Overview of the Corporate Governance and Executive Compensation Provisions

By David Taub and Carshae Dahl

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act), which was signed into law on July 21, 2010, significantly reforms the US financial services industry. In addition to its sweeping financial regulatory reforms, the Act includes important executive compensation and corporate governance provisions that will affect all US public companies.

In general, the Act authorizes the SEC and national securities exchanges to adopt rules that will, within one year after the date of its enactment (and six months after enactment in the case of say on pay), prohibit the listing of any US public company that fails to adopt the new standards. These new requirements are likely to increase shareholder influence on executive compensation and corporate governance matters in upcoming proxy seasons. The SEC recently announced its tentative rulemaking schedule under the Act and although subject to change, it suggests that the only governance and compensation rules described in this article that will be in effect for 2011 proxy season, will be the “say on pay” provisions. Below is a brief summary of the key corporate governance and executive compensation provisions contained in the Act.

Shareholder Voting and Access

Advisory Vote of Executive Compensation: “Say on Pay.” Every public company must include, in its proxy materials for its first shareholder meeting held after January 21, 2011, a separate non-binding shareholder advisory vote on named executive officers’ compensation. In addition, beginning with the first shareholder meeting after January 21, 2011, and at least every six years thereafter, companies are required to seek a shareholder vote on whether its “say on pay” vote should be held annually, biennially, or triennially. These requirements do not apply to US-traded foreign private issuers.

Say on Pay: Golden Parachute Vote. Public companies must include a separate non-binding shareholder advisory vote on executive change in control payments in proxy statements or consent solicitation materials where shareholders are voting on an acquisition, merger, consolidation or proposed sale or disposition of all or substantially all of the company’s assets. The company is required to clearly and simply describe the change in control compensation arrangement and disclose the aggregate amount of such compensation for each named executive officer. The rules apply to any proxy or consent solicitation for meetings occurring after January 21, 2011. The separate advisory vote to approve the golden parachute payments is not required if such payments have already been subject to a general “say on pay” vote.

Voting by Brokers. Effective as of January 2010, NYSE Rule 452 eliminated broker discretionary voting without instruction from the beneficial owners of the shares. The Act expands this prohibition by proscribing broker discretionary voting with respect to elections of directors as well as with respect to executive compensation matters and any other matters deemed significant by the SEC.

Proxy Access. The Act authorizes, but does not require, the SEC to adopt proxy access rules which allow shareholders to use the company’s proxy materials to nominate a slate of directors in opposition to the company’s candidates for election. On August 25, 2010, the SEC adopted final rules that generally provide proxy access to shareholders who have held at least three percent of the voting power of the company’s securities continuously for at least three years. For a more detailed discussion of the SEC’s new proxy access rules, see our Client Alert co-authored with Georgeson.

Other Executive Compensation Provisions

Independence of Compensation Committees and Authority over Compensation Consultants. The Act directs the SEC to adopt, no later than July 16, 2011, rules...
requiring compensation committee members to be “independent.” In defining independence, securities exchanges must consider both the sources of any compensation paid to committee members (including any consulting, advisory or other compensatory fees) and whether the committee members are affiliated with the company, its subsidiaries or affiliates. The independence requirements will not apply to controlled companies, foreign private issuers that disclose why they do not maintain an independent compensation committee and certain other specified entities.

In addition, effective for shareholder meetings held after July 21, 2011, public companies must disclose:

- Whether the compensation committee retained or obtained advice from a compensation consultant
- Whether that work caused a conflict of interest, and if so, the nature of the conflict and how it was addressed

It is unclear whether the additional requirements related to the disclosure of compensation consultants and other advisors will also apply to foreign private issuers.

**Clawbacks.** The Act requires that US listed public companies adopt and implement clawback policies pursuant to which incentive based compensation (including stock options) will be recovered from current and former executives in the event of an accounting restatement as a result of material noncompliance with financial reporting requirements. Such amounts will be recoverable for the three-year period preceding the date the company is required to prepare the restatement, and the amount subject to clawback will equal the excess of what would have been paid as a result of the restatement. Unless addressed in future rulemaking, it is unclear whether foreign private issuers will be subject to the clawback policies required by the Act.

**Enhanced Proxy Disclosure Requirements**

**Executive Compensation Disclosures: Pay for Performance and Internal Pay Equity.** Public companies will be required to disclose information detailing the relationship between executive compensation actually paid and the company’s financial performance, taking into account any change in stock value, dividends and any other distributions. In addition, public companies must disclose:

- The median annual total compensation for all employees (except the CEO)
- The annual total compensation of the CEO
- The ratio of the CEO’s compensation to the median

**Disclosure of Employee and Director Hedging.** The Act requires the SEC to issue rules requiring public companies to disclose whether employees or directors are allowed to purchase financial instruments (including prepaid variable forward contracts, equity swaps, collars and exchange funds) to hedge against a decrease in the value of the company’s equity securities.

**Disclosures Regarding Chairman and CEO Positions.** The Act directs the SEC to adopt rules requiring public companies to disclose the reasons why the same person has been chosen to serve as board chairman and CEO or why different individuals have been chosen to fill each position. Such SEC rules must be adopted within 180 days following the enactment of the Act. Current proxy rules already require similar disclosure, and it is therefore not clear whether the Act will mandate any additional disclosure.

**How Foreign Private Issuers are Affected**

In general, foreign private issuers are exempt from the provisions of the Act that are effected through the US proxy rules or the Regulation S-K, Item 402 rules regarding executive compensation. Accordingly, foreign private issuers are not subject to the “say on pay” and golden parachute advisory vote requirements or the new disclosure requirements with respect to executive compensation, hedging, and Chairman/CEO structure. As stated above, it is unclear whether the required clawback provisions set forth in the Act will apply to foreign private issuers.

**Conclusion**

The Act endeavors to increase the transparency of the reporting of compensation paid and payable to senior executives, and to enhance stockholders’ ability to challenge executive compensation packages that are not sufficiently aligned with stockholder priorities. It remains to be seen whether stockholder activism will increase as a result of the new rules and whether the Act will have a notable impact on the level and design of executive compensation of US public companies and foreign public companies trading in the US.
The UK Pensions Regulator Flexes Its Muscles

By Catherine Drinnan

The UK Pensions Regulator (the Regulator) has been active over the summer, using its powers to issue contribution notices (CNs) and Financial Support directions (FSDs) to protect the members of underfunded UK defined benefit pension plans. These powers allow the Regulator to make parties that are “connected or associated” (a wide definition that includes group companies and directors, and potentially lenders in some cases) with the plan employer liable for the plan’s underfunding. FSDs require support arrangements to be put in place for the pension plan, and CNs require a direct payment of money into the plan. The Regulator can issue CNs in respect of acts that occurred up to six years previously, and FSDs up to two years after connection with the plan has ceased. It must be “reasonable” for the Regulator to act.

Prior to this summer, the Regulator had never issued a CN and had only issued two FSDs (both to the same company). Its uses of both these powers this summer were in situations where the plan employer had entered administration. If a UK employer is subject to insolvency proceedings, including administration (where it is hoped the company can be rescued or the company’s assets sold), and the pension plan is underfunded, the UK Pension Protection Fund (PPF) commences an assessment process whereby it determines whether it can take on responsibility for the pension plan. One of the Regulator’s stated aims is to minimize calls on the PPF.

FSDs

In June, the Regulator decided to issue FSDs against 25 entities in the Nortel group (including in Canada, the US and Europe) after it entered insolvency proceedings in a number of jurisdictions, including the UK. Nortel Networks UK Limited (Nortel UK) was the plan employer, and the PPF would therefore potentially have to take over the plan.

The Regulator determined, when considering whether it was reasonable to act, that other Nortel companies had received substantial benefits from Nortel UK over the years, such as its services being provided to them at an undervalue and interest-free loans. Management decisions high up the corporate chain resulted in group funds being held back instead of using them to cover the pension deficit. The Regulator also found that the group in reality acted as a single global entity.

It is expected the FSDs will require support to be put in place for the full £2.1bn deficit. Interestingly, the US and Canadian entities had already obtained orders in their bankruptcy courts that any FSD issued would be void, so it will be interesting to see how this plays out.

CN

The Regulator has also now issued its first CN, against Michel Van De Wiele NV (VDW), the Belgian parent company of Bonas UK Limited (Bonas), a UK company with an underfunded defined benefit pension plan.

Bonas was in a precarious financial position, and Bonas and VDW started to investigate ways of keeping the business running while dealing with the issue of the underfunded pension plan. They decided that Bonas would enter into a pre-pack administration, whereby a VDW group company would buy its assets, but the pension plan liabilities would be left behind. The Regulator found that one of the main purposes of this was to prevent the recovery of a debt which was or might become due to the pension plan, and therefore it issued a CN demanding £5m against VDW. £5m was the value of the PPF deficit in the plan (a lower measure than the full buy-out deficit).

The Determinations Panel of the Regulator stated that this sum was reasonable because Bonas and VDW had previously considered that paying off the PPF deficit would be the likely price for clearance from the Regulator or agreement with the trustees. In reaching its decision, it took account of VDW’s financial position, its close involvement with the pre-pack sale, its association with the plan through its involvement with Bonas’ finances and its control of Bonas. We understand VDW has appealed the decision.
Foreign-invested Enterprises in China May Now Face Pressure to Enter Into Collective Labor Contracts

By Qiong (Lucy) Lu

Collective labor contracts, being contracts which award certain rights to all employees of a particular employer, have been recognized by PRC regulations for 15 years. However, it was not until recently that the PRC governments began to strongly promote this following labor unrest in China and in response to the financial crisis. On May 5, 2010, a joint notice was issued by the Ministry of Human Resources and Social Security (MOHRSS), the All-China Federation of Trade Unions (ACFTU), which is controlled by the Chinese government, and the Chinese Enterprise Association/Chinese Entrepreneur Association (the Notice), urging the use of collective labor contracts and the implementation of the Rainbow Plan. The Rainbow Plan was introduced by the MOHRSS as long ago as April 2008, with the hope of increasing collective consultation and collective labor contracts in eastern China by 2009, the middle of China by 2010 and throughout China by the end of 2012.

The Notice particularly emphasizes that there should be collective consultation on wages, and sets out the following aims:

• By 2012, all entities that already have a trade union shall have entered into collective labor contracts, with at least 60 percent of them having done so by the end of 2010 and at least 80 percent by the end of 2011; and

• By 2012, those small entities that do not have a trade union shall have entered into a regional or an industry-wide collective contract.

The Notice also provides that if an entity’s trade union (that a trade union which is run by the entity’s employees) has difficulties in presenting a consultation offer to the employer, then the relevant local counterpart of the ACFTU may present the consultation offer to the employer on that trade union’s behalf. If an entity does not have a trade union, the relevant local counterpart of ACFTU shall assist the employees to select their representatives and to present the consultation offer to their employer.

Following the central government’s promotion of collective labor contracts, some local governments, including those in the Tianjin, Guangdong and Heilongjiang provinces, have issued detailed rules on the procedures for collective consultation and the agreement of collective labor contracts. It is likely that more local governments in the PRC will follow their lead.

While it is not mandatory for employers in China to enter into collective labor contracts, foreign-invested enterprises in China, with or without a trade union, may now face pressure from the PRC governments to enter into collective labor contracts, and therefore they would be well-advised to familiarize themselves with the relevant regulations so as to enable them to manage union or workforce requests for collective consultation, in accordance with the Rainbow Plan.
Anonymous Job Applications in Germany and in France

By Norma Studt and Matthias Rubner

Job applicants in Germany usually send a “complete application dossier” to the prospective employer which includes their name and age or date of birth. Surveys show that foreign applicants or those with names that may not sound typically German, may be less likely to be invited to job interviews. In other cases, applicants who disclose their age may be rejected even if they have all the necessary qualifications, and female applicants may be discriminated against, especially if the employer suspects they are likely to have children.

The German Anti-Discrimination Board is running a pilot project to encourage job application dossiers that do not include names, ages and dates of birth. The pilot group includes three German DAX companies and two international companies. The project has received a mixed response, and even those supporting it have expressed concern that discrimination may simply be shifted to the job interview stage of the hiring process. However, it will be interesting to see whether the project will put pressure on German employers to adopt anonymous recruitment practices or encourage the German legislature to require this.

The French Parliament decided back in 2006 that job applications and, in particular, CVs of job candidates should be anonymous. To this effect, the law of March 31, 2006 “promoting equal chances” obliged companies with a headcount of at least 50 to delete from job applications certain information that could lead to discriminatory recruitment decisions, before such job applications can be passed along to the relevant decision makers within the company. The practicalities of this “anonymization” process were to be set forth by decree… but no decree was ever published. Therefore, this part of the law could not be applied.

Despite the absence of an effective legal obligation to use anonymous job applications, certain industry leaders voluntarily decided to promote their equal employment opportunities policy by publicly committing to the anonymous CV model. Among these are the insurance company AXA, the hotel group Accor and the car manufacturer PSA Peugeot Citroën, and others. Some consider that the employee’s home address, for example, if the employee lives in a poor suburban neighborhood, is a specific factor leading to discrimination, and so also delete address details.

A further pilot project was initiated at the end of 2009, by which companies in several French regions, including Paris and certain of its suburbs, voluntarily committed to delete information such as name, age, date and place of birth, citizenship, family situation, photograph and address from job applications/CVs. The conclusions of that pilot project are expected shortly.
Mandatory disclosure to unsuccessful Job Applicants in Germany?

By Norma Studt

Germany’s anti-discrimination law may be on the brink of change following a referral by Germany’s Federal Labor Court to the European Court of Justice (the ECJ). Currently, German discrimination law requires a claimant to produce evidence to show they have suffered a disadvantage by reason of a protected ground before the burden of proof shifts to the employer to demonstrate that there was no unlawful discrimination. A mere assertion that the claimant has the qualifications for the job is not enough.

The case referred to the ECJ concerns a female job applicant born in Russia in 1961, whose job application was rejected. She is seeking damages for unlawful discrimination on the grounds of sex, nationality and age, asserting that she was qualified for the job. The referral relates to whether the requirement under German law for sufficient evidence of discrimination places too heavy a burden on her, and consequently whether the burden of proof needs to be amended so as to comply with EU law.

It is possible that, as a result of the ECJ’s decision, German employers will be required to disclose details about hired candidates which may allow unsuccessful candidates to bring discrimination claims. This would increase the burden on German employers not only to comply with discrimination law, but also to be able to demonstrate that compliance.

Hong Kong Introduces a Minimum Wage

By Jane M.S. Ng

On July 17, 2010, the Hong Kong Legislative Council passed the Minimum Wage Ordinance (the Ordinance), which will introduce a statutory minimum wage on a day yet to be appointed but expected to be in the first half of 2011. The Ordinance provides for a minimum wage at an hourly rate for certain employees. Although most employees in Hong Kong are paid on a monthly basis, the minimum wage has been set by reference to an hourly rate so as to ensure that employees’ pay corresponds to the amount of time they work.

The following categories of employees are exempted from the minimum wage requirements:

- Student interns and students undertaking work experience
- Domestics workers who live in the household in which they work free of charge

The Ordinance requires employers to keep records of the total number of hours worked by employees who earn less than a specified amount (which will be set out in a schedule to the Employment Ordinance). These records must be kept in a single document alongside other general employment records. Any provision in an employment contract which purports to extinguish or reduce any right, benefit or protection conferred on the employee by the Ordinance is void.

A Minimum Wage Commission will be established to make recommendations to the HK Government as to the appropriate level of the minimum wage which is to be reviewed at least once every two years. It has been reported that the Provisional Minimum Wage Commission has initially proposed a minimum wage of around HK $28 per hour.
In Brief

Japanese Parental Leave Developments
By Hiroki Kobayashi

Japanese statute permits employees to take unpaid statutory child care leave (both maternity and paternity) until their child’s first birthday. Though unpaid by the employer, the government pays a subsidy equal to 50 percent of their base salary (subject to a cap at ¥204,750 per month). However, only 1.7 percent of new fathers took the leave in 2009, compared with 85.6 percent of new mothers.

A recent statutory amendment, designed to encourage fathers to take this leave, implemented what is known as “pop-and-mom plus.” This allows the spouse of an employee on childcare leave to take his/her own childcare leave more flexibly. The spouse’s leave may commence on the birth of the child or at any time before the child’s first birthday, and will end when the spouse chooses, provided that this is no later than the earlier of (i) the expiry of 12 months, and (ii) two months after the child’s first birthday. The cut-off under the old statute was the child’s first birthday. The Government hopes that fathers will choose to take/remain on leave for the two months following the expiration of the mother’s 12-months leave, to assist her transition back into the workplace, whether this be the final two months of the father’s 12-months leave or an independent two month period commencing at their child’s first birthday. Though a significant increase in fathers taking the leave is unlikely, it will hopefully increase its social acceptance in the future.

Paid Vacation in Russia
By Igor Gavrikov and Sergey Shorin

According to the Federal Law No. 139-FZ “Ratification of the Convention on Paid Vacation”, Russia has acceded to the International Labor Organization’s Convention No. 132 “Paid Vacation” as of June 24, 1970. Although no major changes will be made as a result of this, the Convention will clarify current Labor Code and practice.

For example, the “Paid Vacation” Convention resolves the longstanding issue regarding whether an employee is entitled to a year’s vacation allowance (28 calendar days) or only part of it (14 calendar days), after six months of work. The Convention states that an employee should be granted vacation in proportion to the time he/she has worked for the employer. The Labor Code currently does not deal with this issue, and so the Convention will provide welcome clarification.

Russia is continuing to develop its labor law system, which is still significantly influenced by regulations originating from the Soviet era. Accessing the “Paid Vacation” Convention is another step on the way to creating a regime that provides protection for employees while bringing regulation of labor relations in Russia closer to international standards.
In Brief

Buyer Beware: Risk of Loss of “Grandfathered” Status for US Health Plans in Mergers and Acquisitions

By Robin Struve and Holly Bauer

The recently enacted health care reform legislation in the United States (collectively referred to as the Act) imposes many new obligations and expenses on group health plans and presents some critical issues that should be carefully considered by parties to a merger, stock or asset purchase, or other business combination (M&A transaction). Specifically, while certain health plans are considered “grandfathered” from many provisions of the Act (specifically, group health plans or individual health insurance coverage that was in effect on March 23, 2010), this grandfathered status may be lost in connection with an M&A transaction or may be difficult to maintain following such a transaction.

Grandfathering will automatically be lost and new non-grandfathered health plans will need to be implemented following the closing of certain M&A transactions, such as an asset purchase transaction where the seller’s benefit plans are not assumed, the purchase of a subsidiary whose employees are covered under the parent’s health plans, or a transaction undertaken by a financial buyer that does not have existing health plans into which a seller’s employees can be enrolled. In addition, a plan will lose its grandfathered status in connection with a merger, acquisition or similar business restructuring the primary purpose of which is to cover new individuals under the grandfathered plan. As a result, even in an M&A transaction in which the buyer assumes the seller’s health plans or plans to enroll a seller’s employees in its existing health plans, continued grandfathering will depend on the facts and circumstances of the transaction.

The rules applicable to grandfathered plans also limit the changes that may be made under a health plan in order to maintain grandfathered health plan status. As a result, buyers may be severely limited in their ability make changes to any assumed, grandfathered health plans following the closing of an M&A transaction.

Grandfathered plans will avoid certain potentially costly requirements under the Act, including:

- Compliance with the non-discrimination rules in the Act, which provide that a plan may not discriminate in favor of highly-compensated employees with respect to coverage or premiums. If a grandfathered plan does not satisfy this requirement, the loss of grandfathered status could require the expansion of coverage to a sufficient number of non-highly compensated employees to allow the plan to meet the discrimination tests
- Compliance with the limits on annual cost sharing, which provide that an employee’s annual cost may not exceed US $2,000 individually or US $4,000 for family coverage
- Provision of certain preventive care and immunization benefits without cost sharing
- Implementation of a new expanded, potentially costly appeals process
- Non-grandfathered plans are expected to have higher premium costs going forward as insurance companies anticipate the new requirements of the Act

These costs need to be weighed against the costs an employer may incur in order to preserve grandfathered status for a plan, which may include:

- Increased premiums resulting from staying with the current insurer where other insurers are offering lower premiums for similar coverage
- Inability to shift additional cost responsibilities to participating employees due to limitations on permissible plan changes
- Maintaining health plans that the employer might otherwise abandon because of their cost

Any party to an M&A transaction should carefully consider the grandfathering rules under the Act. In addition, buyers should weigh the costs and design limitations of maintaining grandfathered status against the costs of complying with the Act and the additional design flexibility of non-grandfathered status.

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