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Terminating Employment Relations With General Directors After Reorganization

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Mergers and acquisitions are inevitable for most investors, and it is rare that the acquisition of a company is not followed by its reorganization. Such reorganizations are often structured so that one or more companies accede into a head company. In most cases, following such a reorganization, some employees of the acceding company or companies will be dismissed. Given that such a reorganization will result in the acceding company or companies ceasing to exist, the position of its or their officers will also cease to exist. Therefore, persons acting as the general directors of the acceding company or companies will unavoidably lose their position and will either be offered a transfer to a new position by the employer, or their employment with the employer will be terminated. It is no secret that general directors of acceding companies are sometimes disinclined to act favorably to their employer, and may, on the contrary, be hostile and uncooperative. In such circumstances, given the strict formalistic approach of Russian labor law, and the limited grounds for dismissal under law, it is important to understand what options the law provides employers for terminating a general director's contract in the event of the reorganization of the employer's group of companies through accession.

From a legal standpoint, the general director of an acceding company may be dismissed by an agreement between the employer and the general director, or by a resolution from the company's relevant authorized body, terminating the general director's employment contract. But undertaking a dismissal on the aforesaid grounds may be highly unfavorable for the employer, given that such a dismissal will often require the employer to pay the general director a "golden parachute." Therefore, a special basis for dismissal, applicable specifically to the employer's reorganization, should be utilized instead.

Although logic would suggest that the employer's right to dismiss the general director of an acceding company in the event of a reorganization would be incontestable, Article 75 of the Labor Code stipulates that the employer's reorganization cannot serve as grounds for terminating its employees' employment contracts, including that of the general director. Therefore, on the basis of a literal reading of Article 75 of the Labor Code, neither the acceding nor the head company has the right to dismiss the general director of an acceding company due to a reorganization.

On the basis of the above restriction, many labor law experts believe that an employer that conducts a reorganization and wishes to dismiss a general director should wait until the reorganization is complete, and then dismiss the general director of the acceded company on the grounds that the employer is conducting a program of staff reduction. But this strategy is not ideal, given that it creates a situation whereby, for at least the two-month staff reduction notice period required under Article 180, there would be two general directors working for the head company, or even more if several companies accede. Also, pursuant to Article 178, when dismissing such employees, the employer must observe the preferential right to retain employment, or in other words give formal consideration to which of the general directors, including the general director of the head company, will remain employed, and who will be dismissed.

Despite the formal restriction on the dismissal of employees due to reorganization discussed above, and therefore also applicable to a reorganization in the form of accession, the Labor Code does appear to permit the dismissal of the general director of an acceding company. Pursuant to Articles 75 and 81, an employment contract with a general director may be terminated upon a change in the ownership of the property of the organization. Reorganization of a company through accession effectively involves a change in the ownership of the property of the acceding company, given that before reorganization the owner is the acceding company, and after the reorganization the owner is the head company.

Therefore, on the basis of Articles 75 and 81 of the Labor Code, on the same day that a reorganization is completed, a head company may dismiss the general director of an acceding company on the basis that the property of the organization has changed ownership. But on the other hand, dismissing the general director on this basis may be held to be contrary to Article 75 of the Labor Code, which prohibits the dismissal of employees due to a reorganization. Significantly, the rule permitting the dismissal of a general director upon a change of owner, and the rule prohibiting the dismissal of employees in connection with a reorganization, are in the same article of the Labor Code, Article 75. We therefore believe that this contradiction in Article 75 is the result of poor legal drafting, and hope that this contradiction will be adequately remedied in the new edition of the Labor Code, which is currently in the process of being drafted.

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