HR legal risks

In the globalized world of mobility, outsourcing and freelancing, do you know who your “employees” are?

26–29 October 2014
Disclaimer

► EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the US.

► This presentation is © 2014 Ernst & Young LLP. All rights reserved. No part of this document may be reproduced, transmitted or otherwise distributed in any form or by any means, electronic or mechanical, including by photocopying, facsimile transmission, recording, rekeying, or using any information storage and retrieval system, without written permission from Ernst & Young LLP. Any reproduction, transmission or distribution of this form or any of the material herein is prohibited and is in violation of US and international law. Ernst & Young LLP expressly disclaims any liability in connection with use of this presentation or its contents by any third party.

► Views expressed in this presentation are those of the speakers and do not necessarily represent the views of Ernst & Young LLP.

► This presentation is provided solely for the purpose of enhancing knowledge on tax matters. It does not provide tax advice to any taxpayer because it does not take into account any specific taxpayer’s facts and circumstances.

► These slides are for educational purposes only and are not intended, and should not be relied upon, as accounting advice.
Presenter

- Dr. Karsten Umnuß
  - Partner, Head of Employment Law
  - Ernst & Young Law GmbH
The matrix organization: an operational reality in global groups
Context

► Old organization: From an operational-based geographic organization of multinational groups with local legal entities:
  ► Most activities are being decentralized and locally performed.
  ► For each employee, a single hierarchical reporting within his/her local legal entity.

► New organization: To a cross-organization by activity/business unit/the matrix organization:
  ► Today’s global business services model is multifunctional, fully integrated and end-to-end process oriented.
  ► Significant changes have taken place within multinational’s political organization orientation. This is due to globalization, tasks sophistication and products life cycle acceleration.
  ► Disconnection between the operational organization/responsibilities and legal organization/responsibilities (legal entities, subsidiaries/ geographical location).
Global matrix organization: an example

Who is in charge of what activity?

- Marketing/communication
- Technical (project manager) and manufacturing
- Real estate and technology assets management
- HR and administrative
- Finance (budget setting)
- Sales

Locations:
- France
- Netherlands
- India
- Portugal
- US
Types of matrix organizations

Overall architecture of matrix organization

Functional matrix structure

Product-based structure

Region-based structure

Legal entity organization

Matrix organization

Types of matrix organizations

- Region-based structure
- Functional matrix structure
- Product-based structure

**Region-based structure**

- North America
- Asia/Middle East/Africa
- Europe/West Africa
- Latin America

**Product-based structure**

- Fresh dairy products
  - Marketing
  - Sales
  - Production
  - R&D
  - Support
- Beverages
  - Marketing
  - Sales
  - Production
  - R&D
  - Support
- Biscuits and cereal products
  - Marketing
  - Sales
  - Production
  - R&D
  - Support

**Functional matrix structure**

- Board
- Technical
- Brand & Marketing
- Sales
- Production
- Strategy

- Technical
- Administrative
- Operational and commercial
- Marketing

**Overall architecture of matrix organization**

- A
- B
- Z
- W
- Y
- C
- F
- D
- E
- X
- XX

**Legal entity organization**

**Matrix organization**
Employee mobility
Is the matrix organization consistent with employment law principles?
There are three core components of the employment relationship in most countries:

1. Work performance (for an employer)
2. Compensation (paid by the employer)
3. Subordination relationship = work performance under the employer’s authority who:
   - Gives orders and guidelines
   - Supervises the employee’s performance
   - Disciplines employees

   Employer’s management authority and disciplinary authority
Who is the boss in a matrix organization?

Who?  
► Who makes decisions?  
► Who gives orders and instructions?  
► Who controls work performance?  
► Who disciplines?

The “employer’s” legal representative in France for example?
Employee from the (foreign) parent company?
Employee from another company in the group (sister-company, subsidiary)?
External party (third-party company/consultant/JV partner)?

Disconnection between the economical/operational organization and the legal contractual structure
Key HR legal issues with ‘employees’

- Civil and criminal liabilities
- Country of social security contributions
- Internationalization of disputes
- Co-employment
- Illegal leasing of employees
- Termination of employment contract: grounds, indemnities, unemployment insurance
What type of working relationships with ‘third parties’ can give rise to HR legal and regulatory risks?
Who are the ‘hidden’ employees?

- Self-employed/“freelance” workers
- Corporate officers
- Temporary employees
- Employees from sister/daughter companies and parent company
- Expatriates/seconded employees
- Trainees/apprentices
- Made “available” employees
- Consultants
- Service providers employees
### Types of ‘non-employee’ arrangements

<table>
<thead>
<tr>
<th>Purchase service agreement (PSA)</th>
<th>Leased workers</th>
<th>Independent contractor/freelancer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Use only when outsourcing an entire service or project to a supplier who traditionally offers those services to the marketplace (e.g., security guards, engineering services, marketing services, IT services, Salesforce.com, etc.)</td>
<td>Short-term assistance to the company’s regular workforce by complementing or providing specific coverage (e.g., work surges, absences, finite projects)</td>
<td>Self-employed individuals who provide specialized services to the company (e.g., marketing consultant, engineering specialist, manufacturing specialist, lean consultants)</td>
</tr>
<tr>
<td>Do not let PSA workers perform the same work as existing workers (likely not a legitimate PSA)</td>
<td>Resources remain employees of their agency throughout assignments</td>
<td>It is required they have clients other than one company, and that such other work is substantial, not minimal in comparison to the company’s work</td>
</tr>
<tr>
<td>Company managers should not “hand pick” or select people, supplier should assign qualified individuals</td>
<td>Daily supervision by the company’s managers is acceptable</td>
<td>Requires written contract through sourcing or legal</td>
</tr>
<tr>
<td>Typically billed on a fixed price cost basis (some structures need sourcing approval)</td>
<td>Typically billed on an hourly rate basis</td>
<td>Do not provide daily supervision</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Typically paid by deliverables, as opposed to by the hour/per diem unless of short duration</td>
</tr>
</tbody>
</table>
The real question: Are they or are they not employees?

Employee vs. non-employee

- Motivation for employer: decreasing direct and non-wage labor costs (e.g., social security), reduction of employee headcount, increased flexibility and competitiveness
- Motivation for employee: higher net income by tax efficient treatment, reducing social security contributions, more flexibility/independence

Benefits of using a “non-employee”

- Personal independence
- No social insurance contributions
- No claim to employee protection laws
- No protection against dismissal
- No continued remuneration
- Using his/her own working equipment
- No consideration concerning employee threshold calculation
Key HR legal issues with potentially ‘hidden employees’

- Claims for all rights deriving from the employment relationship
- Applicable law to the employment contract
- Civil and criminal liabilities
- Co-employment
- Illegal leasing of employees and criminal offense of subcontracting of employees
- Social security contribution

HR legal risks
The issues are not only HR legal issues

► Bribery
► Third-party liability, null and void decision/act
► Loss of confidentiality, disclosure of “trade secrets”
► Unfair competition/non-compete obligations
► VAT issues
Food for thought: solutions and leading practices
Legal entity rationalization (LER)

Concept:
- Companies can improve long-term business performance by aggressively reducing the number of legal entities and combining their operations efficiently with other group members.
- Local legal companies become branches in each country within one legal entity.

HR impact/risk mitigation:
- Only “one employer” reduces co-employer risk.
- Better able to manage “one” workforce.
Global employment organization (GEO)

► Concept:
  ► The GEO is a specific entity in a group with the role of gathering and managing employees performing their work in several countries

► HR impact /risk mitigation:
  ► Only “one employer” reduces co-employer risk
  ► Better able to manage “one” workforce
Proactive risk mitigation framework

Risk framework

External and internal requirements
- Employment law
- Social security law
- TAX law
- Criminal law
- Data protection law
- Co-determination by WC
- Internal regulations

Process
- Description of demand and verifying
- 3rd party selection, check & order
- External workforce review
- Service delivery & ending
- Continuous Auditing
- Change Management
- Training
- Reporting

Stakeholder
- Board of directors
- Management board
- Legal department
- Compliance department
- Internal audit
- Procurement
- HR
- Finance

HR legal risks
Client examples

► External workforce/freelancer project
► Contingent workforce project
► 1:1 ratio of employees vs. non-employees in headquarters
► Use of temporary employment agency to solve the employees vs. non-employees issue