

ALLEN & OVERY

Employment Reorganisation Roadmap

People's Republic of China*

1 January 2024

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are provided through Allen & Overy Lang Yue (FTZ) Joint Operation Office.

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Contents

3
4
6
7
8
12
14
16
19



1. Employee representation

1.1. What are the main forms of employee representation involved in restructurings?

Under the Employment Contract Law of the People's Republic of China, which came into effect on 1 January 2008 (ECL), two main forms of employee representation may be involved in the information and consultation process on a restructuring transaction. For information on their respective rights to be informed and consulted, please refer to [here](#) and to [here](#).

- Pursuant to the Provisions on the Democratic Management of Enterprises published on 13 February 2012, all enterprises (including foreign-invested companies) should set up an **employee representative body**. The Provisions set out, among other matters, the requirements in relation to the frequency of meetings and quorum for the meetings with the employee representative body. In general, companies must consult with it over major issues relating to employee benefits (such as changes to salary, redundancy terms etc) at the meeting.
- **Trade union representatives:** There is no mandatory law that requires an employer to form a trade union for its employees, as long as its employees do not request one. PRC law provides that employees have the right to form and join a trade union. Upper level trade unions have the right to assist and guide the employees to form a trade union, and the employer should not prevent it. In practice, however, the PRC government has been taking specific action to urge foreign enterprises to set up trade unions. The ECL provides for an alternative option and states that the employer may consult the employee representatives instead of the trade union. In practice, certain local labour bureaus recommend that in the event that no labour union is established at the level of the employer, the employer may seek the opinion of the trade union at an upper level. There is no standard practice at a national level. It is currently unclear as to how the consultation process will work if no trade union is established.



1.2. Is there a system of employee participation rights?

Subject to certain exceptions, PRC companies (including foreign-invested enterprises) must set up a board of supervisors to ensure that the board of directors and management comply with their duties. A board of supervisors must generally have at least three members, of whom at least one-third must be employee representatives (usually trade union representatives).

Notwithstanding the above, small companies or companies with a small number of shareholders can have one or two supervisors (who do not need to be employee representative(s)), rather than a board of supervisors. Note, however, that so far there has been no further legislation to clearly define the companies that qualify as “small companies” or “companies with a small number of shareholders” for this purpose.

2. Process on business sales

2.1. Are employees automatically transferred to a buyer by operation of law on a business sale?

There is no automatic transfer of employees in the case of a business sale. To effect a transfer of employment arising out of a business sale, it involves a termination/re-hire process, and employee consent is required (see [here](#)).

2.2. If so, in broad terms, what is the legal test for identifying which employees transfer?

There is no automatic transfer of employees on a business sale.

2.3. Can employees object to the automatic transfer of their employment and what are the consequences of an objection?

There is no automatic transfer of employees on a business sale.





2.4. Do obligations to inform and consult employees or employee representatives arise on a business sale?

Under the ECL, there is a general obligation for a seller to first discuss with the trade union or employee representatives' meeting as a forum (or, in the absence of any trade union/employee representatives, all employees), and then make proposals to the trade union or employee representatives before adopting, any major decision which will directly impact on employees' interests. Although there is no specific definition of "major decisions", a business sale would normally fall within the scope of what constitutes a major decision. However, it is currently not clear if the trade union's and employee representatives' recommendations have any actual impact (including a veto right) on their employer's final decision regarding such matters. While it is usually assumed that such obligation only requires an employer to listen to, but not necessarily follow, the opinions and suggestions of its trade union and employee representatives, this interpretation has yet to be confirmed by the implementation rules and judicial interpretations of the ECL. There are no further details concerning how or when an employer must consult, nor are any penalties specified for non-compliance. Furthermore, if a business sale is subject to regulatory approval (which is often the case when it involves foreign shareholding), the seller is typically required to prepare an employees' settlement scheme, which must be submitted together with other application material to the relevant regulator for approval. As such, it is advisable to complete the consultation prior to the signing of any definitive agreement relating to the business sale.

If a business sale takes place, employees are not automatically transferred by law. If a seller wishes to transfer its employees to a buyer (as part of a transfer of assets or otherwise), the seller may do so by amending the employment contract (ie to change the employer) with the employee's prior consent. Alternatively, the seller can also terminate the relevant employees' contracts and the buyer can then make an offer of employment to the former employees. Such an offer will need to be issued on or before the transfer becomes effective and the employee's consent will be required for both the termination and the acceptance of the new offer.

Note that if the employee does not give their consent to the change of employer, the seller will have the right to unilaterally terminate the employment contract if the sale of the business is considered a major change in the objective circumstances and makes the continued performance of the contract impossible. In this event, however, the employee will receive statutory severance pay (usually one month's salary per year of employment with the same employer, subject to a statutory cap).

2.5. What are the penalties for non-compliance with information and consultation obligations on a business sale?

There are generally no penalties for the seller's breach of its general obligation to consult with the employees and the trade union before adopting decisions on any proposed restructuring or other major operational matter. However, if the seller terminates an employment contract during the restructuring without consultation with the trade union, this will most likely be unlawful and remedies for unlawful dismissal will be available (please see answer to). In addition, as mentioned above, if an employees' settlement scheme is required for regulatory approval in the case of a business sale, the regulators would require the seller to complete such information and consultation procedures.

If the seller/buyer does not obtain the employee's consent to the transfer, the employee cannot be transferred to the buyer along with the business.

3. Process on share sales

3.1. Do obligations to inform and consult employee representatives arise on a direct share sale (ie, on the sale of the company itself)?

There is no obligation to inform/consult employee representatives in relation to a direct share sale of the onshore Chinese entity, unless this is provided for in a collective bargaining agreement, which is very rare.

3.2. Do obligations to inform and consult employee representatives arise on an indirect share sale (on the sale of a company's direct or indirect holding company)?

There is no obligation to inform/consult employee representatives in relation to an indirect share sale, unless this is provided for in a collective bargaining agreement, which is very rare.



4. Process on outsourcings

4.1. Are employees transferred by operation of law in the following scenarios: (i) on an initial outsourcing of processes/services; (ii) on a change of supplier; or (iii) on an insourcing of processes/services?

If an initial outsourcing of processes/services, a change of supplier or an insourcing of processes/services takes place, employees are not automatically transferred by law. If the employer wishes to transfer its employees to the supplier/service provider, it must terminate the relevant employees' contracts. The supplier/service provider must then make an offer of employment to the employees. The employees' consent to the new offer of employment is required. Procedural obligations and severance rights may then be triggered if the employer has to terminate the employment of those employees (see).

4.2. Do obligations to inform and consult employees or employee representatives apply in any of these scenarios?

Under the ECL, there is a general obligation for a seller to first discuss with the trade union or employee representatives' meeting as a forum (or, in the absence of any trade union/employee representatives, all employees), and then make proposals to the trade union or employee representatives before adopting, any major decision which will directly impact on employees' interests. Although there is no specific definition of "major decisions", an outsourcing of processes/services, a change of supplier or an insourcing of processes/services may fall within the scope of what constitutes a major decision. However, it is currently not clear if the trade union's and employee representatives' recommendations have any actual impact (including a veto right) on their employer's final decision regarding such matters. While it is usually assumed that such obligation only requires an employer to listen to, but not necessarily follow, the opinions and suggestions of its trade union and employee representatives, this interpretation has yet to be confirmed by the implementation rules and judicial interpretations of the ECL. There are no further details concerning how or when an employer must consult, nor are any penalties specified for non-compliance.



5. Process on collective dismissals

5.1. Is a “collective dismissal” (or “mass layoff”) defined by law?

The ECL has introduced a “redundancy” dismissal which includes both an individual dismissal and a collective dismissal. A collective dismissal will be deemed to take place when the company proceeds to dismiss the lower of:

- 20+ employees, or
- at least 10% of the workforce,

based on “redundancy” grounds, namely where:

- the business is in the stage of statutory reconstruction as declared by a competent court
- the business has serious operational difficulties
- the business switches production, introduces a major technological innovation or revises its business method, and, after amending its employment contracts, still needs to reduce its workforce (note that this particular ground has been added by the ECL), or
- the employment contract cannot be continued due to a major change in the objective economic circumstances which were the basis for entering into the employment contract in the first place.

The ECL provides for specific categories of employees who have priority to be retained in the event of collective dismissals. These categories include employees with open-ended or long-term contracts and employees who are the sole earner in a family with children or old people dependent on their income. If the employer, who has dismissed employees on the grounds of collective dismissal, needs to re-employ staff within six months, the dismissed employees will have priority.



5.2. Do obligations to inform and consult employee representatives arise on a collective dismissal?

Under the ECL, there is a general obligation for an employer to first discuss with the employee representatives' meeting as a forum (or all employees), and then make proposals to the trade union or employee representatives before adopting, any major decision which will directly impact on employees' interests. Although there is no specific definition of "major decisions", a restructuring transaction would normally fall within the scope of what constitutes a major decision. However, it is currently not clear if the trade union's and employee representatives' recommendations have any actual impact (including a veto right) on their employer's final decision regarding such matters. While it is usually assumed that such obligation only requires an employer to listen to, but not necessarily follow, the opinions and suggestions of its trade union and employees, this interpretation has yet to be confirmed by the implementation rules and judicial interpretations of the ECL. There are no further details concerning how or when an employer must consult, nor are any penalties specified for non-compliance with this general obligation. Furthermore, if a collective dismissal is a result of a share sale that is subject to regulatory approval (which is often the case when it involves foreign shareholding), the seller may be required to prepare an employees' settlement scheme which must be submitted together with other application material to the relevant regulator for approval. As such, as a matter of good practice, it is advisable to complete the consultation prior to the signing of any definitive agreement relating to the restructuring transaction.

In the event of a collective dismissal, the employer must serve a written notice on all employees or the trade union, together with relevant supporting documents explaining the circumstances of the dismissals, 30 days prior to the dismissals. The employer must then prepare a "collective dismissal" plan, including the names of employees to be dismissed, the proposed dismissal dates, and an outline of the procedures and compensation methods. The employer must listen to the opinions of the employees or the trade union on the collective dismissal plan. The plan must be submitted to the local labour bureau which, in principle, must provide its opinion (see answer to).





5.3. Do obligations to inform and consult the competent authorities arise on a collective dismissal?

In the event of a collective dismissal, following consultation with all employees or the trade union (see answer to **5.4**), the employer is required to submit a “collective dismissal” plan to the local labour bureau which, in principle, must provide its opinion.

Although the local labour bureaus are not expressly granted the right to approve collective dismissal plans by law, they have the discretion to do so in practice. We are aware that some local bureaus currently require that companies obtain their approval (rather than only filing their plan with them) if the redundancy involves a certain number of employees. Some other local bureaus (such as Shanghai) have released detailed rules with respect to their filing requirements and process. This increases the burden on a company at the preparation stage prior to the filing and grants the competent labour bureau the right to order a company to rectify its dismissal plan if the bureau finds that the plan is not compliant with the law. As such, professional legal advice should be sought before a company plans to carry out any collective dismissal schemes.

5.4. When are these obligations triggered?

The obligation to consult the employee representatives about collective dismissals arises when there are proposals to adopt any major decision which will directly impact on employees’ interests (ie prior to a decision to proceed with a restructuring and prior to the decision to dismiss being taken).

The employer is required to submit a “collective dismissal” plan to the local labour bureau following consultation with all employees or the trade union, (see answer to), again before taking any decisions.



5.5. What are the penalties for non-compliance with information and consultation obligations on a collective dismissal?

There are generally no penalties for breach by an employer of its general obligation to consult with employees and the trade union before adopting decisions on any proposed restructuring or any other major operational matter. Failure to consult the trade union or local labour bureau in relation to collective dismissals may possibly render the dismissals unlawful, although no regulations provide for specific sanctions. In the case of unlawful dismissal, certain remedies will be available (see answer to).

5.6. Do obligations to inform and consult employee representatives and/or competent authorities arise in the context of multiple dismissals, which do not qualify as a collective dismissal, as defined by law?

In the context of multiple unilateral dismissals (which fall short of a collective dismissal), the employer must give notice to the trade union setting out the reasons for dismissal before dismissing the employees. The trade union may request that the employer rectifies its decision if the employer is in breach of any laws and regulations or the employment contract. The employer must then consider the trade union's recommendation and notify the trade union of its final decision in writing. There is no specific time limit for this and the law is unclear on how the employer can comply with this requirement if the company has no trade union. In practice, certain local labour bureaus recommend that in the event that no labour union is established at the level of the employer, the employer may notify the trade union at an upper level of such dismissal (see answer to).

5.7. Does an employer have options/alternatives when it has been unable to reach agreement with employee representatives during the negotiation period?

It is currently unclear if the employee representatives' recommendations have any actual impact (including a veto right) on their employer's final decision regarding the collective dismissal. It is usually assumed that such obligation only requires an employer to listen to, but not necessarily follow, the opinions and suggestions of its employee representatives. Note, however, that this interpretation has yet to be confirmed by the implementation rules and judicial interpretations of the ECL.

6. Process on individual dismissals

6.1. Are employees entitled to a minimum period of notice on dismissal on redundancy or economic grounds?

The minimum notice entitlement is 30 days (except during the probationary period during which employees can be dismissed without notice). An employer can choose to pay one month's salary in lieu of the 30-day notice period.

6.2. Does any special procedure apply when proposing to implement an individual dismissal on redundancy or economic grounds?

An employer can only dismiss employees on certain limited statutory grounds. The law is unclear as to whether individual dismissals can be based on the grounds of redundancy (see answer to). In the context of an individual dismissal, a key termination event is a change in particular circumstances. An employer may terminate an employee based on the grounds that:

- there has been a “material change in the company’s objective circumstances” which renders the continued performance of the employment contract impossible, and
- the employer and the employee, after negotiation, fail to reach agreement on amendments to the employment contract.

There is no clear definition of “material change in the objective circumstances”. Generally, it refers to a force majeure event or any other event which renders the continued performance of all or part of the employment contract impossible, eg the employer’s business is acquired by, or transferred to, another entity. It is unclear whether the withdrawal of a position or the closing down of a department as a result of a company’s operational/financial difficulties could qualify as a “material change” for individual dismissal cases. There are local regulations which restrict the use of the “material change” ground of termination. For instance, in Beijing, the “material change” ground only applies, for instance, where there is a relocation, asset transfer or change of the line of production etc caused by a change of laws, regulations and policies. Careful analysis on a case-by-case basis is required if a company wants to apply for termination on this ground.

The employer must give notice to the trade union setting out the reasons for dismissal before dismissing an employee. The trade union may request that the employer rectifies its decision if the employer is in breach of any laws and regulations or the employment contract. The employer must then consider the trade union’s recommendation and notify the trade union of its final decision in writing. There is no specific time limit for this and the law is unclear as to how the employer can comply with this requirement if the company has no trade union. In practice, certain local labour bureaus recommend that in the event that no labour union is established at the level of the employer, the employer may notify the trade union at an upper level of such dismissal.





6.3. Does special dismissal protection apply where dismissals are to be implemented following or in connection with a business transfer?

There are a number of categories of employees whose employment is protected from unilateral termination (other than for cause), whether the dismissals are implemented following or in connection with a business transfer or otherwise (see answer to **6.6**).

6.4. Are employees entitled to a minimum severance payment on dismissal for redundancy or economic grounds?

The minimum severance payment is one month's salary (averaged on the basis of total monetary compensation for the employee during the 12-month period immediately preceding their termination (the Salary Basis)) for each year of service, up to 12 months' salary. For the employee's service period after 1 January 2008 (the date when the ECL came into force), the Salary Basis can be capped at three times the local average monthly salary for the previous year. However, for the employee's service period prior to 31 December 2007, the Salary Basis will be for the full amount and is uncapped.

6.5. What are the penalties for non-compliance with individual dismissal procedure?

If an employer dismisses an employee without establishing the necessary redundancy grounds (ie that the reorganisation has rendered the contract incapable of performance), the labour arbitration tribunal may find the dismissal unlawful and order damages (including loss of earnings). The remedy for unlawful dismissal is reinstatement or, if the employee does not want to be reinstated or if reinstatement is not possible, payment of damages to the employee equal to twice the amount of the applicable severance pay for lawful termination.

6.6. Is there any special legal protection or does any special treatment apply for particular groups of workers?

There are a number of categories of employees whose employment is protected from unilateral termination (other than for cause). These are:

- employees who are engaged in work exposed to occupational hazards and who have not undergone a post-employment occupational medical check or who are suspected to have contracted an occupational illness and who are under treatment or medical observation
- employees who are diagnosed as having lost their entire labour capability (or part of it) due to work-related illness or injury
- employees who are ill and still within the statutory medical period
- female employees during their pregnancy, maternity leave, or nursing period, and
- employees who have served an employer for 15 years and are fewer than five years away from their retirement age.

7. Process when implementing alternatives to redundancy

7.1. Can changes to employment terms be made with or without express employee consent?

In principle, changes to employment terms and conditions require consent from the employee, regardless of whether the changes are beneficial, neutral or detrimental to the employee. Oral variation of an employment contract may be enforceable if both the employer and employee have acted in accordance with the oral variation of the employment contract for more than one month, and such variation does not contravene any laws, administrative regulations, or national policy, and is not disruptive to public order or morals. In practice, given the risk of challenge, this form of implied consent is not recommended.

7.2. Must an employer consult individually or collectively with affected employees or their representatives (if any) before making changes to employment terms?

If the changes to employment terms relate to matters contained in the employee handbook or company rules and regulations, and the changes directly impact on employees' interests (eg remuneration, working hours, rest periods, leave, work safety and health, insurance and welfare, employee training and work discipline etc), the employer is required to undergo a consultation process with the trade union or employee representatives or, in their absence, with all the employees, before adopting any changes.

If the changes relate to individual employment terms which are specific to the individual employee, the employer must consult with the relevant employees in order to secure consent from them.

7.3. Do additional restrictions apply if changes are proposed in connection with or following a business transfer?

There are no additional restrictions if changes are proposed in connection with or following a business transfer.



7.4. What are the penalties for non-compliance with these procedures?

Failure to follow the procedures may potentially render the changes unlawful and unenforceable. Further, depending on the nature of the changes, the employer and person responsible may be subject to liabilities. For instance, in the case of a unilateral salary reduction, the competent labour authority will order the employer to be responsible for making back payments within a stipulated period; failing which the employer may be ordered to pay additional monetary damages to the employee at a rate of not less than 50% and not more than 100% of the amount payable. Further, in extreme cases where the employer evades payment of a relatively large amount of labour remuneration by dissipating assets, a fine may be imposed on the employer, while the person directly responsible may be subject to imprisonment or criminal detention and/or a fine.

7.5. Do national laws promote or permit any alternatives to redundancy (eg layoff or short-time working)?

The ECL provides that if there is a material change in the objective circumstances which is relied upon by the parties at the time that the employment contract is concluded, the employer may attempt to enter into an agreement with its employees to change the employment terms.

Further, following the outbreak of Covid-19, the Government's policy in China is to reduce redundancies. The Government has issued notices to permit alternatives to redundancy in response to the Covid-19 situation, including salary adjustment, work shifts, short-time working and leave-taking. Note, however, that these alternatives should be taken after negotiations with employees and after written employee consent has been obtained. Any permanent arrangements, in particular salary-related adjustments, should be documented in writing.

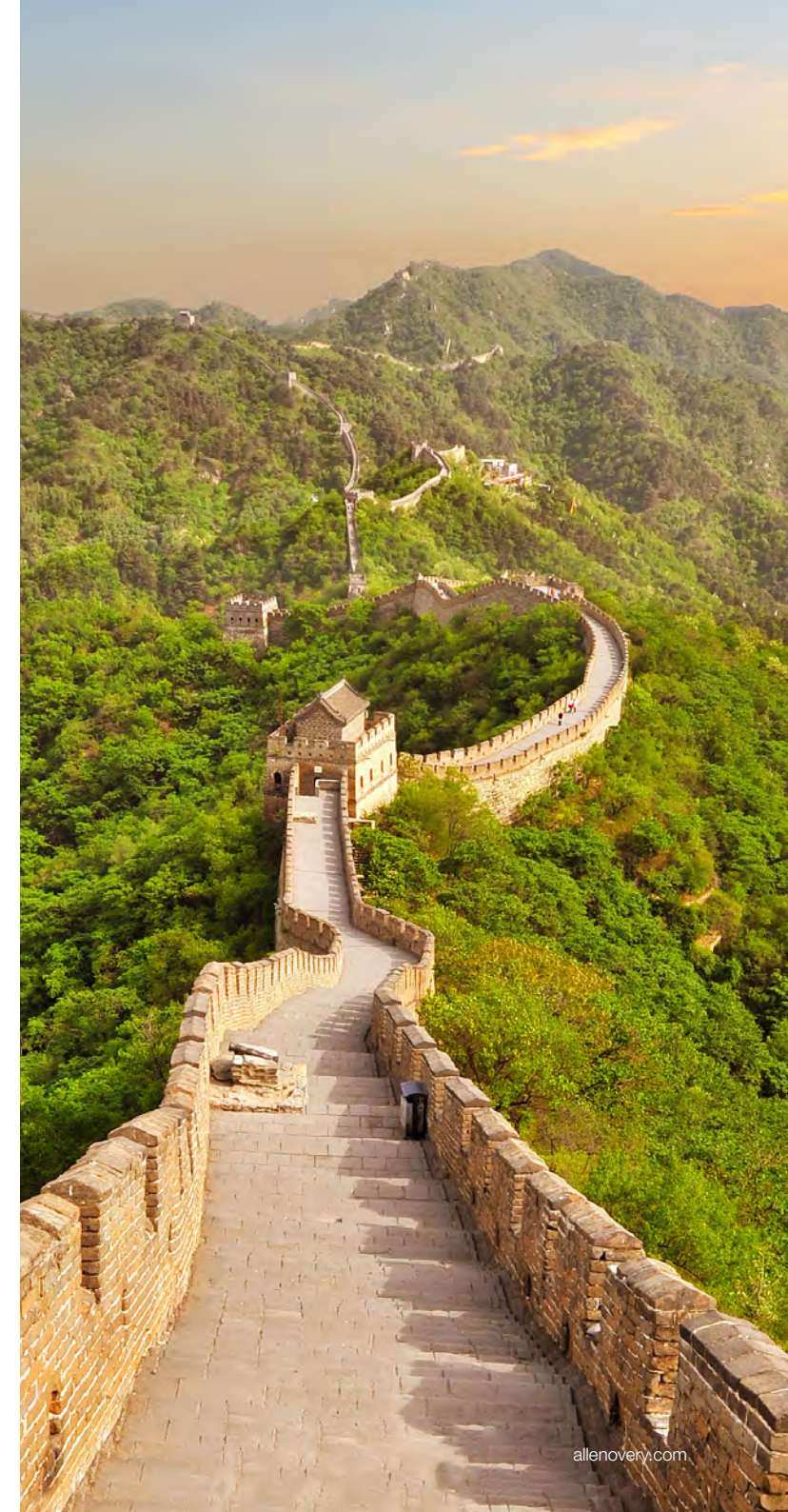


8. Process on insolvency

8.1. Do obligations to inform and consult employee representatives arise on the sale of an insolvent business (whether share sale or business sale)?

While the general obligation for a seller regarding informing and consulting employee representatives still arguably arises in the sale of an insolvent business (see), there are two additional special requirements in an insolvency situation.

- There are three types of bankruptcy proceedings under the Enterprise Bankruptcy Law of the People's Republic of China, which came into effect on 1 June 2007 (EBL): insolvent liquidation, reorganisation, and compromise. If a sale of an insolvent business (whether a share sale or a business sale) is part of any one of these formal proceedings relating to the seller, such sale must be pre-approved by the seller's creditors' meeting. Under the EBL, representatives of employees and the trade union are entitled to attend the creditors' meeting and express their opinions during the creditors' meeting. However, it is currently unclear what impact the opinions of the employees' and the trade union's representatives will have, if any, on the decisions of the creditors' meeting (unless such representatives are the seller's creditors themselves, who may cast votes at creditors' meetings in their capacity as the seller's creditors). While it is usually assumed that such obligation only requires the creditors' meeting to listen to, but not necessarily follow, the opinions of the employees' and the trade union's representatives, this interpretation has yet to be confirmed by the implementation rules and judicial interpretations of the EBL. In the case of a reorganisation, employees with claims for wages, medical benefits, basic pension and other compensation payments constitute a separate category of creditors who are entitled to vote on the reorganisation plan. A reorganisation plan, compromise agreement or liquidation distribution plan which has been approved by the creditors' meeting remains subject to the final approval of the court.



– If a creditors' committee is formed by the creditors' meeting (which is not mandatory), it must have either a representative of the employees or the trade union on board. The creditors' committee is responsible for, inter alia, overseeing the management and disposition of the assets of the debtor (ie the seller). Under the EBL, the creditors' committee may request the administrator or the relevant personnel of the debtor to provide an explanation and relevant documentation in respect of matters falling within their powers and duties, including the sale of an insolvent business. If a business sale involves a sale of certain real property rights and other property rights such as IP rights, the entire inventory or operations of the seller, or such sale amounts to a sale that has a material impact on the creditors' interests, the administrator must report this to the creditors' committee promptly (or to the court if a creditors' committee has not been established). If the administrator or the relevant personnel refuses to cooperate, the creditors' committee may request the court to make a ruling, which must be made within five days of such request. The administrator may be replaced or incur liability if it does not perform its duties in accordance with the law, including the duty to report to and cooperate with the creditors' meeting and creditors' committee. Wrongful or illegal sales, or any other acts done to the detriment of the creditors' interests during a reorganisation proceeding, may result in the termination of the reorganisation proceeding and the declaration of the bankruptcy of the debtor by the court upon the request of the administrator or an interested party.

8.2. Does the buyer of an insolvent business inherit employees and/or employee liabilities by operation of law?

In a business sale conducted as part of any formal bankruptcy proceeding under the EBL, employees are not automatically transferred by law. The transfer of employees and/or employee liabilities is made on a consensual basis between the seller, buyer and the relevant employees (see) and the reorganisation plan, compromise agreement or liquidation distribution plan which contemplates such transfer is subject to the same approvals as discussed in the answer to . It will be a matter for negotiation whether the buyer will assume the transferred employees' accumulated years of employment with the seller, or who will bear the cost of buying out this liability if the buyer wants to start afresh with these employees.



8.3. Do obligations to inform and consult employee representatives arise where collective dismissals are to be implemented in an insolvent business?

Under the ECL, if the business is undergoing a reorganisation proceeding under the EBL and the employer proceeds to dismiss the lower of:

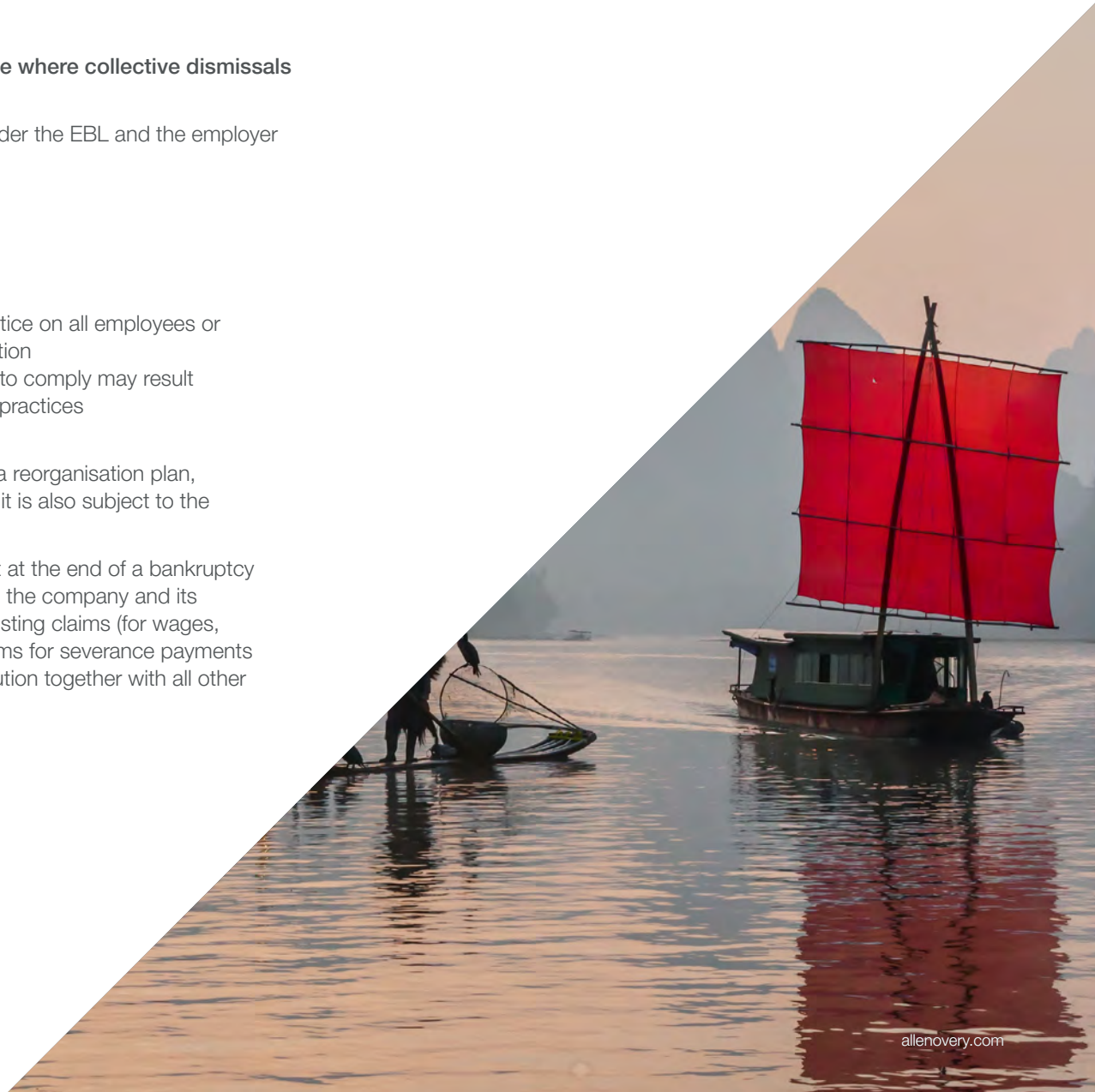
- 20 or more employees, or
- at least 10% of the workforce,

a collective dismissal is deemed to have occurred.

The general consultation obligations and the obligations to serve a written notice on all employees or the trade union in the event of collective dismissals apply, as does the obligation to submit the collective dismissal plan to the relevant labour bureaus. Failure to comply may result in a rectification order by the competent labour bureaus, depending on local practices (see [here](#) for further information).

In an insolvency situation, if a collective dismissal is contemplated as part of a reorganisation plan, a compromise agreement with the creditors or a liquidation distribution plan, it is also subject to the same approvals discussed in the answer to [question 8.2](#).

Under the ECL, when a company is declared bankrupt by a competent court at the end of a bankruptcy proceeding (ie the company is liquidated), all employment contracts between the company and its employees terminate by operation of law. In this scenario, the employees' existing claims (for wages, medical benefits, basic pension and other compensation payments) and claims for severance payments as a result of the termination, will be settled as part of the bankruptcy distribution together with all other creditors' claims.



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