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Tip for Investors: Don't Lock Out Unionized Targets

By Thomas G. Spencer and Philip E. Garber

There's something about the idea of dealing with unions that just plain intimidates investors. Maybe it's from watching "On the Waterfront" one too many times. Both financial and strategic investors often instinctively reject the idea of acquiring unionized companies. This can be a mistake. Although companies with unions may have higher operating costs and other challenges, buyers should not reflexively write them off as acquisition candidates. Healthy, unionized enterprises can turn out to be excellent investments — often better than the nonunion businesses that initially seem like the better deal. The key is analyzing them correctly.

Thomas G. Spencer and **Philip E. Garber** are partners in the Philadelphia office of Duane Morris LLP. Spencer primarily practices in the areas of corporate, capital markets, and mergers and acquisitions. Garber practices in the area of labor and employment law, counseling employers in union matters as well as other employment issues. *Disclaimer: This article is prepared and published for informational purposes only and should not be construed as legal advice. The views expressed in this article are those of the authors and do not necessarily reflect the views of the authors' law firm or its individual partners.*

When considering the acquisition of a unionized business, it's essential to know what should not drive the acquisition decision. Prior experiences from projects involving unionized companies, negative anecdotes from peers, or horror stories in the press should not be the deciding factor on whether to further investigate a unionized opportunity. Instead, buyer's counsel should consider each opportunity logically, rationally and systematically, regardless of the nature of the deal or the client's role in it.

This includes sellers of unionized businesses who may want to retain experienced counsel to help understand the labor law implications for prospective buyers, and how they may be able to prepare their businesses for a future sale. Thorough analysis can determine the risk and where it may have an impact.

'Big-Picture' Overview

Let's start with the big picture and the questions that arise. Before doing anything else, potential investors in — or buyers of — unionized companies may want to consider: How much impact does the presence of a union have on the target company, and how, if at all, does a deal with potential union issues fit into a buyer's overall strategy and goals?

What effect will the union have on the target's business? For example, does the union currently represent employees throughout the target company, or only a small pocket of them? Would the target's union contract cover new facilities if the buyer decides to expand? Would the union contract have to be narrowed to protect the buyer in the future?

How will the union issues impact the buyer's other existing businesses and/or acquisition plans for other businesses? Would the union issues raised by the target's operations have an adverse impact on the buyer's other businesses or investments that outweigh the incremental benefits for the acquisition of the target? Would they have a positive impact because, for example, the buyer wants to pursue work for customers wanting or needing to do business with unionized suppliers or contractors?

Steps for Buyers To Consider

To address these "big-picture" questions, the five-stage process

listed below can assist with evaluating an investment in a unionized company:

1. General Assessment;
2. Due Diligence Concerning Union-Related Issues;
3. Structuring the Transaction;
4. Structuring the Entities; and
5. Implementation.

General Assessment

Experienced employment counsel can walk investors through the specific labor-related issues that need to be evaluated at the outset of any potential transaction, whether in a unionized or non-union context. These issues include compliance with laws and regulations, such as the Worker Adjustment and Retraining Notification Act and those relating to anti-discrimination, wage and hour, government contracting and immigration matters, along with similar state laws, and whether there are or need to be restrictive covenants limiting the seller's key workers from competing and soliciting customers and employees.

Due Diligence Concerning Union-Related Issues

Due diligence relating to any existing unions is critical, and it begins with evaluating union agreements, such as collective bargaining agreements and other related documents. In particular, provisions relating to the duration of jurisdiction (including geography and scope of work) of the agreements and the rights and limitations on management may need to be scrutinized. Successorship provisions also need to be weighed prudently, such as whether they include language that imposes a duty on a buyer to adopt the target's union contract or obligates the target to sell only to a buyer who agrees to accept the accord.

Also part of the due-diligence process is understanding withdrawal liability — the buyer's risk of being determined a "successor" or an additional obligor under ERISA and the Multiemployer Pension Plan Amendments Act for any such liability, the financial magnitude of that risk and how that risk may be reduced or managed. This analysis is particularly key in view of the holding by a federal appellate court that a private equity fund actively involved in the management of one of its portfolio companies could be held jointly and severally liable for the portfolio company's withdrawal obligations. *See Sun Capital Partners III, LP v. New England Teamsters & Trucking Indus. Pension Fund*, 724 F.3d 129 (1st Cir. 2013), cert denied, 134 S. Ct. 1492 (2014).

Prudently structured and operated double-breasted operations can insulate an employer's unionized operations from its non-union operations, and vice versa.

Finally, due diligence should examine the target's recent and current compliance with its union contract and related documents, the buyer's possible approaches for overcoming or working around any identified risks and the union's willingness to cooperate and do business with the buyer. These and other considerations may enable the buyer to assess whether the acquisition makes sense for the buyer on the right economic terms.

Structuring the Transaction

The structure of the transaction — as a stock deal or an assets deal — can significantly affect the buyer's and the target's obligations under the National Labor Relations Board's (NLRB) successorship law. If the transaction is structured as a stock or similar equity deal, the purchaser will step into the shoes of the target and be required to continue honoring the target's labor contract with the union. A purchaser will have greater flexibility in an assets deal depending on the circumstances. The buyer is unlikely to be required to adopt the target's labor contract in an assets deal. It may be able to set the initial conditions of employment for the employees it hires and negotiate a different deal with the union, or even possibly end up without the union, consistent with NLRB rules.

Structuring the Entities

If the financial or strategic buyer wants to prevail in separating the target's unionized operations from the buyer's current or anticipated non-union operations, it will also need to maintain what are commonly referred to as valid "double-breasted operations" under the NLRB's ground rules by creating horizontal and vertical firewalls between its unionized and non-union operations. A vertical firewall is used to avoid a finding that the parent, holding company or private equity fund controls and operates both the

union and non-union operations. A horizontal firewall is used to avoid the integration of sibling or otherwise-affiliated operations that could result in a finding that the affiliated entities constitute a single or joint employer, even in the absence of common labor relations and management. These firewalls can have the added benefit of reducing the risk that a union will prevail in extending its union contract to the buyer's non-union operations.

Prudently structured and operated double-breasted operations can insulate an employer's unionized operations from its non-union operations, and vice versa. The relevant legal theories involve essentially the same analysis: whether the affiliated entities are truly separate and distinct in their operations.

The NLRB and the courts use five principal criteria to make this evaluation:

1. The degree of integration of operations;
2. Centralized control of labor relations;
3. Common management;
4. Common ownership and financial control; and
5. Motive — whether one of the companies is being established for anti-union reasons or to divert work from the unionized company.

The NLRB and the courts place the most weight on integration of operations and centralized control of labor relations, but the other criteria are also significant. Buyers intending to use the double-breasted operations approach should factor into their valuation analysis the loss of many traditional cost-savings synergies that will not be achievable under such a structure.

Affiliated companies may have a better chance of withstanding challenges by unions and benefit funds when the two entities:

- Operate in different geographic areas;
- Perform different work (*e.g.*, sales versus installation);
- Do business in separate markets or industries (*e.g.*, commercial construction versus residential homebuilding);
- Do not bid on the same projects, and
- Are not viewed as diverting work from the union company to the non-union company.

Moreover, some of this law may be evolving to a more restrictive framework. The NLRB under the Obama administration has two cases in its pipeline that may affect when third parties, such as contractors, franchisors and affiliated businesses, are to be viewed together as a joint (or single) employer with the entity that directly employs the unionized workers. Although these pending cases have not arisen in the affiliated businesses (double-breasted operations) context, the decisions are likely to narrow the circumstances under which the NLRB will treat affiliated entities as separate for labor purposes. This makes it even more essential for investors to maintain the separation of their affiliated entities as they move forward with their transactions.

Implementation

Finally, the best-structured transaction and operating entities are unlikely to avoid the risks created by union issues if the actual operation of the entities does not comport with the designed structure. Thus, every facet of the business may need to be evaluated by the buyer, presumably with the help of experienced labor attorneys, to determine whether the buyer will be able to implement the vertical and horizontal firewalls in the operation of the target and its other businesses following the acquisition, while attaining the intended economic benefits of the transaction. This evaluation typically should address human resources (recruitment, hiring, policies and benefits), leadership and supervisory structure, physical separation of offices and facilities, back office operations such as information technology and clerical support, insurance, finance, and marketing/public relations and branding.

Conclusion

The acquisition of or investment in a unionized entity can have potentially negative consequences, such as higher wages and other possible operating costs and the challenges discussed above. Opportunistic investors, however, can realistically and carefully weigh these costs against the prospect of losing out on what — if properly structured and implemented — could be a really great deal.

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