

Private Equity and Venture Capital Firms and Federal Labor and Employment Law

Entrepreneurial Control and Liability

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Private equity firms pride themselves on identifying undervalued operating companies, joining with management in an LBO to acquire them at the right price, and then, through a combination of “hands-on” management, financial engineering, and other controls, creating value in these portfolio companies by increasing revenues and maximizing cash flow. The goal is to prime the target for a successful “liquidity event” over a two-to three-year holding period, through a sale, recapitalization, IPO, or other transaction, which will result in “carry” proceeds to the private equity firm. Venture capital firms target start-up companies, and through the same focus on hands-on management and expertise add value to the entrepreneurial founders’ more limited vision.

From a practical perspective, this control occurs at multiple levels: representatives of the private equity or venture firm sit on the board of directors, the private equity and venture firm’s management company

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works with senior management on operating issues, and the private equity or venture firm may replace senior management or even have its representatives serve as “acting” CEO or CFO during a particularly difficult or challenging period.

The hallmark of these efforts is control and management of the portfolio company’s operations, and with good reason, given the equity investment, the fiduciary duty and accountability that the private equity or venture firm has to its investors (the limited partners), and the terrible damage that a bankrupt investment can have on a firm’s track record and ability to raise new funds and capital in the future.

Under federal labor and employment laws, however, such control and involvement by a venture or private equity firm can present risks. In two recent cases, private equity firms have been charged with violating federal labor laws as a result of their involvement in the affairs of their portfolio companies. In one case, Quantum Industrial Partners (at the time the private equity operation of George Soros) and certain affiliated entities were sued in federal court and were unable to dismiss a complaint arising under the federal WARN Act,¹ due to their alleged involvement in the shut-down of a portfolio company, Outboard Marine, without giving its employees the necessary 60 days’ advance

¹ Worker Adjustment and Retraining Notification Act, 29 U.S.C. § 2101 et seq.

notice. In the other case, Heartland Industrial Partners, the private equity firm founded by David Stockton, was the subject of an unfair labor practice complaint brought by the General Counsel of the National Labor Relations Board (“NLRB”) for entering into a “neutrality” agreement with the United Steelworkers of America (“USW”) to avoid union-organizing disruptions and to recognize the USW as the collective bargaining representative for employees at portfolio companies it acquired in the future.

This exposure to federal labor law arises in an area where private equity and venture firms have not traditionally focused their attention. This article addresses these recent cases and provides guidance on the issues that arise under federal labor and employment law when owners seek to control and manage the affairs of their portfolio companies.²

The Outboard Marine Decision³

The case arose out of a fairly typical situation facing private equity firms when investments go sour. Various Quantum investment entities had acquired Outboard Marine Corp., a designer and manufacturer of outboard motors. By December 2000, as the investment fizzled, Outboard filed for bankruptcy, shut down 13 of its facilities, and laid off approximately 6,500 employees without the requisite 60 days’ advance notice under WARN. A group of former employees filed a sweeping federal lawsuit under WARN against two classes of Quantum defendants: the three investment entities owning Outboard directly (the “Direct Quantum Owners”) and various affiliated entities. These defendants were targeted as “deep pockets” since Outboard was bankrupt. The plaintiffs claimed that the defendant Quantum entities and Outboard together constituted the “employer” under WARN, because the financial, management, and ultimate decisions that resulted in the Chapter 11 bankruptcy filing and “shut-down” decisions were made by the Quantum defendants. The plaintiffs sought damages under WARN, including attorneys’ fees.

The Quantum defendants moved to dismiss the complaint against them on procedural grounds, for failure to state a claim upon which relief could be granted. The plaintiffs countered that the allegations in the complaint concerning the Quantum defendants’ relationship with

Outboard — if proven true — were sufficient to establish liability. The court found that with respect to the Direct Quantum Owners, the plaintiffs had alleged “facts about defendants’ corporate structure and the decision to shut down [Outboard’s] plants and effect mass layoffs which, if true, would entitle them to relief against these [three] defendants under WARN.” However, the court dismissed the claims against the other five Quantum entities.

In reaching its holding that the Direct Quantum Owners could be liable as defendants, the Federal District Court for the Southern District of New York (Judge Gerard E. Lynch) relied on the “five-factor test” that is set forth in the Department of Labor regulations interpreting WARN for determining inter-corporate WARN liability, and rejected defendants’ arguments that they were only investors and that the more stringent standard for “piercing the corporate veil” should apply.

WARN requires employers with 100 or more workers to provide 60 days’ advance written notice of a “plant closing” or “mass layoff” (as defined in WARN) to affected employees. Failure to provide WARN notice in these situations could result in an obligation to pay wages and benefits for up to the full 60-day period of “missed” notice. The economic exposure to an employer that fails to give notice can be significant in large-scale layoffs or shut-downs — in effect the value of wages and benefits during the “missed” portion of the notice period and, under the statute, attorney’s fees to the prevailing plaintiff.

In defending against the WARN lawsuit, the Quantum defendants argued that the appropriate standard for assessing shareholder liability was the more protective standard for “piercing the corporate veil,” under which a shareholder may be held liable for the debts of its

² While these cases involve WARN and the National Labor Relations Act, there are a host of other federal labor and employment statutes (e.g., Title VII, the Fair Labor Standards Act, the Age Discrimination in Employment Act, the Family and Medical Leave Act) that incorporate notions of single or joint employer status and that must be considered when private equity or venture firms intervene in the operations of their portfolio companies. In addition, ERISA, the federal pension law, has a broad provision imposing pension withdrawal liability on entities under “common control” with an employer withdrawing from multiemployer pension plans. For a recent interesting case discussing the further application of “alter ego” and veil-piercing liability theories under ERISA, see the Federal Court decision in *Brown v. Astro Holdings, Inc.*, Civ. No. 04-5031, 2005 U.S. Dist. LEXIS (E.D. Pa. Aug. 29, 2005).

³ *Vogt v. Greenmarine Holding, LLC*, 318 F. Supp. 2d 136 (S.D.N.Y. 2004).

subsidiary only when there is “domination of the entity that works a fraud or injustice.” The defendants argued that, although they had been heavily involved in the company’s bankruptcy preparations and the decision to close the plants, they had not dominated the entity to work a fraud or injustice.

The District Court, however, applied the test set forth in the Department of Labor’s (“DOL”) interpretative regulations under WARN for determining when a parent and a subsidiary should be considered a “single” employer, which it emphasized had been followed by other Federal courts (particularly those in the Third Circuit, covering Pennsylvania, New Jersey, and Delaware).

The DOL standard under WARN utilizes five factors, without the more stringent “domination” and “injustice” components of the traditional veil-piercing test. As a result, the DOL test is easier for plaintiffs to satisfy. The five factors are: (1) common ownership; (2) common directors and officers; (3) *de facto* exercise of control; (4) unity of personnel policies emanating from a common source; and (5) the dependency of operations.⁴ No single factor is controlling, and it is not necessary that all factors be present to find that multiple entities are a single employer for purposes of the WARN Act. Plainly, the first two factors are standard operating procedure in the private equity and venture capital world—leaving the legal debate to focus on whether the last three factors have been implicated.

Applying the DOL factors, the court found the allegations in the plaintiff’s complaint, if true, could establish that the Direct Quantum Owners were part of a “single employer” enterprise under WARN. In addition to owning a majority of Outboard’s stock and having common directors on their respective boards (standard operating procedure for a private equity firm), the Direct Quantum Owners allegedly sat on a “parallel” management com-

⁴ 20 C.F.R. § 639.3(a)(2) (2005).

⁵ Secured lenders also may be vulnerable to WARN Act liability. The U.S. Court of Appeals for the Sixth Circuit recently reversed a lower court’s dismissal of a complaint and held that a secured lender may be liable for WARN violations of a borrower business if the lender becomes involved in operational decision-making and assumes responsibility for overall management of the business. However, a lender is not liable under WARN if its actions are intended only to protect its security interest or preserve the business assets for liquidation or sale. (*Continued on page 33.*)

mittee that mirrored the board of directors of Outboard, hired and controlled Outboard’s CEO (with one such defendant being a signatory party to his employment agreement), made the decision to have Outboard file for bankruptcy, and decided to shut down the facility.

What are the lessons to be learned from the *Outboard* case? First, as a factual matter, only management of the portfolio company should be involved directly in the lay-off and shut-down decisions. Obviously the private equity firm—as the ultimate owner of the business—will be intimately aware of and involved in the decision in its shareholder capacity, but to the greatest extent possible, the “shut-down” decision should be presented as a process largely controlled and “owned” by management of the operating company. It is worth noting that some of the Quantum defendants prevailed in having claims against them dismissed—even though they held “indirect” common ownership (as parents of the Direct Quantum Owners) and held overlapping director positions at Outboard. Thus the key factor to “neutralize” is any factual involvement by the private equity or venture capital owner in the *de facto* control of the key labor and personnel matters of the portfolio company, such as the allegations in the *Outboard* case that Direct Quantum Owners hired and controlled the CEO and decided that Outboard file for bankruptcy and close the plant.

One way to “neutralize” this *de facto* control element is to “sterilize” any board vote to shut down the facility or implement WARN-covered layoffs (or to undertake other material labor decisions), by having the board representatives from the private equity or venture firm abstain from any vote. Instead, the board vote would consist only of the board members from the management of the portfolio company and any outside directors. Additionally, in the context of a shut-down, because it is possible to secure a waiver of WARN claims through the payment of additional severance in exchange for a release, consideration should be given to combining a shut-down with an enhanced severance plan that includes releases executed by affected employees that expressly include, as a released party, the private equity or venture firm and all of its relevant affiliates (such as the fund actually owning the portfolio company, any co-investment vehicles, the general partner of the investment fund, and

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any management company associated with the private equity firm).⁵

The Heartland NLRB Complaint⁶

The situation in the *Heartland* case is very different from the bankrupt portfolio company scenario in *Outboard*, but the underlying theme is the same: in *Heartland*, the private equity firm sought to control the future affairs of its portfolio companies by trying to ensure labor peace and avoid the disruptions associated with bitter and contested union-organizing campaigns.

Some background on recent trends in union organizing may be helpful here. As union representation has waned in recent years, the more aggressive unions, such as the Service Employees International Union (“SEIU”), UNITE HERE, and the United Steelworkers of America (“USW”), have eschewed the traditional NLRB-supervised election approach (triggered by a documented showing that at least 30 percent of the putative bargaining unit supports the union). They view the standard election process limited to workers at a particular factory or facility as a waste of resources, since the employer is permitted to campaign against unionization and, in the context of a secret-ballot election, there is no certainty that at the end of the process the affected employees will vote in favor of the union.

Instead, these unions have focused on “top down” organizing directed at the senior management and/or shareholders of the business and pursued “neutrality” and “recognition” agreements covering organizing activities over broad operations—often in conjunction with aggressive “corporate campaigns”—that seek to pressure the employer into agreeing to (1) a neutrality agreement, in which the employer agrees not to oppose efforts by the union to secure authorization cards from unit employees (at a broad number of facilities) showing their support for the unit, and (2) a recognition agreement, in which the employer agrees to recognize the union and commence collective bargaining if the union can establish, through the presentation of authorization cards, that a majority of the designated workforce supports the union.⁷ Under this approach there is no election, and the unions argue that it provides the employers with more certainty and less workforce disruption, fostering a more cooperative relationship between the union and the employer. There have been successful neutrality and recognition campaigns in the hospitality industry in Las Vegas, and this approach is now being pursued vigorously by the unions in the paper, hospital, and security industries. There have been legislative efforts afoot to outlaw “top-down” organizing through recognition and neutrality agreements, but for the foreseeable future they are a fact of life for private equity or venture firms acquiring or investing in non-union businesses in industries that may be the targets of union organizing efforts.

⁵ (Continued from page 23.) In *Smith v. Ajax Magnathermic Corp.*, No. 04-3348, 2005 U.S. App. LEXIS 15394 (6th Cir. July 26, 2005), Judge Eric L. Clay reinstated WARN Act claims against a group of lenders that allegedly took over the management of a failing Ohio manufacturer, Ajax Magnathermic Corp. (“Ajax”). The suit involves approximately 56 workers who were laid off without any advance notice. The history of the case began in the late 1990s, when a consortium of lenders including Credit Suisse First Boston, BNP Paribas, PB Capital Corp., Balance High Yield Fund II Ltd., Caisse de Depot et Placement du Quebec, Deutsche Financial Services, and Key Bank made a series of loans to Citicorp Venture Capital Ltd., Ajax’s parent company. When Citicorp Venture failed to repay the loans on schedule, the lenders hired Sutter Group, a consulting firm, to evaluate Ajax’s viability as a business. The complaint alleges the lenders “inserted” the consulting firm to “manage” Ajax. The lenders later hired another consulting firm, Gordian Group LP, to find potential investors to buy Ajax, during which time the lenders held off demanding repayment of the loans. Ajax allegedly cited the lenders’ decision in May 2002 to collect on the loans as the event that precipitated the layoffs.

The court found the allegation that the lenders inserted a consulting firm to manage Ajax could reasonably support the conclusion that the lenders were operating Ajax as a business enterprise in the normal commercial sense. The court concluded that a fact-finder could reasonably infer that, by appointing new management, the lenders had become so entangled with Ajax that they had assumed responsibility for the overall management of Ajax’s business. However, the court was quick to note this ruling occurred on a motion to dismiss, a stage at which the court assumes all the plaintiff’s allegations are true and asks whether relief can be granted under any set of facts that could be proved consistent with the allegations. The judge observed, “[T]his case comes to us in the very early going . . . After discovery is complete the record may support a grant of summary judgment in favor of the Lender Defendants.”

⁶ *Heartland Industrial Partners*, 34-CE-9, JD(NY)-23-05, Raymond P. Green, 6/16/05.

⁷ A neutrality agreement customarily contains a promise from the employer to remain neutral when the union seeks to organize its unrepresented employees, as well as an agreement to recognize the union as soon as it collects signed authorization cards from a majority of the employees. In exchange, the union places agreeable limits on its organizing campaign to minimize the inconvenience to the employer.

This continued focus on non-traditional union organizing tactics is likely to be the hallmark of the new breakaway labor federation—“Change to Win”—that was formed during the summer of 2005, when the SEIU, UNITE HERE, and United Food and Commercial Workers (“UFCW”) disaffiliated from the AFL-CIO. Other unions have since joined with Change to Win, or indicated their intention to do so (Carpenters, Laborers, and United Farm Workers), so one has to assume that Change to Win will undertake aggressive efforts at forcing employers to agree to neutrality agreements and card checks. Complicating the political landscape has been the position of the NLRB during the Bush administration, which has filed complaints against employers who have cooperated with these new “top-down” union-organizing efforts on the grounds that they are essentially “jumping the gun” and violating employee rights to self-organization under Federal labor law by entering into agreements with the unions before the workforce has properly designated the unions as their majority representative. This federal action has at times been prompted by labor charges filed with the NLRB by the National Right to Work Legal Defense Fund (“NRTWF”) on behalf of complaining employees. This brings us to the recent *Heartland* decision.

The *Heartland* case dates back to November 2000, when Heartland Industrial Partners, a private investment firm specializing in leveraged buyouts, and the USW entered into a two-part agreement: a neutrality agreement with card-check and recognition procedures, and a side agreement for implementing the neutrality agreement at the firm’s future portfolio companies.

The neutrality agreement established a set of non-adversarial ground rules for any organizing campaign by USW at entities that Heartland controlled through its investments. The agreement granted USW access to its premises to distribute information and meet with employees, and provided for sharing employee names and addresses with USW. In exchange, USW agreed to certain limitations on access to company facilities and the duration and frequency of its organizing campaigns. The card-check provisions provided that Heartland would voluntarily recognize USW as the exclusive bargaining representative of the employees at its facilities if USW could demonstrate through signed authorization cards,

verified by an independent arbitrator, that a majority of the employees was in favor of USW representation.

The side agreement provided for the application of the neutrality agreement to after-acquired Heartland portfolio companies, or what the side agreement referred to as Covered Business Entities (“CBEs”) (defined as an entity in which Heartland directly or indirectly “(1) own[ed] more than 50 percent of the common stock, (2) control[led] more than 50 percent of the voting power, or ha[d] the power, based on contacts, constituent documents, or other means to direct the management and policies of the enterprise”). Under the side agreement, if USW notified Heartland of its intent to organize the CBE, Heartland would require the CBE to execute the neutrality agreement. In June 2002, Heartland acquired Trimas Corp., a manufacturer with facilities in Ohio, Michigan, and Wisconsin. A year later, Heartland extended the neutrality agreement to the newly acquired company. The following month (aided by the NRTWF), four employees of Trimas filed an unfair labor practice charge with the NLRB against both Heartland and the USW.

In somewhat of a surprise, the General Counsel of the NLRB issued an unfair labor practice complaint against Heartland and the USW, charging them with entering into an illegal agreement to effect a “secondary boycott” in violation of the NLRA.⁸ This triggered a hearing on the complaint before an Administrative Law Judge (“ALJ”) at the NLRB. The area of secondary boycotts is one of the most technical and complicated areas of Federal labor law, and Section 8(e) was designed to prevent unions from forcing “neutral” employers to agree not to engage in business with (or in labor law parlance, to “cease doing business with”) primary employers that the unions were targeting in labor disputes—so the unions could not pressure “neutrals” to in turn pressure the primary

⁸ Section 8(e) of the NLRA was designed to prevent agreements to engage in secondary boycotts (so-called “hot cargo” agreements), which occur when the primary employer and union try to enmesh a disinterested (secondary) employer as a pawn in their labor dispute. The section has been interpreted to apply only to agreements that have “secondary” and “cease doing business” objectives. *NLRB v. Longshoremens ILA*, 447 U.S. 490, 504 (1980). An agreement has a cease doing business purpose if it presents an employer with a choice of either not doing business or incurring some “injurious alternative” that is sufficiently burdensome to make it foreseeable that the employer would choose not to engage in the business relationship. *Brotherhood of Teamsters, Local 85 (Southern Pacific Transportation Company)*, 199 NLRB 212, 215 (1972).

employer with whom the union was fighting to give in to unionization. In a novel reading of Section 8(e) the NLRB's General Counsel claimed the side agreement covering "CBEs" was a prohibited agreement under Section 8(e) to "cease doing business" because it limited the range of portfolio companies in which Heartland was able to invest by imposing neutrality agreements on prospective portfolio companies.

Heartland and the USW (which were both named in the unfair labor practice complaint, and were allies in defending their arrangement) argued that Section 8(e) had no application to this type of case.⁹ They argued that a violation of Section 8(e) required a promise to cease doing business with another person—and that this case did not involve any agreement to cease doing business and did not involve the cessation of business with another person.

The ALJ agreed with Heartland and the USW and dismissed the complaint on two grounds. First, the agreement between Heartland and the USW had no "cease doing business effect." To the extent the agreement could impose any type of restriction on Heartland's desire or ability to acquire industrial enterprises, this type of single event or transaction would not constitute "doing business" within the meaning of Section 8(e). The ALJ also rejected the General Counsel's contention that the Heartland Agreement contained "investment restrictions." According to the ALJ, the documents did not contain any restriction nor was there evidence that USW's intentions were to restrict the universe of companies Heartland could invest in or acquire. The ALJ concluded that there was nothing in the agreement itself that restricted Heartland from making any transaction it chose to make: "The agreement does not limit Heartland from negotiating only with unionized firms or with firms

⁹ The fact that Heartland and the USW joined as partners to defend their agreement illustrates how these disputes can make strange bedfellows. In their brief before the NLRB, the USW praised Heartland's management, explaining that "a critical element of Heartland's overall business strategy is that companies in which it invests should not fight unions, but rather should have constructive and cooperative labor relations with them." After learning that the complaint had been dismissed, USW President Leo Gerard proclaimed, "this decision is a monumental victory for both workers desiring the benefits of collective bargaining representation and for employers willing to partner cooperatively to meet the challenges of the of the international marketplace."

that would agree to become unionized. It does not prohibit Heartland from negotiating with companies who would vigorously fight any efforts to unionize or with firms whose management may have never thought about unions at all." Finally, the ALJ highlighted the absence of any cessation of business with an "other person," also required under Section 8(e). The ALJ noted that, if the acquired entity is controlled by Heartland, as was the case of *Trimas*, the neutrality agreement would simply be an agreement by an employer to cease doing business with itself. It would not be an agreement by an employer to cease doing business with "any other person." (The General Counsel has filed technical exceptions and appealed the ALJ's decision.)

There is really a twofold danger in a private equity or venture firm adopting the *Heartland* model. The first is the possibility of being subject to a complaint of the sort filed against Heartland—unless the NLRB at some point definitively approves the arrangement. The second danger is that involvement of the private equity or venture firm in the labor affairs of the portfolio company from the outset could set the stage for (and provide the union with ammunition for) a "single employer" argument against the private equity or venture firm down the road, perhaps with respect to matters arising under the ultimate collective bargaining agreement with the portfolio company (if the union successfully organizes the target) and perhaps also with respect to alleged violations arising under other federal labor or employment laws (such as WARN).

Second, complaints like the one filed by the NLRB against Heartland raise the question of just how far can an employer and union agree—in advance—to terms and conditions of employment to apply once majority status is achieved, without unlawfully recognizing a union that is not yet the bargaining representative of the employees? In *Majestic Weaving Co.*, 147 NLRB 859 (1964), the board embraced the general principle that negotiating a tentative contract with a union before the union has majority bargaining status may constitute "unlawful recognition," even though implementation of the contract is conditioned on the union gaining majority support from the employees.

That was the theory underlying another complaint filed by the General Counsel against Dana Corporation and the UAW,¹⁰ which alleged that an agreement between the parties, negotiated and signed before the UAW became the majority collective bargaining representative at Dana's St. Johns, Michigan facility, violated provisions of the NLRA. Again, the action by the NLRB was initiated by employee charges filed with the assistance of NRTWF and created a coalition of employer and union defending the legality of their arrangement.

The UAW initiated an organizing campaign in Dana's St. Johns facility in early 2002. In August 2003, Dana and the UAW entered into an agreement containing a pledge of neutrality as well as substantive terms "to be negotiated" if the UAW achieved majority status as the exclusive representative of certain of Dana's employees, including those at the St. Johns facility. The agreement committed the parties to negotiate a four-year collective bargaining agreement and to use interest arbitration to reach a contract if they were unable to do so.¹¹

The General Counsel and Charging Parties argued that the UAW and Dana went beyond discussing tentative contract proposals in the letter of agreement and made substantive agreements on the terms and conditions of employment of employees—a process that effectively *granted exclusive bargaining status* to the UAW when it did not represent a majority of employees at the St. Johns plant. They claimed that the agreement interfered with the employees' organizing rights and unlawful support of the union.

The ALJ in *Dana Corporation* dismissed the complaint and found that *Majestic Weaving* was not controlling. First, the ALJ found nothing in the complaint to suggest that Dana recognized the UAW as the exclusive bargaining representative for the employees at the St. Johns facility. The ALJ noted typical and essential elements of recognition entirely absent from the agreement and the facts of this case. For example, Dana did not deal with the UAW to address employee grievances at the St. Johns facility and remained free to make changes in terms and conditions of employment without first notifying or bargaining with the UAW. The ALJ found this arrangement "utterly at odds" with the notion that Dana had recognized the UAW, and

commented that "[t]here is no concept of partial recognition in labor law; there is either recognition or there is not." The ALJ found the agreement in *Dana Corporation* to be "a far cry from a collective bargaining agreement" from which recognition could be inferred because it did not deal with significant matters such as wages, pensions, grievances and arbitration, vacations, and union security.¹²

So what are the lessons of *Heartland* and *Dana*? There is no question that the politics and the law surrounding neutrality and recognition agreements are currently in flux, and the fact that the NLRB General Counsel issued complaints in *Heartland* and *Dana* indicates the risks associated with these types of arrangements. Until the law in this area becomes more settled, private equity and venture firms should avoid dealing with unions directly with respect to agreements that cover non-union workforces at portfolio companies or "after acquired" portfolio companies. The safer approach (for venture or private equity firms as the owners of the business) is to wait and deal with union organizing efforts at the operating company level, through the portfolio company's management. Also, in the case of private equity firms considering the acquisition of business with a unionized workforce, it is best to explore with labor counsel well in advance the steps that can be taken to structure the deal to provide maximum labor flexibility and the lowest possible labor costs (for example, by deciding, in an asset deal, not to assume the collective bargaining agreement of the target, and then managing the hiring of the workforce, post-closing, to maximize the new owner's ability to at least unilaterally set initial terms

¹⁰ *Dana Corporation*, 7-CA-46905, JD-24-05, William G. Kocol, 4/11/05.

¹¹ The letter of agreement also referred to general principles: UAW's commitment that bargaining would not "erode current solutions and concepts" concerning health insurance such as premium sharing, deductibles, and out of pocket expenses; labor agreements bargained pursuant to the letter of agreement must include healthcare costs that reflect the competitive reality of the supplier industry and products involved; minimum classifications; team-based approaches; the importance of attendance to productivity and quality; Dana's idea program (two ideas per person per month and 80 percent implementation); continuous improvement; flexible compensation; and mandatory overtime when necessary (after qualified volunteers) to support the customer for the facility to have a reasonable chance to succeed and grow.

¹² In *Dana*, both the General Counsel and Charging Parties have filed exceptions to the ALJ's decision with the Board. The ultimate disposition in *Dana* should help clarify the outer boundaries of lawful pre-recognition agreements between employers and unions.

and conditions to the extent that bargaining with the incumbent union cannot be avoided).

Conclusion

In the area of federal labor and employment law, the adage that “less is more” may be the most appropriate advice to private equity and venture firms. Control and involvement in these matters—either in the anticipatory context of *Heartland* and *Dana* before there is any acquisition of a portfolio company, or post-acquisition, in the daily operations or liquidation of an investment, such as the case in *Outboard*—could give rise to unanticipated liability.

Given the current legal landscape, private equity firms should be consulting well in advance with outside labor counsel to address their labor and employment issues, both with respect to target companies and their existing portfolio companies. Too often in the past this has been an area overlooked by the owners and left to the management at the portfolio company. But with liability issues now surfacing at the shareholder level, it is time for that practice to change. Private equity and venture firms know how to use corporate, finance, tax and bankruptcy counsel effectively—labor counsel should be added to the mix. ©

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Mergers in the California Marketplace

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ware law applied, then pursuant to Examen’s certificate of incorporation, the holders of preferred stock would vote together with the holders of common stock as a single class on the merger agreement, and, in such case, VantagePoint (with approximately 13.5 percent of the vote on an as-converted basis with the common stock) would not be able to block the merger unilaterally. If California law applied, then the merger could only go through if it were approved by the holders of the common stock, on one hand, and holders of the preferred, on the other hand, voting separately as two classes; so the relevant provision of California law (discussed in the first section of this article) would essentially grant VantagePoint—given its holdings of a majority of Examen’s preferred stock—a veto over the merger, notwithstanding that Delaware law would not.

In *VantagePoint*, the Delaware Supreme Court upheld the Delaware Court of Chancery’s determination that the issue was governed by the “internal affairs doctrine” and therefore the law of Delaware should apply to the exclusion of California’s. The “internal affairs doctrine” is a long-standing choice of law principle that one state should have the authority to regulate a corporation’s “internal affairs”—namely, the state of incorporation.¹⁰ The Delaware Supreme Court, citing historical U.S. Supreme Court cases, as well scholarly analysis concerning Section 2115 of the California Corporations Code, firmly resisted the notion that a corporation should be subject to inconsistent legal standards or that a corporation’s internal affairs should rest with multiple jurisdictions.¹¹ Although the result of the *VantagePoint* case is binding only in Delaware currently, given the deference oftentimes afforded

¹⁰ Id. at 1118 citing *McDermott Inc. v. Lewis*, 531 A.2d 206 (Del. 1987).

¹¹ The Delaware Supreme Court referred for support to the reasoning in U.S. Supreme Court cases *Edgar v. Mite Corp.*, 457 U.S. 624 (1982) and *CTS Corp. v. Dynamics Corporation of America*, 481 U.S. 69 (1987). In addition, the Court pointed out that in her “comprehensive analysis of the internal affairs doctrine, Professor Deborah A. DeMott examined Section 2115 of the California Corporations Code” in her article *Perspectives on Choice of Law for Corporate Internal Affairs*, 48 *Law & Contemporary Problems* 166 (1985) and found “In contrast to the certainty with which the state of incorporation may be determined, the criteria upon which the applicability of Section 2115 hinges are not constants . . . Thus, a corporation might be subject to Section 2115 one year but not the next, depending on its situation at the time . . .”