Podcast Transcript

Rev Up! Deal Drivers: Steering Through Workforce Challenges in M&A

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Kattman: Welcome to Rev Up!, a podcast series focusing on the people and issues driving the fast-paced automotive mobility industry with a view on the future of mobility.

The discussions on Rev Up! will offer insights on the realistic and the futuristic in this evolving industry. I'm Amy Kattman, and you're listening to BakerHosts.

On today's episode of Rev Up!, we discuss key workforce issues facing those doing deals in the automotive and mobility industry from manufacturers to tech startups. Our host is Ashley Hess, a partner and co-leader of BakerHostetler's. Automotive Mobility Industry team. Ashley is joined by BakerHostetler partners Mike Ascencio and Sam Endicott, experienced practitioners advising on labor and employment legal matters. Let's listen in to Rev Up!: Where the Rubber Meets the Law.

Hess: Mike Ascencio and Sam Endicott, welcome to Rev Up!, our podcast focusing on the automotive and mobility industry.

Asensio: Thanks for having me, Ashley.

Endicott: Thanks, Ashley. It is a pleasure to be here.

Hess: Mike, you were with me in the last episode of Rev Up! where you joined me to discuss workforce issues in the automotive industry, including some discussion we had about the UAW activity we saw in 2023 and 2024. On today's show, I want to stay in the topic area of workforce issues. Specifically, I want to discuss the workforce issues and trends we are seeing when businesses in the automotive and mobility industry are going through growth and transitions, especially via mergers and acquisitions processes. Before diving in, let me frame this conversation and give context why these workforce issues are relevant now.

I often refer to the industry as the evolving automotive and mobility industry. What I mean by that is that the automotive and mobility industry is undergoing a significant transition driven by technological advancements impacting the vehicles themselves and the manufacturing processes for the vehicles. We have shifting consumer demands, geopolitics plays a role, and there is an ongoing evolution in the supply chain. Those factors alone create an environment that likely will see more M&A activity because industries in transition often experience cycles of increased M&A activity as the businesses in those industries adapt to changes and figure out what the path forward will be. Then, we add on top of that the potential impact of policy changes resulting from the second Trump term, and I am more convinced than ever that we will see greater M&A as industry players adapt. Mike, Sam, with that buildup, let's go.

Mike, you have a management labor practice and have been practicing law for 39 years, all at BakerHostetler, I'll add. You work in a variety of industries but have worked throughout your career with clients in the automotive and mobility sector, including OEMs and suppliers. Tell our listeners about the work you do day in and day out.

Asensio: What I do day-to-day in my practice is help clients when they might have organizing drives where employees are considering whether to join a union. We do a lot of collective bargaining and then a lot of management administration of bargaining agreements which can include grievance arbitration work and maybe Labor Relations litigation as well.

Hess: Sam, I want to get you introduced to the Rev Up! listeners. As opposed to Mike, you focus on employment matters. Tell us a little more about your practice.

Endicott: My practice really fits into three buckets in the employment law space. The first bucket, I do a lot of employment litigation, enforcing restrictive covenants for employers, and assisting employers defend claims that are brought by current and former employees. I also do a lot of investigations for employers when they have tricky issues that they need an outside perspective on. And then the third bucket of my practice is advice and counsel, and that focuses on helping employers write policies or navigate termination issues, and of course assist in due diligence when they're in acquisition mode.

Hess: Mike, let me start with you on labor issues. I know you are involved in the due diligence process and helping with the identification and negotiation of relevant provisions in purchase agreements when we have clients who are working on deals. So, my first question is, where do you start? What are the basic labor issues you look for in the legal due diligence process when advising a client going through an M&A deal?

Asensio: Well, two things stand out to me, Ashley. First is, I want to know what the plans are for future operations. Is this going to continue to be a business that is going to operate as it has in the past? Is it going to continue manufacturing in the same manner and method as it has in the past with basically the same employee complement or is it going to do it differently as they move forward after an acquisition? And I think secondly, then, is the successorship issue. That is always the key issue from my vantage point as a labor lawyer. What are the plans in terms of successorship? Is the buyer willing to take on the obligation to bargain with the union and then in some instances that may mean taking on or assuming the existing labor agreements. So, having some understanding of what the company's plans are in that regard, to me is absolutely critical as a starter.

Hess: Understood. It is the begin-with-the-end-in-mind adage. It is critical to review the current labor related agreements and have a plan as to how those employees support the mission of the enterprise under new leadership. What about deal structure, Mike? How does deal structure impact the diligence you do?

Asensio: Well, I'm going to do something that I was told long ago as a young lawyer never do, but it is probably the easiest way to explain this issue and that is overly simplify the successorship issue. So, typically if you have a stock purchase agreement, what happens is that the buyer will step into the shoes of the seller and then you take on whatever obligations are out there in terms of labor contracts, the duty to bargain, and actually assume those contracts and manage those going forward after the deal closes. That is in contrast to an asset purchase where typically with an asset purchase, what happens is depending upon whether the buyer engages in the same operation with the majority of the employees in their new operation having been heritage employees of the seller, that can create a successorship obligation to either in one instance at least recognize the union as a representative of the employees, and then there may or may not be obligations to assume the collective bargaining agreements. You may still have the ability to negotiate your own at that point. So, understanding how that deal structure has been put together and what that looks like is really important because that will determine whether or not there is any flexibility for the buyer in terms of its labor obligations.

Hess: Mike, I give you a good solid A on the description of the deal structures. Those are great points you made. Mike, I want to think about the situations where a buyer is doing diligence on a potential target that is not unionized. If the buyer is looking at the business that is not unionized but works with either key customers or suppliers that are unionized, does that create any specific due diligence concern on the buy side?

Asensio: Absolutely it does, because one of the things we've seen generally, and it's gotten a lot of media attention as well in the labor world, is the whole issue about single employment, joint employment, and understanding relationships between companies that may be in business with each other, part of an overall business strategy. And so, one of the things that I think is really important is understanding if there are different customers or suppliers that the target is working with and if those customers and suppliers are unionized, you want to make sure that you don't have a situation where there may be an argument that that union relationship somehow goes to the target company and would be something that you would have to acknowledge and/or assume in the event that you bought the business, and that could be through arguments such as joint employment, could be through single employment depending upon how those are owned and managed. So, I think you really want to have a very good comfort level that those are arm's-length arrangements and that there is no potential for joint liability there.

Hess: Mike, for the final question for you, I want to switch gears for a moment and think about the diligence work from the other side of the table. Let's think about this from the perspective of advising a client on the sell side, and before they take the business to market, if they are starting a process. What are the most significant actions that a client can take before they start the process or before they take the business out and start marketing it for sale?

Asensio: There is something I think that is very important and I always talk about it with clients that could be potential sellers as whether or not you're making your business attractive or unattractive for sale, and that is sometimes unions will want to negotiate into labor agreements, clauses that will guarantee that in the event of a sale or transfer of the business, the buyer will assume the collective bargaining agreements, recognize the union as the representative of the employees, and for an employer to agree to those terms at a point in time when you don't have a sale that is pending or maybe even being contemplated and then later have to abide by those, can make it sometimes difficult to sell the business and can also create some risk of liability on the seller, even after the sale if the buyer doesn't abide by those provisions. So, that, to me, is probably the biggest focal point I have, is trying to make sure that your collective bargaining agreement gives you as much freedom in terms of conducting the business, managing the business, even selling the business as you could possibly want going forward.

Hess: Thank you, Mike. Sam, I want to bring you into this conversation and turn to the employment side matters that are key to consider in the M&A context. What are some of the basic employment issues you look for in the legal due diligence process?

Endicott: There is quite a few, but some of the big ticket items, wage and hour compliance comes to mind. And so, that is typically when you're trying to determine whether an employer is properly paying its employees. And to dive into wage and hour issues, we usually look at a target company's pay stubs, their time keeping records, as well as their wage and hour policies. And of course, the job descriptions to make sure folks are properly classified as exempt or non-exempt for overtime purposes.

In addition to wage and hour issues, another big ticket employment law due diligence issue are restrictive covenants. And what I mean by restrictive covenants are non-competes, confidentiality provisions, and non-solicit provisions which prevent employees from either soliciting clients away from the business or employees away from the business. And now those restrictive covenants are all state law specific. And so, in the diligent process, it is really important to look at the specific state laws to determine whether the restrictive covenants are enforceable in each of the states.

And then of course the last item in the due diligence on the employment side of the house that usually comes up quite frequently, is independent contractor misclassification. And that is really when a company using somebody as an independent contractor or a consultant who really looks more like an employee. For example, the employer may be the only entity that they work for, the employer may be controlling everything they do, and the employer may be paying them an hourly rate every week. When we start to see those kind of sides, it looks more like an employee-employer relationship and there is a misclassification risk. And that could be significant in diligence because it could expose the employer to liability, whether it is unpaid payroll taxes or, in the worst case scenario, employment law claims for failure to pay overtime. So, when we see those kind of issues, we flag them immediately and work with the client to figure out the best way to remedy them.

Hess: Sam, each of those issues is hugely important to consider and properly diligence in a deal. There are so many developments in the employment area, each point you just raised could be the topic of its own Rev Up! episode. I will ask you the question I just asked Mike. How does deal structure impact the due diligence process?

Endicott: An asset purchase deal is where the buyer is only purchasing specific assets at the target entity's business. Unlike a stock purchase deal, that means that all the employees are typically not coming over at closing and only specific employees are coming. Another interesting factor with an asset purchase deal and this means you're not always taking the employment contracts with you. So, on the diligence side, you're going to want to make sure you have the appropriate contracts when those employees that you're bringing over start on day one.

Hess: Good points. Those considerations on deal structure are fundamental to the success of the deal. There are a number of factors to consider when deciding how we structure a transaction, the contracts with and impacting the employees are integral. Sam, we have worked together on a few sell-side engagements where we have helped businesses that are going to market. From the perspective of your practice area, are there steps that can be taken to prepare a business before it goes to market that may lead to a successful process?

Endicott: Absolutely. One of our best practices before going to market is doing a wage and hour audit internally and kicking the tires on the payroll issues, the exemption issues, and making sure everything is in line there, and if not putting in the immediate corrective measures, making sure overtime is being calculated correctly, or if somebody is misclassified, moving them over to a proper classification. Additionally, making sure restrictive covenant agreements are wrapped up and in good working order is essential before going to market. And that involves, of course, looking at the state laws, because those have been changing recently, but also making sure that the proper entity is named on it if there's been any organizational structures. That way, the acquiring company can purchase the agreements and be ready to enforce them on day one if needed.

Hess: Really important point, Sam. Those steps you identify are areas where a seller can proactively improve its chances of securing a buyer and preventing deal hiccups or deal killers. Sam, earlier you said that wage and hour compliance was a big ticket issue when you are conducting due diligence. I know there has been some additional focus in this area over the past few months, driven by the Department of Labor raising the salary threshold for certain exempt worker classification. Can you discuss that recent change in the law and how it impacts the employment due diligence you do?

Endicott: Yeah, Ashley, this is a issue that is really in vogue right now and it is added a layer of complexity to the employment diligence process. As background, in April 2024, the Department of Labor announced that the thresholds to get the salary exemption protections under the FLSA were going to increase, and they most recently increased on July 1 of this year and they're going to increase again on January 1, 2025. And these aren't insignificant sums of money. The annual salary increase used to be around 35,000 to qualify for the exemption from overtime. That increased on July 1 to approximately 44,000 and then it is going to jump up to roughly 58,000 on January 1, 2025. So, what this means is if you have a workforce that is primarily exempt, you have to increase the salary for each of those workers, to make sure they hit that exemption threshold. Now, when you're the acquiring company, it may not make sense to keep everybody at those high salaries and instead you may want to pay them overtime. Now, that is a case-by-case analysis that is going to depend largely on the industry you're in and, of course, the workforce dynamics.

Hess: Agreed, Sam. This area has become increasingly important to diligence. Additionally, I know the Department of Labor action has been successfully challenged and there is going to be a delay in when this regulation actually goes into effect. We'll keep an eye on this.

Another one of your big ticket areas that you mentioned is the area of restrictive covenants. There have been numerous developments in this area throughout the year. Give our listeners a little background and describe how employment diligence has been impacted by the FTC's stance on restrictive covenants.

Endicott: Again, this is a shifting area of employment law. Many of the listeners probably know in May 2024, the FTC issued a final rule that would largely wipe out non-competes for private employers. Now, it made national headlines when that rule was enjoined by a federal judge in Texas. However, that injunction is subject to appeal, so this FTC non-compete issue is still very much at the forefront of many employment lawyers' minds and how it is going to shake out. And so, while we navigate this uncertain area, whether, to determine whether the rule will come into place or not, there is a couple of things that employers should absolutely do when they're in the diligence process.

And one is to make sure that the existing restrictive covenant agreements they have include robust confidentiality provisions that prohibit employees from taking trade secrets and other confidential information when they leave, because even if the FTC rule goes into place, those confidentiality provisions will remain enforceable.

And another area where employers can try and hedge against the FTC rule coming into place is seeing which employees can fit the senior executive exemption to the FTC's rule. Now, with all this said, even if the FTC rule does not go into effect, there is a trend in the United States right now for a disfavoring of non-competes. And so, I think it is even more important than ever to really look into state-specific non-compete laws and keep a pulse on that during diligence.

Hess: Okay, Sam, the final issue I want to ask you about is the independent contractor misclassification issue. This is an issue that impacts the automotive sector and small- and medium-sized manufacturers. How can independent contractor misclassification risk be reduced during the due diligence process?

Endicott: Yeah, this is a tricky issue. I think it is a great one to raise. There is multiple ways an employer can reduce this risk.

First, you could terminate the independent contractor relationship and terminate the agreement post-closing. That is not normally the most efficient because presumably the independent contractor is playing a pivotal role with the industry or with the client, and so one way to address this issue is to renegotiate the contract to include language that very clearly explains the independent contractor relationship.

Another approach you could take is to have a special identification for independent contractor misclassification issues and then, of course, if it is a closer call, you may ultimately need to reclassify the independent contractor as an employee, post-closing.

Hess: Mike Asensio, Sam Endicott, thank you for being on Rev Up!: Where the Rubber Meets the Law. It’s been great having you.

Endicott: Thank you, Ashley.

Asensio: Thank you, Ashley.

Kattman: Thank you, Ashley, Mike, and Sam. If you have any questions for Ashley or his guests, their contact information is in the show notes. Tune in next time as Ashley is joined by former Congressman Peter Roskam, leader of BakerHostetler’s Federal Policy team. They will discuss the impact of the new presidency in Congress on the automotive mobility industry. As always, thanks for listening to BakerHosts.