

Employee Benefits in Acquisitions

Benefits due diligence involves uncovering and examining all of a Seller's benefit plans in order to determine their compliance with law and potential financial impact on the Buyer. The due diligence process begins with the Buyer's request for information from the Seller, typically following a confidentiality agreement or a letter of intent. In the case of due diligence for benefits purposes, the information request should start with a listing by the Seller of all of its employee benefit plans. Included will be all "plans" as we typically think of them as well as informal, unwritten arrangements that some employers may maintain for vacation or bonus arrangements. This request should cover all retirement plans including:

\$ pension plans \$ profit sharing plans \$ 401(k) plans \$ money purchase pension plans \$ employee stock ownership plans, or "ESOPs" \$ multi-employer (union) pension plans.

Benefits due diligence should also include a request from the Buyer for the Seller to list all of its welfare benefit plans including:

\$ group health plans \$ accidental death and dismemberment plans \$ dental plans \$ vision plans \$ cafeteria plans (premium only and "flexible spending account" plans) \$ long-term disability plans \$ short term disability plans \$ life insurance plans \$ severance pay plans \$ retiree medical plans \$ multi-employer (union) welfare plans.

The Seller should also be asked to list its deferred compensation and incentive compensation arrangements, including:

\$ stock option plans (nonqualified and incentive stock option plans) \$ phantom stock plans \$ stock appreciation rights \$ deferred compensation agreements \$ supplemental employee retirement plans \$ excess benefit plans \$ fringe benefit plans (for example, an educational assistance plan or transportation expense reimbursement plan) \$ annual bonus plans

On considering a Seller's benefits, vacation pay plans, severance pay plans, deferred compensation plans and the like, potential liabilities and accounting disclosure issues may be presented. For example, GAAP accounting requires the accrual of liabilities for earned but unpaid vacation and deferred compensation.

Less obvious are other benefit related liabilities that can be so large that, if they are disclosed, they may require adjustment of the purchase price the Buyer is willing to pay. These liabilities include:

- \$ Defined Benefit Pension Plans
- \$ Multiemployer Pension Plans
- \$ Plans of other members of Seller's controlled group or affiliated service group.

The potential of large liabilities associated with underfunded defined benefit pension plans and multiemployer pension plans means that even if you have entered into a letter of intent, it is unlikely that the parties will really have agreed on the purchase price if such a liability arises in due diligence. The Buyer will be unwilling to assume all of it by taking over the Seller's plan, and the Seller will be unwilling to assume all of it by terminating or withdrawing from the plan prior to closing. Because of the potentially disruptive nature of this kind of liability, it makes sense to flesh it out as early as possible in the acquisition process. One way to do that is to insert a Seller representation into the letter of intent that, in effect, states that the Seller has no unfunded pension obligations. Consider the following language:

Neither Seller nor any member of a controlled group of corporations, businesses under common control or an affiliated service group which includes Seller maintains or contributes to a defined benefit pension plan as defined in Section 3(2) of ERISA, 29 U.S.C. ' 1000 et seq., or a multiemployer pension plan as defined by the Multi-Employer Pension Plan Amendments Act of 1980, 29 U.S.C. ' 1381 et seq.

The second stage of due diligence, after all of the Seller's plans have been identified, is to request appropriate supplemental information. The purpose of doing so is (1) to establish that the plans are properly documented and in compliance with all legal requirements, and (2) to quantify any associated liabilities. Once these issues have been resolved, the liabilities can be allocated between Buyer and Seller.

The documents that you should be looking at in this second stage of benefits due diligence include, for defined benefit plans, the most recent actuarial reports, and for multiemployer pension plans, a statement from the plan administrator of the estimated withdrawal liability that would be incurred in the event of a current withdrawal. Other documents that should be reviewed include all plan documents, trust agreements, agreements with third party administrators, summary plan descriptions, annual reports (Form 5500), COBRA notices, HIPAA certificates, all correspondence with the IRS, DOL or Pension Benefit Guaranty Corporation, any employer records concerning disputed benefit claims, and a copy of the Seller's employee handbook.

Once you get your hands on all of this material, what should you be looking for?

\$ undisclosed Seller liabilities (this could be anything from liability for accrued vacation to COBRA continuation coverage) \$ any regulatory audits or inquiries
\$ any contested benefit claim \$ COBRA liabilities \$ Employees out on disability and not carried on Seller's employment rolls

Other points you should be aware of in considering benefits issues in an acquisition transaction:

1. Make sure that any Seller group health insurance contracts that the Buyer wants to leave in place is assignable and, if not, find out what the insurance carrier requires in order to waive any restrictions on assignment. Also, a Buyer should check with any existing group carrier for its existing health insurance for contract restrictions on covering the newly acquired business with a separate policy from another carrier. Try to determine the health risks covered under the Seller's plan. Employees-to-be with significant health problems may cause serious cost increases if these risks are absorbed into the Buyer's plan.

2. Self-insured medical plans - make sure existing stop loss insurance covers all benefits provided under the plan.

3. Plan Termination Issues -

a. Market Value Adjustments

b. Termination to avoid ERISA liabilities

c. Buyer issues if Seller discontinues its business and leaves no mechanism in place to handle plan termination and benefit distributions

d. Seller may not be able to terminate a DB plan unless it's fully funded

4. Severance plans -- are they welfare plans or pension plans? An ERISA compliance issue is presented if the Seller's severance plans do not meet welfare plan criteria, including:

a. all benefits must be payable to the participant within 24 months of termination of employment; and

b. total benefits may not exceed the equivalent of twice the participant's annual compensation during the year preceding termination of employment.

5. Union employees -- a Seller who is going out of existence or disposing of a union plant or facility probably is operating under an existing collective bargaining agreement. Under the labor laws, a Buyer may be deemed to have successor liability under that agreement even in an asset transaction. This could tie a Buyer into the existing collective bargaining agreement as well as related obligations to make pension and welfare contributions. Remember, the rules under the labor laws are less restrictive than the general commercial rules that would attach Seller liabilities to Buyers under the successor liability rules. No continuity of ownership or management is necessary. So union contracts have to be approached more cautiously than other Seller contracts.

6. Retirement Plan Mergers

a. Advantages --

- (1) No full vesting of benefits
- (2) No distributions to Seller's employees
- (3) Continuity of plan through Buyer's plan

b. Procedure --

- (1) Merger Analysis
- (2) Minimum Coverage and Transaction Rules

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