

An Ounce of Prevention: Benefit Plans in Mergers & Acquisitions

When two companies merge, or a business is acquired through a stock or asset purchase, inattention to the potential liabilities of the benefit plans and executive compensation agreements of the acquired company can be a recipe for disaster. The buyer is usually responsible for the benefit plans of the acquired business and consequently for any liabilities associated with those plans. Conducting the appropriate due diligence early can uncover any items that need to be addressed, which may in turn alter the purchase price of the transaction.

Each acquisition is unique, requiring a customized approach to determine how to structure and approach the due diligence process. This commentary provides a general brief and a starting point for consideration. As part of the process, you will likely want to put together a team including benefits experts, actuaries, and ERISA attorneys. A more exhaustive list of issues can be developed across functional lines.

Transaction Type Determines Exposure

In a stock sale or merger, the acquiring or the surviving entity automatically becomes the sponsor of the target's benefit plans and will be responsible for any liabilities associated with those plans. In an asset sale, the purchaser is generally not responsible for the liabilities of a target's benefit plans, unless it explicitly agrees otherwise. There are two notable exceptions: First, the purchaser may become liable for required contributions to a defined benefit pension plan if it is considered a successor to the seller and second, an asset purchaser may be required to offer COBRA continuation coverage to the seller's employees.

The Due Diligence Checklist

Employee benefits are an important part of the negotiations in an acquisition. It is critical that the buyer request all relevant information from the seller regarding the benefit programs to determine:

- The necessity of continuing those plans after the sale;
- The costs of the seller's programs to the seller;
- The costs of bringing the sellers employees into the buyers existing plans; and
- Any potential employee relation issues that may arise regarding the consolidation of the two groups.

As a starting point, the initial request from the buyer should include (for each benefit plan offered):

1. Any oral or written employment-related agreements, consulting or contractor agreements, and any collective bargaining agreements in effect (or as a successor to the current agreement). In addition, it will be important to ascertain whether there are any change of control agreements that provide additional payments or accelerated vesting upon completion of sale.
2. The plan documents and any amendments, Summary Plan Descriptions, Summary of Material Modifications, IRS favorable determination letters for qualified plans, the

- last three Form 5500 filings and all audit reports and actuarial reports as applicable. This information should be provided for every ERISA employee benefit plan (e.g. pension, profit sharing, 401(k), non-qualified deferred compensation plan, SERP, medical, dental, EAP, AD&D, Life Insurance plans, LTD, STD with insured benefits, cafeteria plan, health care and dependent care reimbursement accounts.
3. Copies of administrative forms for all employee benefit plans including COBRA and HIPAA forms.
 4. Identify all COBRA qualified beneficiaries, their qualifying date and premium history.
 5. Any documentation, both formal and informal, relating to promises made to retirees over the past 5 years.
 6. Information with respect to any employee benefits related complaints filed with and federal, state or local agencies during the last 5 years that have not been resolved.
 7. As applicable, if seller has participated in any multiemployer plan within the last six years and any assessment of withdrawal liability.

You've got the data – now what?

Once the data is in hand, it's time to assess the potential costs and challenges the prospective seller's benefit plans present to you, the buyer, and decide on the most appropriate strategy going forward. Some of the most important considerations by plan are listed below:

Health & Welfare Plans

The first step is to assess all plan documentation (plan documents, SPD's, etc.) to verify that all plans are in compliance with all IRC and ERISA laws related to health & welfare plans such as state insurance laws if applicable, COBRA, Mental Health Parity Act, HIPAA, Medicare Modernization Act, etc. The exposure to the acquiring company is potential claims, excise taxes, and civil penalties. All health & welfare plans (including group life, dependent care assistance etc.) must be determined to be non-discriminatory. If the plan is found to be discriminatory, reimbursements from the plans become taxable and seller's highly compensated employees may request a gross up to compensate them for this. Finally plans must be in compliance with fiduciary, plan administration and reporting and disclosure rules otherwise claims and civil penalties could result.

The plans should also have filed 5500 forms as necessary and you should confirm that all employee contributions are deposited on a timely basis. If possible, any operational audits or dependent eligibility audits should be reviewed to ensure benefits were paid appropriately. In addition, any contracts for insurance or administrative services should be reviewed to make sure there is nothing to prevent you from either continuing or terminating the agreement upon the completion of sale.

From a financial standpoint, it should be determined whether all required premiums and benefits have been paid to date for fully insured plans and whether provisions have been made to reflect accrued but unpaid benefits in a self insured plan. The cost analysis should also be extended to deferred compensation plans, other executive benefits such as change in control plans, severance plans and vacation/sick/PTO plans as depending upon the generosity of the seller, these normally unfunded programs can material costs to the buyer.

Retiree Medical Plans

If a company offers retiree medical coverage, you will need to ensure that all necessary disclosures have been made on the seller's financial statements, and determine (through analysis of plan documents, SPDs, employee communications, etc.) the duration and extent of the commitments and decide whether the seller has reserved the right to change or terminate the benefits.

Disability Plans

For organizations that provide disability benefits, the buyer should determine the extent of the benefits provided, whether the benefits are self funded or fully insured and negotiate how disability will be handled during the transition period. Buyer's may find that they must negotiate with their current vendors to allow newly acquired employees to immediately participate in the buyer's plans.

Future Steps for Health & Welfare Plans

Once the data has been collected and analyzed, it comes time to determine the most appropriate course of action for moving forward. It might make sense for the buyer to continue separate plans or terminate seller's plans and incorporate newly acquired employees into Buyer's plans or a transition from one to the other. Continuing separate plans allow newly acquired employees one thing less to worry about coming into a new organization and if acquisition is mid-year then potential mid-year plan termination costs, run out termination liabilities for self funded plans, COBRA coverage, and issues dealing with satisfaction of deductibles, out of pocket limits and contributions elections can be deferred. Terminating seller's plans and integrating Seller's employees upon sale, can have the affect of integrating employees much more quickly into the new organization and provide an opportunity for the buyer to have more leverage in negotiating with vendors for the newly combined plan.

There are many financial and human resource considerations with resulting from an acquisition. The implications of not doing one's due diligence can result in many costly and human resource related consequences. We are ready to help with the level of analysis and strategic planning necessary to ensure your acquisition process proceeds as smoothly as possible.