Employee Benefits at the Time of Mergers and Acquisitions

Mary Komornicka, CEBS
Attorney
Larkin Hoffman
Minneapolis, Minnesota
Possible Situations

- Stock Purchase
- Asset Purchase
- Merger
- Acquisition
- Spin-offs
Benefits Affected

* Retirement Plans
* COBRA
* Flexible Spending Accounts
* Health Insurance
  * ACA issues
* Executive Plans
* Employee Stock Ownership Plans
**Stock Purchase**

* Buyer is purchasing entire stock of the Target
* Target will either disappear entirely or be a subsidiary of Buyer
* Target employees become Buyer employees at closing
* Buyer assumes all obligations & liabilities of Target
  * Including all benefit plans
* Buyer is purchasing certain assets of Target
  * Can be all assets, leaving a shell corporation behind
  * Can be a particular location or division of Target
* Target employees remain Target employees unless hired by Buyer
* Target retains all responsibility for benefit plans (with a few exceptions)
Following the close, what happens to Acquired Business?

- Absorbed within Buyer (merger)
- Treated like any other Buyer division
- Same Buyer benefit structure, generally
- Stand-alone business (acquisition)
  - With separate benefit structure or
  - With Buyer’s benefit structure
* No other entity involved
* Company decides to spin-off a division
  * Often “sold” to management of division
  * Being set up for a possible future sale
* Asset sale
* Benefit Plans
  * Continue in Parent company plans
  * Establish new plans
* Negotiations have been on-going for weeks
* No one has talked to HR until deal is almost done
  * Either side!
* HR has a week to prepare for change
* Don’t forget—deal can collapse at the last minute
First Things First

* Inventory of plans
* Collection of plan documents
* Collection of plan data
* Decision on future of specific plans
  * Some things MUST happen before closing
  * Some things CANNOT happen before closing
Employee Communications

* Don’t get ahead of yourself
* Deals fall through or change
* Need to keep rumors to a minimum
* Prepare a variety of communications, based on alternatives
* Clear everything with senior management
Specific Plan Issues

* Particular issues depend on plans
* Pay close attention to plan specifics
* Carefully review all administrative contracts and insurance contracts
Stock sale: buyer assumes liability for the health benefits
Asset sale: liability stays with seller

* Key Questions regarding Target Plan
  * Are there sufficient funds to cover incurred but unreported funds?
  * Are assets held in a VEBA?
  * Stop-Loss coverage adequacy?

* Merge with Buyer’s Self-Insured
  * Any issues with the current stock-loss coverage?
  * Administration

* Retiree Medical?
Health Plans: Fully insured

* Stock Sale: Buyer assumes insurance contracts
* Asset Sale: Seller retains (or ends) contract
* Key Question for Buyer:
  * Does Buyer want to cancel insurance contracts and merge participants into Buyer’s plan? Or
  * Does Buyer want to assume contract? Need insurance company approval.
* Retiree Medical?
Are the Target plans grandfathered?
Does the size of the Target make a change in the ACA rules that apply to the Buyer?
If a spin-off, does this change the size of the remaining company?
Has the Target company chosen to “pay” rather than “play”?
Was there a salary adjustment as part of this decision?
If changing health plans as a result of transaction, then

1. What happens to the deductible? Carry-over or start over?
2. Change in doctors if in mid-treatment?
3. Change in Rx formulary
Asset Sale Exception “Successor Employer”

* If employees continue doing essentially the same job and
* If the company continues operating essentially the same business and
* If the remaining part of the Target company no longer has a health plan

Then the Buyer has responsibility for COBRA to the terminated employees of the Target company

Buyer may ask for COBRA funds to be escrowed by seller
Stock sale: Buyer assumes plan, regardless of whether currently over or under funded

Asset Sale: Buyer and Seller have two options
- Seller retains participants on seller’s plan, buyer transfers deferral to seller’s plan
- Participants transfer onto Seller’s plan, with transfer of assets.
- No change in participant deferral rates
Retirement Plans

* 401(k) Plans
* Defined Benefit Plan
* Multi-Employer Plans
* Controlled Group Issues
401(k) Plans

* **Stock Sale Issues:**
  * Qualification status of plan
  * Appropriateness of investments
  * An outstanding errors (EPCRS)
  * Quality of plan administration
  * Plan Fees
  * Passing discrimination tests if a combined plan
Transition Period

Discrimination Tests Issue
Can maintain separate plans, without testing together, for plan year of the acquisition/merger and the following year.

Example:
Acme buys Zeno on 3/1/14. Both Acme and Zeno have calendar year 401(k) plans.
   2014—Test Acme and Zeno separately
   2015—Test Acme and Zeno separately
   2016—Test plans together
401(k) Plans

Options
* Maintain two plans
* Merge Plans
* Terminate One Plan
* Freeze One Plan

Considerations
* Will employees move between two divisions?
* Protected benefits
* Plan Feature Issues
* Investment Issues
401(k) Successor Plan

* Cannot terminate plan after stock sale closing if
  * A 401(k) plan exists
  * A 401(k) is established within 12 months following distribution of assets
  * “Successor Plan”
* Not an issue if asset sale
* Need to make decision about future of plan prior to closing
401(k) Plan Features

* Safe-harbor Plan
* Roth contributions
* Roth conversions
* Loans
* Self-directed investments
401(k) Plan Investments

* Stable Value Fund—liquidate or transfer
* Real Estate
* Limited Partnerships
* Insurance contracts
* Company Stock

Don’t forget the blackout period!
SINGLE EMPLOYER PLAN
* Funding status
  * On-going basis
  * Terminated basis
* Benefit Status
  * Frozen (Hard or Soft)
* Investments
  * Allocation
  * Strategy
* Coverage Issues  §401(26)
**Defined Benefit Plan**

* **SPIN-OFF PLAN**
  * Allocation of Plan Assets
  * Determination of funding status
    * Assume level from prior plan
    * Perform new actuarial valuation for spun-off employees

* **PBGC Issues**
  * Is asset allocation appropriate
  * Approval not required, but PBGC can step in over next 5 years to set 5 year
  * Seller liability if principal purpose was to evade termination liability
Multi-Employer Plans

* May participate in more than one union plan
* May cover only a few employees, e.g., truck drivers
* Significant time lag to get current withdrawal liability
* Based on historical share of contribution to plan
* Many multi-employer plans are significantly underfunded

**Stock Sale**
Buyer assume obligations and withdrawal liability

**Asset Sale**
Negotiable item: buyer can assume liability
Otherwise, seller has to pay liability
Assuming Withdrawal Liability

* Sale of assets triggers withdrawal or partial withdrawal liability
* Why assume?
  * Intend to continue with union employees
  * Otherwise would increase sale price to cover liability
* Concept—employer must continue contributions for a period to fund earned benefits
Buyer escrows annual contribution amount for 5 years
* Seller has secondary withdrawal liability if buyer withdraws within 5 years and does not pay withdrawal liability
* Sales contract must state this obligation
* Seller must post security for contingent liability if it liquidates or distributes remaining assets within 5 years
* PBGC can waive the bond/escrow requirement if buyer’s net tangible assets equal bond requirement
Withdrawal Liability Exceptions

* Construction Industry
  * No withdrawal liability if employer ceases to do the same work in the same area that was covered by the union agreement
  * Retirees
  * Closes business down
  * Sells the business

* Trucking Industry
  * Withdrawal liability only if
    * Employer continues to work in same geographical area
  Or
    * Withdrawal does substantial damage to contribution base
**ESOPS**

* If the acquiring entity:
  
  * Will new employees come into the ESOP?
  
  * If all company stock is held in ESOP and already allocated to participants, what do the new employees get?

* If being acquired, price of stock must be established by a fair appraisal.
Protected Benefits

* Normal and early retirement age
* Disability benefits
* Forms of distributions
* Withdrawal provisions
* Allocation requirements
* Accrued benefits
* Existing Controlled Groups may no longer exist
* New Controlled Groups may have been created
* Impact:
  * HCEs
  * Key Employees
  * Plan structure
Executive Plans

* What plans exist? Are they all in writing?
* Are there any Rabbi Trusts?
  * Sufficient assets to fund the promised benefits?
* Any Company Owned Life Insurance contracts?
* Any “Split-dollar” insurance plans?
* Do any plans have a “Change-in-control” provision?
  * If so, who is responsible to pay for the promised benefit?
Due Diligence

* Retirement Plans
  * Qualification status
  * VCPs
  * Loans
  * DB Funding Status
* Executive Plans
  * 409A status
* Health Plans
  * ACA Status
  * §125 tests
  * COBRA administration
* Short Term Disability
  * “Payroll Practice” or Insurance contract
  * Clear Policy
1. Set strategic concept early (but recognize that it may need to change)
2. Gather full and complete information on all employee plans
3. Evaluate plans and identify issues, possible conflicts, limiting factors
4. Develop implementation process for entire benefit package
5. Confirm understanding with senior management
6. Negotiate with record-keepers; insurance carriers; investment managers
7. Manage Employee Communication