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Meeting Announcement

SESSION: **A PROACTIVE APPROACH TO HR AND BENEFITS PLANNING FOR MERGERS AND ACQUISITIONS**

Cynthia Marcotte Stamer & Raymond P. Turner
Akin, Gump, Strauss, Hauer & Feld, L.L.P.

In an age of corporate change, human resources and employee benefit managers must be prepared to respond quickly when their corporation engages in a merger, acquisition, sale, restructuring, or other significant corporate change. As attorneys with the law firm of Akin, Gump, Strauss, Hauer & Feld, L.L.P., Cynthia Marcotte Stamer and Raymond P. Turner regularly counsel and assist human resources managers, employee benefits managers, and other members of corporate management involved in a corporate sale, acquisition, merger, restructuring or other significant corporate change. Ms. Stamer and Mr. Turner will brief attendees about practical human resources and employee benefit strategies that may enhance their ability to respond effectively to a corporate merger, sale, acquisition, or other similar event involving their employees. Ms. Stamer and Mr. Turner also will provide tips to help attendees anticipate and manage selected legal and practical problems that frequently arise in the course of implementing these activities.

DATE: Tuesday, February 25, 1997

PLACE: The Cooper Aerobic Center, Guest Lodge I, McKinney Room (above lobby)
12230 Preston Road, Dallas, Texas (Maps available upon request)

TIME: Registration and Networking begin: 11:30 a.m.
Lunch begins: 12:00 noon Program begins: 12:20 p.m.

COST:	Pay In Advance:	Members: $20.00	Non-members: $30.00
	Pay At Door:	Members: $25.00	Non-members: $35.00

Please make your reservations and reserve your seating no later than Friday, February 21, 1997. Your check should be made payable to WEB and sent to:

Colleen Davidson
PageNet
4965 Preston Park Blvd., Suite 700
Plano, Texas 75093

You may fax your reservation by completing the form on the reverse side of this announcement and faxing it to **Colleen Davidson** at **(972) 985-6702**. Unless reservations are received 24 hours prior to the meeting, a lunch cannot be guaranteed. Reservations not canceled 24 hours prior to the meeting will be billed.

(OVER)

A PROACTIVE APPROACH TO HR AND BENEFITS PLANNING FOR MERGERS, ACQUISITIONS, AND OTHER SIGNIFICANT CORPORATE EVENTS

for

Dallas Chapter, Working in Employee Benefits
February, 1997

Presented by
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CAUTIONARY NOTE: ***This paper is intended only to be a brief discussion of the laws and issues discussed herein. It is not intended to be a comprehensive analysis of each and every aspect of such provisions. Because of the generality of the discussion and because interpretive guidance is still developing regarding the laws discussed in this paper, the information contained herein may not be applicable in all situations and may not, after the date of this presentation, even reflect the most current authority. For these reasons, nothing contained in this paper should be relied or acted upon without the benefit of legal advice based upon the particular circumstances presented.***

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EMPLOYEE BENEFIT ISSUES THAT AFFECT CORPORATE ACQUISITIONS, SALES, MERGERS AND DOWNSIZING: AVOIDING COMMON PITFALLS

by
Cynthia Marcotte Stamer

I. INTRODUCTION

Employee benefit plan considerations have become increasingly important in general corporate transactions involving acquisitions of companies, sales of companies, restructuring, and downsizing of the workforce. Employee benefit plans give rise to significant balance sheet liabilities and off-the-balance-sheet liabilities. Parties to a corporate transaction also must be aware of fiduciary obligations that may significantly alter the way transactions can be structured. Employee benefit plans are important tools for managing legal risks during corporate downsizing, but they must be correctly designated, implemented and maintained. The following article discusses some of the most important employee benefit issues that should be reviewed during corporate transactions and offers practical suggestions to help identify and manage the associated risks.

II. CORPORATE ACQUISITIONS AND MERGERS

In a sale or merger of a company, the parties should discuss and negotiate employee benefit plans early. The structure of the transaction will significantly affect what employee benefit plan liabilities or benefits go to the seller or the purchaser.

- In a stock sale or a merger of a seller's company into a purchaser's company, the purchaser usually "steps into the shoes" of the seller and assumes the seller's employee benefit plan liabilities under the plans sponsored by the seller unless a purchase agreement specifically provides otherwise.

- In the case of a sale of assets, the terms of the purchase agreement normally determine who is responsible for the employee benefit liabilities. If the agreement is silent, the liability usually remains with the seller.

A. Evaluate Employee Benefit Plans For Hidden Liabilities

1. Retirement Plans/Defined Benefit Plans

The type of employee benefit plan that typically involves the greatest potential liability is a defined benefit plan. A defined benefit plan, unlike a defined contribution plan, guarantees participants a specific level of benefits upon retirement. Usually, a defined benefit plan ties the promised retirement benefit to the employee's earnings, length of service, or both. The employer makes regular contributions to the plan to fund the future benefits of the participants. An actuary determines the amount the employer must contribute to the plan each year to meet that specific target level of retirement benefits. The actuary bases his determination upon a formula and such factors as the age of the participants and the plan's investment returns. However, the employer bears the risk of providing a guaranteed level of benefits even if the actuary's projections underestimate the contributions actually required or the plan's investments go bad. Further, defined benefit plans may have unfunded liabilities created by plan amendments, actuarial gains, unanticipated losses from bad investments, and guaranteed benefit increases pursuant to a collective bargaining agreement. Therefore, defined benefit plans may be under-funded, i.e., there are not enough assets to cover accrued benefits.

Purchasers should verify that they do not incur liability due to underfunding by the seller or a member of its control group. An employer that sponsors a defined benefit plan that is not fully funded must make minimum contributions each quarter and every year.[1] If the sponsoring employer fails to pay a required quarterly contribution, it also must pay interest on late installments. The rate of interest charged equals the higher of 175% of the midterm applicable federal rate or the interest rate used by the plan to determine costs.[2] If the employer fails to contribute the minimum amount for the year, it initially will be assessed a non-deductible excise tax equal to 10% of the defined benefit plan's accumulated funding deficiency (5 percent in the case of multiemployer plans).[3] Additionally, if the employer fails to pay the annual minimum contribution within certain periods, an additional tax equal to 100% of the unpaid accumulated funding deficiency may arise.

In a stock acquisition, the purchaser may become jointly and severally liable for the unpaid minimum contributions and the accrued penalties. In an asset acquisition, the nonpayment of minimum contributions may result in the purchaser acquiring the assets subject to liens.

A lien on all property of the employer and any other commonly controlled entity may arise if the quarterly or annual minimum contribution is not paid by the due date and if the underfunding is sufficiently large.

2. Welfare Benefit Plans, Including the Retiree Medical Time Bomb

A welfare benefit plan is any plan, fund, program, or arrangement established or maintained by an employer or employee organization or both for the purpose of providing participants or beneficiaries with medical, health, accident, disability, death, unemployment, or vacation benefits, apprenticeship or other training programs, day-care centers, scholarship funds,

[1] I.R.C. § 412 (1994).

[2] Different interest rate rules apply to money purchase and target benefit plans. *See* Q&A-3 Notice 89-52, 1989-1 CB 692, I.R.C. § 4971(a).

[3] I.R.C. § 4971(a).

prepaid legal services, and benefits described in the Labor Management Relations Act (primarily severance benefits) other than pensions, other than those arrangements exempt from welfare plan status under the Employee Retirement Income Security Act (ERISA) or the regulations of the Department of Labor.[4] Examples of welfare benefit plans include:

- Health Plans;
- Life Insurance Plans;
- Disability Plans;
- Severance and Supplemental Unemployment Plans;
- Dependent Care Assistance Plans;
- Educational Assistance Plans;
- Vacation Plans;
- Life-cycle benefits, group legal services, long-term care, housing assistance, and other after-tax benefit programs;
- Cafeteria Plans; and
- Retiree and Other Post Employment Coverage under any of the above listed plans.

a) General Issues

The parties should consider the following issues in connection with corporate transactions involving health plans:

- Cost of the plan and comparability to existing plans;
- The affected employees' transition to the new program (managed care and point of service features);
- Pre-existing condition limitations;
- Deductibles and out-of-pocket caps; and
- Implications of Internal Revenue Code Section 125.

[4] 29 U.S.C. § 1002(1) (1994).

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b) Coverage Transferability Issues

Parties should review existing insurance contracts and Voluntary Employees' Beneficiary Association Trusts (VEBAs) to determine if the coverage can be transferred.

- Will the insurance carrier allow the policy to be transferred?
- Is the policy worth transferring?
- Are there policy reserves (including waivers of premium) for disabled persons?
- Can an equitable, reasonable basis for a VEBA spin-off be negotiated?
- What is the applicability of the transferred assets?

c) Retiree Medical and Other Post-Employee Benefit Obligations

Retiree medical benefits often represent a major liability to employers because these benefits are usually not funded in advance. A party's obligation to provide health, life, and other welfare benefits to retired employees should be carefully evaluated and negotiated prior to a sale or merger.

Determining the amount of liability related to post-retirement medical and life insurance benefits is even more difficult than determining the amount of liability for defined benefit plans. To determine the amount of future liability, an actuary must predict the rate of increase in medical expenses over many, many years and the degree to which future Medicare benefits will be reduced in addition to predicting life expectancies and interest rates.

The following issues should be identified and evaluated to determine what the retiree liabilities are:

- Any Federal Accounting Standards Board (FASB) accounting should be reviewed;
- Have promises been made to early retirees about health care benefits?[5]
- Are there possible age discrimination claims?

[5] In *Sprague v. General Motors*, 843 F. Supp. 266 (E.D. Mich. 1994), General Motors offered early enhanced retirement benefits to certain employees as part of its downsizing. The Employees contended that General Motors promised then full lifetime health care coverage as part of the early retirement package which General Motors disputed. The court held that the employees had presented oral and written evidence of such promises and the General Motors was required to provide these benefits to the employees during their entire retirement.

- Are there dedicated or booked reserves, 401(h) accounts, "dedicated" profit sharing funds, Employee Stock Ownership Program (ESOP) benefits, or other "funding" assets?

- Are there possible maintenance-of-effort obligations under health reform?

- Is there a right to amend or terminate the plan?[6]

d) Transition Period Issues

The following transition period issues should be considered:

- Funding reconciliation;

- Lingering exposure for prior claims or violations (including Medicare secondary claims); and

- Access to relevant data.

e) Multiple Employer Welfare Arrangements Considerations

A seller may agree to provide medical coverage to employees for a period following the merger or acquisition. To the extent that the purchaser and seller are not under common control, the seller's welfare plan will become a multiple employer welfare arrangement (MEWA). MEWAs are required to comply with certain federal and state insurance laws.[7] The parties should ensure that applicable federal or state laws are not violated or that other liabilities unique to MEWAs are not overlooked.

f) COBRA Requirements

The Consolidated Omnibus Reconciliation Act of 1985 (COBRA), as amended, requires private employers who normally employ 20 or more employees to offer their employees (and their immediate family members) the opportunity to continue to receive group health coverage after the occurrence of certain qualifying events. COBRA specifies what the qualifying events are, the length of time that the employee or dependent can maintain coverage under the group plan, and how much the employer can charge the employee for the group health coverage.

[6] A purchaser who assumes a retiree health and welfare benefit liability cannot create a right to amend or terminate the plan in the purchase agreement. The right must exist in the plan itself. *Moore v. Metropolitan Life Insurance Co.*, 856 F.2d 488, 489, (2nd Cir. 1988).

[7] 29 U.S.C. 1003(40 (1994); 29 U.S.C. 1144(b) (1994).

(1) Qualifying Events Common to Corporate Transactions

Corporate mergers, acquisitions, reductions in force and bankruptcies often give rise to qualifying events. COBRA defines a qualifying event to include, among others, a change or termination in medical coverage due to any of the following events:

- A termination (other than by reason of gross misconduct) or reduction in hours of employment; and

- A Title 11 bankruptcy proceeding against an employer from whose employment the covered employee retired at any time.[8]

Parties to corporate transactions also need to evaluate and address the effect of the transaction on pre-transaction COBRA liabilities.

The following affected employees should be taken into consideration when determining COBRA liability:

- Employees of the seller who continue in the same or similar jobs with the new ownership;

- Employees of the seller who lose or leave their job as a result of, or simultaneously with, the change in the ownership; and

- Former employees of the seller and their families who are on COBRA status at the time of the transaction.

(2) Effect of Corporate Transactions on COBRA Obligations

In most cases, the sale of assets/sale of stock distinction determines who is responsible for complying with COBRA. If the purchaser does not adopt the seller's medical plans, the purchaser or seller (depending on how the transaction is structured) must normally provide COBRA notices to employees and qualified beneficiaries. The penalty for not doing so is $100 per day for each affected employee and qualified beneficiary.[9]

(3) Prior COBRA Violations

A purchaser may inadvertently acquire the seller's prior COBRA violations.[10] Under the proposed Treasury Regulations, a purchaser of assets who assumes the seller's health plans may become liable under certain circumstances for prior COBRA violations and has one year

[8] 29 U.S.C. 1163 (1994); I.R.C. § 4908B (1994).

[9] I.R.C. § 4099B(b)(1) (1994).

[10] Proposed Treas. Reg. § 1.62-26 Q&A-3(b).

to correct **all** of those violations.[11] If not corrected, the COBRA penalties will be imposed on the purchaser.

B. Consider How The Transaction May Affect The Non-Discrimination Rules For Existing Employee Benefit Plans

1. What Are The Non-Discrimination Rules?

In order to maintain a tax qualified status, employee benefit plans may not discriminate with respect to contributions or benefits in favor of corporate officers, shareholders or highly compensated employees.[12]

Self-insured medical plans, cafeteria plans, and certain other benefit plans also are subject to non-discrimination rules. Examples of these rules include:

- I.R.C. Section 401(a)(4) imposes three basic requirements in order to be considered non-discriminatory:

  1. Contributions or benefits must not discriminate in favor of highly compensated employees;

  2. The benefits, rights, and features provided under the employee benefit plan must be made to employees in a non-discriminatory manner; and

  3. The effect of plan amendments and plan terminations must be non-discriminatory.

- For plan years beginning after 1996, a defined benefit plan must benefit at least the lesser of the following on each day of the plan year:

  1. 50 employees of the employer

  2. the greater of:

     - 40 percent or more of all employees of the employer or

     - 2 employers (or one employee if the employer only employs one).[13]

[11] *Id.*

[12] The term "highly compensated employee" is specifically defined in I.R.C. § 414(q) (1994).

[13] I.R.C. § 401(a)(2b) (1994).

- A qualified plan must satisfy the minimum coverage and participation rules of I.R.C. Section 410.[14]

- A self-funded medical plan must satisfy the non-discrimination requirements of I.R.S. Section 105(h).[15]

- A cafeteria plan must comply with the non-discrimination requirements of I.R.C. Section 125.[16]

2. Evaluate Whether An Employee Benefit Plan Currently Meets The Non-Discrimination Requirements And Will Meet The Non-Discrimination Requirements After The Purchase Or Sale Of A Company

- Does the employee benefit plan have a current favorable IRS determination letter?

  A qualified plan need not have an IRS determination letter to be a "qualified plan." As a practical matter, though, an IRS determination letter is very desirable because of the complexity of and frequent changes to the tax rules governing provisions in employee benefit plans. Minor omissions can result in technical disqualification. A favorable determination letter provides protection if the IRS subsequently decides to challenge the tax qualified status of an employee benefit plan.

- What kind of data was used in getting the IRS determination letter and has any of this data changed significantly since the submission date?

- Was the data used accurate? For example, were independent contractors classified as employees?

- If only a portion of the seller's employees are being acquired, will the seller's existing employee benefit plans continue to be non-discriminatory? If the purchaser plans to allow the new employees into its existing employee benefit plans, will that affect the non-discriminatory status of the purchaser's plan?

- Will the purchaser grant past service or other credit to the former employees of the seller?

[14] I.R.C. § 410(a), (b) (1994).

[15] I.R.C. § 105(h) (1994).

[16] I.R.C. § 125 (1994).

C. Evaluate Employee Benefit Plans For Hidden Assets

An employee benefit plan can be overfunded - that is, the assets of the employee benefit plan exceed the liabilities. In a defined benefit plan, just as an employer would be required to fund any deficiency in assets, any excess in assets typically accrues to the employer's benefit. The employer generally can use the surplus assets for the following without any adverse tax consequences:

- Reducing the employee's out-of-pocket costs by freezing employer contributions to the plan until the surplus is used up;

- Merging the overfunded employee benefit plan with an under-funded employee benefit plan; and

- Using a part of the surplus to pay retiree medical benefits in accordance with special rules set forth in the Internal Revenue Code.

However, purchasers and sellers alike should be aware that while these are an attractive source of funds, they cannot simply take the excess assets without an excise tax being imposed. This is called a "reversion."[17] A reversion is defined as the amount of cash and property the employer receives from a qualified defined benefit plan as a result of the termination of the plan. The excise tax is equal to 50% of the amount of the reversion. However, the excise tax is limited to 20% if the employer establishes a "qualified replacement plan" or amends the terminating defined benefit plan to provide for pro-rata increases in benefits.[18] A "qualified replacement plan" is a qualified defined contribution or defined benefit plan that (i) is established or maintained by the employer in connection with the termination of a plan, (ii) covers 95% of the active participants in the terminated plan that remain employees, and (iii) received a direct transfer of assets from the terminated defined benefit plan equal to 25% of the maximum reversion possible from the terminated plan.[19]

Also, plan participants frequently assert entitlement to surplus assets remaining in a pension plan.

D. Options For Handling Employee Benefit Plans

There are several options for dealing with existing employee benefit plans in a corporate transaction. The feasibility and desirability of these options may vary depending on the nature of the plan and the circumstances. Also, purchasers and sellers often view the desirability of these options differently. Consequently, the parties usually negotiate the manner in which the benefit arrangements will be handled.

[17] I.R.C. § 4980(c)(2)(A) (1994).

[18] I.R.C. § 4980(d)(2)(C) (1994).

[19] I.R.C. § 4980(d)(2)(B) (1994).

1. Adoption Of The Plan

A purchaser may choose to adopt the seller's existing plan if the purchaser intends to continue the business and has an incentive to keep the current, trained employees. Prior to adopting the plan, a purchaser should do the following:

- Determine whether the benefit plan that is intended to be qualified under Section 401(a) of the Internal Revenue Code is, in fact, qualified.
- Identify any prior violations of the law since, in most cases, the purchaser will assume the future duties and obligations of the employer sponsor of the plan, including those prior violations. The purchase agreement should divide the responsibility between the purchaser and the seller.

2. Adoption Of The Plan With Changes

Before adopting the plan, the purchaser should review the plan documents and summary plan description to ensure that the plan can be changed and the acquiring company can adopt the changes. Further, before any changes are made, the employer should make sure that the changes do not result in a tax disqualification of the plan under ERISA. It also should confirm that the terms under which it agrees to adopt the plan adequately protects its right to modify or terminate the arrangement without unacceptable consequences or costs.

3. Plan Merger

A purchaser who already has a business may want to integrate the existing employee benefit plans of the acquired company into its own employee benefit plans. In a plan merger, the two plans become combined so that the assets of both former plans become commingled. Specific rules for plan mergers must be precisely followed in order to avoid adverse tax consequences:

- **Defined Benefit Plans:** The benefit structure, very likely, will not be the same in the two plans and the purchaser must decide whether to change one of the plans or develop a new benefit structured. Further, should the new plan terminate within five (5) years after the merger, the participants must not get less than what they would have received if the two prior plans terminated immediately prior to the merger.[20]
- **Defined Contribution Plans:** If two defined contribution plans are merged, the account balances for each participant in the new plan must be the same as his or her previous account balance in the former plans immediately prior to the merger.[21]

[20] Treas. Reg. § 1.414(l)-1(d).

[21] Treas. Reg. § 1.414(l)-1(d)(2).

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[20] Treas. Reg. § 1.414(l)-1(d).

[21] Treas. Reg. § 1.414(l)-1(d)(2).

4. Plan Spin-Off

Sometimes only a division of a company is sold to a purchaser. In that case, a spin-off plan may be created for the purchaser.[22] Certain benefits and features of a spun-off plan may not be changed. A spun-off plan must contain all of the optional forms of benefits and subsidized early retirement benefits which the prior plan contained. In addition, no optional forms of benefits can be eliminated under a qualified plan at the time of the spin-off. The defined benefit features of the defined benefit plan or the defined contribution features of a defined contribution plan must be preserved.[23] The rules for spin-off plans are only applicable to qualified retirement plans and are not applicable to welfare plans.

5. Plan Freezes

A purchaser can acquire the plan but freeze it in terms of future eligibility or future accruals or both. Under this method, current employees are allowed to remain in the plan but no new employees are allowed to enter. In order to freeze future pension accruals in connection with a merger or acquisition, participants and certain other persons must be given notice at least 15 days prior to the effective date of the freeze.[24] Freezing plans, however, can result in substantial non-discrimination problems (See Section B above).

6. Plan Terminations

Purchasers often prefer to terminate existing plans. However, termination of plans can result in substantial liability for the employer responsible for the termination. (See Section III below). The ability to terminate a benefit arrangement also may be restricted by political concerns, terms of plan documents, terms of insurance or other vendor contracts, or other considerations. Ultimate responsibility is determined by the structure of the sale or by the explicit agreement of the parties.

III. TERMINATION OR WITHDRAWAL LIABILITY

Special procedures apply when terminating single employer pension plans and multiemployer pension plans.

[22] I.R.C. § 411(d)(6) (1994).

[23] Treas. Reg. § 1.411(d)-4, Q&A-3(a)(2). *See also Gillis v. Hoechst Celanese Corp.*, 4 F.3d 1137 (3d Cir. 1993), *cert. denied*, 114 S.Ct. 1540 (1994), where the court held that after a sale of a business, employees were still entitled to earn enhanced early retirement benefits and that the seller should have transferred sufficient assets to a buyer's plan to cover the cost of the enhanced benefits.

[24] 29 U.S.C. § 1054(h) (1994).

A. Single Employer Plans

1. Full Or Complete Termination

Termination of employee benefit plans can result in substantial liabilities. If an employee benefit plan is not transferred to a purchaser during an acquisition or merger, this triggers a termination of employment for employee benefit plan purposes. If a defined benefit plan is terminated, the employees automatically become fully vested in their accrued retirement benefits to the extent funded. The allocation of assets on termination of a defined benefit plan must not be discriminatory.[25]

2. Partial Termination Of Single Employer Plans

Partial terminations also result in all accrued benefits of affected employees becoming fully vested to the extent that these benefits are then funded.[26] There are two types of partial terminations. A vertical partial termination is where a significant group of employees cease to participate in the plan. A horizontal partial termination occurs when the plan sponsor amends the plan in a manner that reduces the benefits provided by the plan and increases the likelihood that the employer will receive a reversion of surplus plan assets.[27] For example, the sale of a division or subsidiary is an event that can cause a vertical partial termination.[28]

B. Multiemployer Withdrawal Liability Under Multiemployer Collectively Bargained Pension Plans

A multiemployer plan is a defined benefit pension plan maintained by more than one employer pursuant to a collective bargaining agreement with one or more labor organizations. However, a plan maintained by more than one employer is not a multiemployer plan if all of the employers are members of a single controlled group of corporations or a group of trades or businesses under common control.[29] A multiemployer plan has two essential characteristics. First, it must provide retirement benefits and not health and welfare benefits. Second, the plan

[25] Guidelines for the non-discriminatory allocation of assets on termination of a defined benefit plan are set forth in Rev. Rul. 80-229, 1980-2 CB 76.

[26] I.R.C. § 411(d)(3) (1994).

[27] The terms "vertical and horizontal partial terminations" were coined by Stuart M. Louis in his article "Partial Terminations of Qualified Retirement Plans - An Evolving Doctrine."

[28] *See e.g., In re Gulf Pension Litigation*, 764 F. Supp. 1149 (S.D. Tex. 1991). Termination of 8,534 employees out of over 24,000 employees was determined to be a significant number of terminated employees as well as a sufficient portion to result in a partial termination.

[29] ERISA § 3(37).

may not be an individual account plan, and must be a defined benefit plan. An employer who either completely or partially withdraws from a multiemployer pension plan is assessed a withdrawal penalty which can be substantial.

1. Complete Or Partial Withdrawal

A **complete withdrawal** occurs when there is (1) a permanent cessation of the employer's obligation to contribute under the plan; or (2) permanent cessation of the employer's covered operations under the plan.[30] Special definitions apply to withdrawals from plans in the construction, entertainment, and trucking industries.[31]

A **partial withdrawal** occurs where there is (1) a 70% employer contribution decline; or (2) a partial cessation of the employer's contribution obligation.[32] The 70% decline is measured with respect to the employer's contribution base units (C.B.U.'s) (e.g., hours worked, not the employer's actual contribution).

a) Sale of Stock

A sale of stock does not usually trigger withdrawal liability because an employer merely undergoes a change in corporate identity without any interruption in contributions or obligations to contribute to the plan. The entity resulting from the stock sale is considered the original employer and retains an obligation to contribute to the plan. *Teamsters Pension Trust of Philadelphia v. Central Michigan Trucking, Inc.*, 857 F.2d 1107 (6th Cir. 1988).

Since the purchaser usually takes over the contribution obligations and other liabilities for a multiemployer plan, that employer should have a well defined strategy for determining the actual potential liabilities if that purchaser subsequently needs to withdraw.

- Obtain all relevant information on the funds in which the employer participates;[33]

- If possible, find out how the plan has dealt with withdrawing employers in the past. This information may be obtained from employers who have withdrawn or from those who are managing the plan;

- Obtain a complete description of the plan's withdrawal liability rules;

[30] ERISA § 4203(a).

[31] ERISA § 4203(b)-(d).

[32] ERISA § 4205(a).

[33] The plan is required to furnish the basic information needed to enable the employer to determine his withdrawal liability exposure in response to written requests by an employer participating in the plan.

- Compile the necessary facts to determine an employer's liability, including the unfunded vested liability as well as the contribution history of the employer and the plan.

- Document events pursuant to collective bargaining agreements which may affect the withdrawal liability such as changes in asset values, changes in assumptions, changes in withdrawal rates and benefit structure, status of the applicable collective bargaining agreements, and the certification posture of the unions entering into these agreement; and

- Obtain the seller's contribution history and current contribution obligation since this obligation is also acquired by the purchaser as a result of the sale.

The are a number of approaches that a purchaser can take if he is going to acquire such plans. It may, for example, want to structure the sales agreement such that the seller will indemnify the purchaser for any withdrawal resulting from the sale. Alternatively, the purchaser may wish to restructure the transaction to minimize or avoid liability for withdrawal.

b) Asset Sale

An asset sale usually will trigger withdrawal liability unless certain conditions are met.

Section 4204 of ERISA provides an exception for a qualifying sale of assets to an unrelated third party that would otherwise constitute a complete or partial withdrawal. However, a number of conditions must be met in order to get this exemption:

- The sale must be a bona fide, arms-length transaction with an unrelated party;

- The purchaser must have an obligation to contribute for substantially the same number of contribution base units as the seller;

- The purchaser (or seller, on his behalf) must post a bond or establish an escrow amount equal to the seller's annual contributions, to be paid to the plan if, within five years, the purchaser withdraws or fails to make a contribution when due; and

- The sales contract makes the seller secondarily liable if the purchaser withdraws within five years and defaults on his withdrawal liability payments. the seller's liability is the amount for which he would have been liable at the sale date. The seller must post a bond for his secondary liability if his assets are distributed within five years.

If all of these conditions are met, then the purchaser assumes the seller's contribution history for the five plan years ending with the year of the sale. However, this may not protect the purchaser known as the successor employer. In one recent case, the Seventh Circuit held that the purchaser of an employer's assets could be held liable for the prior employer's delinquent contributions to a multiemployer plan because there was a sufficient continuity of operations, i.e., the purchaser had hired all of the predecessor's employees and signed a significantly similar collective bargaining agreement and the purchaser had prior notice of the delinquency. *Upholsterers Int'l Union Pension Fund v. Artistic Furniture of Pontiac*, 920 F.2d 1323 (7th Cir. 1990).

IV. DOWNSIZING THE WORKFORCE

A. Severance Plans And Downsizing The Workforce

1. Severance Plans Are Employee Welfare Plans And Are Subject to ERISA

Most severance pay arrangements and severance pay plans are employee benefit plans regulated by ERISA.[34] This means that employers generally must administer these plans in accordance with the applicable requirements of ERISA. These requirements generally include:

- The plan must be in writing;[35]
- Participants must be given a summary plan description;[36]
- Form 5500 must be filed with the IRS. If Form 5500 is not filed, there is now a $1,000 per day penalty;[37]
- The fiduciary duty requirements of ERISA apply; and
- Claims and appeals procedures must comply with ERISA.

2. Waivers in Severance Plans

Employers frequently consider using severance arrangements as a tool for managing legal liabilities associated with employment termination. A severance plan can include a properly designed waiver agreement whereby the employee accepting the severance benefits agrees to waive certain legal claims against the company. However, the waiver must be voluntary and the courts will look at the specific facts to determine the legality of the waiver. Specific requirements for waiver of ADEA claims are as follows:

- Requirements for individual waivers whereby one or more employees who are not part of a group of employees agrees to waive the claims in exchange for severance benefits.

[34] 29 C.F.R. § 2510.3-2(b) (1994).

[35] 29 U.S.C. § 1102 (1994).

[36] 29 U.S.C. § 1022 (1994).

[37] 29 U.S.C. § 1132 (1994).

1. The waiver must be in writing and specifically refer to the fact that the employee is waiving rights under the ADEA.[38]

2. The waiver cannot waive any rights or claims that arise after the date that the waiver is executed.[39]

3. The waiver must be received in exchange for consideration in addition to anything of value to which the individual is already entitled.[40] The employee must receive some sort of enhanced severance benefits in addition to the severance benefits for waiving any of the other claims; and

4. The employee must be advised in writing to consult with an attorney prior to executing any waiver.[41]

- Requirements for group waiver where the employee is part of a class of employees eligible for an exit incentive or other employment termination program for which the participants have been selected on the basis of various factors:

  1. All of the individual waiver requirements described above must be met;

  2. The employee must be informed of the eligibility factors for participating in the program, as well as any time limit applicable to the program[42]; and

  3. The employee must be given the job titles and ages of all eligible participants and the ages of all individuals in the same classification/unit who are not eligible.[43]

[38] 29 U.S.C. § 626(f)(1)(A), (B) (1994).

[39] 29 U.S.C. § 626(f)(1)(C) (1994).

[40] 29 U.S.C. § 626(f)(1)(D) (1994).

[41] 29 U.S.C. § 626(f)(1)(E) (1994).

[42] 29 U.S.C. § 626(f)(1)(H)(i) (1994).

[43] 29 U.S.C. 626(f)(1)(H)(ii) (1994).

3. Timing of the Waiver

An employee must be given twenty-one (21) days to consider an individual waiver agreement before being required to execute it and seven (7) days after the execution to revoke it.

In connection with an exit incentive program offered to a group of employees, an employee must be given forty-five (45) days to consider the waiver and seven (7) days to revoke the waiver.

4. Severance Plans and Corporate Transactions

Like other employee benefit plans, severance plans should be thoroughly evaluated for hidden assets and hidden liabilities. Severance plans are usually unfunded. Therefore, triggering widespread severance benefit rights with a corporate transaction can be a big liability.

a) Sale of Stock/Asset Distinction

In a stock purchase, the purchaser will assume all plans including any severance plans. In any asset purchase, the seller will retain liability for severance payments unless the purchaser actually acquires liability pursuant to the purchase agreement.

b) Does An Asset Purchase Trigger Severance Payments?

Language in a union contract may determine whether or not an asset purchase will trigger severance payments. If the plan states without ambiguity that no benefits are available for employees who retain their job and work for the new employer, then the employees are not entitled to severance plan benefits. *Duggar v. Boise Cascade Corp.*, 966 F.2d 1451 (6th Cir. 1992).

If the plan terms are ambiguous, severance benefits may be triggered even if the employees continue to work for the new employer. Currently, circuits are split over whether employees who continue with a new employer are eligible for severance. In *Bedinghaus v. Modern Graphic Arts*, 15 F.3d 1027 (11th Cir. 1994), the Eleventh Circuit held that employees could receive severance pay even though they continued with the new employer after an asset sale. However, in that case, the court may have been influenced by the fact that the new employer did not credit service with the prior employer for purposes of the severance plan, nor were employees given the choice of remaining with the old employer. However, in another case, *Fuller v. FMC Corp.*, 4 F.3d 255 (4th Cir. 1993), *cert. denied*, 114 S.Ct. 1062 (1994), the Fourth Circuit rules that employees of a factory were not terminated when the factory was purchased by a company which was obligated to offer similar employment to all employees. Therefore, the employees were not entitled to severance pay. The employees continued to work at the same jobs, with the same responsibilities and salaries, but the purchaser did not have a severance pay policy. The court determined that the severance provision regarding plant closing was ambiguous and considered extrinsic evidence of the severance plan's meaning. The prior employer would have been liable if the court had decided that the employees were entitled to severance pay. However, the prior employer was able to demonstrate that, even though the terms were ambiguous, the policy under the severance pay plan was not to pay severance benefits to employees who are offered employment with purchasers or who procured employment elsewhere after they were laid off. The court, refusing to impose a duty greater than the company's past practice, concluded that the employees were not entitled to severance benefits because the employees had suffered no unemployment or loss of income.

V. FIDUCIARY DUTIES AND CORPORATE TRANSACTIONS

A. Who Is A Fiduciary?

Under ERISA, a person is a plan fiduciary "to the extent" he or she:

- Exercises discretionary authority or control over plan management or any control over management or disposition of plan assets;
- Renders investment advice regarding plan assets for a fee or other compensation, or has authority or responsibility to do so; or
- Has any discretionary authority or responsibility in plan administration.[44]

However, in determination whether someone has fiduciary status under ERISA, the courts will use the "functional test." The courts will look to whether the person or the firm has actually exercised any of the functions described above.

B. Fiduciary Obligations In The Sale Of A Company

The courts will look at the functions of a particular person is performing at the time the fiduciary breach is alleged. When an employer also is a fiduciary to an employee benefit plan, fiduciary rules come into play. ERISA does not usually prohibit an employer from acting in accordance with its own interest as an employer when not administering the plan or investing its assets. *Sutton v. Weirton Steel Div. of National Steel Corp.*, 724 F.2d 406 (4th Cir. 1983), *cert. denied*, 467 U.S. 1205 (1984).

1. An Employer's Fiduciary Duty On The Sale Of A Business

The case law varies concerning when an employer who is negotiating the transfer of plan assets in a transaction, such as the sale of business, may be acting in a fiduciary capacity. Courts usually distinguish between an employer acting as an employer versus an employer acting as a fiduciary.

Some courts have held that an employer has a right to act in its own interest when selling its own business. For example, in *Phillips v. Amoco Oil Co.*, 799 F.2d 1464 (11th Cir. 1986), *cert. denied*, 481 U.S. 1016 (1987), the court found that the employer did not breach its fiduciary duty to act solely in the interest of participants and beneficiaries by allegedly

[44] 29 U.S.C. § 1002(21)(A).

bargaining away employee past service credits in return for a higher sales price on the sale of the business. The court found that the fiduciary provisions were not implicated in the sale of the business merely because the terms of the sale would affect contingent and non-vested future benefits. The court found that the employer continued to fulfill its obligations with respect to vested retirement benefits earned under the plan.

Similarly, the court in *Johnson v. Georgia-Pacific Corp.*, 19 F.3d 1184 (7th Cir. 1994), found that a corporation targeted for hostile takeover did not violate its ERISA fiduciary duty to current retirees when, as a takeover defense, it increased benefits for future, but not current, retirees. Current retirees' rights were limited to those specified in the contract.

In contrast, the courts have ruled that corporate officials must act for the exclusive benefit of participants when acting as plan fiduciaries. In *Donovan v. Bierwirth*, 680 F.2d 263 (2nd Cir. 1982), the court ruled that corporate officers used their positions as fiduciaries for a profit sharing plan to cause the plan to purchase stock in the company in order to ward off a takeover attempt.

2. Termination Of A Plan

At least one court has said that the fiduciary standard imposed upon plan administrators does not apply to a decision to terminate a retirement plan. *See District 65, UAW v. Harper and Row, Publishers, Inc.*, 576 F.Supp. 1468 (S.D. N.Y. 1983). Other courts have held that the decision to terminate must at least be based on a rational business judgment and the termination must not be solely motivated by a desire to end in an individual's coverage since this would violate the fiduciary's obligation to "discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries." *See Vogel v. Independence Federal Sav. Bank*, 692 F. Supp. 587 (D. Md. 1988).

3. Liability of Successor Fiduciaries

In most cases, a fiduciary is not liable for the consequences of a breach of the fiduciary duty committed by a prior fiduciary. However, trust law and the Department of Labor suggests otherwise. A fiduciary is liable for a breach committed by a predecessor trustee if he or she: (1) knows or should know of the breach and improperly permits it to continue; (2) neglects to compel the predecessor to deliver over trust property; or (3) neglects to redress a breach committed by the predecessor.[45] Further, the Department of Labor has ruled that a fiduciary who is aware of a predecessor's breach must take reasonable and appropriate remedial action or that fiduciary would be guilty of a separate breach.[46] This may mean that a fiduciary must change investments made by a predecessor fiduciary upon assuming fiduciary duty.

[45] 29 U.S.C. § 1105 (1994).

[46] ERISA Op. Ltr. 76-95.

4. Fiduciary Obligations In Connection With A Merger Of Plans Or The Transfer Of Plan Assets

Courts have generally found that if an employer/fiduciary satisfies its obligation of protecting employees' vested benefits upon the sale of the company or a division it will fulfill its fiduciary duty. The negotiations that affect future [non-vested] benefits do not implicate fiduciary duties. If the merger satisfies the requirements of ERISA Section 208, no further obligations are due to plan participants. *Dougherty v. Chrysler Motors Corp.*, 840 F.2d 2 (6th Cir. 1988).

VI. COLLECTIVE BARGAINING OBLIGATIONS

If operating under collective bargaining agreements, employers undertaking an acquisition, merger, sale, reduction in force or other similar action should examine their collective bargaining obligations before modifying benefit arrangements or offering special incentives.

A purchaser in a stock acquisition generally becomes liable as a successor to the collective bargaining obligations of the seller. A purchaser in an asset acquisition also may become liable for the collective bargaining obligations of the seller under certain circumstances. For instance, an asset purchaser will be obligated to comply with the seller's collective bargaining obligations if the purchaser assumes those liabilities as part of the acquisition. In addition, an asset purchaser who acquires substantially all of the assets of the seller and hires the employees of the seller generally also becomes liable as a successor to the seller's collective bargaining agreements.

United Steelworkers of America v. Mead Corp., Fine Paper Div., 21 F.3d 128 (6th Cir. 1994) is illustrative. While experiencing economic difficulties, Mead Corporation offered cash bonuses to maintenance employees as an early retirement incentive without first bargaining with the union. The union alleged the retirement incentive program violated Mead Corporation's duty under the collective bargaining agreement to maintain a retirement plan as agreed upon by the union. Since the collective bargaining agreement required arbitration to resolve disputes, the Court ruled that Mead Corporation must arbitrate their right to offer the retirement incentives.

VII. PLANT CLOSING LAWS

The Worker Adjustment and Retraining Notification Act (WARN) generally requires that an employer provide certain advance notices before a "plant closing" or a "mass layoff." The requirements of WARN generally apply to an employer if it employs more than 100 full-time employees or if it employs more than 100 employees who in the aggregate work at least 4,000 hours a week exclusive of overtime.

For purposes of WARN, a "plant closing" is the permanent or temporary shutdown of a single site of employment, or one or more facilities or operating unitis within a single site of employment, if the shutdown results in an employment loss at the single site of employment during any 30-day period for 50 or more employees, excluding part-time employees.

WARN defines a "mass layoff" as a reduction in force that

- Does not result from a plant closing
- Results in an employment loss at a single site of employment during any 30-day period for:
  - at least 33% of employees (excluding part-time employees, and at least 50 employees (excluding part-time employees), or
  - at least 500 employees excluding part-time employees.

For purposes of determining if a mass layoff or plant closing has occurred, employemnt losses for 2 or more groups at a single site of employment, each of which is less than the otherwise applicable minimum number of employees, but which in the aggregate exceed that minimum number are considered to be a plant closing or mass layoff if the occur within 90 days of eachother unless the employer proves that the employment losses are the result of separate and distinct actions and causes and are not an attempt by the employer to evade WARN.

Additionally, a layoff or more than six months, which, at its outset, was announced to be a layoff of six months or less, is treated as an employment loss for purposes of WARN unless the extention results from unforseen business circumstances and the employer gives notice in accordance with WARN when it becomes reasonably forseeable that the layoff will extend beyond six months.

Prior to any plant closing or mass layoff, WARN generally requires that an employer provide at least 60 days advance written notice to:

- If the employees are represented by a union, the union,
- If the employees are not represented by a union, each affected employee, and
- To the State dislocated worker unit and the chief elected official of the unit of local government where the closing or layoff will occur.

Less than 60 days notice may be provided if any of the following exceptions are met and the employer provides as much notification as is practical:

- When the notice would have been required, the employer was actively seeking capital or businesss which, if obtained, would have allowed the employer to avoid or postpone the shutdown and the employer reasonably and in good faith believevd that giving the notice would have precluded the employer from obtaining the needed capital or business;
- The mass layoff or closing is caused by business circumstances not reasonably forseeable when the notification would have been required; or
- The plant closing or mass layoff is the result of a natural disaster.

WARN also excepts certain other employment losses from its requirements.

In the case of a sale of assets or stock, the WARN regulations contemplate that responsibility for providing notification may be allocated by negotiation between the parties. Otherwise, the responsibility for providing the notice generally applies to the entity who is the owner at the time of the employment loss. However, the WARN regulations also indicate that a purchaser may be exposed to WARN Act liabilities if the seller fails to provide required WARN notifications and the purchaser does not thereafter provide the notices.

Additionally, many employers assume that that they do not need to comply with WARN if the purchaser hires the employees of the sellers, so that no break in employment occurs. It is not clear, based on the express language of the statute or the regulations, that WARN incorporates such an exception. Therefore, prudent parties to the transaction generally will want to provide a WARN notification.

CHECKLIST: ITEMS TO REVIEW

1. Review the following to determine if any employee benefit plans exist:

   - Group health, group life, retiree medical and other welfare plans;
   - Payroll and employment practices and policies (for example, vacation pay, severance plan, etc.);
   - Personnel and administrative manuals and procedures;
   - Insurance contracts paying particular attention to any "guaranteed payment provisions";
   - Collective bargaining agreements; and
   - Any consulting or other contracts of independent contractors.

2. For all benefit plans determine the extent to which the plans are subject to collective bargaining agreements or arbitration and the extent to which these collective bargaining agreements obligate the sponsor to increase or change benefits after a certain amount of time.

3. Determine what type of employee benefit plans are maintained by the selling company and its ERISA affiliates.

4. If the seller maintains a defined benefit plan, determine the extent of any over-funding or under-funding.

   - If the plan in question is a multiemployer plan, determine whether all required contributions have been made and whether any complete or partial withdrawal has occurred during the past five years.

5. Make sure that the seller's current plan complies with ERISA.

6. Examine all plan documents and summary plan descriptions and amendments for potential plan liabilities.

7. If there are any post-retirement medical and life insurance benefits, determine the extent of funding and/or under-funding.

8. Determine if any employee benefit plans will be assumed.

   - If any will be assumed, determine the mechanics of how the plan will be assumed and how the transfer of assets and liabilities to successor plans will be accomplished.

9. Identify any and all fiduciary documents and obtain these documents prior to the transfer.

10. For all plans, determine whether there have been any prior breaches of fiduciary duties.

11. Review all written employment agreements with any individuals.

12. Review all oral agreements.

13. A purchaser of a company who intends to assume employee benefit plans should have its own actuary review the financial statements and the funding status of the pension plans since the balance sheet liability may not fully reflect the full extent of the liabilities of the plan.

14. Any purchase agreement should contain explicit and detailed provisions with respect to how any employee benefit plans will be handled. If the purchase occurs in the middle of a plan year, the responsibility for the employee benefit plan should be divided in advance.

15. Determine who will be responsible for COBRA should any health plans be terminated and start drafting the COBRA notices as soon as possible.

16. If the purchaser or company is going to acquire any health plans, it should require the seller to give a warranty to the fact that the seller has complied fully with COBRA.