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MAY 16

# Employment and Benefits Issues Arising from Mergers & Acquisitions



# EMPLOYMENT ISSUES

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# Agenda

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- Brief Overview of M&A Transactions
- M&A Transaction Process
- Key “Hard” Diligence Issues
- Key “Soft” Diligence Issues
- Diligence Resources/Toolkit
- Corporate Integration Issues
- Examples

# Transaction Process

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- Preliminary Stages – Acquisition Strategy and Criteria Development; Target Identification; Valuations and Negotiations
- Due Diligence
- Purchase Agreement
- Closing/Financing
- Implementation and Integration

# Types of Acquisitions

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- Stock Purchases – buyer gets everything, the good and the bad.
- Asset Purchases – sellers employment issues likely to stay with seller. However, are you a successor in interest? Totality of circumstances.
- Mergers

# Overall Goals

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- Understand what you want and identify key issues.
- What are your business objectives?
- Don't buy problems you don't want.
- Avoid unwanted costs for noncompliance.
- Prevent employment liability arising from reductions in force, discrimination claims, and the Worker Adjustment and Retraining Notification Act.

# Key “Hard” Diligence Issues

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## “Material” Issues

- Wage and Hour Policy and Compliance
- Worker Misclassification
- Class Action Litigations/Arbitration Agreements?
- Governmental Audits and Investigations
- Restrictive Covenants, Confidential Information and IP matters

## Example: Misclassification liability

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- A key area in nearly every transaction.
- Misclassification of independent contractors.
- Misclassification of employees for overtime purposes



# Restrictive Covenants

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- Non-Competiton Agreements
- Non-Solicitation Agreements
- Confidentiality Agreements
- Are these agreements transferable to the seller?
- Will new agreements need to be issued after the sale?

## Key “Hard” Diligence Issues *(continued)*

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### “Material” Issues *(continued)*

- Key Employee Agreements
- Immigration Compliance
- Workplace Safety Exposure
- Severance and RIF obligations; WARN Act(s)
- Benefits & Labor matters

## Key “Hard” Diligence Issues *(continued)*

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### Other Key Issues

- Credible Complaints against Key Employees
- Litigation History, Informal Complaints
- Compensation Incentive Arrangements
- Personnel Management Hygiene
- Record-Keeping Hygiene
- Certain Policy Compliance (i.e., Background Checks, Leave Policy)
- Pay Equity

## Key “Soft” Diligence Issues

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- Spot Review of Personnel Materials, Complaints and Investigation Files
- Litigation/EEOC Detail
- Employee Surveys
- Demographic Data
- Hiring, Turnover and Promotion Data
- Policy & Perquisite Analysis and Benchmarking
- Social Media
- Work/Social Environment
- Corporate Activities

# Diligence Tools

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- Organizational Charts
- Policies
- Formal Proceedings (Litigations, Audits, Investigations, Enforcement Actions)
- Informal Proceedings (Internal; Demand Letters)
- Contracts & Agreements



## Diligence Tools *(continued)*

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- Employee Census Materials:
  - Wage Summaries, Hours & Title History
  - Extended Demographics
- Time Records
- Payroll Documents
- Filings (OSHA Logs, Forms I-9)
- Personnel Records
- Job Descriptions

## Diligence Tools *(continued)*

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- Other Descriptive/Narrative Requests (Time Keeping Practices & Processes, Descriptions of Work)
- Self-Audits
- Opinion Letters and Other Privileged Documents
- Benefit Plans and Summaries
- Incident Logs
- Insurance Policies
- **Interviews with Employment Counsel, Human Resources Professionals, Management, Institutional/Historical Knowledge (Prior Practices)**

## Diligence Tools *(continued)*

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- Review laws and regulations for each new state and city you are entering via the acquisition.
- Local ordinances should be considered.
- Determine current compliance prior to closing.



## Emerging Areas of Focus

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- #MeToo Exposure; Key Employees
  - Brand Exposure (Weinstein Clauses)
- Training Quality
- Board Minutes
- D&I Commitment & Success
- Minimum Wage and Scheduling Laws
- Use of Technology/Expectations
- Pay Equity Laws; PE Diligence Constraints (Asset Deals)



# Diligence Reports

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- Material Issues
- Noteworthy Issues for Transaction Documents
- Issues Closely Related to Post-Acquisition Operations and Integration

# Transaction Document Considerations

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- Reps & Warranties:
  - Legal Impact – Disclosure of litigation, employee classification, etc.
  - Financial Impact:
    - Indemnification – matters predating the purchase, WARN related events and violations of representations.
    - RWI
    - Escrow
    - Walk Rights; Litigation
  - Negotiation and Drafting Considerations; Qualified Reps
  - Connection to Diligence; Anti-Sandbagging Provisions

## Transaction Document Considerations (*continued*)

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- Disclosure Schedules:
  - Affirmative v. Negative Disclosures (Lists & Exceptions)
  - Sellers typically produce first draft; Tied to R&W
  - “Materiality” Standards
  - Pre-Closing Updates

# Successor Liability

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## **Courts often focus on two main factors:**

- Continuity in operations and workforce
- Ability of the predecessor to provide relief to the alleged victims
- Courts generally focus on continuity in business operations and predecessor's ability to provide relief

## **“Totality of the Circumstances”**

- Is it fair and necessary?
- Would alleged victim be without a remedy?

# Successor Liability

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When liability is based on a violation of a federal statute relating to labor relations or employment, a federal common law standard of successor liability is applied that is more favorable than most state-law standards to which the court might otherwise look.

- *John Wiley & Sons, Inc. v. Livingston*, U.S. 543, 548–49, 84 S.Ct. 909, 11 L.Ed.2d 898 (1964) (Labor Management Relations Act);
- *Wheeler v. Snyder Buick, Inc.*, 794 F.2d 1228, 1236 (7th Cir.1986) (Title VII);
- *EEOC v. G–K–G, Inc.*, 39 F.3d 740, 747–48 (7th Cir.1994) (ADEA);
- *Sullivan v. Dollar Tree Stores, Inc.*, 623 F.3d 770, 781 (9th Cir.2010) (FMLA).

# Successor Liability

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Courts impose liability on successors “when necessary” to protect and vindicate employment-related policies arising under employment statutes (including the discrimination laws) by considering:

- whether the buyer knew or should have known of the claim before acquisition;
- the ability of the seller to provide relief (e.g., does it still exist?); and
- whether there has been substantial continuity of the same business.

*EEOC v. MacMillan Bloedel Containers, Inc.*, 503 F. 2d 1086, 1094 (6th Cir. 1974).

# Successor Liability

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- **NLRA** – Issuance of reinstatement and backpay order against a purchaser permitted where it acquires business with knowledge that the wrong was unremedied. *Golden State Bottling Co. Inc. v. NLRB*, 414 U.S. (1973)
- **FMLA and FLSA** - An exclusion of liabilities provision in the asset purchase agreement is not a defense. *Teed v. Thomas & Betts Power Sols., L.L.C.*, 711 F.3d 763 (7th Cir. 2013)
- **Title VII and ADEA** – Purchasers have been bound by anti-discrimination injunctions and consent decrees entered into by the seller as well as been held accountable for damages caused by seller. *Baker v. Delta Airlines, Inc.*, 6 F. 3d 632 (9<sup>th</sup> Cir. 1993).



# Successor Liability

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- **OSHA** – Congress intended for Federal Court to impose successor corporation liability where, the violator has sold or transferred its entire operation to another entity which, in essence, merely continues the business using the same premises, machinery, employees, and supervisory personnel. *Dole v. H.M.S. Direct Mail Service, Inc.* 752 F. Supp. 573, (W.D.N.Y.).

# Successor Liability

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- Require representations state that employment liabilities, if any, are the sole responsibility of seller
- Consider adding an escrow or special indemnity for additional liabilities to recover any potential successor liability costs
- Integrate seller's employees into organization to eliminate flaws in seller's practices, policies, and procedures.

# Post-Acquisition Integration

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- Who is the employer?
- Is there a termination of employment?
- What agreements will be assigned over?
- Communications Team(s)
- Purchase Agreement Bogeys
- Day One Activities; Personal Connections and Resource Availability

## Post-Acquisition Integration *(continued)*

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- Hiring, Restrictive Covenants
- Retention Agreements – i.e. executive agreements, bonus plans, transaction bonus agreements.
- Immigration Compliance
- RIF Analysis and Implementation?

# WARN Notice Issues

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- 60 days written notice before any plant closing or mass layoff
- WARN Problems
  - Notices must be written, with specific dates
  - Many states have separate and different WARN-type notice laws

# Restructuring

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- Buyers frequently force seller to do restructure or conduct RIF because it reduces buyer liability.
- RIFS by Buyer: Buyer does not believe restructuring by seller will be done right or the RIF is too complicated prior to acquisition.
- Alternatives:
  - Structure deal so that buyer only acquires certain facilities.
  - Selective hiring, seller terminates all employees and buyer only hires some of the seller's former employees.

## Post-Acquisition Integration *(continued)*

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- Policy and Plan Continuation or Integration? Consequences?
- Reorganization (Non-RIF)
- Harmonizing Job Titles and Duties
- Communications Plan
- “Target” Coordination and Buy-In



# Post-Acquisition Integration: Employee Handbook

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- PTO – accrued vs. unaccrued PTO
- FMLA – Calendar
- Each employee should acknowledge new handbook.



# Post-Acquisition Integration: New Managers

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- Review previous performance metrics
- Announce changes in writing and meet in person to discuss
- Follow up meeting in writing
- Micromanagers?
- Identify disgruntled employees, if any



# BENEFITS ISSUES

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# AGENDA

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- Why Managing Employee Benefits is a BIG DEAL in M&A Transactions
- Implications of Transaction Type – Stock or Asset
- Employee Benefit Plans Commonly Impacted
- Overview of Due Diligence Requirements
- Overview of Common Compliance Concerns
- Overview of Communication Obligations
- Review of Fiduciary Responsibilities

# Definitions

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- **Asset Purchase** – Buyer Purchases Same or All of Seller’s assets
- **COBRA** – Consolidated Omnibus Budget Reconciliation Act of 1985, as amended
- **DB Plan** – Defined Benefit Plan (e.g., traditional pension, cash balance plan)
- **DC Plan** – Defined Contribution Plan (e.g., – 401K, profit sharing)
- **DOL** – Department of Labor
- **EAPs** – Employee Assistance Programs
- **EB** – Employee Benefit(s)

# Definitions

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- **ERISA** – Employee Retirement Income Security Act of 1974, as amended
- **HIPAA** – Health Insurance Portability and Accountability Act of 1996, as amended
- **IRC** – Internal Revenue Code
- **Multiemployer Plan** – Plan Sponsored/Created by a Union or Collective Bargaining between Employer and Union
- **PBGC** – Pension Benefit Guaranty Corporation
- **SERP** – Supplemental Executive Retirement Plan
- **Stock Purchase** – Buyer Purchases Seller’s Outstanding Stock - Buyer gets everything, the good and the bad

# Who Cares?

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- IRS
- DOL
- PBGC
- Plan Participants & Beneficiaries
- Shareholders
- Executives
- Community

# Nature Of Transaction **Matters**

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## **Asset Purchase**

- Transaction in which the Buyer picks and chooses the particular assets or liabilities acquired. Seller continues as a separate entity.

Generally, unless there is an agreement otherwise, EB plan assets and liabilities are retained by the Seller.

## **Stock Purchase/Merger**

- Transaction in which the Buyer acquires an equity interest in the Seller (e.g., purchases Seller's stock). Seller's employees often become Buyer's employees at closing. Plans are often merged by combining two or more plans into a new plan or an existing plan of the Buyer.

Generally, unless Seller terminates plans prior to a stock purchase or merger, Buyer will, by law, acquire Seller's plan assets and liabilities.

# Controlled Group Of Corporations Or Affiliated Service Group - **Stock Sales Are Complicated**

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**Seller / Target**

**Buyer / Acquirer**

Plan Assets



**Potential Plan Liabilities**



1. Minimum funding liabilities
2. PBGC premium payments
3. Plan termination liabilities
4. Accrued benefit obligations



# Guiding Principles

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1. Stop and Evaluate any proposed reduction in accrued benefits
2. Identify merger date and set aside adequate time for Due Diligence
3. Set date for confirming the costs and significant EB risks associated with the deal type/strategy
4. Understand communication obligations
  1. External: IRS, DOL, PBGC, shareholders, non-employee beneficiaries, stop-loss carriers, insured benefit(s) providers, third party administrators, actuaries, etc.
  2. Internal: Participants and Eligible Employees, Executives, Deal Team
5. Understand Fiduciary Responsibilities

# Which Employee Benefit Are Commonly Impacted?

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## Retirement Plans

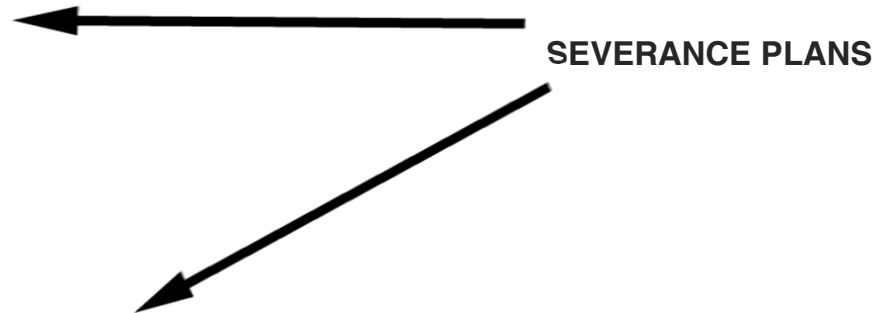
- DC plans
- DB plans
- Multiemployer (usually DB)
- Employee Stock Ownership Plans (ESOPs)

## Health & Welfare

- Group Health
- Flexible Spending Accounts
- Disability, AD&D, Life
- Retiree Medical

## Executive Compensation

- Bonus Plans
- SERPs
- Change-in-Control Agreements and Golden Parachutes
- Long Term Incentive Plans (“LTIPs”)
- Deferred Compensation
- Equity based arrangements – stock options, etc.





# Retirement Plans

# Retirement Plans

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## Due Diligence Highlights

- Volume
- Commonly Impacted Benefits: DB Plans, DC Plans, Multiemployer Plans, ESOPs, Severance Pay Plans
  - Frozen Plans
  - Grandfathered Plans
  - Existence of a Controlled Group of Corporations or Affiliated Service Groups
- Documents Commonly Reviewed:
  - Plan documents and amendments
  - IRS Determination Letters
  - SPDs, SMMs
  - Trust documents
  - Form 5500s
  - Nondiscrimination test results and corrective actions
  - Audit reports and corrective actions
  - Service provider agreements
  - Employee handbooks and personnel files
  - Fidelity Bond(s)

# Retirement Plans

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## Potential Compliance and Administrative Concerns

### Compliance

- Plan Qualification
- EPCRS Liabilities
- Nondiscrimination Testing on Combined Plan (also controlled group)
- Final Plan Testing
- Anti-Cutback Rule / Protected Benefits
- Vesting
- Successor Plan Rule
- DB Plan Funding
- Plan Loan Repayments
- Formal Plan Actions (Amendments, Terminations)
- Plan Expenses

### Administration

- TPA/Recordkeeping Contracts
- Investment Manager Agreements
- Investment Termination/Surrender Fees
- Trustee, Auditor, Consulting Agreements

# Retirement Plans

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## Communications

### ✓ Participants and Beneficiaries

- ❑ **Summary Plan Descriptions – Summary of Material Modifications**
  - ❑ **Specific Notification Requirements**
  - ❑ **Specific Delivery Requirements for Electronic Notifications**
- ❑ **Plan Updates; SAR Updates**
- ❑ **Enrollment Forms**
- ❑ **Blackout Notice, Notice to Interested Parties, Rollover Notice, Distribution Notice and Consent**

### ✓ External Agencies

- ❑ **IRS and DOL– Form 5500, Form 5310, Form 8955-SSA, Tax reporting distributions**
- ❑ **PBGC – reportable events; Missing participant program**
- ❑ **SEC – Annual Report, Form 8-K**

### ✓ External Stakeholders

- ❑ **Shareholders – Annual Report – Form 8-K**
- ❑ **Third Party Administrators and Advisors**



# Health and Welfare Plans



# Health & Welfare Plans

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## Due Diligence

- ❑ Volume
- ❑ Commonly Impacted ERISA Benefit Plans
  - Group Health Benefits – Active Employees
    - Medical
    - Vision
    - Dental
    - EAP & Prescription Drug
    - Wellness Programs
    - On-Site Medical Clinics Providing Medical Care
  - Cafeteria Plans
  - Flexible Spending Accounts
    - DCFSA
    - HFSA
  - Group Accidental Death & Dismemberment (AD&D)
  - Group LTD & STD (w/ insurance benefits)
  - Group Life
  - Retiree Benefits (Medical, Dental, Life Insurance)



# Health & Welfare Plans

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## Due Diligence

- ❑ Documents Commonly Reviewed:
  - Plan documents and amendments
  - SPDs, SMMs
  - IRS Form 5500s
  - Nondiscrimination test results and corrective actions
  - Audit reports and corrective actions
  - TPA agreements
  - ACA reporting
  - Insurance contracts
  - Fidelity Bond(s)

# Health & Welfare Plans

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## Common Health and Welfare Plan Compliance Concerns

- ❑ Ensure plan can be amended pursuant to plan terms
- ❑ Funds to cover incurred expenses
- ❑ ERISA's statutory vesting generally does NOT apply to welfare benefits – however, exception for those already “entitled” to benefits (e.g., disability)
- ❑ Nondiscrimination testing on combined plans
- ❑ Transaction resulting in either party becoming an applicable large employer (ALE)
- ❑ If Seller's employees become covered under Buyer's plan
  - deductibles change or carry over
  - change in prescription drug charges
  - provider/network changes

# Health & Welfare Plans

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## Common Health and Welfare Plan Compliance Concerns

### ❑ INSURED BENEFITS:

- In stock sale Buyer assumes insurance contracts, provided insurer will allow assumption
- Potential penalties if cancel Seller's insurance or merge participants in Buyer's plan
- Surrender fees
- State insurance law application (HMOs, Multiple Employer Welfare Arrangements (MEWAs))



# Health & Welfare Plans

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## Common Health and Welfare Compliance and Administrative Concerns

- For terminated plans, Final 5500 and SAR
- Transfer or remittance of participant contributions
- Trustee, Auditor, Consulting Agreements
- Plan expenses
- Fidelity Bond(s)
- Stop loss coverage – self-insured plans
- Plan and operational compliance with multiple federal laws – HIPAA, COBRA, Pregnancy Discrimination Act, GINA, Mental Health Parity, etc.

# HIPAA Privacy & Security Concerns

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- Seller may be asked to provide claims data containing PHI from its medical plan to the Buyer (e.g., names, dates of services, and high dollar claim amounts)
- Privacy and Security Rules often limit Seller's ability to transfer information directly to the Buyer
- Solutions:
  - Structure plan to plan disclosures
  - Share only de-identified information

# Flexible Spending Accounts (FSAs)

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- IRS Rev. Rul. 2002-32 provides guidance as to how a Buyer and Seller in an asset purchase may continue the health FSA coverage of transferred employees:
  - The ruling describes two strategies to facilitate a seamless transition for employees



# COBRA – General Rules and Options

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- If Seller maintains a plan after the sale, then Seller's GHP provides COBRA coverage to M&A Qualified Beneficiaries
- If Seller does not maintain any GHP after the sale, a GHP of the Buyer must provide COBRA coverage
- The Seller and Buyer may contractually allocate COBRA coverage responsibility. Note, the party responsible for COBRA under the regulations remains ultimately liable



# Health & Welfare Plans

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## Communications

### ✓ Participants and Beneficiaries

- ❑ Summary Plan Descriptions – Summary of Material Modifications
- ❑ Plan Updates – Formal Written Amendments if allowed, and as required by the Plan.
- ❑ Enrollment and Election Forms
- ❑ Termination and/or Transfer notices

### ✓ External Agencies

- ❑ IRS and DOL– Final Form 5500 and Final SAR if terminating

### ✓ External Stakeholders

- ❑ Insurance carriers (for fully-insured plans)
- ❑ Stop-loss carrier (for self-insured plans)



# Executive Compensation

# Executive Compensation

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## Due Diligence

- ❖ Finding the agreements
- ❖ Impacted Plans/Arrangements
  - Options (Individual grants and plans)
  - SERPs
  - Change-In-Control Provisions and Severance Agreements
  - LTIP's
  - Bonus Plans
  - Deferred Compensation Arrangements and Top Hat plans
  - Rabbi Trusts
- ❖ Former Executive obligations
- ❖ Remember – Executive Benefits often include extended health and welfare benefits (medical coverage, life insurance, etc.)

# Executive Compensation

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## Common Compliance Concerns

- ❑ Sufficiency and/or funding of assets in Rabbi Trust
- ❑ Whether “top hat plan” participation limited to HCEs or highest paid employees, as applicable
- ❑ Whether the M&A transaction will trigger accelerated vesting or payments. Golden Parachute payments for a Change in Control – triggering Section 280G
- ❑ 409A compliance



# FINAL CONSIDERATIONS

# Common Representations And Warranties

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## Seller/Target Warranties

- ✓ Warranty initial and continued plan qualification
- ✓ Warranty compliance with ERISA, securities laws, HIPAA, COBRA and other applicable federal, state and local laws
- ✓ Warranty no outstanding issues pending before the DOL, IRS, or PBGC regarding current or past plans
- ✓ Outline outstanding benefit liabilities and warranty full and continued disclosure through the merger date
- ✓ Warranty accuracy and timeliness of all reporting and disclosure obligations (Form 5500s, SPDs, SMMs, SARs, etc.)
- ✓ Outline any outstanding claims or threatened litigation or administrative procedures or active audits against the Seller or Seller's Plan, and warranty full and continued disclosure through the merger date
- ✓ Identify and warrant full disclosure of all retirement, health and welfare, and executive compensation plans, trusts, collective bargaining agreements, arrangements and practices – domestic and foreign
- ✓ Warrant intention to comply with/support Buyer with resolving compliance concerns that remain post-merger

**Seller indemnification for breach of reps and warranties should include claim amounts and cost of defending**

# Baseline Fiduciary Obligations

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ERISA imposes the following fiduciary duties:

- Duty of Undivided Loyalty
- Duty to Diversify Plan Assets
- Exclusive Benefit and Anti-Alienation Rules
- Follow the Terms of the Plan
- Paying only Reasonable Expenses
- Prudent Man Rule

# Best Practices

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- Best Practices

- Set strategic concept/goals early (and get HR/benefits folks involved early!)
- Gather full/complete information on all employee benefit plans
- Evaluate plans and identify issues, possible conflicts, strategy limitations
- Develop implementation process
- Confirm understanding with senior management
- Negotiate with record-keepers, insurance carriers, trustees, etc.
- Manage employee communications and expectations
- Obtain reps, warranties and indemnities
- Understand and comply with your fiduciary responsibilities



# Final Questions





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# THANK YOU

FOR THIS OPPORTUNITY

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