



The Morning After: A Buyer's Post-Closing To-Do List for Employment and Benefits Issues

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The purchase agreement has been signed and the funds have been transferred. After a celebratory toast, the buyer's acquisition team got its first good night's sleep in weeks. And now, the buyer is wholly responsible for a business that was, just yesterday, owned and run by others. Whether the newly acquired entity is a financial buyer's first foray into an industry, or a strategic buyer's addition to an established offering, the buyer's attention must turn toward the future of that business. Detailed employment and benefits diligence likely identified numerous potential liabilities and differences between the buyer and the target company, and it is now time to integrate the acquisition into the buyer's established business or portfolio. Although integration planning was underway prior to closing and a transition management team is already in place, crucial work remains. Where is a buyer to begin, and what post-closing employment and benefits issues should be prioritized?

Employee Benefits

Some key employee benefit issues likely to have implications for a buyer include:

Post-Closing Compensation & Benefits Entitlements. Sellers often seek to include covenants in the purchase agreement, obligating a buyer to provide target company employees with minimum levels of compensation and benefits for a period of time post-closing, as well as credit for prior service, and for copays and deductibles paid in the year of the transaction. Buyers should consult with outside counsel to understand the implications of any such covenants and coordinate with their human resources departments and insurance providers to ensure any post-closing covenants are practicable under the buyer's benefit plans.

Employment Agreements. It is common for a target's senior management to enter into new agreements with a buyer, setting forth the terms of employment post-closing. The terms can vary from deal to deal, but often include base salary and annual incentive compensation eligibility, severance entitlements, and restrictive covenants. Buyers will often seek to enter into agreements contemporaneously with the signing of the purchase agreement, with the agreements springing into effect at closing.

Equity Arrangements. A financial buyer will often establish a new equity incentive program in connection with a transaction to incentivize key employees and align their interests with those of the

buyer. These programs typically provide for the grant of stock options, other derivative securities (e.g.,

restricted stock units) and/or restricted stock. Strategic buyers, on the other hand, often have an existing plan, in which case they may elect to grant key target employees equity awards in buyer under that plan. A buyer establishing a new equity incentive program will need to determine what type of equity incentive awards to offer, as well as the amount of equity to be reserved for grants (typically a percentage of the fully diluted equity). These arrangements will often be negotiated with management during the period between signing and closing or soon after closing and be utilized by the buyer going forward post-closing.

Employee Benefit Plans. In a merger or stock purchase, a target's employee benefit plans transfer by operation of law; in an asset purchase, plans must be affirmatively assumed by buyer. A financial buyer will typically continue the target's plans, while a strategic buyer will need to analyze the target's plans and determine whether to assume them or move transferring employees to the buyer's plans. Often, short transaction timelines lead strategic buyers to retain target plans for some period post-closing and transition target employees onto buyer plans later (e.g., during the next open enrollment). When making determinations around target plans, strategic buyers should be cognizant of the time and logistics required to onboard transferring employees and plan accordingly.

Additional issues can arise around qualified retirement plans. If a buyer wishes to terminate a target's retirement plans, defined contribution plans must typically be terminated pre-closing. The Employee Retirement Income Security Act of 1974 (ERISA) restricts a company's ability to terminate one plan while maintaining others, and the ability to terminate defined benefit plans may be limited depending on the plan's funding level and requirements under Title IV of ERISA. Buyers should also be aware that the assumption of a retirement plan can impact the buyer plan's discrimination testing, since plans are typically aggregated for such purposes. Merging a target's retirement plan into buyer's plan requires both plan sponsors to notify the IRS of the merger, and could affect the qualification of the merged plan if the target's plan had compliance issues or if pre-closing benefit levels aren't preserved in accordance with ERISA. Buyers should properly diligence target company retirement plans before a determination is made to assume or merge them.

If a target contributes to a multiemployer pension plan, the buyer will want to understand the magnitude of potential withdrawal liability and whether the transaction could trigger plan withdrawal. Mergers and stock purchase transactions do not typically trigger a withdrawal since the contributing employer remains unchanged. Asset sales, however, typically trigger seller withdrawal unless the parties comply with an exception under §4204 of ERISA, which generally seeks to mitigate risk to the plan by requiring buyer to maintain contribution levels and post a bond, and requiring seller to remain secondarily liable for five years.

Employment Issues

Wage & Hour Policy and Practices. Although wage and hour practices receive priority during diligence, that review is less searching than a compliance audit. Even when diligence identifies policies and practices indicative of compliance with overtime and worker classification requirements, including job descriptions that correlate with asserted overtime exemptions and industry-typical overtime payments, buyers cannot rely on these indicia of compliance. Off-the-clock violations, overtime for “exempt” employees, or wage and tax underpayments for workers misclassified as independent contractors are liabilities determined only by careful and accurate application of sound policies to actual circumstances.

Revising troublesome policies is a first step, especially if the target operates in a jurisdiction with challenging compliance obligations (including New York). More crucially, managers and employees must adhere to those policies. If managers encourage workers to return after clocking out or if employees are not properly utilizing time measurement mechanisms, a facially lawful overtime policy approaches worthlessness. Uncovering weaknesses in the acquired entity’s application of its policies requires boots-on-the-ground investigation, including interviews with management to analyze hours of work and job duties actually performed by workers, both employees and independent contractors.

Depending on the level of disconnect between policy and practice, training should be planned—especially, but not limited to, managers. Moreover, if practices must be revised, clear communications with the workforce will be crucial to assure future compliance, and to explain the bases for changes to work rules, classifications and job descriptions. Doing so near the time of closing is a natural decision point, and those changes are likely to meet less skepticism than later changes that may appear prompted by complaint, litigation or government audit.

Key Employment Policies. Beyond wage and hour issues (as well as labor distress and massive litigation), few labor and employment issues typically rate as deal changers in an acquisition. In all likelihood, the employee handbook and related policies were not considered potential material liabilities. Even an off-the-shelf handbook typically covers basics such as inclusion of “at will employment” language; a policy against illegal workplace discrimination, harassment and retaliation; and coverage of major employment laws (or at least a broad confirmation that the company follows applicable employment, immigration, workplace safety, privacy and related laws). Ignoring policy issues upon acquisition is, nonetheless, bad practice. It is crucial to appreciate and address the target’s policies—and failing to do so will impede a smooth integration, cause confusion, and lead to trouble.

At a bare minimum, it is important to promptly correct or supplement missing, wrong or otherwise lacking policies. For example, if the target fails to address local laws that impose obligations greater than federal law (i.e., local paid sick leave or background check laws), the buyer must bring these policies into compliance.

In addition, even where employment policies and practices are mature and comprehensive, to the extent that the buyer intends to harmonize or integrate the target into its broader operations, important decisions must be made so that employees are working under consistent rules: How does a buyer select and harmonize PTO and leave policies? Are there meaningful differences in how the entities treat the privacy of electronic communications? What are standard work hours? Which performance appraisal process will apply and which metrics are appropriate? In some matters, failing to address such questions will reverberate in small ways on a daily basis; other unaddressed issues may lie silent for a time, only to emerge as problems for personnel at many levels.

Restructuring; Operational Efficiencies. If the acquisition may result in restructuring or layoffs, the buyer must be acutely aware of obligations it has under federal and state Worker Adjustment and Retraining Notification (WARN) laws to provide notice to affected workers and governmental entities. In addition, such force reductions must be planned and implemented thoughtfully and carefully so as not to run afoul of anti-discrimination laws that are strongly suspicious of any adverse impact on protected groups. Last, the force reduction must take into account the costs resulting from existing severance obligations.

In assessing the opportunities and challenges associated with an acquisition, buyers should endeavor in a serious way to not just make it to the finish line of a closing, but to be ready to tackle the legal and practical consequences of integrating a new business and its personnel. Focusing on these will result in fewer bad surprises and a more successful integration of the target company.

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