Some (But Not All) Employee Benefit Issues To Consider In Mergers & Acquisitions

Mark A. Bodron, Baker Botts L.L.P.
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Some (But Not All) Employee Benefit Issues To Consider In Mergers & Acquisitions

• 401(k) Plan Distributions and Termination
• Safe Harbor 401(k) Plan Mid-Year Merger
• 401(k) Plan Loans and Hardship Distributions
• Controlled Group Issues
• Successor Liability
• Obamacare/Section 4890H
• Collective Bargaining Agreements and Multiemployer Plan Withdrawal Liability Issues
M&A Transactions – Where to Start

• What type of transaction is it?
  – Asset
  – Equity/Merger
  – Spin-Off
  – Joint venture

• What employees and employee benefit plans are involved in the transaction?
  – Is there a collective bargaining agreement/union?

• What does Buyer want to happen with respect to Seller employees and their benefits?

• What does Seller want to happen with its employees and their benefits?

• Other considerations particular to the transaction?
  – Which party is driving the transaction? Is it a bid situation?
  – Due diligence and/or rep/wty insurance
M&A Transactions – Benefits Due Diligence

• Some (But Not All) Things to Think About:
  – Has 401(k) or pension plan been timely amended for law and design changes?
    • What about operational errors? What to do if a problem is discovered?
  – Have qualified and welfare plans passed non-discrimination testing?
  – Can the benefit plans be amended and/or terminated at any time?
  – Obamacare compliance, including backup documentation to support that it is not subject to a penalty under Section 4980H?
  – Is there a retiree medical obligation that cannot be terminated?
  – Will the transaction trigger accelerated vesting or payments under any plans or agreements? What about for equity awards?
    • Is Section 280G excise parachute tax triggered? Are there tax gross-ups for Section 280G or Section 409A?
  – Employment law issues, including employee misclassifications?
  – Are there any Code Section 409A compliance issues?
  – Is there a CBA addressing employee compensation and benefits?
  – What about potential withdrawal liability?
Issue 1: 401(k) Plan Distributions and Termination

- Distribution of 401(k) elective deferrals and Roth contributions limited to (i) severance from employment, death and disability, (ii) age 59½ in-service withdrawals, (iii) hardship withdrawals, and (iv) plan termination

- Severance from employment means participant is no longer employed by employer (controlled group basis) that maintains the 401(k) plan
  - In an asset transaction, generally, Seller employee has a severance from employment for Seller 401(k) plan if he or she becomes a Buyer employee, unless Buyer assumes and continues Seller 401(k) plan
  - In an equity transaction where a Seller subsidiary is acquired, Seller employee should have a severance from employment for Seller 401(k) plan, assuming no spin-off or transfer of employee’s benefit to Buyer 401(k) plan

- 401(k) plans are subject to special successor plan rules that limit the ability to terminate a 401(k) plan
Issue 1: 401(k) Plan Distributions and Termination

- Distributions are not available upon termination of a 401(k) plan if there is another 401(k) plan in the controlled group during the 12-month period beginning after termination and distribution of all plan assets
  - In an equity transaction, Buyer will want to require Seller to terminate its 401(k) plan no later than the day before the closing to permit plan termination distributions following closing
  - If the plan is not terminated before the closing, Buyer is not able to terminate it if Buyer or a member of Buyer’s controlled group maintains another 401(k) plan within the 12-month period noted above
  - The successor plan rules do not apply in an asset transaction, unless Buyer assumes and continues Seller 401(k) plan
  - “Termination” occurs when Seller’s board or other governing body takes formal action to terminate the plan (even though the plan assets will not be distributed until after the closing)

- Generally, the parties will want the transaction agreement to address disposition of any 401(k) plans at issue
Issue 2: Safe Harbor 401(k) Plan Mid-Year Merger

- Safe Harbor 401(k) Plan rules under Section 401(k)(12) and (13) and the accompanying regulations place limitations on mid-year changes to the plan
  - Specific guidance on permissible mid-year amendments/changes to a safe harbor 401(k) plan provide under IRS Notice 2016-16
  - An impermissible mid-year change is an operational error jeopardizing the plan’s tax-qualified plan status
- Lacking guidance, if Buyer assumes Seller 401(k) plan and Seller 401(k) plan and/or Buyer 401(k) plan is a safe harbor 401(k) plan, a mid-year plan merger is generally not available
  - Without merger option, if a mid-year transaction the parties will either have to terminate the safe harbor 401(k) plan prior to the closing or operate both plans for the duration of the merger year
    - If operating both plans, consider post-closing eligibility issues
- In light of the foregoing, parties may want to address disposition of safe harbor 401(k) plan in the transaction agreement
Issue 3: 401(k) Hardship Distributions and Plan Loans

- 401(k) elective deferrals and Roth 401(k) contributions can be distributed as a hardship withdrawal
  - Hardship withdrawals must satisfy the requirements under the 401(k) regulations
  - Concern for Buyer assuming Seller 401(k) plan that provides hardship withdrawals is whether the plan terms have been followed and/or operational compliance – including back-up documentation supporting the withdrawal

- 401(k) plan may permit loans subject to compliance with Section 72(p) and ERISA prohibited transaction rules
  - Concern for Buyer assuming Seller 401(k) plan that outstanding loans violate repayment requirements
  - If Buyer does not assume Seller 401(k) plan and Seller 401(k) plan permitted loans, to avoid a loan default and early distribution 10% penalty, Seller may want to require Buyer 401(k) plan to accept rollover of loans or, if Seller 401(k) plan continues post-closing, cause Seller 401(k) Plan to accept loan repayments from former Seller employees post-closing

- Buyer due diligence should focus on whether there are operational issues related to hardship withdrawals or loans and if so correction responsibility
Issue 4: Controlled Group Issues

- ERISA and the Code contain “controlled group” rules that treat multiple corporations or related trades or businesses as a single employer
  - Parent-subsidiary, brother-sister or affiliated service group
- Members of the controlled group are jointly and severally liable for a number of purposes, including for
  - Multiemployer plan withdrawal liability
  - Plan termination liability
  - Minimum funding obligations
  - Excise taxes for failure to make minimum required contributions
  - PBGC liens for unpaid contributions greater than $1,000,000
  - PBGC premiums
- In addition, there can be issues if some members of Seller controlled group were not included for plan testing requirements
- Participation in plans by non-controlled group members can also trigger issues (e.g., MEWA reporting obligations/penalties, state insurance law compliance reporting/penalties and multiple employer plan status)
Issue 4: Controlled Group Liability

- Another potential issue:
  - If a private equity fund invests in a portfolio company that maintains a defined benefit plan, and thus has funding liabilities under the Code and ERISA, can the fund be aggregated with the portfolio company as a single employer under the controlled group rules?
  - If so, the fund - Buyer - would be jointly and severally liable for the portfolio company’s defined benefit plan’s liabilities
  - In the past, the answer was no - the fund is not considered part of Seller’s controlled group because fund is not a “trade or business” but a “passive investment”
  - In 2013 case Sun Capital Partners III, LP v. New England Teamsters & Trucking Industry Pension Fund, 724 F.3d 129 (1st Cir. 2013), the U.S. Court of Appeals for the First Circuit held that a private equity fund was not merely a passive investor, but was in fact a “trade or business”
  - The Supreme Court refused to review the case and thus the decision stands
Issue 5: Successor Liability

• Generally in an asset transaction Buyer can elect not to assume Seller’s defined benefit plan and not take on the plan liabilities
  – But remember the controlled group liability issue
• An exception to the general rule is successor liability where there is a *de facto* merger, such as:
  – A continuity of ownership or of enterprise, a dissolution of Seller or an assumption necessary for uninterrupted continuation of Seller’s operations
  – Buyer is really Seller as in the case of a reorganization or restructuring
  – A fraudulent transfer design for the avoidance of liability
• This was the result in the *Upholsterer’s International Union Pension Fund v. Artistic Furniture*, 920 F.2d 1323 (7th Cir. 1990)
  – Buyer had successor liability with respect to a multiemployer defined benefit plan where there was (i) a continuity of operations and (ii) knowledge of the liability
  – The court basically looked to unfair labor practice situations and considered employee protection in its holding
Issue 5: Successor Liability

• The Artistic Furniture holding has been agreed with by the First, Second, Third, Sixth and Ninth Circuits and by district courts in the Fifth Circuit

• Most recently, in PBGC v. Findley Industries, Inc., 902 F.3d 597 (6th Cir. 2018), the Sixth Circuit continued the expansion of successor liability with respect to ERISA pension plans, holding
  – A “trust” created by a pension plan sponsor’s founder was a “trade or business” under ERISA, and
  – The federal common law doctrine of successor liability applied in determining liability for unfunded pension liability under ERISA
Issue 6: Obamacare/Section 4980H

• Affordable Healthcare Act (“ACA”) added Section 4980H “Pay or Play” penalty tax
  – If an “Applicable Large Employer” (“ALE”) fails to offer any coverage – whether “affordable” or not – to at least 95% of its full-time employees, and at least one full-time employee enrolls in subsidized coverage on the Exchange, the employer is subject to a Section 4980H(a) penalty
    • ALE is generally an employer with 50 or more full-time equivalent employees on average in the prior calendar year
  – If any ALE offers coverage to at least 95% of its full-time employees, but it is not affordable or does not provide minimum value, and an employee enrolls in subsidized coverage on the Exchange, the employer is subject to a Section 4980H(b) penalty for that employee
• ALEs must file Form 1095-C, Employer-Provided Health Insurance Offer and Coverage, and Form 1094-C, Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns, with IRS annually beginning with 2015 tax year
  – Separate penalties apply for failure to file that can be substantial
Issue 7: CBAs and Multiemployer Plans

• Seller may be a party to a defined benefit plan that is a multiemployer plan, which is a plan maintained pursuant to a CBA between an employee organization and an employer, which can raise the following concerns:
  – Partial or complete withdrawal liability
  – ERISA provides that “all trades or businesses (whether or not incorporated) which are under common control within the meaning of ERISA section 4001(b)(1) are considered a single employer” and thus there is controlled group responsibility for the withdrawal liability
  – Successor liability (discussed previously)
  – If a CBA provides for a defined benefit plan for Seller union members, Buyer could be required to provide a defined benefit plan for such members it employs
  – If Buyer has its own defined benefit plan and assumes Seller's defined benefit plan, whether an asset or equity transaction, Buyer needs to consider how Seller’s plan will integrate with its overall benefit structure
  – Covenants may limit what Buyer can do with Seller’s plans for a certain period of time; CBAs can have the same limiting impact on Buyer
Issue 7: CBAs and Multiemployer Plans

• If Seller is a party to a CBA, what benefits are required under the CBA, including whether it requires a defined benefit plan for the covered employees
• In an equity transaction, the CBA will generally come over with the acquired entity
• In an asset transaction, depending on the assets being acquired, Buyer may be subject to a “successor” clause in the CBA. If there is not such a clause, Buyer may be required to bargain in good faith with the union
• CBAs can govern not only current pension benefits at the time of closing, but may also provide for pension increases for future years that are subject to the CBA
Issue 7: CBAs and Multiemployer Plans

• Future benefit increases may not be reflected in the plan document or the actuarial reports prepared for the plan

• The CBA may require covering the union members in a single-employer plan or a multiemployer plan
  – If Seller is party to a multiemployer plan, that plan may be substantially underfunded
  – If the plan is substantially unfunded, Buyer may be able to avoid the multiemployer plan with an asset transaction

• If an equity transaction, since Seller will continue to make contributions to the multiemployer plan, generally, there is no withdrawal and thus no accompanying withdrawal liability, as a result of the transaction
  – Buyer succeeds to Seller’s contribution history, which may result in a larger withdrawal liability should Buyer in the future experience a partial or complete withdrawal from the plan
Issue 7: CBAs and Multiemployer Plans

- If an asset transaction and Seller ceases to make contributions to the multiemployer defined benefit plan, a complete plan withdrawal results
  - Seller will have complete withdrawal liability
  - If Seller continues to make contributions to the plan for union members employed at one or more of Seller’s other businesses, but the contributions total less than 30% of the total Seller contributions prior to the transaction, Seller will have a partial plan withdrawal, and thus partial withdrawal liability

- Seller may avoid complete or partial withdrawal liability if it and Buyer rely on the "sale of assets rule" under ERISA Section 4204
  - Buyer agrees (i) to continue to make contributions to the plan the same as Seller and (ii) posts a bond or deposits funds in an escrow for a five-year period
  - If Buyer doesn't stop making contributions to, or withdraw from, the plan during that five-year period, Seller will avoid withdrawal liability
  - Seller remains secondarily liable for withdrawal liability it would have had if Buyer stops making contributions or withdraws during the five-year period (and doesn't make its withdrawal liability payment)
Issue 7: CBAs and Multiemployer Plans

• Opting to use ERISA Section 4204 changes the impact of withdrawal liability on the parties
  – Seller: Only secondary liability triggered in a narrow circumstance and thus can avoid a withdrawal liability
  – Buyer: Liability for the last five years of Seller’s contribution history (rather than all of Seller’s contribution history as in the equity transaction case)
  – It is possible that the last five years contribution history will actually result in no potential withdrawal liability for Buyer
  – The multiemployer plan may grant Buyer a variance from the bond or escrow requirement

• If the ERISA Section 4204 sale of assets rule is not used, Buyer doesn't take on any Seller liability or Seller’s contribution history; Buyer treated as a new employer joining the multiemployer plan
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• Questions?

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