Employee Benefits and Executive Compensation Attorney's Role in Corporate Transactions

A Practical Guidance® Practice Note by Michelle Capezza, Mintz

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A corporate transaction often requires employee benefits and executive compensation (EBEC) attorneys to utilize all aspects of their knowledge in the field in order to review the transaction parties' current arrangements, assess and address explicit and potential liabilities, and advise on program structures post-transaction. The goal of this practice note is to assist EBEC attorneys in their approach to a corporate transaction and reference common issues that may arise, which will require their competencies. It may also assist attorneys from other practice areas to identify employee benefits and executive compensation issues in a transaction and the appropriate time to engage further review by an EBEC practitioner who specializes in these issues.

This practice note is organized in the following sections:

- Preliminary Questions
- Due Diligence Process
- Identifying Liabilities
- Addressing Treatment of Benefit Plans and Integration Issues
- The Purchase Agreement
- Transaction-Related Agreements
- Sample Buyer's Initial Due Diligence Request List

For additional practical guidance, see the Corporate Transactions EBEC Resource Kit.

The following is meant to serve as an outline of common employee benefits and compensation issues that may arise in a corporate transaction and to assist the EBEC attorney (or the non-EBEC practitioner) in identifying risks and liabilities associated with the plans, programs, and arrangements in a transaction. More complex or nuanced transactions may raise additional considerations and liabilities. The key is to identify all of the relevant plans, programs, and arrangements; assemble the appropriate parties to provide a thorough review and analysis of each one so that transaction agreements can be properly tailored; ensure that potential and existing liabilities are addressed; and that any related plans, documents, and agreements impacting the employees can be amended or prepared so that the transaction is a success.

Preliminary Questions

There is a certain excitement which arises when a corporate transaction commences because transactional work can be fast-paced. It is not uncommon for the EBEC attorney to receive a random email or communication from a client, a colleague, or co-counsel that a corporate deal is in the works and that the EBEC attorney will be called upon to assist at any moment. Communication may increase at a furious pace and the EBEC attorney may find themselves reviewing initial documents with limited context regarding the deal. The following sections address the most basic aspects of any contemplated transaction that an EBEC attorney should be aware of to prepare for advising on the matter.

Who Do You Represent?

One of the first questions the EBEC attorney should ask is *"Who do we represent?"* It is important for the EBEC attorney

to know if he or she will review the transaction from the point of view of the buyer, the seller, or another party in a transaction that may have nuanced issues such as in a joint venture, a private equity deal, or an outsourcing arrangement. It is also important to know the status of each of the parties to the transaction as a public corporation or a private company in order to identify any additional issues that may be relevant to review, such as securities filings or other legal considerations which may apply to a public company versus a private company under applicable law.

If the EBEC attorney will represent an ongoing client in a transaction, the attorney may already have a more fulsome idea of the benefits and compensation programs that they sponsor or the executives who may have special compensation arrangements. In such a case, it would be advisable to prepare a preliminary list of known programs and arrangements as well as any known compliance issues. If advising the client for the first time in connection with the transaction, the EBEC attorney will rely more heavily on client representations as to the scope of their programs and their compliance status, and will need to pose more questions to understand the possible gamut of issues that will come into play.

What Kind of Transaction Is This?

It is important for the EBEC attorney to know from the outset the type of transaction that the client is pursuing. In an asset deal, the buyer seeks to purchase certain assets and liabilities of the seller. With certain exceptions, it is possible to not acquire all employee benefit plan liabilities in an asset deal. That being said, successor employer rules and successor liabilities under applicable law can impose liability on a buyer despite the structure of the transaction. In a stock deal or merger of a target entity (whether it is the entire entity or a subsidiary of a larger ongoing entity) into the buyer, the buyer obtains a majority equity interest in such entity. The buyer steps into the shoes of the seller/target and assumes the seller/target's employee benefit plan liabilities as a matter of law. Therefore, consideration of the type of transaction will shape how to address adequate protections in the transaction agreement (e.g., liability allocation, indemnification, adjustments to purchase price, and escrow arrangements).

Other types of transactions may raise special issues not addressed in this article. For example, in a joint venture, parties may come together to form an organization, co-sponsor benefits programs, and co-employ individuals, which will require consideration of co-liabilities. In a private equity transaction, an organization may seek to invest in an entity that could cause it to become part of certain controlled group analyses (e.g., multiemployer pension plan withdrawal liability). An outsourcing transaction might implicate international benefits laws or necessitate a need for special incentive programs to retain employees.

The important takeaway is that the EBEC attorney should review the employee benefit plan and compensation issues in the context of the transaction at hand so that liabilities can be assessed accordingly.

Who Is on the Transaction Team?

The EBEC attorney should be aware of the other attorneys, in-house client personnel, and advisors who are on the transaction team, as well as who to contact with information gleaned from review of the employee benefits and compensation programs produced during the due diligence phase and as the transaction progresses. A list may be circulated with deal team names and contact information. The EBEC attorney should confirm any additional parties that may need to be consulted to resolve open issues related to benefits and compensation issues and to obtain agreement to contact such parties (e.g., benefit plan service providers, advisors, insurers, and members of the buyer's and the target's legal and/or human resources departments). It also may become necessary to coordinate document requests, responses, and provisions for the transactional agreements with the corporate, securities, labor and employment, tax, and data privacy and security attorneys on the deal.

Due Diligence Process

Requesting and Producing Documentation and Information

With the context of the transaction confirmed and the deal team organized, the EBEC attorney will be prepared to tackle the due diligence phase. Before commencing a substantive analysis, it may be necessary to undergo training in order to utilize new tools being engaged for the diligence review, such as with regard to virtual data rooms or artificial intelligence tools. Often, the requested documents are provided through a data room and it will be the responsibility of the parties to regularly log into the data room to assess which documents have been provided, which documents must still be provided and to continuously update the diligence request, as needed. In other cases, an artificial intelligence tool may be utilized to review, collate, and summarize the information as it is updated. It will be important to become comfortable and familiar with any tools being used in the transaction to ensure that all of the information required to be analyzed is properly discovered and addressed.

When representing a seller in a transaction, among the first substantive tasks may be to review a diligence request from

the buyer and assist the seller in identifying the appropriate documents to provide in response to the request. In the early stages of review, the EBEC attorney will also likely summarize the key provisions in all of the benefit plans. Among other things, this will typically include identifying triggers for accelerated vesting and compensation payouts upon a change in control and, in both cases, whether the contemplated transaction will trigger such benefits and payments.

When representing a buyer in a transaction, the EBEC attorney will likely prepare a due diligence request of the seller's plans, programs, and arrangements. Typically, a buyer in a transaction will lead with the due diligence request regarding a seller's employee benefits programs and executive compensation arrangements. It will be necessary to review the documents in the data room and seller's summaries of the programs. The EBEC attorney should also consider whether any locations outside of the area designated for the benefits files may contain relevant information (e.g., areas designated for corporate, tax, or labor and employment files).

The EBEC attorney will need to identify potential compliance issues and liabilities and the triggers for payouts under existing arrangements. The buyer will seek to identify potential issues that could become their responsibility, such as pension plan funding to pay accrued benefits; pending or potential liabilities for benefit plan noncompliance under the Internal Revenue Code of 1986, as amended (the Code) and the Employee Retirement Income Security Act of 1974, as amended (ERISA); multiemployer pension plan withdrawal liability; benefit claims and appeals; employee benefits-related investigations, audits, litigations, and outstanding compliance issues under applicable laws; and benefit funding or vesting/payout triggers as a result of the transaction.

A buyer's due diligence inquiry typically includes a request for copies of all written benefit plans and agreements (as well as descriptions of informal plans, programs, practices, and arrangements), and any material related documentation for each (e.g., as applicable, plan documents, plan amendments, trust documents, qualified plan IRS determination letters, summary plan descriptions, qualified plan compliance statements or closing agreements, financial statements, actuarial valuations, recent annual Form 5500 filings, service agreements, nondiscrimination tests for tax-qualified plans, government filings, and reporting and disclosure documents). The due diligence request may be organized by category such as tax-qualified plans, multiemployer plans, nonqualified plans, health and welfare plans (including retiree arrangements), equity awards, bonus arrangements, and executive agreements (such as employment agreements, change-in-control agreements, retention agreements, severance agreements, equity award agreements, and incentive compensation arrangements).

It is common for the diligence request to be limited to a request for all applicable documents within the last three to six years, as correlates to the most common statute of limitations under the Code and ERISA, or to add an additional year to the typical scope of the records request as a buffer. There may be reasons to request documents beyond such time periods. For example, the limitations period for claims for benefits may be based on a longer applicable state law statute of limitations for contract claims unless the benefit plan includes a contractual limitations period. Therefore, as documents are received and reviewed, supplementary due diligence requests may arise to delve deeper into review on certain issues.

A sample buyer's initial due diligence request list appears at the end of this practice note in Sample Buyer's Initial Due Diligence Request List. For another example, see Due Diligence Request List (Executive Compensation and Employee Benefits). See also Due Diligence Checklist (Retirement and Retiree Benefit Plans), Due Diligence Checklist (Employment Agreements), Due Diligence Checklist (Incentive Plans), and Due Diligence Checklist (Award Agreements).

The EBEC attorney should also confirm the different types of worker relationships maintained by the target that may inform benefits and compensation issues. For example, the EBEC attorney should seek to confirm whether the organization has union-represented employees subject to a collective bargaining agreement. This may dictate which benefits or benefit plans must continue and whether benefit plans may be amended or terminated by the seller. If the organization is using a staffing agency or professional employer organization (PEO) to provide workers and/or benefits, information regarding these arrangements will need to be reviewed. If the target utilizes independent contractors, there is also risk of worker misclassification, which can impact benefit plans if individuals were erroneously excluded from plan participation based on being misclassified as ineligible nonemployees. It will be important to work closely with labor and employment attorneys on the transaction team to drill into these and related issues.

The EBEC attorney should also be prepared to draft and review the disclosure schedules that will be part of the transaction agreement. These schedules should also be reviewed for completeness and accuracy based on what is discovered as the due diligence is updated. The EBEC attorney should continue to follow up with the transaction team to confirm that the items that are disclosed in the schedules are accurate, that any open issues have been

addressed, and that the other provisions in the agreement coordinate to address agreed-upon terms and are cross-referenced properly.

Identifying Liabilities

As the requested documents are reviewed by the EBEC attorney, it will be necessary to identify and flag the issues that raise explicit and potential liabilities and payment triggers. An ongoing summary should be compiled so that the issues can be seen at a glance and circulated to the larger deal team for purposes of discussion, negotiation, and drafting of the related transaction agreement provisions; such as those which address representations and warranties, covenants, conditions precedent, indemnification, any escrow arrangements, and purchase price adjustments.

When analyzing these issues to keep in mind the topics discussed in the following sections.

Controlled Group Liability

Under ERISA and the Code, two or more related entities with common ownership as statutorily defined can be treated as a single employer, or as affiliates, and there are various kinds of liabilities associated with employee benefit plans and programs that are assessed on a controlled group basis that will need to be considered during the due diligence analysis. For example, joint and several controlled group liability can arise in connection with:

- Minimum funding obligations of defined benefit pension plans
- Excise taxes related to minimum funding failures
- Unfunded pension benefits upon plan terminations
- Pension plan termination proceedings initiated by the PBGC
- PBGC insurance premium requirements for defined benefit pension plans
- Pension liability liens
- Multiemployer pension plan contributions and withdrawal liability
- Withdrawals of substantial employers from single employer plans, or termination of single employer plans, under multiple controlled groups
- Failures related to COBRA continuation coverage under group health plans (which can lead to springing liability for a buyer)

The controlled group rules also require certain benefit plan determinations to be made on a controlled group basis or can give rise to potential controlled group penalties for noncompliance with statutory obligations. Examples include:

- Nondiscrimination testing rules under the Code for fair and nondiscriminatory provision of benefits
- Requirements that subject an entity with less than 50 employees that is part of a larger group of entities to be considered part of an applicable large employer for purposes of the employer shared responsibility and information reporting requirements under the Patient Protection and Affordable Care Act (ACA) (see ACA Employer Shared Responsibility Mandate)
- Separation from service determinations for purposes of payments of nonqualified deferred compensation subject to I.R.C. § 409A (see Section 409A and Severance Arrangements) –and–
- Prohibited transactions under ERISA and the Code

Thus, it will be important to determine if the target entity is part of a larger controlled group and to identify those entities, whether the seller or another entity is the actual sponsor of their benefit plans and programs, whether the seller participates in multiple or multiemployer programs as opposed to single employer plans within the same controlled group, any potential liabilities that the target entity may be subject to based on its controlled group status, and the effect of the proposed transaction on the designation of such liabilities. In transactions where underfunded pension plans or multiemployer plans are involved, the parties should especially consider whether the underfunding (or potential withdrawal liability) warrants a purchase price adjustment, funds should be placed in escrow, or broader indemnification provisions should be designated in the purchase agreement. The goal is to identify risks and address the transaction agreement provisions accordingly.

For more information on the controlled group rules, see Controlled Group and Affiliated Service Group Rules for Employee Benefit Plans. For a discussion regarding prohibited transactions, see Prohibited Transactions and Prohibited Transaction Exemptions.

Successor Liability

In a stock transaction or merger, the buyer will acquire an entity and its liabilities as a matter of law. In an asset transaction, even if a buyer specifies in an asset purchase agreement that it will not assume certain liabilities, there may be instances under various theories of law where the buyer will be held liable for liabilities related to the acquired assets. General theories of successor liability include express or implied agreement to assume, de facto merger, mere continuation, fraud, continuity of enterprise (substantial

continuation), product line, duty to warn, inadequate consideration for the transfer and failure to make provision for creditors, and statutory liability. A theory of successor liability which can commonly arise in benefits cases is continuity of enterprise particularly where there is continuity of business operations, products and services offered, and use of trade names and retention of the same employees).

One context in which courts have found that an asset purchaser has successor liability is in connection with delinquent multiemployer plan contributions of the seller, especially where there is sufficient continuity between the parties and the successor had notice of the liability. See, e.g., Upholsterers' Int'l Union Pension Fund v. Artistic Furniture of Pontiac, 920 F.2d 1323 (7th Cir. 1990); M.L. Einhorn v. Ruberton Constr. Co., 632 F.3d 89 (3d Cir. 2011); Resilient Floor Covering Pension Trust Bd. of Trs. v. Michael's Floor Covering, Inc., 801 F.3d 1079 (9th Cir. 2015). Thus, it may be necessary in an asset transaction involving a seller that contributes to a multiemployer pension plan to follow the requirements under Section 4204 of ERISA (29 U.S.C. § 1384), which provides for conditions under which withdrawal liability will not be triggered upon a sale of assets. The statute requires that the buyer and seller agree to adhere to the ERISA § 4204 rules and that the transaction is structured to meet certain conditions. Among other things, the buyer will need to agree to assume the obligation to contribute to the plan for substantially the same number of contribution base units as the seller was obligated to contribute to the plan, post a bond for a period of five years based the seller's historical annual contributions (unless an exception applies), and assume the past five years of contribution history of seller (for purposes of determining liability of buyer upon buyer's subsequent withdrawal). The seller will need to agree in the purchase agreement to be secondarily liable for the amount of the liability it would have otherwise incurred if the buyer withdraws within five years and does not pay its withdrawal liability, and further agree that if the seller liquidates all or substantially all of its assets within five years, it must post a bond based on the amount of withdrawal liability it would have otherwise incurred. See 29 C.F.R. § 4204.1.

It will be important to consider if there are other applicable withdrawal liability rules for particular industries or small employers under ERISA. The manner in which withdrawal liability is assessed and the extent of potential liability must be confirmed. Section 4212(c) of ERISA (29 U.S.C. § 1392(c)) also provides that if a principal purpose of any transaction is to evade or avoid liability, the provisions governing employer withdrawals from multiemployer plans, and liability imposed thereby, will be applied without regard to such transaction.

Excise Taxes and Penalties

Liability for excise taxes and statutory penalties associated with benefit plans and compensation arrangements can arise in many ways. For example, they can arise in connection with violations of COBRA continuation coverage requirements, ERISA reporting and disclosure obligations, notification and disclosure obligations under various laws affecting group health plans, prohibited transactions under ERISA and the Code, and violations under Code Sections 409A and 280G. The EBEC attorney will need to assess whether the target has any existing or potential liabilities for excise taxes or statutory penalties due to compliance issues, and whether they agreed in particular agreements to provide gross-ups to certain individuals for any potential excise taxes associated with their individual arrangements. With such an assessment, transaction provisions can be tailored accordingly to address responsibility for these taxes and liabilities.

Pending or Threatened Litigation

The due diligence should also indicate whether there is any pending or threatened litigation related to any of the target's benefit plans or compensation arrangements. Common areas involving litigation in this context include breach of ERISA fiduciary responsibilities, COBRA litigation, claims for benefits, executive lawsuits related to top hat plans, and other compensation arrangements. Litigation related to cybersecurity of employee benefit plan data such as participant personally identifiable information is also on the rise. With regard to this area, the diligence should confirm not only pending or threatened litigation, but also any recent breaches which have been identified, any ongoing processes to notify participants, and costs associated with addressing the consequences of same.

Payment Triggers

Certain plans and programs may provide for payments to be triggered upon the employer's change in control, acquisition or sale, or sale of substantially all of its assets. For example, severance plans may provide for payments to be triggered under the plan even if employees are hired by a buyer. Executives may have employment agreements or change-in-control agreements that set forth certain payments to be made in the event of a corporate transaction. It may be important to consider whether any employment agreements or compensation plans address the impact of the parachute payment rules (and excise tax on parachute payments) of I.R.C. §§ 280G and 4999 and undertake a Section 280G analysis. Retirement plan arrangements and incentive and equity programs may provide for acceleration of vesting provisions triggered by transactions. The EBEC attorney will need to identify payment triggers among all of the target's

plans and programs and assist the team in determining how they can be addressed in the transaction agreement (e.g., whether any plans require amendments, the transaction agreement requires covenants or purchase price adjustments regarding payments, or escrow needs to be established to make payments).

Overall Compliance

The EBEC attorney will need to garner a sense through the due diligence process of the overall compliance level of the target's benefit plans and executive arrangements as well as a sense of prudent governance by ERISA plan fiduciaries. These issues will also be addressed by the target's representations and warranties. For example, it will be important to search for indications that:

- For qualified retirement plans:
  - The requisite documentation is in place and duly authorized.
  - Applicable reporting and disclosure obligations have been met.
  - Contributions and pension plan funding obligations have been timely made.
  - Any known documentation or operational errors have been documented and have been or are in the process of being corrected.
  - The plan is under audit or remains subject to a closing agreement.
- For group health plans:
  - The requisite plan documentation is in place and duly authorized.
  - Notice and disclosure requirements have been satisfied.
  - If applicable, ACA employer shared responsibility information reporting requirements have been met and any employer shared responsibility payments owed or information reporting penalties incurred have been identified.
  - The plan has complied with ACA and other applicable laws affecting group health plans.
- Post-retirement welfare benefits, such as medical and life insurance, are identified and assessed as to whether any of the plans could be construed as providing for vested lifetime benefits or whether the plans could be amended or terminated at any time.
- Equity award programs have the requisite documentation and filings, and, where applicable, have been documented and operated to comply with or be exempt from Section 409A (e.g., assessing risk of problematic fair market value determinations for equity grants in private companies).
- Executive agreements and arrangements are properly documented and potential documentary and operational compliance issues under Section 409A and other applicable laws are assessed.
- Any other nonqualified deferred compensation arrangements have been documented and operated in compliance with Section 409A.
- Determine whether nonqualified deferred compensation plans, incentive plans, and severance plans and programs are subject to ERISA in full, eligible for treatment as a top hat plan, or are potentially exempt as a payroll practice.
- For plans covered by ERISA's fiduciary rules, the status of fiduciary liability insurance and ERISA bonding requirements is assessed and that plan fiduciaries:
  - Were duly appointed
  - Have documented policies and procedures and meeting minutes –and–
  - Are not subject to pending or threatened litigation

This list is not exhaustive. Essentially, each type of benefit program and compensation arrangement should be evaluated in the context of the applicable legal requirements to assess the state of compliance.

In light of the foregoing, it is essential for the EBEC attorney to provide a detailed due diligence request to the target to find the information and clues that will lead to the proper assessment of any potential issues. Thorough due diligence is a crucial first step in identifying risks and potential liabilities. An understanding of the overall transaction will assist in analyzing these issues and determining areas of potential successor liability. Other techniques may also be useful to handle risks. In addition to negotiating specific exclusions of liabilities (as applicable) and representations and warranties in the agreement, additional provisions concerning indemnification and escrow arrangements, purchase price adjustments, post-closing covenants, and insurance may be appropriate.

For additional practical guidance on compensation- and benefits-related liabilities in corporate transactions, see Corporate Transactions EBEC Resource Kit. Also see Severance and Change-in-Control Agreement Liabilities in Corporate Transactions, Equity Award Treatment in Corporate Transactions, Employment and Employee Benefits Issues in Carve-Out Transactions, Retirement Plan Issues in Corporate Transactions, Section 280G Parachute Payment Rules, Section 280G for Private Companies, COBRA Considerations in Corporate Transactions, COBRA Considerations in Corporate Transactions Chart, Executive Compensation Issues in Corporate Transactions Involving Public Companies, and Executive Compensation Considerations in IPOs.

Addressing Treatment of Benefit Plans and Integration Issues

Once the EBEC attorney has identified all of the benefit plans and programs at issue in the transaction, and the potential risks and liabilities, it will be important to address handling of the target's plans and programs as affected by the transaction. These decisions will impact drafting of applicable provisions in the transaction agreement and the offerings available to the acquired employees following the transaction. For example, discussions will be needed regarding the transfer of the target's retirement plans to the buyer, potential retirement plan mergers, freezing plans, plan spin-offs, or requirements for plan terminations prior to the closing (which will trigger full vesting). Health and welfare plan participation and continuation coverage issues under COBRA will need to be addressed. The ability to cancel, assume, or substitute equity awards will need to be analyzed. Collective bargaining agreements may need to be revisited for applicable employees. Pension plan underfunding or withdrawal liability issues may need to be addressed. Transition periods and employee communications will need to be discussed and distributed.

If the transaction is a carve-out transaction—whereby a line, division, or part of a company is acquired—some employees may stay with the seller or be terminated, while others are transferred to the buyer. This type of transaction may require additional planning around plan spin-offs and transfers of benefit liabilities and payment obligations. It could also trigger a partial plan termination of a seller's qualified retirement plan, which must be addressed. Employee and plan participant communications may also require special attention.

Depending on the agreed-upon approaches, new plan documents or plan amendments for the impacted programs may be required, Board resolutions may need to be adopted, government notifications and filings may be needed (including those related to controlled group or plan changes and plan mergers or terminations), participant communications and/or required notifications regarding benefits changes may be triggered, service provider agreements may need to be amended, and qualified plan nondiscrimination testing will need to account for the transaction under applicable rules. Discussions will need to be undertaken to understand the agreed-upon approaches and to document and communicate them accordingly.

At this stage, discussions may also begin regarding key executives who will need to be retained or terminated. In a stock or merger transaction, the buyer will assume existing executive employment and change-of-control agreements unless (1) the parties agree that the seller will assume the obligations, (2) the executives will be terminated and paid out prior to the closing, or (3) the agreements are renegotiated and amended. In an asset transaction, the buyer may agree to assume these agreements or may be the successor employer under successor liability principles. The EBEC attorney may be called upon to assess these agreements and payment triggers, draft new executive agreements, develop new retention programs, and assess liabilities associated with terminations. If the diligence of the employment agreements also reveals confidentiality, noncompetition, nonsolicitation, invention assignment, or similar agreements signed by transferring employees of the target business, it will be important to identify these issues and work with employment counsel on the transaction team to evaluate whether their terms provide that such agreements terminate upon a sale of a controlling interest in the target, whether they remain enforceable, or whether an employee has a right to veto the assignment of any restrictive covenants (which could apply if the buyer is purchasing the assets of the target). These issues could shape which employees the buyer seeks to retain and the terms of new agreements.

It may be necessary to also consider potential severance plans or voluntary retirement programs. It will be important to understand the terms of any current agreements in place and to design any future agreements, programs, and packages in compliance with applicable laws (including Section 409A rules regarding, for example, substitutions, changes in time and form of payments, and permissible payment events).

For additional practical guidance on transitional issues for benefit plans, see Employment and Employee Benefits Issues in Carve-Out Transactions, Equity Award Treatment in Corporate Transactions, Equity Award Treatment in Corporate Transactions, Retirement Plan Treatment in Corporate Transactions Checklist, Employee Stock Ownership Plans in Corporate Transactions, Board Resolutions: Qualified Retirement Plan Merger Approval (Defined Contribution Plan) (Buyer), Board Resolutions: Qualified Retirement Plan Merger Approval (Defined Contribution Plan) (Seller), Section 409A Change-in-Control Payment Events, and Board Resolutions: Nonqualified Deferred Compensation Plan Termination (Change in Control).

The Purchase Agreement

EBEC attorneys assisting with corporate transactions are generally most involved with the portions of the transaction agreement concerning (1) representations and warranties; (2)

interim and post-closing covenants; (3) conditions precedent; (4) indemnification; and (5) escrow and earnouts, in each case, as they relate to benefits, compensation, and employee matters. They may also be involved in other provisions, depending on the deal terms, such as provisions dealing with liability allocation and treatment of outstanding equity where equity awards are involved.

For annotated clauses of EBEC purchase agreement provisions, see Employee Benefits and Labor Clauses (Stock Purchase Agreement) (Pro-buyer), Employee Benefits and Labor Clauses (Stock Purchase Agreement) (Pro-seller), Employee Benefits and Labor Clauses (Stock Purchase Agreement) (Pro-seller Auction), Employee Benefits and Labor Clauses (Asset Purchase Agreement) (Pro-buyer), and Employee Benefits and Labor Clauses (Asset Purchase Agreement) (Pro-seller).

Representations and Warranties

In many cases, the buyer will present the seller with the first draft of a corporate transaction agreement. The buyer will include a form of representations and warranties that it will seek from the seller regarding its employee benefits programs and executive arrangements. Although the length and type of the requested representations and warranties will vary depending on the type of transaction, the buyer will generally seek a certain minimum of assurances from the seller regarding benefit plans and compensation arrangements.

For example, the buyer will seek representations and warranties that the seller has disclosed all benefit plans, programs, and executive arrangements and requested documents, and that, except as otherwise disclosed:

- There are no compliance issues with respect to the benefit plans, programs, and executive arrangements under all applicable laws.
- There are no known material liabilities as of the date of the closing with respect to any plan or program nor any material controlled group liabilities.
- All required premiums and contributions have been timely remitted or paid.
- All required reporting and disclosure obligations have been met.
- The funded status of applicable plans is above certain thresholds.
- There are no unreported ERISA reportable events.
- There is no pending or threatened litigation or government audits or claims regarding the plans or programs (other than ordinary-course claims for benefits).
- There are no plan submissions to the IRS or DOL for plan correction issues (such as tax-qualification, fiduciary issues, and violations under Section 409A).
- There are no breaches of fiduciary duty or prohibited transactions under ERISA or the Code.
- There are no multiemployer or multiple-employer plans in which the target (or any ERISA affiliate) participates.
- There are no violations under Section 409A and no arrangements that will result in an excess parachute payment under Sections 280G and 4999 in connection with the transaction.
- No plans invest in company stock.

These are typical compliance representations and warranties for employee benefit plans regarding matters under ERISA, the Code, and other applicable laws, but it is by no means an exhaustive list. In many cases, the disclosure schedules will address exceptions or provide further information where an unmodified representation cannot be made.

It will be necessary to prepare and review the representations and warranties in the context of the transaction and the types of benefit programs and compensation arrangements discovered during the due diligence so that they can be appropriately tailored. The EBEC attorney should also consider whether they need to update any model provisions that may have been used in past transactions as changes in the law could necessitate new types of representations and warranties (or covenants). Updates to model forms for transaction agreements were common after enactment of the ACA (especially with regard to liability for employer shared responsibility payments) and enactment of Section 409A.

Similarly, practitioners are beginning to incorporate representations concerning compliance with the Paycheck Protection Program and Employee Retention Credit made available under the Coronavirus Aid, Relief, and Economic Security (CARES) Act to assist businesses harmed by the pandemic. It will be important to confirm in a transaction whether these programs were utilized and, if so, whether they were used properly (e.g., where applicable, if required restrictions on executive pay were put in place) and whether any potential liability could be attributed to the buyer (e.g., due to restrictions prohibiting use of both programs). It will also be important to confirm if the target deferred remitting payroll taxes or making minimum pension contributions, as permitted by changes in the law, or made any other changes to their benefit programs and policies requiring a compliance check or responsibility on the part of the buyer in light of all of the guidance issued due to COVID-19.

The representations and warranties are utilized to provide notice to the buyer of known risks, may provide a basis not to proceed to a closing, or may serve as the basis for a right to indemnification in relation to liabilities for any programs or arrangements that the buyer will assume in the transaction. The seller will often seek to caveat representations and warranties as sufficiently as possible to add materiality, knowledge, and other qualifiers. A buyer's post-closing claims for breach of representations and warranties would be addressed in other provisions such as indemnification. Where the buyer's due diligence process uncovers a significant potential liability, the parties may agree to address the issue by adding special indemnification provisions that address the specific concern raised by the buyer. As the due diligence phase unfolds, it may become necessary to expand or modify the initial representations and warranties as drafted in early versions of the transaction agreement and update the disclosure schedules.

Covenants

The parties to the transaction may use covenants to assign responsibility for events that must occur between the signing of the transaction agreement and the closing of the transaction. This may include assigning responsibility for certain government filings (such as reportable events with the PBGC or an IRS Form 5310-A in connection with a plan merger or transfer), plan corrections (such as tax-qualified plan corrections under the IRS EPCRS program), or providing certain disclosures to employees.

Covenants may also address certain commitments related to the seller's benefit programs or actions the buyer will take with respect to benefits programs. For example, covenants may include the seller's promise to take certain actions to terminate certain plans prior to the closing, continue certain benefits for a period of time, fully vest participants in its plans, make certain amendments to plans or arrangements, or to not change benefits or make compensation increases. Or the covenants may address steps necessary to undertake a plan merger or transfer of plan assets, as agreed to by the parties. The seller may also be required to agree to pay any severance obligations or be liable for any plan funding shortfall in existence, or benefits claims filed, prior to the closing. It may also be necessary to obtain post-closing covenants from a seller such as a clause that they will not dissolve within a certain period of time following the closing.

A buyer may also agree to certain plan mergers, to assume plans, or to amend its benefit plans to provide past service credit for purposes of eligibility and vesting in its plans for the acquired employees or address other out of pocket costs already incurred related to benefits. The seller may also insist that the buyer provide severance payments if employees are involuntarily terminated within a specified period of time after closing or that the buyer agrees to provide substantially similar benefits to the transferred employees for a period of time. The parties may also agree as to which party will provide COBRA continuation coverage to certain qualified beneficiaries whose COBRA qualifying event is associated with the transferring business (but if no agreement is made, the party having the obligation is determined under the COBRA business reorganization rules in Treas. Reg. § 54.4980B-9).

It is also important to consider including a covenant in the transaction agreement which states that the agreement is not intended to create third-party beneficiary rights for any employees or other parties; and does not establish, amend, or modify any employee benefit plan, program, agreement, or arrangement; require any entity to continue any employee benefit plan; or create any right to employment, compensation, or benefits. In some transactions, there may be a specific covenant to maintain the salary and benefits (or seniority levels) of acquired employees at substantially similar levels. It is important in these cases to ensure that no third parties other than parties to the agreement can enforce the buyer's obligations and that the provision will not be construed as a grant of employment rights or rights with regard to benefits, or otherwise interfere with the buyer's employee management rights. A buyer that does covenant to maintain a certain level of compensation or benefits may also seek agreement on certain exceptions, such as its ability to make changes to acquired employees compensation that was otherwise assured if necessitated by certain events that may be anticipated (e.g., executive pay cuts required as a condition to participate in a governmental pandemic relief program).

Conditions Precedent

The transaction agreement may include certain conditions precedent to the parties' obligations to close the transaction. From a benefits and compensation perspective, the buyer may require that certain key executives execute employment agreements with the buyer, a requirement that a certain percentage of employees accept the buyer's offer letter prior to closing, or that the seller has performed or complied in all material respects with its covenants and obligations, and that all of its representations and warranties remain true on the closing date, except as otherwise noted (i.e., a bring down clause). Seller may seek reciprocal provisions, as applicable, including receipt of any applicable promissory note to reflect any agreed-upon arrangements with respect to the purchase price.

Indemnification

Each transaction will require an assessment of the appropriate indemnification terms to negotiate as there is not a standard boilerplate provision to add to an agreement. Generally, for all matters in the transaction, the parties will want to ensure that the representations and promises agreed to in the agreement will survive the closing (as expressed in an applicable survival clause) and serve as the basis of post-closing monetary remedies, where applicable.

One aspect of the indemnification provisions may address seller's employee benefit plans and programs, and their agreement to indemnify the buyer (or, more specifically, the indemnified persons so defined) for any damages (as so defined) arising with respect to any of its benefit plans and programs and its retained liabilities. There may be different techniques negotiated for this purpose, such as baskets with a threshold (whereby if losses exceed the basket/threshold amount, the seller is liable for all losses) or deductibles (whereby once losses exceed the deductible, seller would be liable only for excess losses over the deductible). A seller will seek to limit the period of time it has post-closing indemnification obligations, place a cap on its liability (which may be established for seller's liability as a percentage of the sales price), or seek a deductible so that they do not incur liability until buyer's losses exceed a certain amount. The parties will also likely seek to except any obligation for indemnification related to the indemnified party's gross negligence or willful misconduct.

Therefore, it is crucial for the EBEC attorney to have identified the potential liabilities and alert the deal team to the potential economical consequences so that transaction agreement provisions, including indemnification, can be drafted appropriately and any escrow, purchase price adjustments, or insurance needs can be addressed with the transaction parties.

Escrows and Earnouts

If it is determined that an escrow arrangement may be needed as part of the transaction agreement, an escrow can be established to hold part of the purchase price in order to pay buyer's potential claims under the indemnification provisions. This will ensure that monies are available to satisfy seller's indemnification obligations. A buyer could also provide seller with a promissory note for deferred purchase price payments for a portion of the price to use as potential setoff/offset for breaches of representations, warranties, or covenants discovered after the closing.

Earnout arrangements, whereby part of the payment of the purchase price requires that the business attain certain performance metrics after the closing, can be common in private company transactions. In the case of escrow or earnout arrangements that could affect compensatory payments (such as stock option cash-outs or bonus payments) being made in the future, attention must be given to potential tax issues under I.R.C. §§ 409A and 83. If any portion of an option cash-out or other compensatory payments are held back due to such arrangements so that they can be adjusted accordingly based on the finally determined purchase price, the structure must be reviewed so that it can meet the requirements of delayed settlements of certain transaction-based compensation under Section 409A (such as the short term deferral exception, depending on when the amount ceases to be subject to a substantial risk of forfeiture in relation to the payment date, or aligned with the timing of earnout and escrow payments to the shareholders under the special rule in Treas. Reg. 1.409A-3(i)(5)(iv)(A) (provided that payment must be made within five years)). Also, be mindful of any tax effects the escrow funding could have under Section 83. Funding an escrow account that will be used to pay certain equity-based compensation amounts could cause those equity awards to become immediately taxable unless they remain subject to a substantial risk of forfeiture or subject to the claims of the company's general creditors in insolvency.

Transaction-Related Agreements

The role of the EBEC attorney in a corporate transaction may extend beyond the closing of the transaction and the EBEC attorney may be called upon to assist in the planning and transition of the target's benefit programs and executive arrangements. For example, the EBEC attorney may be involved in drafting and negotiating the following types of agreements:

- **Transition services agreement.** In some situations, especially when an entity is being carved out of a larger group of companies, the need for a transition services agreement (TSA) may arise. The TSA may address handling of payroll, filing of benefit payment claims for certain plans, or specific employee benefits that may need to continue to be provided by the seller's group for a certain period of time before they can be established or provided by the buyer. The EBEC attorney may also need to consider how to address coordination of certain procedures with applicable plan service providers. The TSA will identify any processes that need additional time beyond the closing to facilitate the provision of benefits and services.

- **Executive agreements.** As decisions are made in the earlier stages of the transaction to attract and retain certain executives, the EBEC attorney may be called upon to draft and negotiate new employment agreements, retention agreements, incentive arrangements, and overall executive packages. Review of existing packages is needed to assess agreements that will be assumed, payments that may be triggered, and any that can be renegotiated. As noted above, the integration process could also evolve into separation from service discussions and development of related plans and agreements related to same.
- **Benefit plan amendments and agreements.** The benefit plans on both sides of the transaction may require amendments, adoption of board resolutions, creation of new plan documents, service provider agreement amendments, fiduciary governance document amendments, communications, and attention to reporting and disclosure requirements, just to name a few. Essentially, the agreed-upon terms of the transaction will need to be addressed in all of the related documentation for the applicable plans and programs and may require coordination of efforts with service teams from all of the related service providers to the plans and programs.

Sample Buyer's Initial Due Diligence Request List

The following is intended as a sample of a buyer's initial due diligence request for illustrative purposes. A shortened or more extended request list for documents may be appropriate depending on the type of transaction. As diligence commences, the request may also need to be supplemented.

I. Tax Qualified Retirement Plans

a. Legal names of all employee benefit plans sponsored by seller and by seller's controlled group or affiliated service group members

b. Seller's current Controlled Group Chart (and any revised Chart within the last three years)

c. Copies of plan documents, including any amendments, trust agreements, pre-approved plan adoption agreements, service agreements, investment manager agreements, and collective bargaining agreements as they pertain to the seller's plans currently in effect or at any time during at least the last six years

d. Copies of summary plan descriptions and all summaries of material modifications thereto and copies of all plan-related administrative forms and procedures (including QDRO, loans, and hardships) for at least the last three years

e. Most recent IRS Determination Letters or Opinions regarding the tax qualified status of the plans

f. Form Series 5500 filings for at least the last three years (with all schedules and financial statements attached thereto)

g. Board resolutions/minutes regarding adoption of the plans or plan-related issues for at least the last three years

h. Plan fiduciary governance documents (e.g., charter, investment policy statement, and meeting minutes) for at least the last six years

i. Nondiscrimination test result reports for at least the last three years, including ADP/ACP and Section 415 tests and 416 tests, and 410(b) coverage and compensation tests

j. Copies of any insurance company or group annuity contracts currently in effect

k. If retirement plan allows participants to invest in employer stock, all registration statements (Forms S-8), annual reports (Forms 11-K), and prospectuses for at least the last three years

l. Copy of fiduciary liability insurance policy and ERISA bond currently in effect

m. Copies of each plans' audited financials for at least the last three years

n. For defined benefit pension plans, all information regarding funding status of the plan, actuarial reports, and PBGC filings for at least the last three years

o. Copies of participant communications regarding plans, notifications for at least the last three years

p. Copies of any notices or investigations or communications with or by a government agency including Internal Revenue Service, Department of Labor, PBGC, and Securities Exchange Commission within the last five years

q. Copies of any pending qualified retirement plan correction submission with the IRS or fiduciary correction submission with the DOL under applicable government programs

r. Information regarding any litigation, or cybersecurity breach and notification processes, regarding any employee benefit plan either currently pending or resolved within the last three years

s. List of all parties in interest with respect to the plans and any other service providers, consultants, brokers, and other professional service providers

t. Provide claims information for the last three years including any significant claims disputes for benefits and claims that are currently outstanding under claims appeal procedures and any settlements or judgments within the last seven years

u. Provide any assessments or notices for penalty or excise taxes currently pending

v. A list of any prohibited transactions at least within the last five years

w. If seller participates in a multiemployer pension plan, a statement from the plan administrator of the estimated withdrawal liability that would be incurred in the event of a withdrawal

II. Nonqualified Deferred Compensation Plans; Bonus, Incentive, or Equity Arrangements; and Executive Arrangements

a. Legal names of all nonqualified deferred compensation plans, bonus, change in control, retention, incentive, or equity arrangements sponsored by seller and seller's controlled group or affiliated service group members

b. Copies of all plan documents, including any amendments, rabbi trust agreements, service agreements, and investment agreements currently in effect or at any time during the last six years

c. Copies of plan communications to eligible employees regarding these arrangements, including offer letters and employment agreements currently in effect or at any time during the last six years

d. Board resolutions/minutes regarding adoption of plans or plan-related issues, including documentation regarding approvals of awards currently in effect or at any time during the last six years

e. Evidence of compliance with Section 409A of the Code, including elections, deferral information, and operational practice in compliance with documents

f. Copies of any top hat filing with Department of Labor

g. Copies of any notices or investigations by a government agency, including the Internal Revenue Service, Department of Labor, or Securities Exchange Commission within the last five years

h. Information regarding any pending litigation regarding any plan

i. Copies of any filings with the SEC for the last three years

j. Copies of accounting and financial statements and tax reporting for plans for at least the last three years

k. Copies of change in control agreements currently in effect or at any time during the last six years

l. Copies of any 280G calculations that have been performed with respect to potential parachute payments

m. Copies of retention agreements currently in effect or at any time during the last six years

n. List of individuals who will have payments triggered under plans as a result of the transaction and supporting documentation

III. Health and Welfare Plans

a. Legal names of all health and welfare plans including medical, dental, vision, prescription drug, life, disability, accidental death and dismemberment, cafeteria plans, and reimbursement accounts or arrangements

b. Indicate whether plans are self-insured or fully insured

c. Indicate whether any group health plan is grandfathered under health reform legislation

d. Indicate whether any health or welfare plan provides post-employment benefits (other than under COBRA or required under other applicable laws)

e. Copies of all plan documents, including any amendments, trust agreements (if applicable), summary plan descriptions and modifications, summary of benefits and coverage, insurance contracts, including stop-loss policies, and riders currently in effect or at any time during the last six years

f. Copies of Form Series 5500 filings for at least the last three years and all attachments

g. Evidence of health reform compliance including required notices and operation with the law and ACA Information Reporting for at least the last three years

h. Any ACA Information Reporting IRS Letter 226-J notification regarding liability for employer shared responsibility payments

i. Copies of any nondiscrimination testing reports for at least the last three years

j. Evidence of COBRA compliance, COBRA election forms, notices, and procedures

k. List of employees and their spouse/dependents currently receiving COBRA and remaining maximum duration of their coverage; list of individuals who will be eligible for COBRA as a result of the transaction (in a de-identified or redacted format as determined by the parties)

l. Evidence of HIPAA compliance, including copies of HIPAA notices and privacy and security procedures and business associate agreements; information regarding HIPAA breach and notification processes within at least the last three years

m. Communications regarding any retiree welfare benefits, plan documents, offer letters, or other communications pertaining to lifetime benefits

n. Retiree medical plan documentation, if applicable, and related FAS reports for at least the last three years

o. Claims information for the last three years, including any significant claims disputes for benefits and claims that are currently outstanding under claims appeal procedures, and any settlements or judgments within the last seven years

p. Financial information regarding medical claims experience, estimated run-off liability for any self-insured health plans, accrued but unpaid insurance premiums, and annual cost of premiums and percentage of premiums paid by employees for the most recent five years

q. Penalties for midyear termination of contracts related to the health and welfare plans. Copies of any severance plan documentation and list of employees who currently receive severance and who will be eligible for severance as a result of the transaction

r. Copies of any notices or investigations or communications with or by a government agency including Internal Revenue Service and Department of Labor within the last five yearssss

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Michelle Capezza, Of Counsel, Mintz

Michelle is an accomplished employee benefits and executive compensation lawyer with more than 25 years of experience advising clients on ERISA, benefits, and executive compensation matters, including in connection with corporate transactions. She also brings this knowledge and experience to counsel clients that are digitally transforming their business on the use of automation and artificial intelligence in the workplace and the related implications for employee benefits and compensation for their changing workforce. Michelle is called to represent Fortune 500 companies, multinational corporations, nonprofit entities, medium-sized businesses, and individual executives across a variety of industries, including financial services, health care, life sciences, technology, artificial intelligence, media, telecommunications, hospitality, and retail.

Drawing on her law firm, corporate in-house, and business experience, Michelle partners with clients' in-house attorneys, human resources professionals, and benefit plan service providers to develop practical solutions to technical issues that advance clients' business goals. Clients value Michelle's clear advice and dedication to working with their project teams. She is often approached to provide guidance on the design, administration, compliance, and termination of qualified plans (such as 401(k), profit-sharing, and pension plans); nonqualified deferred compensation arrangements (including top hat plans and SERPs); employee welfare benefit plans (including group health plans, cafeteria plans, wellness programs, and COBRA requirements); equity/incentive compensation programs (such as stock option, restricted stock, phantom stock, and executive bonus programs); severance plans, and other benefits programs. For corporate transactions, Michelle's practice includes counseling clients on such issues as the treatment of equity awards, change-in-control and golden parachute issues, plan spin-offs and terminations, post-transaction benefits integration issues, severance, COBRA, multi-employer plan withdrawal liability, and PBGC issues. She also regularly reviews and negotiates her clients' severance, vendor, trust, investment management, and service provider agreements, and advises clients on the design of plan participant communications.

Michelle serves as a trusted advisor to clients on compliance with ERISA, the Affordable Care Act, the Internal Revenue Code, the SECURE Act, the CARES Act, CAA 2021, ARPA, and other laws affecting employee benefit plans. She regularly counsels clients on fiduciary responsibilities under ERISA, including providing advice on plan governance, fiduciary training, and cybersecurity risks for employee benefit plans, and assists plan sponsors, trustees, and Investment and Administrative Committees with the development of best practices. Michelle also represents clients in matters before the Department of Labor, Internal Revenue Service, and other government agencies, including in connection with the DOL Voluntary Fiduciary Correction Program and the IRS Employee Plans Compliance Resolution System.

She has received national awards and recognition for her work in employee benefits and executive compensation, including from The Legal 500 United States, Who's Who in America, Who's Who in American Law, and Marquis Emerging Leaders. She has also been included on the New York Metro Super Lawyers, New York Metro Top Women, New York Metro Rising Stars, and New Jersey Rising Stars lists for her work in the area of employee benefits. In 2012, she received the Excellence in Achievement Award from Seton Hall University School of Law's Peter W. Rodino, Jr. Society for her commitment to excellence and compassionate service in the field of law.

In addition to her practice, Michelle frequently speaks and writes articles on topics related to employee benefits and executive compensation, including health care and financial regulatory reform, fiduciary issues under ERISA, cybersecurity risks for employee benefit plans, and the outlook for employee benefits in the "future of work." She has been a featured faculty speaker for continuing education programs offered by the New York City Bar Association, DC Bar Association, Strafford, Lawline, Clear Law Institute, and The Knowledge Congress. She has also published articles in and been interviewed for numerous publications such as The Employee Benefit Plan Review, The New York University Review of Employee Benefits and Executive Compensation, Journal of Pension Benefits, Practical Law (Practice Notes), Lexis Nexis Practice Advisor, Law360, Benefits Law360, The BNA Health Insurance Report, The BNA Pension & Benefits Reporter, The BNA Health Law Reporter, The Metropolitan Corporate Counsel, Confero Magazine, TechNews, and Financier Worldwide. Michelle has also served as an adjunct faculty member of the Seton Hall University School of Law, where she taught a course in Corporate Transactional Skills.

Prior to joining Mintz, Michelle was a member of a national law firm in the Employee Benefits & Executive Compensation and Health Care & Life Sciences practices. She has also practiced employee benefits law in the New York and New Jersey offices of several national and international law firms. In addition, Michelle has served in corporate in-house counsel roles with financial institutions, where she provided legal support to their retirement plan and equity award plan recordkeeping businesses. Michelle worked at a Wall Street brokerage company earlier in her career, assisting with retirement product development and obtaining her Series 7, Series 63, and other professional licenses required in the financial services industry. After law school, Michelle served as a judicial law clerk in the Civil Part of the Superior Court of New Jersey.

In law school, Michelle served as a member and assistant notes and comments editor of the Seton Hall Law Review and a co-captain of the Phillip C. Jessup International Moot Court Team. She also received several scholarships and interned with the civil court in Essex County, New Jersey and Seton Hall Law School's Center for Social Justice.

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