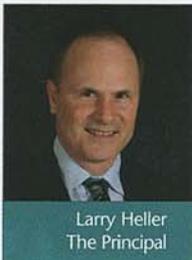


# Don't Forget:

## acquisitions and mergers impact other plans



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Corporate mergers and acquisitions are often considered, and ultimately implemented, to increase efficiencies, reduce aggregate costs, and generally simplify business structure and support services. But the long road from due diligence to the closing of any such transaction will, more often than not, produce short-term complexity. This is especially true with respect to ESOPs and other retirement plans maintained by both the buying and selling entities.

While decisions relating to the retirement plans are not always addressed up front, a plan sponsor's failure to address some pivotal questions early on during preparation for a merger or acquisition can lead to unintended results. On the following pages are some of the key questions that should be considered prior to, or in conjunction with, the merger or acquisition.

### Is this a stock acquisition or an asset acquisition?

In an asset acquisition, the buyer generally does not take on responsibility for the seller's retirement plans, unless specifically contracted to do so. In a stock acquisition, the buyer assumes all of the seller's liabilities, including any retirement plans. In circumstances where the seller's plans carry benefit provisions that are unattractive to the buyer or significant unfunded liabilities, it might be advantageous to the buyer if the transaction is an asset sale.

Alternatively, the buyer may require the termination of the plans prior to the transaction date. Another difference between stock and asset acquisitions is that retention of pre-transaction service credit (*see question on page 19*) is generally automatic in a stock sale, but is negotiated in an asset sale.

### What is the timing of the plan merger or spin-off?

It is generally easier to merge or spin off plans as of the first day of the plan year. Doing so will avoid short plan years before and/or after the transaction closing date, as well as potential issues with plan compliance testing, recordkeeping, and administrative processes and procedures.

Note that a transitional period may be available to allow both the buyer and seller to maintain separate retirement plans following the corporate transaction through the end of the next plan year.

## How long will the buyer's and seller's plans need to be maintained beyond the closing of the corporate transaction?

Plan mergers are often delayed for months, or even years, beyond the transaction closing date, as there is no requirement to merge plans, however each plan will need to satisfy 410(b) minimum coverage testing. In the interim:

the status of each prior plan's shares should be confirmed – to the extent any have been liquidated, participants' options for the investment of the cash proceeds should be established; plan documents should be reviewed for definitions of eligible versus excluded employees, distribution options, etc.; plan compliance testing should be revisited for each plan in advance of the corporate transaction and again during the transitional period for any anticipated changes in participation levels, controlled group status, etc.; and plan administrative procedures should be re-evaluated to minimize operational breakdowns caused by systems changes.

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## Is the buyer's or seller's plan addressed in the buy/sell and purchase agreements?

Responsibility for all retirement plans, along with their proposed ongoing design, should be addressed in each of these agreements. In addition, the objectives, structure, and ongoing investment policies of ongoing retirement plans, the handling of union plans, and the assignment of responsibilities for government filings are often established in these agreements. Failing to address these items may lead to unintended results and costly corrections.

## What is the most appropriate ongoing structure for all affected plans?

Aside from merging plans (*with or without grandfathered provisions from the predecessor plans*) alternatives exist for the buyer who acquires the seller's plan. These range from adopting the plan as is, adopting it with modifications, or freezing it, to a partial or full plan termination. Legal, accounting, actuarial, and human resource subject matter experts, as appropriate, should participate in an evaluation to uncover cost implications, liabilities, protected benefit issues, plan design opportunities, and the like.

In this manner, the due diligence process can then properly uncover items such as plan qualification defects, plan costs (*such as liabilities triggered by plan termination*), or the liabilities of a nonqualified plan – any of which could significantly affect the cost of the entire transaction, and perhaps its viability.

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## Should the benefit level provided by the acquiring plan be maintained?

New participants from the merger or acquisition will increase the plan population's total eligible compensation. If the intention has been that relatively constant annual company contributions approximate a specific percentage of employees' compensation, the company will need to contribute more money to the plan annually for participants to experience the same level of benefit. Without an increase in the total annual contribution by the company, new participants will dilute the amount each participant's account receives.

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## Will the seller's retirement plan be terminated to allow distributions to participants who remain actively employed by the ongoing company?

If you want to allow distributions to actively employed participants in the seller's plan, you must terminate that plan or not acquire the seller's plan as part of the transaction so that severance of employment will apply. Otherwise, if the buyer does acquire the seller's plan, the pre-transaction rules of the seller's plan will not likely consider that the merger or acquisition constitutes an event permitting distributions to actively employed participants. The timing of a plan termination affects whether or not "successor plan" rules come into play which, in turn, can prevent distributions to participants actively employed by the ongoing company.

If the plan is terminated prior to the effective date of a merger or acquisition, distributions can be made to participants subject to the plan's rules for a plan termination, which are irrespective of participants' employment status.

Successor plan rules generally come into play upon a stock acquisition where the acquiring entity has agreed to take on responsibility for the seller's retirement plan(s). Under those circumstances, a similar type plan cannot be established by the acquiring entity for the same employee population less than 12 months after all the assets have been distributed from a terminated 401(k) plan. However, a newly established ESOP is not considered a successor plan to a 401(k) plan. When successor plan rules do not apply, distributions upon plan termination are permitted even if the termination occurs after the acquisition date.

## How far does "due diligence" need to go for retirement benefits purposes?

"Due diligence" is the investigation of the legal and financial activity of a company in connection with a corporate transaction. For ESOPs, this should include confirmation of "adequate consideration" on behalf of the buyer – that its purchase of ESOP shares is at a reasonable price given current market value. This process needs to recognize where the acquired plan documents and agreements dictate benefit issues upon change in control.

Documentation review should extend to IRS determination letters, confirming any operational issues or plan compliance problems. Financial reports should be reviewed with an eye toward any underfunding, or failure to make required or timely contributions. With all of this in mind, plan fiduciaries are obligated to participate directly in much of this due diligence, especially any pricing negotiations.

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## What are the differences between maintaining single and multiple plans, and are there advantages or disadvantages?

Maintaining one plan is usually less expensive than multiple plans. One plan also means a lesser plan compliance testing burden. To gauge which approach best fits a specific circumstance, consider the cost and manpower implications of each of the following: distinct rules for each legacy group of employees within a single plan, Form 5500 filings, accountants' audits, plan compliance testing, coordination with service providers, and maintenance of plan documents, agreements, and contracts.



## What are the implications of one plan covering two previously unrelated populations?

New participants from the merger or acquisition will increase the plan population's total eligible compensation. If the intention has been that relatively constant annual company contributions approximate a specific percentage of employees' compensation, the company will need to contribute more money to the plan annually for participants to experience the same level of benefit. Without an increase in the total annual contribution by the company, new participants will dilute the amount each participant's account receives.

## What are common administrative considerations upon a merger or acquisition?

*Newly acquired employees' eligibility to participate in the acquiring company's plan. Is pre-acquisition service recognized? Is eligibility immediate regardless of past service? Vesting of newly acquired employees' accounts in the acquiring plan. Is pre-acquisition service recognized? The definition of compensation used at plan year-end, following a mid-year merger or acquisition. Will the acquiring plan recognize compensation with the prior employer? Will partial year compensation with the acquiring employer be annualized?*

*Newly acquired employees' eligibility for diversification of shares in the acquiring employer's ESOP. Is pre-acquisition plan participation recognized toward the 10-year requirement? Plan amendments. Have plan amendments been drafted to reflect the issues outlined above and other similar decision points?*

## Where does employee communication and education fit in?

The success of plan changes relies, in large part, upon the participants having a clear understanding of the impact on retirement benefits. This is especially important at a time of significant and sensitive cultural change. In 401(k) plans, this includes adequate advance notice of any impending investment transaction blackout periods. For any retirement plan affected by a merger or acquisition, clear communication of plan and operational details, such as ongoing vesting provisions and distribution options, is also essential.

### SUMMARY

Mergers and acquisitions are complex transactions. Whether you're the selling or acquiring party, it's important to make sure your bases are covered when it comes to the effect of the transaction on both parties' retirement plans. ■