

A critical part of the due diligence conducted before a buyer acquires the stock or assets of a target company is a review of the employee benefits offered and maintained by the target company. The objective of employee benefits due diligence is to identify all of the potential issues and liabilities associated with the target's employee benefits and to adequately address these issues in the acquisition agreement.

Stock Purchase vs. Asset Purchase

If the acquisition is structured as a stock purchase, the target company's employees will not have their employment terminated and the buyer will automatically inherit all of the target company's employee benefit plans. This is advantageous because termination of employment often triggers payments to the employee under employee benefit plans. Due diligence is important in a stock purchase in order to identify the types of employee benefit plans the target company maintains, to determine whether the plans have been maintained in compliance with their terms, and applicable law, and to establish whether there are any potential issues relating to the employee benefit plans.

If the acquisition is structured as an asset purchase, the buyer has the flexibility to choose the assets and liabilities it wishes to acquire, including the employees and employee benefit plans. In an asset purchase, the target company's employees' employment with the target company will terminate, which creates additional issues. Due diligence is important in an asset purchase in order to assist the buyer in determining which employee benefit plans, if any, the buyer is willing to assume.

What to Look For

The following is a general list of the types of documents a buyer should request and review as part of due diligence, as well as a brief description of the information that is relevant to the acquisition:

- **Employment, Change-in-Control, Retention, and Severance Agreements:** These agreements should be reviewed to determine whether the employee is entitled to any enhanced payments upon the acquisition or upon the employee's termination from employment after the acquisition. It is also important to determine if key employees are subject to a noncompetition or nonsolicitation provision. There can be significant tax consequences to both an executive of the target company and to the buyer under section 280G of the U.S. Internal Revenue Code if the executive receives payments or benefits as a result of the change in control.
- **Stock Option and Other Equity Compensation Plans:** U.S. companies often have a wide variety of stock or equity compensation plans, including

stock options, restricted stock, and stock acquisition rights. Equity compensation plans should be reviewed to determine the type of stock or equity granted to target company employees and the consequences of the acquisition on the equity awards. Often, equity compensation plans are triggered by a change of control, and the buyer will need to either make a large cash payment to certain of the target company's employees or obtain the employees' consent to waive the payment and continue the plan postclosing.

- **Nonqualified Deferred Compensation Plans:** A nonqualified deferred compensation plan is typically an unfunded promise to pay a benefit in the future. As such, these plans should be reviewed to determine how much the target company has promised to pay its employees and whether any employees are entitled to payments as a result of the acquisition.
- **Qualified Retirement Plans:** Generally, qualified retirement plans should be reviewed for compliance with applicable laws. Any defined benefit pension plans should be reviewed to determine whether the plan is underfunded and the potential liabilities associated with such underfunding.
- **Postretirement Benefits:** Similar to nonqualified deferred compensation plans, postretirement benefits are typically an unfunded promise to pay a retiree a certain amount in the future and are often in the form of postretirement medical benefits. Postretirement benefits may carry significant liabilities for the target company and often may not be modified or eliminated easily.
- **Health and Welfare Plans:** Generally, health and welfare benefits should be reviewed to determine which types of benefit plans the target company offers to its employees, whether the plans have been maintained in compliance with applicable law, and how the buyer would like to treat these plans after the acquisition (i.e., maintain, terminate, or merge into buyer's similar plans).
- **Collective Bargaining Agreements; Multi-Employer Plans.** Collective bargaining agreements and multi-employer plans should be reviewed to determine the obligations the target company may have with respect to any union employees and whether withdrawal liability will be triggered by the acquisition.

The Acquisition Agreement

The acquisition agreement (a stock purchase agreement, merger agreement, or asset purchase agreement) will contain a section of representations and warranties relating to employee benefits. It is in these sections that the target company makes certain promises to the buyer relating to the types of employee benefit plans, practices, agreements, policies, and so on, it maintains, whether such plans comply with applicable law, and the liabilities associated with these plans. Performing a thorough due diligence review will assist buyers in protecting themselves from potential issues and liabilities.

Postclosing Considerations

Whether inheriting all of the target company's plans in a stock purchase or inheriting specific plans in an asset purchase, the buyer will need to determine how the employee benefit plans will be treated after the acquisition. In making this determination, the buyer will need to evaluate its own employee benefit plans and evaluate whether the target company's plans should be maintained, terminated, or merged with buyer's plans. In making this evaluation, the buyer will need to consider employee relations and efficiency of administration.

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