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Morgan Lewis provides Workforce Change Inside Business *periodically to executives and in-house attorneys responsible for the employment, labor, benefits, and other legal issues arising from workforce reductions, corporate transactions, and other types of restructuring.*

Post-transaction Labor, Employment, and Employee Benefits Integration Issues

Once a corporate transaction closes and the dust settles, companies can often be left with a laundry list of labor, employment, and employee benefits issues to resolve as part of the post-transaction integration process. These issues can include post-acquisition integration of employees, the obligations acquired by a buying entity, the complexities of restructuring, how to deal with different employee groups with different levels of employee benefits, and compliance problems with newly assumed employee benefits plans.

The following is a brief overview of some of the more important integration issues that an employer may encounter.

"Inbound" Issues for the Buyer

The buying party can often find that it has significant post-closing integration issues to address. These issues only multiply if the buyer is retaining a significant portion of the seller's workforce or assuming any of the seller's employee benefits plans. These issues include the following:

Labor/Employment

What Did I Just Buy? Particularly in a stock transaction, to be followed by a merger, the buyer "steps into the shoes" of the seller, and is often left to deal with potentially significant liabilities, such as pending lawsuits and executive employment contracts. In addition, where a union or unions are present, the buying party often steps into a longstanding collective bargaining relationship, often without having any of the historical knowledge of the relationship.

The Problem of "Successorship." When buying the assets of a unionized company, the issue of "successorship" often arises. Whether an acquiring business is a legal "successor" of the predecessor is among the most complicated issues in labor law. Various tests are applied to determine whether the buying party will have liability for the seller's discrimination or other conduct, a duty to bargain with the seller's union, a duty to arbitrate grievances under the seller's labor contract, and/or a duty to adopt the seller's labor contract.

Restructuring. Many buying parties seek to make immediate changes to the acquired entities by engaging in significant restructuring, either concurrent with or shortly following the transactions. Usually, the buying party must quickly determine determine which employees it needs, which employees it is obligated to keep (due to employment contracts, collective bargaining agreements, etc.), the time frame of the restructuring (such as., is there a short-term but not a long-term need for some employees), the discrimination risks attendant with any restructuring, and whether terminations will implicate any short- or long-term benefits issues (such as retiree medical benefits).

Post-acquisition Integration. One of the most difficult challenges for many acquisitions is reconciling the variety of employment practices, policies, and procedures.

Structural aspects of the acquisition can promote or undermine integration efforts – for example, the extent to which key employees are retained, and deal-related commitments concerning the wages or benefits to be afforded seller employees. Other aspects of business integration – such as coordinating production methods, reconciling divergent financial or accounting practices, and consolidating post-transaction costs – require careful handling before and after the transaction.

The three stages of business integration include adhesion (basic alignment of employee information, benefit plans, forms, and policies), cohesion (the integration of process-related items such as hiring procedures and performance measurements), and unification of cultural issues, values, and how employees fundamentally relate to the organization.

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Employee Benefits

Enrollment in Buyer's Employee Benefits Plans. Depending upon the nature of the transaction, it could be the case that the buyer's primary obligation is to offer participation in the buyer's plans to employees who are acquired or hired as part of the transaction. But even this simple approach may raise issues, such as:

- The need to credit employees with their pre-transaction service with the seller under the buyer's plans
- The need to waive preexisting condition exclusions or provide "credits" toward deductibles under the buyer's medical plans
- The need to amend existing plans to extend participation to newly hired employees and/or newly established subsidiaries
- The need to enter into new provider arrangements (for example, a new arrangement with an HMO provider that covers employees at the new work location)

Satisfaction of "Comparability" Standard. Under the terms of the transaction, the buyer may be required to provide "comparable" benefits to newly hired employees for some period of time following the transaction. Satisfaction of this comparability standard may require the buyer to establish new benefits plans, amend its existing plans, and/or monitor the benefits being provided for the comparability period, to ensure satisfaction of the standard.

Harmonization of Benefits. One of the most difficult sets of issues that may confront a buyer is whether (and how) to harmonize different benefit levels among current employees who have one set of benefits, and newly acquired or hired employees, who have another set of benefits. Different harmonization approaches can be taken depending upon the facts and circumstances (such as, move all employees to a common program of benefits, maintain historical benefit structures for different employee groups in different geographic regions or businesses, etc.), but care must be taken in deciding upon the approach and implementing it. During the implementation phase, it likely will be necessary to amend employee benefits plans, provide notices to employees, and take other steps to comply with the applicable requirements of ERISA and the Internal Revenue Code (the Code).

Compliance Issues. A buyer may face a host of post-transaction employee benefits compliance issues, particularly if the buyer has assumed one or more employee benefits plans as part of the transaction. These issues may include:

- **Reporting and Disclosure Obligations.** A buyer must be careful to ensure that it complies with any and all reporting and disclosure obligations for acquired plans (for example, filing Form 5500 annual reports and distributing summary plan descriptions and other notices to participants for ERISA-covered plans).
- **Violations of Fiduciary or Tax-Qualification Requirements.** As part of the transaction or soon thereafter, a buyer may identify compliance problems that are not "material" for purposes of the transaction, but still need to be corrected. Often it may be possible to correct these problems at a reasonable cost through one of the voluntary remedial correction programs sponsored by the Department of Labor or the Internal Revenue Service.
- **Nondiscrimination Issues.** If a buyer chooses not to harmonize benefits and to maintain different benefit structures for different businesses or different groups of employees, care must be taken to satisfy any applicable "nondiscrimination" rules. These nondiscrimination rules are intended to prevent an employer from establishing a set of "rich" benefits plans for its highly paid management employees and a less generous set of benefit plans (or no benefits) for other groups of employees. Sometimes it is possible to satisfy these rules by applying complicated mathematical tests that compare the relative levels and amounts of benefits provided to employees or by establishing "separate lines of business" and applying the nondiscrimination testing requirements to each line of business separately.

"Outbound" Issues for the Seller

In general, the selling party in a transaction faces fewer post-closing integration issues. Nonetheless, there are still issues that a selling party may need to address, outlined in the following section.

Labor/Employment

What, If Anything, Remains? Typically, a seller will have "outbound" issues only if the particular deal involves something less than the entire pre-deal entity. If not, the seller is generally extinguished or subsumed within the buyer. However, a seller should take care to avoid being left any liability for discrimination or other employment-related claims that arose before the deal closed.

Adjustment Issues: Filling the Holes. Where a seller sells only a part of its business, the most common "outbound" issue arises where the seller must make adjustments based on the "hole" that now exists in its organization. For example, remaining seller employees may no longer have the opportunity to transfer into (or out of) jobs associated with the sold business, and remaining employees may not have the same number or range of advancement, promotion, or development opportunities.

The sale of a part of the business – if substantial – may require subsequent additional business changes in the seller's organization (for example, workforce

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reductions among administrative or office support employees in accounting, legal, or administration). Also, the sale of a large part of the business – and the resulting inflow of capital – may permit greater investment in new businesses that are acquired, the expansion of existing businesses, or technological improvements, all of which produce significant employment-related issues.

Employee Benefits

Transition Services and/or Continued Benefits Plan Participation. Transition arrangements whereby the selling party provides certain transition services and/or continued participation in its plans after the transaction can help provide seamless benefits plan participation to affected employees, but care must be taken to address compliance concerns (including special reporting obligations) that exist for "multi-employer welfare arrangements" and "multiple employer plans" that cover the employees of two unrelated companies.

Transfer of Employee Benefits Plan and/or Plan Assets. In many instances, a corporate transaction may result in all or a portion of an employee benefits plan (or the assets of that employee benefits plan) being "spun off" to the buyer. In these instances, it often will be necessary to conduct an interim valuation or accounting so that the plan or a portion of the plan assets can be transferred to the buyer.

Partial Termination of a Plan and Full Vesting. In the case of tax-qualified retirement plans, if a substantial number of employees (more than 20%) who are covered by the retirement plan are terminated as part of a transaction (for example, a purchase of assets where the seller terminates employees associated with the sold assets and the buyer hires all or substantially all of the employees), it may be necessary to fully vest these employees in their plan benefits to comply with ERISA and the Code.