



**NAHU** Mergers & Acquisitions  
Discover the Value



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## HEALTH AND WELFARE PLANS IN A MERGER OR ACQUISITION

Employee benefit plans are often overlooked or not addressed during an M&A transaction. As a result, many companies are left with significant compliance issues and legal liabilities after the sale that could have been avoided with some due diligence.

What follows is a high-level overview of benefit-plan issues in mergers and acquisitions. Because each merger, acquisition and benefit plan is unique and the process can be complex, use this list as a starting point. We also recommend that you work with legal counsel to avoid any unwanted surprises when the sale closes.

### WHAT TYPE OF SALE IS IT?

The legal form of M&A transaction will dictate many benefit issues. There are tax and corporate-law reasons for the structuring the transaction as either an asset transaction or a stock acquisition or merger. It is important to know what type of transaction is taking place as it will determine whether the seller's liabilities will be transferred by operation of law to the buyer, although this

can be altered to some degree by agreement of the parties.

An asset transaction is when the acquiring entity purchases some of the selling company's assets but does not purchase all liabilities.

**Why does it matter?** If the seller retains ownership of the company in an asset sale, it will also likely retain responsibility for the benefit plans. Often buyers will not want to assume the risks associated with another company's benefit plans in an asset sale. If some of the seller's employees go to the buyer's company then, depending on the benefit plan, there is potential for a partial plan termination.

A stock acquisition or merger is when the acquiring entity acquires the assets, liabilities and other contracts of the selling company.

**What does it matter?** In a stock sale, the buyer typically also acquires the seller's benefit plans, either intentionally or accidentally. If the buyer does not want to acquire the benefit plans, it needs to work with the seller so that those plans are terminated

prior to the sale. If the buyer acquires the plans, it will need to do due diligence to make sure the plans have been compliant and to see how those plans fit into the plans the buyer is currently offering.

### PURCHASE AGREEMENT

The purchase agreement will reflect the parties to the M&A transaction, their respective responsibilities and various other provisions. Usually, except in very small transactions, employee benefit plan representations and warranties are made. The following list can be used to explore benefit-specific representations and warranties, allocation of responsibilities between the seller and buyer, and other issues:

- Normally all benefit plans are listed on the disclosure schedule to the purchase agreement. This would include specifics on particular welfare benefits plans.
- The seller represents that its benefit plans are in conformity with the applicable federal laws (e.g., ERISA, IRC, ACA, etc.),



all appropriate tax returns have been filed, all contributions have been made, there have been no prohibited transactions or fiduciary violations, and there are not outstanding liabilities relating to the plan.

- **If the buyer acquires the benefit plans without these representations, the buyer may be full responsible for any liabilities later discovered in those plans post-closing.**
- If the seller is aware of issues that it cannot make the above representations, the seller can disclose this information in the purchase agreement. Options to address out-of-compliance benefit plans include indemnity language, purchase price reduction and correction prior to finalized sale.
- Section on certain conditions for the acquisitions to be finalized. If the seller's employee benefit plans are to be terminated and when this will occur. Which party is responsible to provide COBRA/state continuation coverage; who is responsible for incurred but not reported claims; which party is responsible for payment of self-insured claims if the plan is not fully insured?
  - **If the form of the transaction is a stock sale and the seller does not terminate its plan(s), the buyer will typically be responsible for all liabilities, including compliance issues, incurred claims, etc.**

Failing to include in the agreement who is responsible for offering COBRA leaves it up to federal law.

- **In an asset or stock sale, if the selling group maintains a group health plan after the sale, it is responsible to provide COBRA coverage to qualified M&A beneficiaries.**
- **In an asset sale, if the selling group discontinues any group health plan in connection with the sale, the buying group has the obligation if:**
  - **the buyer maintains a group health plan**
  - **and the buyer is a successor employer that continues business operations of the seller without substantial change.**
- **In a stock sale, the buyer provides COBRA coverage if the buyer maintains a group health plan**
- Another important section is on employees from the selling group. Will employees be transitioned to the buying group and what is the timeframe for the transition? Which party will be responsible for offering continued coverage (outside the scope of federal COBRA/state continuation)?

#### **DUE-DILIGENCE PROCESS**

At some point during the acquisition process, the buyer usually undertakes a due-diligence process, which is a thorough investigation of the seller or the portion of the seller's business that it seeks to purchase. It is important for the buyer to conduct a thorough investigation of the seller's

employee benefit plans in order to understand the type of plans offered, determine how they will fit within the buyer's existing employee benefits programs and determine whether there are any potential compliance risks or liabilities associated with the plans. Assistance with legal counsel with experience in ERISA and the Internal Revenue Code is highly recommended.

Following is a checklist of common items to be reviewed:

- I. Collect and review plan and trust documents:
  - Summary Plan Descriptions (SPDs)
  - Any Summary of Material Modifications (SMMs)
  - Annual Form 5500s filings
  - Third-party contracts in connection with employee benefit plans
    - i. See Section VI. below
  - Insurance policies
    - i. See Section VI. below
  - Employee communications
  - Stop-loss policy, if applicable
  - Claim and utilization reports
    - i. Area to address in purchase agreement: If it is a self-insured plan, who is responsible to pay outstanding claims?
  - Review of potential and/or pending litigation, arbitration and unpaid judgments
    - i. Area to address in purchase agreement: Which party is



responsible post-close? Alternatively, will it be conditioned to be finalized before transaction is finalized?

- ii. **Failure to address could result in the buyer assuming the risk for any pending litigation, unpaid judgments, etc.**

II. Review plan design for outstanding liabilities:

- Eligibility language and if it is being administered correctly
  - i. Note if there are any ineligible individuals covered on the plan.
- Coverage details and is it accurate or have there been changes not reflected?
- Outstanding plan liabilities
  - i. Note who will be responsible for such.
- How is the plan funded (e.g., employer's general assets, separate accounts, trusts)?
- Any employee contributions and how they are handled (e.g., segregation from employer assets, forwarded timely and consistently to insurance carrier)
- Termination of seller's plan(s)
  - i. See Section V. below
- Contribution strategy and if employees from the selling group will be transferred to buying group, will the same structure remain in place?
- Benefits offered—will the buyer continue to offer the same benefits?
- Benefits offered—will the buyer continue to offer the same benefits?

III. Review plan design if seller's employees will be transferred to buying group

- Contribution strategy
- Assumption of seller's plans or mirror benefits
- Elections status for transferred employee; will new elections be required or will previously ones continue?
- Deductible credits and out-of-pocket credits for transferred employees

- Potential modification to eligibility language to buyer's plan if allowing transferred employees to join plan
- **Why does this matter? If the buyer is assuming the seller's plans, it needs to know how those plans fit together with its current benefit strategy. Will the buyer terminate the plans after the sale? If so, what are its obligations upon termination? Will it merge the plans together? If so, are the contribution strategies, eligibility standards, coverage details and funding the same?**

IV. Review of compliance obligations under federal and state law (e.g., ERISA, HIPAA, COBRA, IRS, ACA, group health plan mandates, etc.)


- i. **In a stock sale, the buyer will typically be responsible for any compliance issues if responsibility is not spelled out in the agreement. In an asset sale, the seller will typically retain responsibility for any compliance issues.**
- Form 5500s (filed if applicable; timely filed; match plan documents; applicable schedules included; final Form 5500 if seller terminating, etc.)
- ERISA
  - i. Are all ERISA covered benefit plans in compliance? Are any under audit?
- COBRA
  - i. Who is responsible to send COBRA notices after closing? Will it differ from statutory obligation? Is this described in the acquisition agreement?
- Nondiscrimination
  - i. Has annual testing been done and records retained?
- HIPAA
  - i. Potential breaches of personal health information (PHI)
  - ii. HIPAA training
  - iii. Safeguards implemented to protect PHI
- Section 125 Cafeteria Plan
  - i. Written plan document



- ii. Assumption of seller's cafeteria plan and how employees' elections will be handled
  - Multiple Employer Welfare Arrangement
    - i. Avoid an inadvertent creation of a MEWA
      - 1. Coverage of non-employees (e.g., independent contractors, individuals not employees of buying group)
      - 2. Non-related employers participating in the plan
    - ii. Review M-1 filings, if applicable
    - iii. Check with the insurance carrier to see if group contract permits a MEWA.
    - iv. If the plan is self-insured, check state law MEWA rules.
  - ACA
    - i. Is the buyer or seller an applicable large employer?
      - 1. Does the transaction make the buyer an ALE?
    - ii. Does the seller remain in business after purchase?
      - 1. Determine ALE status and who is responsible for ACA reporting.
    - iii. Does the seller dissolve after purchase?
      - 1. Determine ALE status and who is responsible for reporting.
    - iv. Determine full-time/part-time status if the ACA applies. What measurement method does each plan use?
      - 1. Look-back method
      - 2. Monthly measurement
  - WARN Act
    - i. Employees may have to be notified of the sale.
- V. Is the seller terminating its plans? **In a stock sale, if the plans are not terminated by the time the sale closes, the buyer may still assume responsibility for the plans and any of their liabilities and compliance responsibilities.**
- What is the termination date?
  - Is final compliance testing and filing completed?
  - Are there any unpaid claims? Who is responsible for paying them?
- Are there any notice requirements?
  - Who is responsible for the disposition of plan assets?
- VI. Review any third-party agreements. **If the buyer assumes the plans, it also assumes any contractual obligations associated with the plans. This could mean working with vendors you have no relationship with, paying fees you are not accustomed to and have not budgeted for, and changing administrative processes to ensure plan compliance.**
- TPA, insurance carrier, stop-loss
    - i. Are there any anti-assignment provisions?
    - ii. Run-out
    - iii. How much notice is required to terminate the agreement?
    - iv. Are there any notification requirements? Which party is responsible for providing notification?
    - v. Is conversion an option? What are these provisions?
    - vi. Make sure the acquisition agreement includes provisions on who is responsible for terminating with the carrier and when it must be completed.
- VII. Who is responsible for continuation of care? **Typically, the successor employer is responsible for continuation of care once the sale closes.**
- Any there any employees on disability leave, FMLA or currently hospitalized?
  - Are there any death claims (life insurance)?
  - Have you reviewed the short- and long-term disability plans? Who is responsible if an employee is currently out on short- or long-term disability?
- VIII. P&C insurance
- Prepare a document that outlines all insurance policies, effective dates, expiration dates, limits, deductibles, premiums and who is/is not covered under the policies.
  - Review the insurance policies. Are current limits appropriate or should they change? Should policies be cancelled? Who is responsible for cancelling the policies, informing the carriers, etc.?



- Are there any pending claims? Is there any pending or ongoing litigation or arbitration?
- Are there any issues that could give rise to a claim after the sale closes?
- Should the buyer's and/or seller's insurance carriers be informed of a merger or acquisition? Are there change in control provisions in the insurance policies?
- Do the E&O policies cover the full scope of professional services?
- Do the policies have an extended reporting endorsement because of a purchase?
- Review the loss experience of each policy compared to the overall limits. Have current claims already exhausted the limits?
- Have you included indemnity provisions?
- Is a representation and warranty policy appropriate?

This checklist is only the beginning. Start the conversation about employee benefit plans early so any issues can get resolved before the sale is closed. Doing so can help all parties have a smooth transaction and avoid any post-closing surprises. 



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