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10 Common Benefit Issues in M&As During the Covid-19 Era

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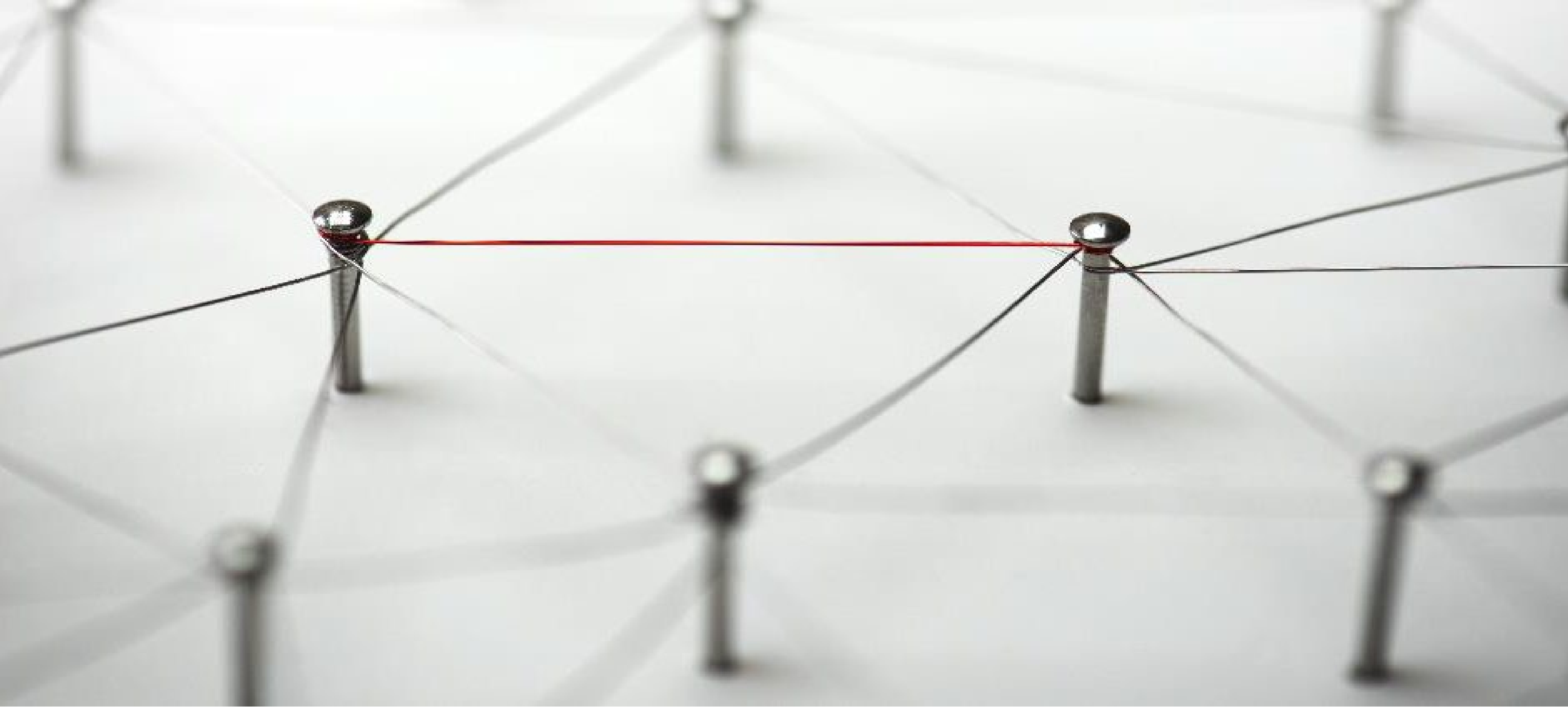

10 Common Benefit Issues in M&As During the COVID-19 Era

Presented by: Megan Monson, Esq. and Taryn E. Cannataro, Esq.

Lowenstein Sandler

Overview

- Mergers and acquisitions particularly, among private companies present a range of HR challenges, especially in light of COVID-19.
- Many of those issues revolve around benefits and transition of employees.
- We plan to discuss some of the most common challenges that organizations typically face and tips for navigating corresponding pitfalls.

COVID-19 Specific Representations in Transaction Documents

- COVID-19 has impacted businesses and workforces being acquired in transactions.
- Transaction documents more frequently include COVID-specific representations pertaining to:
    - Compliance with the Families First Coronavirus Response Act
    - Compliance with COVID-19 rules for workplace safety, sick leave, and the Family and Medical Leave Act
    - An intention not to terminate or furlough employees or to defer or reduce compensation as a result of the pandemic
    - No actual or anticipated changes to benefit plans as a result of COVID-19
- If a company received a loan under the Paycheck Protection Program, an acquirer may request representations that the seller is not aware of any facts that would jeopardize the ability of the loan to be forgiven.

General Representation and Warranty Deal Concerns and Traps for the Unwary

- Companies are more routinely seeking representation and warranty insurance in transactions.
- RWI deals often require a more detailed and fulsome review of a seller's operations through the due diligence process.
- In light of COVID-19, R&W insurers have started inquiring about specific employment and benefit diligence related to the pandemic such as:
  - Whether there have been furloughs or layoffs due to COVID-19
  - Details on employee and workplace-related safety precautions
- During the pandemic, companies undergoing a corporate transaction should be prepared to provide:
  - Detailed information regarding the effects that COVID-19 has had on its workforce, benefit plans and
  - Any precautionary measures that it has taken to protect its workforce

Addressing the Federal Workers' Adjustment and Retraining Notification (WARN) Act in Transaction Documents

- WARN, to the extent triggered, requires advance notice for certain terminations of employment.
- However, there are exceptions to the notice requirement, such as:
  - Unforeseen business circumstances exception as a result of COVID-19
- Since companies may have laid off employees as a result of the pandemic, it is important to include provisions in a purchase or merger agreement that would highlight to a buyer any WARN issues or contemplated layoffs.
- Depending on the deal structure, consider whether to include a covenant addressing allocation of liability for any layoffs contemplated as a result of the transaction.
- Some states have their own WARN or mini-WARN requirements.

Furloughed Employees

- When a buyer is acquiring a business, the seller's workforce and whether to continue employment of existing employees plays a role in determining the future of the business.
- A buyer will be interested to know whether a seller:
  - has employees on furlough,
  - what the company has communicated to such employees, and
  - the benefits for which they are eligible

Dealing With Employees on COBRA

- Employees who incur a “qualifying” termination in connection with a transaction (or have incurred a termination within the 18 months prior to the transaction, due to Covid-19 or otherwise) may be eligible for health, dental, and vision insurance coverage (at the employee’s expense) for up to 18 months (subject to extensions) to the extent they had such coverage prior to termination under COBRA.
- Often this responsibility will fall on the acquirer when a seller ceases to provide any group health insurance plan following closing.
- The responsibility of providing such benefits after closing should be clearly allocated within the transaction documents, especially with a growing number of employees who have been terminated due to the recent economic downturn and may be electing COBRA coverage.
- Smaller companies that may not be within the purview of COBRA should also be mindful of state “mini-COBRA” laws that create similar responsibilities under state law.

Continuation of Benefit Plans and Onboarding of Employees

- Common questions that arise in transactions are:
  - whether to assume or terminate benefit plans and
  - how to transition employees into a buyer's business.
- If an acquirer has existing benefit plans in place, it may be administratively easier to transition acquired employees to existing plans than to maintain multiple benefit plans for different groups of employees.
- Cost, administrative burdens, and benefits offered are some key considerations in determining how to address these items, in particular for companies that may be cash-strapped due to COVID-19.

Comparable Compensation and Benefits

- Consider whether to agree to provide substantially similar or comparable compensation and benefits to continuing employees for a certain period of time after closing.
- As a result of the uncertain economic climate, buyers may be less likely than in the past to agree to comparable compensation and benefits.
- A buyer might desire to set new terms of employment.
- A buyer can always agree to provide comparable compensation and benefits and bear the cost of terminating such employees.

Treatment of Seller 401(k) and Other Retirement Plans

- Buyers frequently require, through a covenant in the transaction document, that a seller take formal action to terminate its 401(k) plan and take steps to terminate other retirement plans prior to closing.
- If a buyer has an existing 401(k) plan, this request helps to avoid inheriting historical liability, creating additional administrative work or operational complications, such as passing nondiscrimination testing.
- Such termination often requires coordination between all parties involved and the plans' service providers.
- This includes possible amendments to a buyer's plan to allow for rollover of 401(k) loans or to allow immediate eligibility for a buyer's plan.
- Consider early in a transaction to avoid unnecessary closing delays.

Section 280G and Reduced Compensation Due to COVID-19

- In response to the pandemic, executives may be asked by an employer to reduce their cash compensation (e.g., base salary or bonuses).
- For those who may be subject to the “golden parachute” rules of Section 280G of the Internal Revenue Code of 1986, a compensation reduction could increase excise tax exposure in the event of a change in control of an entity taxed as a corporation in the next few years.
- The Section 280G excise tax applies to amounts in excess of a “base amount” (which, in general, is the executive’s annual taxable compensation with the company over the five-year period preceding a change in control).

Section 280G and Reduced Compensation Due to COVID-19

- Companies that could undergo a change in control in 2021 or later should be mindful that such a reduction would likely reduce base amounts and potentially subject certain executives to the golden parachute excise tax.
- For a change in control of a private company, the shareholder vote exception should be explored to avoid subjecting the executives to the excise tax.

Treatment of Outstanding Equity Awards

- If a business is anticipating a sale in the near future, it is important to confirm that any existing equity plan provides adequate flexibility for the treatment of outstanding equity to align with the business deal.
- Both buyers and sellers should review equity plan to see what treatment is permitted in a deal context.

Treatment of Outstanding Equity Awards

- To the extent a seller's equity plan does not provide its plan administrator broad discretion, sellers should consider amending their equity plan so that the plan administrator can take one or more of the following actions upon a change in control:
  - Cancel out-of-the-money ("underwater") or unvested stock options without payment of consideration therefor;
  - Cancel any equity awards (vested or unvested) in the event such equity is not exercised prior to closing; and/or
  - Cancel any equity award in exchange for the deal consideration equity holders would be entitled to had they exercised it prior to closing. Consider permitting the plan administrator to take any such action without the consent of equity holders, which can often be administratively burdensome to obtain. A seller may also want to consider whether this can be an opportunity to obtain a release of claims from option holders. This flexibility would be particularly helpful to companies whose stock options may currently be underwater due to COVID-19.

Conclusion

Questions?

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With a focus on ensuring compliance and minimizing cost, Megan advises businesses and C-suite executives on a wide variety of employee benefits and executive compensation matters. She represents an array of public and private businesses of varying sizes and across multiple industries.

Megan's experience ranges from plan design, implementation, and ongoing administration and compliance through termination. She provides legal counsel pertaining to tax qualified plans, welfare plans, and Affordable Care Act issues, as well as on deferred compensation and equity arrangements intended to attract and retain employees.

Megan also assists in the negotiation of employment and separation agreements and applies honed skills in both company and executive representation. Due to her exposure to analyzing the issues from both perspectives, Megan is able to effectively negotiate, identify, and advise on potential problems before progress can be obstructed.

Moreover, she provides counsel on the employee benefits and executive compensation aspects of business transactions. This includes assisting with the transition of employee benefits arrangements; implementing new benefits arrangements such as retention bonuses, management incentives, and equity plans; complex 280G analyses and completion of shareholder votes; and negotiating the terms of benefits deal documents.

Prior to joining the firm, Megan worked as a tax consultant for Deloitte Tax LLP. While attending law school, she served as a judicial intern for the Hon. Freda L. Wolfson of the U.S. District Court for the District of New Jersey.

Education

- Seton Hall University School of Law (J.D. 2013), Tax Law Society; Social Justice – Pro Bono Program
- Syracuse University (B.A. 2010), magna cum laude

Bar Admissions

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Taryn provides employee benefits and executive compensation counsel and advice to corporate executives as well as public and private companies from a broad array of industries.

She assists with all aspects of plan design and compliance related to tax-qualified plans, welfare plans, and deferred compensation plans and arrangements, including equity and other incentive compensation plans. Taryn also advises on compensation and benefits aspects of corporate transactions, including complex 280G issues and negotiating employment terms.

Her practice includes counseling companies and executives on the design, drafting, and negotiation of executive compensation arrangements, such as employment, equity, change in control and separation agreements.

Prior to joining the firm, Taryn worked as a tax manager in Deloitte Tax LLP's Global Employer Services practice group, where she assisted a wide variety of public and private companies with U.S. and international employee benefits and ERISA tax issues.

Education

- Rutgers School of Law (J.D. 2012)
- Ramapo College of New Jersey (B.A. 2009)

Bar Admissions

- New York
- New Jersey

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