Employee Benefits Issues in Mergers, Acquisitions and Dispositions

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Dealing with Employee Benefits in Mergers, Acquisitions and Dispositions

I. Introduction

Employee benefit issues present interesting challenges and significant liabilities in any business transaction. Issues arise under the Code, ERISA, and other federal laws as well as under state laws.

II. Determine Your Role in the Transaction

The issues that affect you and your clients will depend on the type of transaction and your client’s role in the transaction. A business transaction generally involves particular assets and liabilities of an entity (an “asset deal”) or an equity interest in the entity (a “stock deal”). Parties to a business transaction generally fall into one of two roles – a party is either a buyer or a seller. Accordingly, it is important at the outset to determine your client’s role in the business transaction and whether the transaction is an asset deal or a stock deal.

The principal advantage of an asset deal is that the buyer can pick and choose the assets and liabilities acquired. Thus, a buyer in an asset deal can choose not to acquire all or certain employee benefit liabilities. On the other hand, the value of the equity interest purchased by a buyer in a stock deal automatically is affected by all employee benefit liabilities of the entity in which the interest is purchased.

III. Conducting the Diligence

The buyer in any transaction, and each party in a merger, will want to conduct significant diligence on the employee benefit plans and programs offered by the other party. An asset deal may require less diligence as to plan operation and administration than a stock deal or merger, provided the buyer is not assuming employee benefit liabilities in the transaction. However, where the buyer is assuming a plan of the seller, the diligence should be the same as with a stock deal so that the buyer can determine if there are any specific liabilities with respect to the plan that should remain with the seller.

The buyer should review every current employee benefit plan, program or practice and, for a stock deal, any plan, program or practice that has been maintained for some period of time prior to the transaction. It is not unusual for a buyer to require the seller to make representations and warranties with respect to the administration and operation of employee benefits for an unlimited period of time prior to the transaction. However, many practitioners are comfortable with a period of time of three to six years prior to the transaction. There is no magic to these numbers except that three years approximates the general limitations period for recovering taxes under the Code and six years is the general statute of limitations on actions under ERISA.

Ask for written descriptions of informal plans, programs and practices, for example, an informal practice of paying severance upon termination of employment. Employee handbooks and personnel manuals for managers are a good source of informal plans, programs and practices.

After you have identified each plan, program or practice, collect the relevant documentation for each one – the written plan document, amendments to the plan document, the trust document, summary plan description, Internal Revenue Service (“IRS”) Form 5500, and so forth. It is also a good idea to request copies of service arrangements with third parties relating to the plans, for
example, the service agreements with the third party administrator for self-insured health plans or 401(k) plans. For plans subject to Code nondiscrimination requirements where failure to comply has tax implications, ask for evidence that the plans satisfy those nondiscrimination tests and of any corrective action taken in the event the plans failed the tests.

Each plan, program or practice should be reviewed to ensure it reserves to the sponsor of the plan the right to terminate or amend the plan. If the plan cannot be amended or terminated, the buyer may be forced to continue to provide benefits under the terms of the seller’s plan indefinitely for those employees who were participants on the date of the acquisition.

Pay particular attention to whether the plan, program or practice provides for accelerated vesting or any other consequence as a result of the transaction. For example, do stock options provide for full vesting upon a sale of the company? Does an employment contract provide for a golden parachute payment as a result of the transaction? Does any rabbi trust associated with an executive plan require increased funding in the event that ownership of the target changes? Does the pension plan provide for automatic termination of the plan if the target is sold and the buyer does not expressly assume the plan? Will the terms of the seller’s severance pay plan result in payments to all employees in an asset deal? Such provisions may carry hidden costs that significantly increase the transaction costs.

Request information on outstanding participant claims under the target’s plans and how those are being handled. Ask whether any governmental audits are underway or pending and if they are underway, what the auditors have found.

Pay particular attention to collective bargaining agreements and inquire about any union organizing activity that has taken place within the last several years prior to the transaction.

IV. Controlled Group Liabilities

A. General

The Code and ERISA impose joint and several liability on a controlled group basis for many employee benefit plan liabilities, including:

- liability for satisfaction of minimum funding liabilities under Code Section 412 and ERISA Section 302;¹³
- liability for unfunded benefits upon plan termination under ERISA Section 4041(c) (distress termination) and ERISA Section 4042 (termination proceedings initiated by the Pension Benefit Guaranty Corporation (“PBGC”));¹⁴
- liability under ERISA Section 4063 (withdrawal of substantial employer from single employer plan under multiple controlled groups)¹⁵ or ERISA Section 4064 (termination of single employer plan under multiple controlled groups);¹⁶
- lien for liability under ERISA Section 4062, 4063 or 4064;¹⁷
- multiemployer plan withdrawal liability under Title IV of ERISA;¹⁸
- liability for excise taxes on failure to satisfy minimum funding;¹⁹ and
liability for violations of the continuation health coverage rules under Code Section 4980B.\(^{[20]}\)

For a stock deal or a merger, diligence also should focus on identifying the controlled group of the target entity and on ascertaining any liabilities the target could incur simply by being a member of the controlled group.

**B. Identification of Controlled Group Members**

For purposes of Code requirements, for example, COBRA and minimum funding contribution requirements, “controlled group” liability can be imposed on (1) any entity in a parent-subsidiary group or a brother-sister group of either corporations or unincorporated trades or businesses,\(^{[21]}\) (2) any entity that is part of an affiliated service group\(^{[22]}\) and (3) any entity treated as part of the controlled group under regulations of the Secretary of the Treasury designed to prevent the avoidance of certain employee benefit requirements.\(^{[23]}\) The same definition of controlled group also applies for minimum funding liability under ERISA and for purposes of PBGC premium requirements.\(^{[24]}\) However, the controlled group is limited to a group of corporations or unincorporated trades or businesses as described in Code Section 414(b) or (c) in determining multiemployer plan withdrawal liability.\(^{[25]}\)

**V. Representations and Warranties**

In most transactions, the seller will be asked to provide representations and warranties regarding various items, including employee benefit plans. The breach of these representations and warranties can have varying consequences to the seller depending on the terms of the transaction. Often times a transaction will be structured such that representations and warranties do not survive the closing. This structure puts tremendous pressure on the diligence phase of the transaction.

**A. Stock Deals**

In a stock deal, the buyer will want extensive representations and warranties to the effect that there are no material liabilities with respect to the seller’s employee benefit plans. In a merger, both parties are buyers and the representations and warranties with respect to employee benefit plans typically will be mutual. A checklist of representations and warranties that might be used in a stock deal or a merger is attached to this paper as Exhibit A.

The seller generally represents that the seller has identified all employee benefit plans, programs and practices. The buyer generally also will ask for identification of employment contracts and collective bargaining agreements. If the seller does business outside the United States, buyers also should obtain representations about employee benefit plans, programs and practices for in foreign jurisdictions.

The seller generally will be asked to represent that it has furnished copies of plan documents that are complete and up-to-date.

Representations about the existence of defined benefit plans governed by Title IV of ERISA also are typical, for example, whether there has been a termination of such plans, whether there is an obligation to contribute to multiemployer plans and whether there has been withdrawal liability or a funding waiver under such plans. Because the liability with respect to these plans
can be imposed on a controlled group basis, the buyer generally will ask for the same representations regarding any member of the seller’s controlled group.

The seller also must frequently identify funding arrangements for its employee benefit plans, for example, (1) trusts associated with its ERISA pension or welfare plans and (2) grantor trusts (often referred to as “rabbi” trusts) associated with its nonqualified executive plans, and must frequently represent that the assets as shown on the financial statements of such funding arrangements are valued at fair market value. Additionally, the seller typically will be asked to represent that the transaction will not accelerate vesting under any of the arrangements (which could accelerate funding requirements) or otherwise trigger additional funding requirements under the plans.

Many buyers also ask for a representation that the seller has the power to terminate or amend each employee benefit plan, that the buyer will succeed to this same power after the transaction and that the transaction itself will not result in additional vesting or payments under the employee benefit plans or any employment contracts. It is also important to ascertain whether the surviving entity after the transaction will have the authority to interpret the plan and amend the plan or whether a plan amendment is necessary prior to the transaction.26

B. Asset Deals
In an asset deal, the seller typically is not asked to provide extensive representations and warranties about employee benefit plans unless the buyer is assuming those plans or particular liabilities with respect to those plans.

Where the asset deal is structured to be the functional equivalent of a stock deal, it will be typical to see exactly the same representations and warranties of the seller that would be requested of a seller in a stock deal.

VI. Employee Benefit Plan Options

A. Stock Deal
In a stock deal, the buyer becomes responsible (either directly or indirectly) for the benefit plans maintained by the target prior to the transaction. The buyer typically will select one of the following options:

option 1 - continue the seller’s plans as is;

option 2 - terminate the seller’s plans and distribute benefits, if distribution is permitted;

option 3 - freeze the seller’s plans, which is essentially the same as terminating the plans except that benefits are not distributed; or

option 4 - merge the seller’s plans into the buyer’s plans.

Option 1 (continue the plan as is) is the least disruptive option to the employees affected by the transaction and is the most likely option if the target will remain a separate subsidiary or division of the buyer following the transaction. The success of Option 1 depends upon whether the qualified plans will continue to satisfy the coverage and nondiscrimination rules when
considered as part of the buyer’s controlled group. Coverage and nondiscrimination rules are discussed at VII. B. below.

Option 2 (plan termination) is typical if the buyer will provide its own plans to former seller employees. A buyer may make termination of the seller’s plans a condition to closing the transaction or the buyer may terminate the plans immediately after the transaction. If the buyer terminates the plans after the transaction, the qualified plans will have to satisfy the coverage and nondiscrimination rules when considered as part of buyer’s controlled group. Typically, benefits are distributed from a terminated plan as soon as practicable following the termination and, in the case of a qualified plan, the receipt of a favorable determination letter from the IRS. A defined benefit plan generally cannot be terminated until it is fully funded to satisfy all benefits. See VII. C. below. Also, see VII. E. below for special rules related to 401(k) plans.

Option 3 (freeze plan) is similar to Option 2 in that the plan is amended to cease future benefit accruals; however, the buyer maintains the plan and pays benefits when they become due. If the plan is qualified, the buyer will be required to amend the plan to bring it into compliance with changes in the Code affecting qualified plans. If a defined benefits plan is “top-heavy,” the plan may have to continue to accrue benefits for non-key employees for years before January 1, 2002. The Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRA”) amended the top-heavy rules, for years after December 31, 2001, to eliminate the requirement that top-heavy frozen defined benefit plans have to continue to accrue benefits. Additionally, ERISA reporting and disclosure requirements continue to apply to a frozen plan. For example, the buyer must continue to file an annual report (IRS Form 5500) and to distribute summary material modifications of amendments affecting the content of the summary plan description. Because the buyer must continue to keep the plan qualified and continue to satisfy ERISA reporting and disclosure requirements, Option 3 is rarely used. However, Option 3 is likely to be used for 401(k) plans (discussed below at VII. E. 2.) or for defined benefit plans that are not fully funded.

Option 4 (merge the plan into buyer’s plan) is the more typical option if the buyer’s benefit strategy is to provide the same benefits to all employees. In the case of ERISA pension plans and qualified plans, the buyer must be careful to preserve any early retirement options and any optional forms of benefits (including the right to a distribution at a particular time) from the seller's plan (with respect to the portion of the benefit attributable to the merging plan). See VI. C. below.

In many cases, the target will not maintain plans, rather target employees will participate in plans maintained at the parent company level of the seller’s controlled group or by another related company. In this case, the buyer will not become responsible for the plan solely as a result of the stock acquisition.

However, in some cases, it may make sense for the buyer to replicate the seller’s benefit plans for the target. For example, the buyer may choose to replicate the seller’s plan if the buyer intends to operate the target business as a separate subsidiary with its own benefit plans. In addition, replicating the seller’s plans will result in one less change for the seller’s former employees and is likely to be viewed by such employees as a positive action. Replication of the seller’s plans is accomplished either by the seller dividing the plan covering the target employees into two plans, one for the target employees and one for the remaining seller employees. The target plan is then transferred to the buyer. More commonly, the buyer adopts a new plan, the terms of which are identical to the seller’s plan covering the target employees. The assets and liabilities of the seller’s plan that are attributable to the target employees are
transferred to the new buyer plan. The adoption of a new plan with terms identical to the seller’s plan often is referred to as “cloning” the seller’s plan. Cloning the plan and accepting an asset and liability transfer from the seller’s plan carries with it the obligation to preserve the early retirement benefits and optional benefit forms as with the plan merger (Option 4). See VI. C. below. In order to avoid duplication of benefits, the buyer’s plan typically will provide an offset for benefits provided under the seller’s plan. Nondiscrimination regulations allow such a plan to satisfy regulatory safe harbors notwithstanding the offset feature. 

B. Asset Deal

In an asset deal, the buyer generally will not take a seller’s plan unless the buyer desires to continue the plan (Option 1) or merge the plan into the buyer’s plan (Option 4). However, the buyer in an asset deal often will clone the seller’s plan and accept a transfer of assets and liabilities from the seller’s plan attributable to the employees acquired as part of the asset deal.

C. Elimination or Reduction of Benefits and Changes in Optional Forms

At the time of sale, a seller (as well as a buyer who assumes pension liabilities) must take care not to eliminate or reduce “accrued benefits” in violation of ERISA Section 204(g). Most commonly, such benefits include the earned portion of benefits under a defined benefit plan which are payable at normal retirement age. For example, under a plan, an employee may have to work 5 years before acquiring a “vested” right to a particular retirement benefit beginning at age 65. That benefit is not, however, earned in the instant that the employee completes his or her fifth year of employment. Rather, the employee had “accrued” a bit of the benefit with each passing day or year. Under ERISA Section 204(g), while the employer may “freeze” or stop further “accruals” of benefits, it may not take away what is already accrued. Thus, in the above example concerning the 5-year vested pension benefit, if the employer stops further accruals when the employee has three years of service, and the employee ultimately completes 5 years of service, the employee will become vested in the benefit accrued prior to the time that the employer stopped future accruals.

In addition, since 1984, ERISA Section 204(g) has protected subsidized early retirement benefits (e.g., a pension payable at age 55 with 30 years of service, in amount which is not actuarially reduced) and optional benefit forms. The section prohibits “plan amendment[s] which ha[ve] the effect of -- (A) eliminating or reducing an early retirement benefit or a retirement-type subsidy…or (B) eliminating an optional form of benefit...” For retirement-type subsidies, the participant is protected where the participant satisfies “…(either before or after the amendment) the pre-amendment conditions for the subsidy” (emphasis added).

The weight of authority now holds that ERISA Section 204(g) protects a subsidized early retirement pension even if one of the conditions to get the benefit is plant shutdown or layoff. Thus, in Bellas v. CBS, Inc., the plaintiff ultimately satisfied all conditions to be eligible for a “job-loss pension”, i.e., (1) he gave the company more than 25 years of work; (2) he reached age 50; and (3) his employer laid him off. His layoff did not take place, however, until after the employer purported to amend the plan to eliminate the job-loss pension. The Third Circuit ruled for plaintiff, rejecting the employer’s argument that the job-loss pension lacked ERISA protection since one of the eligibility requirements was permanent job separation.

There is an issue as to whether ERISA Section 204(g) requires that participants be entitled to “grow into” eligibility for benefits earned with the seller prior to the sale based on service
completed with the buyer after the sale. When the sponsoring employer in Gillis v. Hoechst-Celanese Corp., spun off a portion of its defined benefit plan in connection with an asset sale, plan participants affected by the spinoff filed a suit alleging, inter alia, that the seller-employer violated ERISA Section 204(g) by refusing to allow them to use service with the buyer to "grow into" eligibility for early retirement benefits under the seller's plan. Because plaintiffs continued working in the same positions with the buyer, they argued that their service with the successor employer should be counted towards the seller plan's early retirement requirements. Looking to the "same desk rule" adopted by the IRS in other contexts, the court held that the participants had not separated from service, and that ERISA Section 204(g) therefore allowed them to grow into the seller plan's early retirement benefits. Again, Gillis found an ERISA Section 204(g) violation even though employees went to work for the successor after an asset sale before meeting all conditions. Indeed, there was not even any formal plan "amendment" in Gillis limiting the ability to "grow into" benefits. The court held that the seller's categorical refusal to award benefits to the transferred employees was tantamount to amendment. But see Richardson v. Pension Plan of Bethlehem Steel Corp., 112 F.3d 982 (9th Cir. 1997), where an employer amended its plan to allow a plan administrative board to adopt rules and regulations regarding whether a particular sale would trigger shutdown benefits. The union filed a grievance, alleging that the proposed transaction would trigger the shutdown benefits, and the union and employer settled the grievance by agreeing to provide shutdown benefits if the plan were closed within 48 months of the sale. The buyer closed the plant more than 5 years after the purchase and no shutdown benefits were paid. Participants sued alleging that the 48 month limitation on shutdown benefits violated ERISA § 204(g). The Ninth Circuit originally agreed, but on rehearing, decided that the agreement to limit the shutdown benefits was an interpretation of the plan not an amendment. Thus, ERISA § 204(g) was not implicated.

Gillis has been distinguished (and possibly limited) by subsequent cases. These later cases suggest that Gillis remains viable when one and/or both of the following circumstances are present: (1) the seller spins off fund assets from its pension plan to fund the new pension plan sponsored by the purchaser; or (2) there is "promise" made to the employees that they will continue to receive pension credit while working for the buyer.

ERISA Section 204(g) also protects optional forms of benefit, which generally means any distribution form available under the plan. The Treasury has issued regulations regarding the elimination of protected optional benefit forms. Prior to 2000, any buyer who continued the seller's plans (Option 1 above) or merged the seller's plans into plans of the buyer (including transferring assets of the seller's plans to the buyer's plans) (Option 4 above) had to be careful to protect any optional benefit form in the seller's plan, including “...the payment schedule, timing, commencement, medium of distribution (e.g., in cash or in-kind), the portion of the benefit to which such distribution features apply and the election rights with respect to such optional forms...” In 2000, the Treasury revised its regulations to relax the circumstances under which a plan must preserve optional benefit forms so buyers (or seller) may eliminate unwanted options rather than terminate plans.

The revised regulations also add specific rules allowing optional forms of benefits to be eliminated in connection with elective transfers from one plan to another in the case of an asset or stock acquisition, merger or similar transaction. The regulations require a voluntary, fully informed election by the employee and that the employee must have the right to elect to have his or her benefit remain in the seller's plan. In the case of a money purchase pension plan, 401(k) plan or an employee stock ownership plan, the transfer must be to another plan of the same type.
EGTRA amends both ERISA Section 204(g) and Code Section 411(d)(6) to permit transfers between defined contribution plans if the transfer is voluntary, the terms of both plans authorize the transfer, the employee is given notice of the effect of the transfer and the transferee plan provides for a lump sum distribution. These new provisions, which are effective for years after December 31, 2001, apply to “plan mergers and other transactions having the effect of a direct transfer, including consolidations of benefits attributable to different employers within a multiple employer plan.”46 EGTRA also amends ERISA and the Code to give the Secretary of the Treasury the authority to make regulatory exceptions to the prohibition against reducing early retirement benefits or retirement-type subsidies if the benefits or subsidies create significant burdens or complexities for the plan and plan participants unless the amendment adversely affects the rights of any participant in more than a de minimis manner. Finally, EGTRA appears to broaden the ability of an employer to amend defined contribution plans to eliminate forms of distribution if a lump sum option is available.

VII. ERISA Pension Plans

A. General

An ERISA pension plan is a plan that provides retirement income or results in deferral of income for periods extending to the termination of covered employment or beyond.47 There are two general types of pension plans – the defined benefit plan and the defined contribution plan.

A defined benefit plan provides income at retirement based on a formula that typically includes service and compensation as well as age at retirement. In a defined benefit plan, the employer typically makes contributions to fund the benefit at retirement. The benefit payable to the employee does not depend on how the employer invested the contributions. The employee is entitled to the formula benefit no matter what the investment performance of the fund. In a defined benefit plan, the contributing employer bears the investment risk in providing the formula benefit.

A defined contribution plan provides income at retirement based on the value of an account established for the employee. Contributions made to the plan by the employer and, in some plans, by the employee are credited to the employee’s account and invested. The benefit at retirement depends on the performance of the investment of the assets over time. In a defined contribution plan, the employee bears the investment risk.

Most ERISA pension plans also are “qualified” plans, that is, they attempt to satisfy the requirements of the Code48 so that the trust fund associated with the plan is tax exempt and benefits are not taxable to employees until actually paid to them. Most of the buyer’s diligence in a transaction is geared towards determining if the seller’s pension plans are “qualified” and whether any defects that exist may be remedied without significant cost.

Pension plans may be “nonqualified,” which means that they are not intended to satisfy the requirements of the Code. However, most such nonqualified plans are unfunded plans for highly compensated executives. Nonqualified plans generally are unfunded in order to avoid taxation of the benefits to executives before those benefits are actually paid. Nonqualified plans are discussed at XIV below.
B. Qualified Plans

Each qualified plan has to satisfy a variety of rules under the Code. The plan must satisfy the requirements by its terms and in operation. A buyer may derive some comfort regarding the adequacy of the terms of the plan from a favorable determination letter issued by the IRS; however, in today’s environment, an employer often has several years following a change in a qualification requirement to bring the terms of its plan into compliance. For example, plans (other than certain prototype plans) have until the end of the 2001 plan year to incorporate amendments required by several recent laws. Thus, the seller’s favorable determination letter may be outdated.

Each plan must satisfy the qualification requirements in operation. The only way to get a feel for the plan’s operation is through disclosures from the seller or by conducting an audit of the plan’s operations. Typically, there is little time for an audit prior to the transaction.

Plan coverage and nondiscrimination issues are of particular concern in a business transaction.

Code Section 401(a)(26) requires each defined benefit plan to cover at least 50 employees, or if fewer, 40% of the nonexcludable employees of the controlled group. Defined benefit plans that are not top-heavy are exempt from these rules if they cover no highly compensated employees or former highly compensated employees or if the plan is underfunded and benefits are frozen. A seller defined benefit plans that covers less than 50 employees may satisfy the 40% test of Code Section 401(a)(26) while the plan is part of a smaller controlled group, but could fail to satisfy those rules as part of a larger buyer’s group.

Code Section 410(b) requires each qualified plan to cover a nondiscriminatory group of employees when viewed in light of the controlled group of the employer maintaining the plan. A plan that satisfied Code Section 410(b) in the seller’s controlled group may not satisfy the coverage rules when it becomes part of the buyer’s controlled group. For example, if a southeastern manufacturing company acquires a west coast high tech operation, the plans of the target may not satisfy the coverage rules when considered as part of the buyer’s controlled group because the target employees are more highly compensated than the buyer’s employees.

Fortunately, Code Section 410 provides limited relief for a buyer that wishes to continue the seller’s plan after the transaction. If (1) an employer becomes or ceases to be a member of a controlled group, (2) the employer’s plan satisfied the coverage rules immediately before the transaction and (3) there is no significant change in the plan or in the coverage of the plan (other than the transaction), the plan may be treated as satisfying the coverage rules until the last day of the first plan year beginning after the date of the transaction. Treasury regulations provide that this rule applies to an asset or stock acquisition, a merger or other similar transaction involving a change in the employer of the employees in a trade or business. Thus, provided no significant changes are made to the seller’s plan following the transaction and the seller’s plan satisfied the coverage rules immediately before the transaction, the seller’s plan can stand alone for up to two plan years.

One important question is what constitutes a significant change in the plan or the coverage under the plan. Must coverage be frozen as of the date of the transaction? What about new employees hired into the business? What if the plan is amended to clarify that other employees of the buyer’s controlled group are not eligible to participate? Further, the transitional relief does not expressly apply to situations in which the buyer terminates the seller’s plan or the buyer replicates the seller’s plan and accepts a transfer of assets and liabilities from the seller’s plan.
In the former case, termination arguably is a significant change in the plan and in the latter case, the buyer does not maintain a plan of the seller, but rather establishes a new plan. These questions and others will await future IRS guidance or Treasury regulations.  

Satisfaction of nondiscrimination rules under Code Section 401(a)(4) is another issue affecting qualified plans. Nondiscrimination, like coverage, is tested on a controlled group basis, and as with coverage, a seller’s plan may have satisfied the nondiscrimination rules prior to the transaction, but fail to satisfy those rules once it becomes part of the buyer’s controlled group. After the transaction, buyers who take on the seller’s plans or merge the seller’s plans into the buyer’s plans typically attempt to implement a single benefit formula within each plan, which necessarily requires preserving some of the seller’s formula for periods prior to the transaction. The buyer must take care that the preserved or grandfathered benefit formulas continue to satisfy the nondiscrimination rules even though they may apply to less than all of the participants in the plans. The nondiscrimination regulations under Code Section 401(a)(4) contain special rules to assist employers to continue certain benefits, rights and features for former seller employees.  

Consideration also should be given by the seller as to whether the transaction will cause a partial termination of the seller’s plans. A partial termination can occur either as a result of the exclusion of a significant group of employees from participating in the plan or the cessation or decrease of future benefit accruals if, as a result of the cessation or decrease, the potential reversion to the employer is created or increased. Depending on the facts and circumstances, a partial termination can occur as a result of the transaction or after the transaction and the IRS or a court may look at the plan’s participation over more than one plan year. A determination that there has been a partial termination will require all affected participants to be fully vested in the benefit accrued to the partial termination, to the extent funded. A buyer may negotiate that a seller fully vest affected employees or give employees vesting crediting under the seller’s plan for service with the buyer. A seller who agrees to fully vest need not be concerned about a partial termination. A seller who merely agrees to give vesting service credit may nevertheless be required to fully vest if the IRS or a court determines that a partial termination has occurred.  

Diligence in connection with any business transaction is likely to discover some defects in plan operation or plan terms. Fortunately, the IRS has established a number of programs to permit correction of plan defects. It is not uncommon for a buyer to insist that the seller’s plans go through one of these correction procedures after the transaction at the seller’s expense. The amount of the expense will vary with the type of operational failure, the period over which the failure occurred, and whether the correction procedure is a standardized correction or will require negotiations with the IRS.  

C. Defined Benefit Plans  

The most significant issue with respect to defined benefit plans is compliance with the funding requirements of ERISA and the Code. Both the Code and ERISA require employers to make quarterly contributions to defined benefit plans in an amount necessary to satisfy minimum funding requirements. These funding requirements do not require an employer to fully fund benefits accrued under the plans, but rather provide a floor below which funding cannot drop.  

Buyers should review the most recent IRS Form 5500 available, particularly Schedule B, which is the actuary’s report, to determine information on the funded status of defined benefit plans. The information in this report may be stale by as much as 21 months since the actuarial valuation information on Schedule B reflects assets and liabilities as of the beginning of a plan
year, but the report may not be finalized until nine and one-half months after the end of the plan year for which the report is prepared. Information about the funded status of the plan also will appear in the employer’s financial statements if the employer is subject to the requirements set forth in the Statement 87 of the Financial Accounting Standards Board (“FAS 87”).

The funding assumptions (particularly the interest rate) used to determine whether the plan is adequately funded for purposes of the minimum funding rules under the Code and ERISA very likely will be different from the interest rate assumptions to report liabilities for purposes of financial accounting (FAS 87) and for termination liability to the PBGC. Generally, the higher the interest rate assumption, the lower the contribution liability. A plan that is adequately or over funded for satisfaction of minimum funding requirements may or may not be adequately funded for termination purposes. Thus, a buyer who wishes to terminate the plan following or in connection with the transaction may have a significant additional contribution liability in order to terminate the plan.

If the plan is overfunded for plan termination purposes, a buyer or seller may choose to terminate the plan and take for itself any residual “surplus” plan assets. Residual “surplus” assets can be distributed to a plan sponsor only after three conditions have been fulfilled: “(A) all liabilities of the plan to participants and their beneficiaries have been satisfied [typically through the purchase of annuities], (B) the distribution does not contravene any provision of law, and (C) the plan provides for such a distribution in these circumstances.” Plan documents are frequently unclear and courts typically use normal rules of contract construction to determine whether the plan “provides for such a distribution.”

The practice of terminating overfunded plans was much more common prior to 1986; however, these days, fewer plan sponsors are interested in recovering surplus assets (and litigation of these issue is therefore becoming rare) due to the large excise taxes levied on the returned surplus. Beginning in 1986, the Code was amended to impose excise taxes on the reversion of surplus defined benefit plan assets in addition to the normal income taxes. The excise tax rate went from 10% in 1986, to 15% in 1988, to 20% in 1990. In addition, the excise tax rate is increased to 50% when the plan sponsor keeps the surplus rather than uses it to provide benefits to employees through a new plan or by increasing benefits under the terminated plan.

If a portion of the seller’s defined benefit plan is spun-off to the buyer in connection with a transaction, the division of the assets must satisfy Code Section 414(l). A buyer generally will want to involve its own actuary in negotiating the assumptions to be used in assessing the liabilities and the assets. In any transaction involving the assumption of a defined benefit plan, the buyer should engage the services of an actuary to help it evaluate the potential liabilities and structure any spin-off.

A buyer should confirm that the plan administrator has timely paid premiums to the PBGC. These premiums are based on the number of participants (both active and inactive) and the funded status of the plan.

If a defined benefit plan is amended in connection with a transaction, both parties should consider ERISA Section 204(h), which requires at least 15 days’ advance notice of plan amendments resulting in a significant reduction in the rate of future benefit accruals. Such a notice generally will be required in connection with plan terminations, mergers and actions to freeze benefits.
Production and Maintenance Employees’ Local 504 v. Roadmaster Corp. makes clear that an amendment freezing benefit accruals will not be given effect if the plan sponsor fails to comply with the requirements of ERISA Sections 204(g) and (h). The plan sponsor adopted an amendment freezing benefits on June 27, 1986, but made the amendment retroactive to March 31, 1986. After being challenged, the sponsor later revised the effective date to June 30, 1986. The court ruled that the plan sponsor violated the notice provisions of ERISA Section 204(h). Rather than give each participant written notice of the amendment, the sponsor instead posted general notices on bulletin boards throughout its workplace. Because of these deficiencies, the court held that the amendment was ineffective.

EGTRA changes ERISA Section 204(h) and adds similar notice provisions to the Code for plan amendments taking effective after June 7, 2001. Under the new provisions, a plan administrator is required to give advance written notice of any plan amendments significantly reducing the rate of future benefit accruals under the plan to each participant and alternate payee whose benefit may reasonably be expected to be affected by the amendment. Plan amendments significantly reducing or eliminating early retirement subsidies are deemed subject to the advance notice requirement. Except as provided in regulations, notice must be provided within a reasonable period of time before the amendment is effective and may be provided before the amendment is adopted if there is no material change when the amendment is adopted. The Secretary of the Treasury is authorized to promulgate regulations allowing a simplified notice or complete exemption for plans with fewer than 100 participants accruing benefits and plans that offer participants a choice between the old and new formula.

An egregious failure to provide the notice can result in the participant getting the benefit without regard to the amendment if that is greater than the benefit with the amendment. Additionally, for qualified plans, there is an excise tax of $100 per day per failure for failure to provide the notice (up to $500,000 per year for unintentional failures). There is no excise tax if the person failing to provide the notice exercised reasonable diligence to meet the requirements and the failure is corrected within 30 days of the date the person knew (or by exercising reasonable diligence would have known) of the failure.

D. Defined Contribution Plans

The principal issue with respect to defined contribution plans is whether such plans satisfy the qualification requirements discussed above at VII. B. There is rarely a funding issue with defined contribution plans since the participant’s benefit is equal to the value of his or her individual account; however, the employer contributions for any plan year may be delayed until sometime in the following plan year. The distribution restrictions also apply to certain types of employer contributions used to satisfy nondiscrimination requirements. Additionally, some assets held in defined contribution plans may have deferred sales charges that will be deducted if such assets are liquidated prior to a certain date. One option is to require the seller to pay the deferred sales charges outside the plan; however, many vendors will resist such a payment. Further, such a payment by the seller or the buyer could be treated as a contribution to the plan.

Similar to defined benefit plans, money purchase pension plans are subject to minimum funding rules and to advance notice requirements for amendments significantly reducing the rate of future contributions.
E. 401(k) Plans

1. Distribution Restrictions

401(k) plans present special issues in business transactions because of the distribution restrictions applicable to those plans. As a general rule, for distributions made before January 1, 2002 elective deferrals contributed to a 401(k) plan and earnings on those deferrals cannot be distributed before death, disability, separation from service, age 59½, hardship or the occurrence of certain transactions described below. As a result, parties to a transaction closing before January 1, 2002 may find that their options with respect to a 401(k) plan are limited because the transaction is not a distributable event.

Distributions before January 1, 2002 are permitted in connection with one of the following transactions but only if the distribution is made in a lump sum:

- termination of the plan without the establishment of a successor plan,
- disposition by a corporation of substantially all of the assets used by the corporation in a trade or business of the corporation, but only with respect to an employee who continues in employment with the corporation acquiring the assets and only if the selling corporation continues to maintain the plan after the transaction ("the disposition of assets");
- and

- disposition by a corporation of the corporation’s interest in a subsidiary, but only with respect to an employee who continues in employment with the subsidiary and only if the selling corporation continues to maintain the plan after the transaction ("the disposition of a subsidiary").

Effective for distributions made after December 31, 2001, EGTRA amends Code Section 401(k) to substitute the phrase “severance from employment” for “separation from service” and to limit the transactions after which a distribution may be made to the termination of the plan. Accordingly, effective January 1, 2002, distributions from a 401(k) plan may be made upon severance from employment, death, disability, age 59½, hardship or the termination of the plan. The exceptions for the disposition of assets and the disposition of a subsidiary have been deleted for distributions after December 31, 2002. While it is not clear, Congress presumably intended the term "severance from employment" to be broad enough to permit a distribution upon a sale of assets or a sale of a subsidiary. The Conference Report explains that “[a] severance from employment occurs when a participant ceases to be employed by the employer that maintains the plan.” Clearly, any asset deal would involve a severance from employment, but it is less clear if the transaction is a stock deal since the employee technically does not sever employment with the employer whose stock is being sold. Perhaps the sale of the stock of a subsidiary also would result in a severance from employment if the plan covering the target’s employees is maintained by an member of the seller controlled group other than the target company (for example, a plan maintained at the parent holding company level). In this circumstance, the employee would sever employment with the controlled group maintaining the plan and arguably should be entitled to a distribution from the 401(k) plan maintained by the seller’s controlled group. However, this is not clear. What is clear from the Conference Report is that if there is a transfer of plan assets and liabilities from the seller’s plan to the buyer’s plan (other than a rollover or an elective transfer), there is no severance from employment.
2. Plan Termination

In a typical transaction, both parties have a 401(k) plan and the buyer may not want to continue the seller’s plan or merge it into the buyer’s plan because the seller’s plan may have some unattractive distribution options, for example, annuity distributions, that the buyer does not want to continue. Accordingly, both parties would like to terminate the plan and make distributions to employees.

In order to have a distribution following a plan termination, the employer may not maintain a “successor plan” at any time during the period beginning on the date of the termination and ending 12 months after the distribution of all assets from the terminated plan. A “successor plan” is any other defined contribution plan (other than an employee stock ownership plan (“ESOP”) or a simplified employee pension plan as defined in Code Section 408(k) (“SEP”)) maintained by the same employer. The reference to “employer” includes all entities in the same controlled group.91 However, a plan will not be a successor plan if fewer than two percent of the employees who were eligible to participate in the terminated plan as of the date of the termination are eligible to participate in the other defined contribution plan during the 24-month period beginning 12 months before the termination. For example, if a seller maintains more than one 401(k) plan and employees of the business being sold are not eligible to participate in any plan except the one maintained for that business, the other 401(k) plans of the seller may not be treated as successor plans.

If the buyer assumes the plan in the transaction and the buyer maintains another defined contribution plan (not an ESOP or a SEP), termination will not be a distributable event. In this situation, the employer that terminates the plan (the buyer) also has another defined contribution plan which will be treated as a successor plan. Applicable Treasury regulations provide that the employer is identified at the time of the termination.92 Accordingly, in an asset deal, the seller could terminate the plan either before or after the transaction. However, in a stock deal, the seller will become part of the buyer’s control group as a result of the transaction. Thus, the termination must occur prior to the transaction in order for the termination distribution exception to apply.

There is no guidance on what constitutes termination of a plan for purposes of Code Section 401(k)(10).93 However, many practitioners are of the view that the plan is terminated if the sponsor undertakes the formal action to terminate the plan, such as a board resolution, even though plan assets are not distributed prior to completion of the transaction. Informal discussions with the IRS suggest that such a practice will be accepted.94

Where some employees continue with the seller, for example, because the buyer does not buy the entire business, care must be taken that the seller does not destroy the termination (for purposes of Code Section 401(k)(10)) with the creation of a successor plan. The seller must not maintain a successor plan within 12 months of the distribution of all assets following plan termination.95 Distribution of assets could take six months or longer if application is made for a favorable determination letter on the termination, assets are difficult to liquidate or all participants cannot be located. However, if less than two percent of the employees who were eligible to participate in the terminated plan as of the date of the termination remain with the seller, the seller should be able to establish a new plan (or permit such employees to participate in another seller plan) without adversely affecting the earlier termination and distribution to those former employees who were hired by the buyer.96
EGTRA did not substantively amend the provision of Code Section 401(k)(10) regarding plan terminations.

3. Disposition of Assets or Subsidiary

Prior to January 1, 2002, distributions also may be made to former employees of the seller under the disposition of assets exception and the disposition of a subsidiary exception.

The disposition of assets exception applies only in corporate transactions. Both the buyer and the seller must be corporations. Distribution is not permitted if one of the parties to the transaction is not a corporation, for example, a partnership or limited liability company. Additionally, the seller must dispose of “substantially all” of the assets used in a “trade or business”. “Substantially all” means the sale of at least 85% of the assets.

For both the disposition of assets and disposition of subsidiary exceptions, the buyer must be unrelated to the seller. “Unrelated” means that the buyer and seller are not part of the same controlled group for purposes of Code Section 414. Thus, a buyer may have some ownership interest in a seller prior to the transaction as long as it does not rise to the level that would make the buyer and seller one employer for purposes of Code Section 414.

Additionally, for both exceptions, the distribution must be made to an employee who is transferred to the purchaser. There generally will be employees who do not remain with the seller after the transaction, but do not transfer to the purchaser. Distribution to these employees must satisfy one of the other distribution events described in Code Section 401(k)(3)(B)(i).

The distribution must be made in connection with the disposition. Generally, this requires the distribution to be made by the end of the second calendar year after the calendar year in which the disposition occurred.

Finally, the seller must continue to maintain the plan after the disposition. This requirement is met if the buyer does not maintain the plan after the disposition. For this purpose, a buyer “maintains” the plan if the buyer adopts the plan or otherwise becomes an employer whose employees accrue benefits under the plan or if the seller’s plan is merged or consolidated with, or any assets or liabilities are transferred from the seller’s plan to, the buyer’s plan. Acceptance of an elective transfer (within the meaning of Treasury Regulation Section 1.411(d)-4, Q&A-3(b)(1)) or a rollover from the seller’s plan will not be treated as maintaining the seller’s plan.

4. Lump Sum Distributions

Distributions made under Code Section 410(k)(10) must be made in a lump sum. A lump sum distribution is determined under the rules of Code Section 402(d)(4) without regard to (1) the reasons for the distribution, (2) the requirement that a participant can have only one lump sum after age 59½ and (3) the minimum period of plan participation. For purposes of determining the balance to the credit of the employee, all profit sharing plans maintained by the same employer are treated as a single profit-sharing plan and all stock bonus plans maintained by the same employer are treated as a single stock bonus plan. Thus, a seller that maintains a profit sharing plan with a 401(k) feature and a profit sharing plan that does not have a 401(k) feature could not distribute the profit sharing/401(k) account in a different taxable year than it
distributes the profit sharing plan account and could not distribute the profit sharing plan account in a form other than a lump sum. The term “lump sum distribution” also includes a distribution of an annuity contract.\textsuperscript{109}

There will be transactions that do not fit the disposition of assets or subsidiary exceptions, for example, where the seller is an individual shareholder or group of individual shareholders. Additionally, plan termination may not be an alternative because the seller’s plan covers employees other than the employees of the business sold in the transaction. In these circumstances, the application of the “same desk rule” generally will prevent a distribution to any employee of the seller who becomes an employee of the buyer.\textsuperscript{110} The IRS relaxed its construction of the “same desk rule” as it applies to a sale of assets to allow a distribution in an asset sale involving a disposition of less than 85% of the assets used in a trade or business.\textsuperscript{111} Under the facts of that ruling, most of the employees associated with the assets were hired by the buyer (the “transferred employees”) and continued to perform their same jobs for the buyer. The seller did not receive any services from the transferred employees after the transaction. The IRS concluded that the employees were no longer employed in a continuation of the same trade or business as had been carried on by the seller and there was a sufficient change in their employment status to constitute a separation from service. The ruling would apply without regard to whether the parties to the transaction were corporations and without regard to whether there was a contractual obligation of the buyer to hire the employees of seller. The ruling is effective for transactions occurring on or after September 1, 2000. Note that the ruling will not apply in a transaction in which the seller continues to receive services of the transferred employees after the sale, for example, in a outsourcing transaction. Additionally, it is questionable that this ruling will have any further effect after December 31, 2001, when the EGTRA changes become effective.

If the transaction will not constitute a distributable event, the parties might consider a plan-to-plan transfer of assets and liabilities from the seller’s plan to the buyer’s plan. However, many buyers refuse to accept a transfer from the seller’s plan because of the requirement that the buyer’s plan preserve optional forms of benefits available under the seller’s plan with respect to any amounts transferred.\textsuperscript{112}

5. Plan Loans

Another issue with respect to 401(k) plans is how to handle participant loans. If there is a distribution from the seller’s 401(k) plan, participants have several options. The participant could (1) repay the outstanding loan prior to distribution, (2) allow the loan to go into default and have taxable income equal to the outstanding balance at the time of default plus, in some cases, a 10 percent early distribution penalty\textsuperscript{113} or (3) rollover the loan to the buyer’s plan.\textsuperscript{114}

If a distribution is not permissible from the seller’s 401(k) plan, the employee who goes to work for the buyer must find some way to continue to repay the loan or risk default and the resulting income. In many cases it will be impossible to repay the loan because the seller’s plan requires repayment by payroll deduction. The buyer could agree to make deductions and remit those to the seller, but few buyers are willing to take on that burden for the entire period of the loan. Another alternative is to have the seller or the buyer make a “bridge” loan to permit employees to repay their loan under the seller plan prior to distribution from that plan. Typically, the employee will then rollover his or her account balance from the seller plan to the buyer plan and immediately take out a new loan from the buyer plan to repay the bridge loan. There are two problems with a bridge loan -- the lender cannot take a security interest in the plan account and the employee is under no obligation to rollover the distribution from the seller plan to the buyer plan.
plan or take out a loan from the buyer plan. Additionally, if the buyer makes the bridge loan, care should be taken that there is no pressure on the employees to rollover and take out a loan under the buyer plan. Informal conversations with the Department of Labor support a conclusion that where there is absolutely no obligation to obtain a loan under the buyer plan or to use the proceeds of a buyer plan loan to repay the bridge loan, the presence of the bridge loan should not cause the loan program to be treated as containing a precondition designed to benefit a party in interest (the employer) other than the participant, which would make the loan a prohibited transaction.115

If the buyer accepts a plan-to-plan transfer from the seller’s plan, participant loans would be transferred to the buyer’s plan as other assets and liabilities.

One issue that can arise with respect to a rollover or a transfer of a participant loan is whether the repayment of the loan after the transaction is on a different frequency than before the transaction because the buyer’s payroll is on a different frequency from the seller’s. It is not clear whether such a change could create a new loan, requiring new disclosures to the participant under Federal Truth in Lending law.116

The buyer is not required to preserve the right of a former employee of the seller to borrow from a 401(k) plan since participant loans are not protected benefit options under the Code.117 Thus, a buyer who accepts loans from the seller’s plan is not required to permit new loans to such employees.

F. Multiemployer Plans

Multiemployer plans are maintained pursuant to collective bargaining agreements. More than one employer makes contributions to the plan. A board of trustees (one-half appointed by the union and one-half appointed by management) generally controls the plans. Each plan has its own benefit formula and contributions are required as bargained under the collective bargaining agreement. When an employer has a complete withdrawal or a partial withdrawal from a multiemployer plan, the plan can assess a withdrawal liability based on the formula used by the plan to calculate withdrawal liability. A “complete withdrawal” is when an employer permanently ceases to have an obligation to contribute to the plan or permanently ceases all covered operations under the plan.118 A “partial withdrawal” means there is a 70% contribution decline or there is a partial cessation of the employer’s contribution obligation.119 An employer can be liable even if the plan is fully funded.120

A withdrawal is unlikely to occur solely as a result of a stock deal because the employer doesn’t change and continues to have the same obligations that the seller (or target) had immediately before the sale. The buyer in a stock deal succeeds to the contribution history of the seller (target) and that will affect the buyer’s liability if it later withdraws from the plan. Accordingly, a buyer in a stock deal will want to learn as much as possible about the funding level of the multiemployer plan and the seller’s contribution history. The buyer should look for information on the plan’s IRS Form 5500 and should obtain a copy of the plan’s rules for determining withdrawal liability. The buyer should request from the seller whether any withdrawal liability calculations have been made for the seller within recent years and, if so, obtain a copy of those calculations. The buyer can request that the seller require the multiemployer plan to provide a calculation of estimated withdrawal liability, but most sellers will be reluctant to do so in advance of a transaction, particularly when the transaction will not result in withdrawal liability. Because
the buyer succeeds to the seller’s contribution history in a stock deal, it may be advantageous in some situations to structure the deal as an asset deal rather than a stock deal.

There should be no withdrawal liability on the part of the remaining members of a controlled group when a subsidiary is sold and another subsidiary or the parent continues to have an obligation to make contributions to the plan. Sellers of financially troubled subsidiaries, however, may be held liable for post-sale withdrawal liability if a principal purpose of the transaction is to avoid withdrawal liability.

A withdrawal may occur in an asset deal; however, it will be the seller’s liability, not the buyer’s. The asset deal will result in a complete withdrawal if the seller makes no other contributions to the plan and a partial withdrawal if the seller continues making some contributions to the plan. Special rules exist for the construction industry and the entertainment industry. Under those rules, the seller can avoid withdrawal altogether if the seller ceases operations in the jurisdiction covered by the collective bargaining agreement (or plan in the case of the entertainment industry) of the type for which contributions were previously required for a period of at least 5 years. There also is a special rule for the trucking industry, the household goods moving industry and the public warehousing industry, under which a complete withdrawal will occur only if the PBGC determines that the plan has suffered substantial damage to its contribution base as a result of the cessation or the employer fails to post a bond equal to 50% of the withdrawal liability that would have occurred.

A seller in a bona fide, arm’s-length asset deal can avoid the imposition of withdrawal liability under the sale of assets exception of ERISA Section 4204. Under that exception, the buyer must satisfy three requirements:

(i) the buyer has an obligation to contribute to the plan for substantially the same number of contribution base units as the seller;

(ii) the buyer must provide a bond to the plan for a period of five years after the asset sale in an amount equal to the greater of (1) the average annual contribution required to be made by the seller for the three plan years preceding the plan year in which the asset deal occurred or (2) the annual contribution that the seller was required to make for the last plan year before the plan year in which the asset deal occurred; and

(iii) the contract for sale must provide that if buyer withdraws from the plan in a complete or partial withdrawal during the first five plan years beginning after the asset deal, the seller is secondarily liable for any withdrawal liability.

The PBGC has the authority to vary or waive the bond and contract requirement and has promulgated regulations waiving the bond requirement in certain circumstances. By using the sale of assets exception, the seller converts primary liability into secondary liability. Further, the buyer only succeeds to the contribution history of the seller for the year of the asset deal and the four preceding years. ERISA Section 4204 also can be used with respect to a sale of assets of only a portion of an employer’s assets, or one member of a controlled group.
Under certain circumstances, a sale of assets will not result in the imposition of withdrawal liability on the seller. This would be the case if the seller continues to have an obligation to make contributions to the plan that exceeds 30% of the seller's historic level of contributions so that the seller avoids a partial withdrawal. In this case, the buyer would start fresh with the multiemployer plan and would not have to post a bond.

VIII. Reportable Events

The plan administrator or a contributing sponsor to a defined benefit plan is required to provide notice to the PBGC of certain events called "reportable events." In most cases the notice must be provided within 30 days after the event occurs unless the notice is waived; however, in some cases advance notice is required. Advance notice is not required if the contributing sponsor or a member of its controlled group to which the event relates is a public company, or has a subsidiary that is a public company, or the plans maintained by the controlled group do not in the aggregate have unfunded vested benefits of at least $50 million or a funded vested percentage of less than 90%.

Parties to a transaction should consider whether the transaction itself is a reportable event. Those reportable events that are most likely to arise in a business transaction are listed below:

1. the number of active participants is less than 80% of the number of active participants at the beginning of the plan year or is less than 75% of the number of active participants at the beginning of the previous plan year;

2. the Secretary of the Treasury determines that there has been a termination or partial termination with respect to the plan under Code Section 411(d)(3), that is not a termination under Title IV of ERISA;

3. a plan merger, consolidation or transfer of assets to another plan;

4. a person ceases to be a member of a controlled group;

5. a liquidation or dissolution of a contributing sponsor or member of its controlled group;

6. a contributing sponsor or member of its controlled group declares a dividend or redeems 10 percent or more of the total value or voting power of its own stock;

7. in any 12-month period, an aggregate of three percent or more of the benefit liabilities of a plan are transferred to a person or to a plan maintained by a person that is not the contributing sponsor or a member of its controlled group;

8. a default by any member of the plan's controlled group with respect to a loan with an outstanding balance of $10 million or more; and

9. the commencement of a bankruptcy proceeding.

IX. Valuation of Plan Assets

Review statements of plan assets to determine whether there are any assets that are not valued at market or for which there is not an established market. For example, guaranteed investment
contracts often are valued at book, without regard to the substantial penalties that may be imposed at liquidation. As another example, the value of bonds may be based on their amortized yield to maturity rather than fair market value. Finally, there may be wide variation in valuations for certain limited partnership interests or other assets that are not readily tradable.

X. Collective Bargaining Agreements

In a stock deal, the buyer assumes the obligations under seller’s collective bargaining agreement, including the obligation to provide employee benefits. In an asset deal, the buyer may agree to assume the seller’s collective bargaining agreements or may have an obligation to bargain with the union before changing the wages and benefits provided to employees covered by the collective bargaining agreement with the seller if the buyer is deemed to be a “successor employer.” A buyer generally will be treated as a “successor employer” with bargaining obligations if the buyer maintains the same business as the seller and hires a majority of its employees from the seller (generally, more than 50%).

The duty to recognize and bargain with the union does not generally, however, include the duty to be bound by the seller’s contract with the union. Basically, if there has been no agreement to accept the terms and conditions of the existing contract, the successor has only the obligation to bargain over the terms and conditions of the existing contract, although as stated above, in some circumstances the successor may be bound by the terms of the predecessor’s agreement. If the seller’s collective bargaining agreement has a successorship clause, however, requiring any buyer of the business to assume the collective bargaining agreement, the seller will be pressed to negotiate that such buyer assume the agreement in order for seller to avoid a breach of the collective bargaining agreement.

Notwithstanding the foregoing, however, some courts have found buyers liable for delinquent contributions owed by the seller to multiemployer funds under a theory of successorship liability, notwithstanding contrary language in sales agreements denying any assumption of liability and state law that may preclude such liability. The Seventh Circuit has applied a federal successorship liability rule under ERISA where there is a sufficient continuity of interest between the buyer and the seller and where the seller has notice of the predecessor’s liability. Liability has also been imposed on merged unions as successors even in the absence of notice, on the basis merely of the “substantial continuity” between the old and the new unions.

XI. Welfare Benefits

Welfare benefit plans include medical, dental, life insurance, disability, and severance pay plans. The most significant practical issue is allowing employees of the seller to continue welfare benefit coverage uninterrupted by the transaction. This requires careful attention to the nature of the transaction and the type of coverage provided by the seller and the buyer.

A. Stock Deal

If the transaction is a stock deal, the buyer will want to determine whether the target has its own plans or whether the target’s employees obtain benefits from some other company in the seller controlled group. If the target has its own plans, those plans will continue to be maintained by the target after the transaction.

If the target’s employees participate in welfare benefit plans maintained by some other company in the seller’s controlled group, the buyer will have to make arrangements for the target’s
employees to participate in the buyer’s plans as of the closing or to create plans for the target that will be effective as of the closing. The new plans could be “clones” of the seller’s plans or could be entirely different. Obviously, the seller’s employees will be most happy with plans that are at least equally generous in coverage as the seller’s plans; however, there is no “grandfather” requirement for welfare benefits similar to the requirements that exist for qualified plans.

B. Asset Deal

If the transaction is an asset deal, the buyer may wish to assume the seller’s plans or “clone” the seller’s benefits. If the seller’s plans are insured, the buyer should investigate whether the insurance contracts can be assigned or whether the buyer will have to obtain other insurance coverage or self-insure. Alternatively, the buyer may make arrangements for the employees to participate in the buyer’s plans as of the closing.

C. Claims Incurred Prior to Transaction

Another issue is what happens to claims incurred but not paid prior to the transaction. Claims incurred but not paid generally remain with the seller in an asset deal but remain with the entity sponsoring the plan in a stock deal. For example, where a division of an entity is sold, the liability for claims incurred before the transaction will remain with the seller unless the buyer assumes that liability. If the transaction is a stock deal, and the subsidiary being sold sponsors its own health plans, the liability for claims incurred before the transaction would remain with the subsidiary. On the other hand, if the subsidiary had participated in the health plan of its parent corporation, the liability for health claims incurred before the transaction would remain with the seller parent corporation.

D. Medical Plans

It is not unusual for sellers to negotiate that buyers give employees hired by the buyer credit under the buyer’s plans for copayments and deductibles paid under the seller’s plan during the year in which the transaction occurs as well as an exemption from the buyer’s pre-existing condition exclusions. The buyer will need to make arrangements with the seller’s plan administrator to obtain information on individual deductible and co-payment information.

E. Disability Plans and Workers’ Compensation

Buyers should consider that many disability claims and workers’ compensation claims that arise after the transaction likely are attributable in part to activity that took place prior to the transaction while the employee was employed by the seller. Accordingly, it is typical for a buyer to negotiate shared responsibility for certain of those disability or workers’ compensation claims, perhaps on the basis of the length of the employee’s period of employment with the seller. Another approach is to have the seller assume partial responsibility for disability or workers’ compensation claims arising within one or two years of the transaction.

F. Enrollment

Unless the buyer is assuming the seller’s plans, another big challenge is enrolling the seller’s employees in the buyer’s plans. Some states require written authorization or acknowledgment of payroll deductions. Further, it is advisable to have employees execute new life insurance beneficiary designations prior to or coincident with the closing. In many cases, the seller will
allow the buyer or the buyer’s agents to meet with the seller’s employees prior to the closing for the purpose of explaining the new benefits and enrolling employees. Where that is not possible, the buyer will want to be prepared for enrollments as soon as possible after the closing.

Related to the enrollment issue is whether employees who are in a cafeteria plan can make changes to their salary reduction agreements in place before the transaction as a result of coverage changes that may occur in connection with the transaction. If the transaction is an asset deal, an employee will be treated as a new employee of the buyer and should be permitted to make a new election in connection with enrolling in the buyer’s plan. However, it is not clear whether such an employee would be permitted to make a new election when the buyer assumes the plan.

If the transaction is a stock deal, an election change generally would not be permitted solely as a result of the transaction; however, if the transaction results in changes in cost or coverage, an election change may be permitted.

In final regulations which were published on January 10, 2001, the Treasury set forth when cafeteria plan participants are allowed to modify their salary deferral elections during the plan year on account of changes in cost or coverage. The regulations do not, however, apply to an election change with respect to a health flexible spending account (“FSA”).

The regulations permit “automatic changes”, that is, if the cost of a qualified benefits plan increases or decreases during the coverage period and the cafeteria plan requires employees to make a corresponding change in their payments, the cafeteria plan may prospectively increase or decrease the employees’ elective contributions.

The regulations also provide that if the employee’s cost for a benefit package option significantly increases or decreases during a period of coverage, the plan may permit employees to make corresponding election changes. The permissible election changes include: (1) in the case of a cost decrease, commencement of participation in plan for the option; (2) in the case of a cost increase, revocation of an election for coverage for a particular option and, in lieu thereof, receiving on a prospective basis coverage under another option providing similar coverage or dropping coverage if no other option provides similar coverage. For example, if the cost of an indemnity option significantly increases, employees may make corresponding increase in payments, or revoke the election of the indemnity option and elect other similar coverage such as HMO coverage instead, or drop coverage if no other option with similar coverage is offered. A cost increase or decrease in amount of elective contributions under the plan may occur either because of employee action (for example, changing from full time to part time status) or because of employer action.

The regulations also permit election changes in the case of the following coverage changes: “significant curtailment without loss of coverage,” “significant curtailment with loss of coverage,” and “addition or improvement of a benefit package option.” With respect to “significant curtailment without loss of coverage,” if an employee experiences a significant curtailment of coverage under the plan, such as a significant increase in the deductible, the co-pay, or the out-of-pocket cost sharing limit under an accident or health plan, the plan may permit an employee to revoke election for that coverage and, in lieu thereof, elect to receive on prospective basis coverage under any other option providing similar coverage. However, employees are not allowed to drop coverage altogether if there is a significant curtailment in coverage that does not constitute a loss of coverage. For coverage to be considered to be significantly curtailed, there
must be an overall reduction in coverage to constitute reduced coverage generally. For example, the loss of one particular physician in a network would not be significant curtailment.\textsuperscript{156}

An employee who experiences significant curtailment that is a loss of coverage may be permitted to revoke his/her election for that coverage and, in lieu thereof, elect to receive on a prospective basis coverage under any other option providing similar coverage or drop coverage if no similar option exists. Loss of coverage refers to a complete loss of coverage, such as elimination of an option, an HMO ceasing to be available in area where the employee lives, or loss of coverage by an individual because of overall lifetime/annual cap.\textsuperscript{157} Plans have discretion to treat the following occurrences as losses of coverage: (1) a substantial decrease in available medical care providers (for example, a major hospital ceases to be member of a preferred provider network or there is a decrease in the physicians participating in a PPO or HMO); (2) a reduction in benefits for specific medical condition for which employee is receiving treatment; or (3) any other similar fundamental loss of coverage.\textsuperscript{158}

With respect to an “addition or improvement of a benefit package option,” if a plan adds a new option or if coverage under an existing option increases, the plan may permit eligible employees to revoke their election under the plan and, in lieu thereof, to elect on prospective basis coverage under new or improved option.\textsuperscript{159}

A plan also may permit an employee to make a prospective election change that is on account of and corresponds with a change made under another employer plan (including a plan of the same employer) if: (1) other cafeteria or qualified benefits plan permits participants to make election change that would be permitted under the regulations; or (2) the plan permits participants to elect a period of coverage that is different than period of coverage under other cafeteria plan or qualified benefits plan.\textsuperscript{160}

Finally, a plan may permit an employee to elect on a prospective basis to add coverage for an employee, spouse or dependent if the employee, spouse or dependent loses coverage under any group health coverage sponsored by governmental or educational institution, such as state children’s health insurance or state health benefits risk group.\textsuperscript{161}

An additional issue arises with FSAs because the full amount of the deductions elected for any year must be available for use at any point in the year.\textsuperscript{162} If the employee knows he or she will cease contributions to the seller’s plan as a result of the transaction, the employee can make a claim for the entire coverage amount even though the employee has paid less than the full year’s premium. For that reason, the seller may desire to have the buyer assume the plan and transfer assets equal to the amounts previously withheld to the buyer.

It also is common for a buyer to negotiate with the seller for the employees to remain on the seller’s plans for a short period of time following the closing until the buyer can get new plans or enrollment set up. Alternatively, where only a few employees will remain with the seller after the transaction, the seller may try to negotiate coverage for those employees under the buyer’s plans for a short period of time until either their termination or the seller finds other coverage. In each such case, consideration should be given to whether such coverage will make the plan a multiple employer welfare arrangement (“MEWA”)\textsuperscript{163} that is subject to state insurance regulation.\textsuperscript{164}
G. Nondiscrimination Requirements

The provision of welfare benefits to employees may be completely or partially free from income tax to the employee provided certain nondiscrimination requirements are satisfied. The nondiscrimination requirements are applied on a controlled group basis. Unlike the rules for qualified plans, there is no transition rule for changes in the controlled group resulting from acquisitions, dispositions or mergers.

H. COBRA

Group health plans are required to make available continuation health coverage to those employees and dependents who lose coverage under the plan as a result of a qualifying event (“COBRA Coverage”). A termination of employment (for reasons other than gross misconduct) is a qualifying event. Whether a particular business transaction results in a termination of employment for purposes of Code Section 4980B is addressed in a recently issued set of Treasury regulations which finalize (with limited modifications) 1999 proposed COBRA regulations.

A stock sale does not result in a termination of employment as a result of the sale for an employee who continues to be employed by the acquired corporation. The sale is not a qualifying event regardless of whether the employee is provided with group health coverage after the sale.

An asset sale is a qualifying event unless (1) the buyer is a “successor employer” and the affected employees are employed by the buyer immediately after the sale or (2) the employee or dependent does not lose coverage under a group health plan of the seller after the sale. A “successor employer” is a buyer that continues the business operations associated with the purchased assets without substantial change provided the seller ceases to provide group health plan coverage to any employee in connection with the sale. The final regulations clarified the proposed regulations by expressly stating that the buyer does not fail to be a “successor employer” merely because the sale takes place in connection with a bankruptcy proceeding.

The seller’s plan must provide COBRA Coverage to individuals who become entitled to COBRA Coverage before the transaction or as a result of the transaction provided the seller (or another member of its controlled group) continues to maintain a group health plan after the transaction. This rule applies without regard to whether the transaction is a stock sale or an asset sale.

In a stock sale, if the seller (or any other member of its controlled group) does not provide group health coverage to any employee after the transaction, the buyer’s group health plan must make COBRA Coverage available to qualified beneficiaries. However, if the transaction is an asset sale, the buyer must provide COBRA Coverage to qualified beneficiaries if the buyer is a successor employer.

The parties to a transaction can negotiate a different result than required by the regulations, but if the party required to provide COBRA Coverage under the contract breaches its contractual obligation, the party liable for COBRA Coverage under the regulations remains liable to provide such coverage.

Where the seller will retain few active employees after the transaction, those qualified beneficiaries entitled to COBRA Coverage may well outnumber the active employees. In such a case, insured coverage may be prohibitively expensive. Accordingly, the seller may negotiate to
have the buyer assume the seller’s COBRA responsibilities for individuals that became qualified beneficiaries prior to the transaction in order to make the seller’s premiums more reasonable after the transaction. It is unclear under the regulations what constitutes assumption of seller’s COBRA responsibilities.

Before agreeing to assume any liability that is not imposed under the regulations, the buyer should check with its insurer or, if self-insured, its stop loss insurer, to determine whether the coverage will be available for the additional liability. Further, if the buyer is self-insured, the buyer may negotiate that the seller retain liability for claims in excess of a specific dollar amount (either an individual claim limit or aggregate limit).

Failure to comply with COBRA may trigger serious penalties. The IRS may assess a non-deductible excise tax in the amount of $100 per day per qualified beneficiary for each COBRA violation. If applied, the excise tax will be capped at $200 per day if there is more than one qualified beneficiary. The excise tax is paid directly from the employer to the IRS.

It does not appear that in the case of a sale of assets or stock the purchaser assumes liability for uncorrected COBRA violations of the acquired company which occurred prior to the sale unless the purchaser assumed the seller’s group health plans. The regulation provides that “[n]either a stock sale nor an asset sale has any effect on the COBRA continuation coverage requirements applicable to any group health plan for any period before the sale.” In contrast to a sale of stock or of assets, the successor by merger assumes all of the acquired company’s COBRA obligations.

I. Retiree Medical Liabilities

The buyer in any stock deal (as well as in any asset deal where the buyer assumes the obligation to continue a medical benefit or life insurance plan) should carefully review the seller’s obligation to provide “post-retirement welfare benefits.” Such benefits include medical or life insurance benefits for persons who have retired. Retirees often assume that these benefits are part of their retirement package, and are therefore “lifetime” benefits which the employer cannot eliminate or reduce. Indeed, over the past twenty years, numerous court decisions have addressed retirees’ lawsuits challenging employers’ termination or reduction of retiree welfare benefits. In these lawsuits, courts decide whether coverage was meant to be a “vested” lifetime benefit (not subject to reduction), or whether it was meant to be “gratuitous,” subject to modification or termination at the will of the employer.

1. Plan Breach or “Contract” Claim.

The plan breach or contract claim is the claim most often litigated. It is brought under Section 301 of the Labor Management Relations Act of 1947 (“LMRA § 301”) for union retirees or under ERISA Section 502(a)(1)(B) and (a)(3) for all retirees. In resolving this claim, Courts employ traditional contract analysis -- and several circuits apply an added “inference” in favor of union retirees. Regardless of whether the court employs such an inference, the case will turn on the parties’ intent, as manifested in documents governing the plan. If the documents are ambiguous, extrinsic evidence is scrutinized to determine the true meaning of the plan.

Former non-union employees have had limited success. An example is the much publicized en banc decision in Sprague v. General Motors Corp., where a panel decision in favor of approximately 85,000 non-union GM retirees was reversed and judgment entered for the
employer, even though many representations had been made to plaintiffs through the years that benefits would continue for their lifetimes.\textsuperscript{184}

Former union employees have most often prevailed. A clear majority of the decisions in the union setting conclude that the retiree benefits were meant to endure throughout retirement -- even in the absence of language explicitly so stating.\textsuperscript{185} However, during the past two years, five circuit court decisions dealing with union retiree benefits have reached conflicting results: two affirmed summary judgment for the retirees,\textsuperscript{186} one decision reversed summary judgment for the employer,\textsuperscript{187} and two decisions found for the employers, citing \textit{Sprague}.\textsuperscript{188}

2. Compliance with Amendment Procedures.

Even if employers involved in a transaction are quite certain that plan language gives the employer the right to amend or terminate the coverage, the employer desiring to change benefits must make certain that any amendment to or termination of the plan carefully complies with the plan’s amendment or termination procedure.\textsuperscript{189}

3. Alternative Estoppel Claims.

Even where the contract itself unambiguously allows the employer to modify or terminate benefits, plaintiffs could argue that misrepresentations by the employer give rise to a promissory estoppel or equitable estoppel claim.

Estoppel can be argued under both LMRA § 301\textsuperscript{190} and ERISA\textsuperscript{191}. The alleged misrepresentations usually are in the form of oral statements or statements in an SPD. Generally, to prevail under estoppel principles, plaintiffs need to show that defendant made a material misrepresentation upon which plaintiffs reasonably relied to their detriment. Following these principles, courts generally deny relief under the estoppel theory where plaintiffs failed to show reasonable reliance -- particularly where plaintiffs knew of the actual plan provision which contradicted the misrepresentation.\textsuperscript{192}

Some decisions allow "estoppel" claims only where an oral statement is an "oral interpretation" of ambiguous plan provision.\textsuperscript{193} These cases greatly diminish the usefulness of the estoppel doctrine for plaintiffs. In its en banc decision in \textit{Sprague}, the Sixth Circuit seems to accept the reasoning of such cases.\textsuperscript{194}


In alleging a breach of fiduciary duty claim, retirees may cite the very same misrepresentations which serve as the basis for a promissory estoppel claim. In \textit{In re Unisys Corp. Retiree Med. Ben. “ERISA” Litig.},\textsuperscript{195} the court concluded that the plan language unambiguously reserved in the employer a right to reduce or terminate retiree health benefits, and the court therefore rejected the retirees’ claim that the employer breached the terms of the plan. The retirees also alleged, however, that the employer had breached fiduciary duties by misrepresenting to them that benefits were “for life” when in fact the plan language made benefits terminable. The court held a fiduciary’s duty to inform “entails not only a negative duty not to misinform, but also an affirmative duty to inform when the trustee knows that silence might be harmful.”\textsuperscript{196} The court concluded that the retirees’ complaint stated a claim and it remanded the case for trial.
The Supreme Court upheld a similar fiduciary misrepresentation claim in Varity Corp. v. Howe. There, the plaintiffs alleged that they had been induced to leave the old employer’s retiree health plan because of that employer’s misrepresentations about the financial condition of the new corporation. When the new corporation went bankrupt and plaintiffs were left without retiree health benefits (benefits they would have had if the employer’s misrepresentations had not induced them to leave), they brought suit against the former employer. The Supreme Court held that employers have a fiduciary duty not to make misrepresentations to participants, that an employer acts in a fiduciary capacity in making such representations, and that there is a remedy available to individuals who are the victims of such misrepresentations. The Court added that ERISA Section 502(a)(3) gave the former employees a right to “appropriate equitable relief . . . to redress” the harm that this deception had caused them individually. Among other remedies the Court considered to be “appropriate equitable relief” was an order that the defendant reinstate the former employees into its own plan (which had continued to provide benefits to those retiring from defendant’s profitable divisions).

However, in the en banc decision in Sprague, the Sixth Circuit held that GM’s refusal to abide by representations it had made concerning its early retirement programs was not a breach of fiduciary duty under Varity Corp. The court held that: (1) “GM never told the early retirees that their health care benefits were vested upon retirement,” but instead told them that their coverage was to be paid by GM for their lifetimes; (2) GM did not breach its fiduciary duties by failing to “tell the early retirees at every possible opportunity, that which it had told them many times before -- namely, that the terms of the plan were subject to change;” (3) there is “a world of difference between the employer’s deliberate misleading of employees in Varity Corp. and GM’s failure to begin every communication to plan participants with a caveat;” and (4) ERISA’s fiduciary duties do not require disclosure of information that “ERISA’s detailed disclosure provisions [for SPDs] do not require to be disclosed.” The court further held that “[w]e are not aware of any court of appeals decision imposing fiduciary liability for a failure to disclose information that is not required to be disclosed”.


Just because a union acquiesces in a sale and signs a new agreement with the buyer purporting to transfer responsibility for benefits of past retirees, it does not mean that the seller is “off the hook” and is relieved of responsibility for vested retiree health benefits: the union is no longer the representative of past retirees. In Steelworkers v. Textron, Inc. the court contrasted active employees and past retirees: Those persons [actives] who could have retired while the operation was in the hands of [the seller], but decided not to do so, and stayed on as active employees of [the buyer] may have “thrown in their lot” with the purchaser. As active employees subsequent to the sale they were represented by the Union in its negotiations with their employer. The same is not true, however, of pre-sale retirees. They had nothing to say about the sale. They had retired when it took place. They had relied upon the bargaining agreement which had been signed by Textron [the seller], not upon the future conduct of some other entity. The Union, moreover, is the bargaining agent for active employees, not for retirees; hence, the Union could not waive any of the retirees’ rights, nor could they assent on their behalf to a release of Textron from duty owed to the retirees.

An employer who spins off a portion of its business to a new joint venture may find itself the target of litigation when the new joint venture changes benefits. Sengpiel v. The B. F. Goodrich
Co. addressed these circumstances. In 1986, B.F. Goodrich ("BFG") transferred to a recently-formed joint venture all the assets and liabilities of its tire business, including the pension and welfare benefit liabilities of retirees who had worked in the company's tire business. The group of transferred non-union retirees also included a small group of randomly-selected retirees who had worked on BFG's corporate staff. Several years after the transfer, the new company increased deductibles for participants of its retiree welfare plan. The transferred corporate retirees sued BFG. Although the plaintiffs essentially conceded that the spinoff was a business decision, rather than an act of discretionary control, they argued that BFG's random selection of corporate retirees constituted a fiduciary act. On appeal, the Sixth Circuit rejected the plaintiff's distinction between a business decision and the actions taken to carry out such a decision, holding that BFG's actions in selecting retirees for transfer was not a discretionary act of plan management or administration, and thus not a fiduciary act.

6. FAS No. 106.

Liabilities for post-retirement medical benefits are required to be reflected on the balance sheet for employers subject to Statement of Financial Accounting Standards No. 106. However, it may be helpful to have an actuary review the assumptions used to determine the liability and advise on whether those assumptions are reasonable.

J. Severance Pay In Sale Situations

1. Terms of the Plan or Contract

Typically, severance pay plans provide for payment upon a termination of employment. In a stock deal, an employee does not experience a termination solely as a result of the consummation of the transaction because the employee continues to work for the same entity. However, in an asset deal there typically is a termination of employment with the seller even if the employee is immediately employed by the buyer. Whether an employee will be entitled to severance pay as a result of a business transaction depends on the terms of the seller's severance pay plan or the labor contract.

Interpreting plan language, numerous decisions by courts and arbitrators have addressed this question of whether plant sales constitute events which trigger the right to severance pay and/or special shutdown pensions.

One arbitration decision supporting employers is Dillingham Shipyard. That case involved a corporate reorganization, not an arms-length asset sale. The employer, Dillingham, merged into a new company, which offered employment (albeit at lesser terms) to the employees in question. The arbitrator denied severance pay to the employees and concluded that Dillingham has, in reality, continued in business at “the Dillingham Shipyard” through the modified form of a new company of which it maintains majority stock ownership and control.

Sutton v. Weirton Steel involved the purchase of National Steel’s Weirton plant by an ESOP. The union there agreed to amend its labor agreement to waive the employees’ entitlement to severance pay and shutdown pensions upon the sale in return for a “safety net” if the plant closed within five years after the sale. Some disappointed employees sued, alleging that the union had breached its duty of fair representation by amending the contract. The district court held that the union did not breach its duty of fair representation by amending the contract. But
the district court went on to state that the sale would not have triggered entitlement to severance pay in any event.

In litigation involving non-union employees -- and particularly those in which the “arbitrary and capricious” standard is used -- courts most often find that the sale is not an event which triggers severance pay or other shutdown benefits.

2. Timing of Plan Amendment.

Can the employer amend its severance plan just before the sale to make it clear that the sale is not an event which triggers severance pay? In the non-union setting, the answer is probably yes. In the union setting, the general rule for “non-vested” benefits is that the employer can unilaterally amend or terminate benefits after expiration of the collective bargaining agreement and after bargaining with the union. (The union, of course, is free to strike).

There are no “magic words” that are necessary to create “vested” rights that survive the expiration of the collective bargaining agreement (the “contract”). Vacations, retirement benefits, and severance pay are the types of benefits that courts most often find to be vested and nonterminable even after contract expiration.

In Bunn-O-Matic Corp., the employees struck after contract expiration. The Company subsequently decided to move to a new facility. During bargaining over the effects of the closing, the Company refused to pay severance allowance. The arbitrator found for the union, stating:

> The language of the severance pay clause in the instant case is extremely broad and nonrestrictive. It provides for the benefit "whenever" the employee is terminated because of the closing of the plant. "Whenever" is defined as "at any and all times" "no matter when." Nothing therein indicated that the right to severance pay dies with the Agreement. If anything, it supports the opposite inference.

The Arbitrator noted in passing that the National Labor Relations Act requires an employer to bargain to impasse before implementing unilateral charges. However, the arbitrator's "earned rights" theory and other language in the opinion make clear that the employer would not have been permitted to escape the obligation through bargaining to impasse. According to the arbitrator, an essential feature of severance pay rights is that bargaining will result in its elimination only if there is a "bi-lateral agreement."

3. Compliance with Plan Amendment Procedures.

Even if employers have the right to amend or terminate severance plans before the sale, the employer desiring to change benefits must make certain that any amendment or termination carefully complies with the plan’s amendment procedure.

K. VEBAs

The seller may have established a trust to fund welfare benefits. Such a trust likely will be set up as a tax exempt voluntary employee beneficiary association ("VEBA"). VEBA’s are subject to nondiscrimination requirements that are different from the requirements applicable to qualified plans.
XII. Reporting and Disclosure Requirements

The plan administrator of each employee benefit plan covered by ERISA generally is required to file IRS Form 5500 annually.\textsuperscript{219} Failure to do so can subject the plan administrator to penalties of up to $1100 per day.\textsuperscript{220} There is a compliance resolution procedure to correct such failures.\textsuperscript{221}

XIII. ERISA Section 510 Claims

ERISA Section 510 prohibits discharge or discrimination to prevent employees from attaining benefits under an employee benefit plan. The sale of an ongoing business has generated many claims under ERISA Section 510 by former employees of the seller. Generally, even such employees who are hired by the buyer experience a reduction in non-vested benefits when they become participants under a less favorable plan. These claims have been largely unsuccessful.

In \textit{Phillips v. Amoco Oil Co.},\textsuperscript{222} Amoco sold its liquid propane gas operations in the southeastern United States. The plaintiffs were former Amoco employees that became employed by the buyer after the sale. Under the terms of the buyer's retirement plan, in which plaintiffs became participants after the sale, years of service with Amoco were not credited for certain purposes. Plaintiffs claimed that this violated ERISA Section 510. The court dismissed plaintiffs' claim, holding that ERISA Section 510 does not require a successor employer to credit service with a predecessor employer. "ERISA simply does not require that every purchaser of a going concern credit service with a predecessor employer for purposes of the successor's separate plan, nor does it require that a successor's plan be identical in every respect to the predecessor's. Certainly § 1140 [Section 510] contains no such requirement, expressed or implied."\textsuperscript{223}

In \textit{Brown v. Firestone Tire \\& Rubber Co.},\textsuperscript{224} Firestone sold its unprofitable Retread Division. All division employees then became employees of the buyer and participants under the buyer's pension plan. Plaintiffs, who lost the opportunity to accrue benefits under the more favorable Firestone plan, sued under ERISA Section 510. The court dismissed the claim, finding no evidence that "Firestone sold the Retread Division to prevent plaintiff[s'] . . . pension from vesting."\textsuperscript{225}

In \textit{Blaw Knox Retirement Income Plan v. White Consolidated Indus.},\textsuperscript{226} defendant White Consolidated sold a group of unprofitable businesses to Blaw Knox Corp. and transferred the associated pension plans. Plaintiffs alleged that the purpose in selling the business was to avoid liability for the plans' greatly underfunded benefits, and that the sale of the plans to the buyer put the plans at financial risk. The court dismissed the claim under ERISA Section 510.

XIV. Executive Compensation

Executive compensation plans include salary reduction agreements, bonus plans, supplemental executive retirement plans, excess benefit plans, special welfare benefits and golden parachute severance arrangements. Executive compensation plans also include equity based arrangements such as stock options, restricted stock, stock appreciation rights, and phantom stock units. Executive plans providing pension benefits are nonqualified plans.

In many cases, executive compensation is described in the executive's employment agreement.
Executive compensation benefits are a potential source of large unfunded liabilities. Because executive compensation plans are limited to the highest paid employees, they generally must be unfunded plans to avoid taxation of the executive before benefits are paid. Often, a rabbi trust will be set up to serve as a source for payment of executive benefits. However, there are no funding requirements for a rabbi trust and the plan liabilities may exceed trust assets. Further, the assets of a rabbi trust belong to the grantor and would not necessarily be acquired by the buyer in an asset deal.

Additionally, executive compensation plans or arrangements typically contain provisions that provide substantially enhanced benefits in the case of a change in control. Such provisions typically include full vesting and additional benefits that may more than triple the payments otherwise payable in the case of termination of employment. These payments are referred to as “golden parachutes.” Further, some plans or agreements and rabbi trust documents require the seller to fully fund the benefits as a result of the transaction.

If a parachute payment exceeds a certain amount, the excess will be nondeductible by the employer. In addition, the executive receiving an “excess parachute payment” is subject to a 20% excise tax that must be withheld from the payments. Many executive arrangements contain a “gross-up” provision requiring the employer to pay the executive additional compensation to cover the excise tax and income taxes on the additional compensation.

ERISA generally requires a pension benefit plan to satisfy certain participation, vesting and benefit accrual requirements as well as funding requirements. However, a plan that is maintained primarily for the purpose of providing “deferred compensation for a select group of management or highly compensated employees” (often referred to as a “top-hat” plan) is exempt from the funding requirements. Neither the statute nor regulations define what constitutes “management” or “highly compensated” employees. Accordingly, it is not uncommon to see unfunded plans covering middle management or lower level employees.

If the plan covers employees other than those who fit within the Department of Labor’s view of the top-hat group, the employer runs the risk that its plan must satisfy all of the ERISA participation, vesting and benefit accrual requirements. Satisfaction of those requirements might include, for example, allowing employees to participate after one year of employment, vesting benefits after seven years and providing benefits for surviving spouses.

Additionally, benefits under a plan that covers more than the top-hat group would have to be funded with a trust or insurance contract. However, because such plans typically would not satisfy the coverage and nondiscrimination requirements of the Code applicable to qualified plans, highly paid employees would be taxed on the value of plan benefits before such benefits were paid. Accordingly, the buyer will want to carefully consider the risks associated with providing such coverage following the closing.

In the case of equity-based compensation, most plans will permit the buyer to assume the plan and substitute buyer stock for seller stock under the arrangement. In the case of a stock option plan, substitution in accordance with the rules under Code Section 425 generally will not be treated as the grant of a new option for financial accounting purposes.

As with severance pay plans, the parties will want to review executive compensation plans to determine whether the transaction itself will trigger accelerated vesting and/or payments under
the plans. If amendments are necessary to avoid such a result, the amendments should be made in advance of the transaction.

Finally, for executive compensation plans based on satisfaction of certain performance goals, those performance goals may be meaningless following the transaction. Most public company executive compensation plans are set up to satisfy the requirements for deduction under Code Section 162(m), which limits deductible compensation to $1 million for each of the five most highly compensated officers of a public company. As a general rule, performance goals may not be changed during the performance period.234 It may be possible to change performance goals for stock-based compensation in connection with the transaction;235 but there is no such authority for other types of performance-based compensation. Additionally, Section 162(m) requires certain aspects of performance-based compensation to be approved by shareholders and the buyer will want to carefully consider how those shareholder approval requirements apply to the transaction.

XV. Foreign Plans

If the seller has operations outside the United States and the transaction is a stock deal or the buyer is assuming employee benefit plan liabilities in an asset deal, it is important to know what plans are maintained for foreign jurisdictions and to get advice from local experts (who are likely to be consultants or accountants operating in that jurisdiction) as to an assessment of the liabilities under those plans.
EXHIBIT A

Checklist of Warranties and Representatives for Stock Deal or Merger

Regarding the target company's qualified plans:

[ ] Warranty the qualification of the Plan(s) under the Internal Revenue Code ("Code")
[ ] Warranty compliance the Employee Retirement Income Security Act of 1974, as amended, ("ERISA")
[ ] Outline outstanding sponsor liabilities for:
  [ ] employer contributions accrued but not yet paid
  [ ] employee salary deferrals withheld but not yet paid
  [ ] unfunded liabilities in a pension plan
[ ] Representation as to whether the plan has been amended to conform to most recent legislation (for example, GUST).
  [ ] Received favorable determination letter
  [ ] approved prototype plan that can rely on opinion letter; or
  [ ] submitted to IRS for favorable determination
[ ] Warranty that no outstanding issues pending before the Internal Revenue Service ("IRS"), Department of Labor, or Pension Benefit Guaranty Corporation ("PBGC") with regard to the disclosed plan(s) or any past plans
[ ] Warranty that there are no qualified plans other than those disclosed
[ ] Warranty that there are no prohibited transactions
[ ] Warranty that there are no plan liabilities other than those reported above
[ ] Warranty that there are no PBGC reportable events
[ ] Warranty that all reporting and disclosure requirements have been met for all years, including, but not limited to, 5500-returns and attached schedules, PBGC-1 filings and premium payments; SPDs to employees; Summary Annual Reports to employees; Notice of PBGC Reportable Events
[ ] Warranty that there are no outstanding claims or threatened litigation against the company or the plan by participants, beneficiaries, or alternate payees relating to the plan(s)
[ ] Provide any information regarding administrative procedures that have been adopted that may have established a precedent upon which participants, beneficiaries, or alternate payees may rely

Regarding the target company's welfare plans:

[ ] Identity of target company’s welfare plans (health, dental, vision, life insurance, disability, including post-retirement benefits)
[ ] Identity of third party administrators in self-insured plans and copy of agreements
[ ] Identity of insurers and copy of contracts for insured plans
Identity of funding arrangements (VEBAs)
Warranty that the plans and funding arrangements are in compliance with the Code and ERISA (including COBRA and HIPAA) and other applicable laws
Provide information regarding known outstanding claims
Provide information regarding claims not yet outstanding but that the target company knows to exist
Provide estimate of incurred but unreported claims in self insured plans
If the target company’s health insurance is to be replaced by the purchaser, be sure to address how to cover the target’s ex-employees who are currently covered by COBRA
Warranty that all reporting and disclosure requirements have been met for all years

Regarding the target company’s severance pay plan:

Identity and provisions of target company’s severance pay plan
Provide information regarding known outstanding claims
Provide information regarding claims not yet outstanding but that the target company knows to exist
Warranty that the severance program is in compliance with the Code, ERISA and other applicable laws

Regarding the target company’s deferred compensation program(s):

Identity and provisions of existing nonqualified deferred compensation plans
Information regarding benefits accrued to date
Information regarding funding arrangements, if any (Rabbi trusts)
Compliance with ERISA (to the extent applicable), securities law and other applicable law

General issues:

Warranty that there are no other employee benefit programs other than those disclosed above
Warranty and representation that there are no currently pending or threatened claims, or any facts that would give rise to a claim, of sexual harassment, discrimination in hiring or advancement, or wrongful termination
Identify the amount of accrued but unpaid vacation and sick pay
Obtain copy of employee policy manual(s) and employee handbook
Obtain copy of collective bargaining agreements
Description of labor relations history
Description of benefits for non-U.S. employees
Note: Indemnifications for breach of warranties and representations should include, not just the amount of the claims, but the cost of defending against

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5 Internal Revenue Code of 1986, as amended.
7 This paper will address some of the more common issues that arise under the Code and ERISA, but will not address other federal laws such as the Worker Adjustment and Retraining Notification Act (“WARN”) (WARN requires employers to provide 60 days' advance written notice of plant closings and mass layoffs or to provide the equivalent of 60 days’ pay and benefits), the Family and Medical Leave Act of 1993 (“FMLA”) (FMLA requires buyers to reemploy former employees of seller out on leave at the time of the transaction under certain circumstances), fiduciary issues arising under ERISA, or issues related to employee stock ownership plans. State laws govern employee benefits that are not covered by ERISA, for example, vacation pay, holiday pay, and sick leave paid from an employer’s general assets. Parties to an asset deal will need to check state laws regarding whether employees must be paid accrued but unused vacation, holiday or sick leave days.
8 For purposes of this paper the term “stock deal” refers to any equity investment. Thus, the term stock deal will be used to refer to purchases or dispositions of interests in corporations, limited liability companies or partnerships. Merger transactions involve combinations of equity interests and, therefore, a merger transaction is like a stock deal.
9 Most business transactions can be classified as acquisition/disposition transactions or merger transactions. In the acquisition/disposition transaction, one party is buying assets of or an equity interest in the other. Thus, one party is the buyer and one party is the seller. In a merger transaction, the assets and liabilities of one party are combined with the assets and liabilities of another party. The interests of both parties to a merger transaction are more like those of a buyer in an acquisition/disposition transaction since both parties will have some equity stake in the combined entity after the merger.
10 The purchaser of an equity interest in a partnership or a limited liability company often can limit the liabilities associated with the interest by having the partnership or limited liability company agreement assign the economic responsibility for losses associated with certain liabilities to other partners or members. Additionally, the purchaser’s liability can be further limited through the purchase of a limited partnership interest or limited liability company membership. This paper will not address such limitations.
11 Code § 6501(a) provides that the amount of tax shall be assessed within 3 years after the return is filed. See generally Code §§ 6501-6504 for provisions relating to exceptions, collection, and suspension of the period of limitations.
12 ERISA § 413 provides that no action may be begun under Title I of ERISA with respect to a fiduciary breach after the earlier of (1) 6 years after the date of the last action that constituted the breach or violation or, in the case of an omission, the last date the fiduciary could have cured the breach, or (2) 3 years after the earliest date on which the plaintiff had actual knowledge of the breach. However, in the case of fraud or concealment, the action may be brought up to 6 years after the date of discovery of the breach or violation. ERISA § 4003(e)(6) (relating to actions brought by PBGC to enforce the provisions of Title IV of ERISA or ERISA
§ 302 or Code § 412), ERISA § 4070(f) (relating to actions under Title IV of ERISA with respect to single employer plans) and ERISA § 4301(f) (relating to actions under Title IV of ERISA with respect to withdrawal liability) have a similar limitation period.
13 Code § 412(n); and ERISA § 302(f).
14 ERISA § 4062(a).
15 ERISA § 4063(b).
16 ERISA § 4064(b).
17 ERISA § 4068.
18 ERISA § 4001(b); ERISA § 4202; 29 C.F.R. 4001.1; 29 C.F.R. 4001.2; PBGC v. Ouimet Corp., 630 F2d 4 (1st Cir. 1980), cert. denied, 450 U.S. 914 (1981).
19 Code § 4971(e).
20 Code § 414(t).
21 Code §§ 414(b), (c) and (t), and 412(c)(11); and Treas. Reg. §§ 1.414(b)-1 and 1.414(c)-1 to 5. A parent-subsidiary group includes any entity in a chain if each entity in the chain is owned directly or indirectly at least 80% by a common parent. A brother-sister group generally includes any entity at least 80% of which is owned by 5 or fewer individuals and, considering the ownership interests of such individuals only to the extent that they are identical in each entity, such 5 or fewer individuals have effective control (a majority interest) in such entity.
22 Code § 414(m) and Prop. Treas. Regs. §§ 1.414(m)-1 to 4. An affiliated service group generally consists of a business (a “first service organization” or “FSO”) and a second organization whose principal business is the performance of services and (i) the second organization is a shareholder or partner in the FSO, and regularly performs services for the FSO or is regularly associated with the FSO in performing services for a third party; or (ii) a significant portion of the second organization’s business is performing services of a type historically performed in the FSO’s area employees and 10% or more of the second organization is owned by highly compensated employees of the FSO. Additionally, an affiliated service group can include a business with respect to which an entity or a related entity is performing management functions.
23 Code § 414(o).
24 29 C.F.R. § 4001.2.
25 29 C.F.R. § 4001.3.
27 Code § 410(b)(6) provides limited transitional relief for satisfaction of plan coverage rules following a transaction. See the discussion at VII.B. However, neither the statute nor the regulations specifically provide relief when the buyer terminates the plan of a seller within the transition period.
28 ERISA § 4041.
29 Code § 416(c)(1).
31 ERISA § 104.
32 ERISA § 204(g); Code § 411(d)(6); Treas. Reg. § 1.411(d)-4.
33 Code § 410(b)(6) transitional relief generally should be available if the seller splits the plans before the transaction and the buyer assumes the new target plan as part of the transaction. However, neither the statute nor the regulations appear to provide Code § 410(b)(6) relief where the buyer clones the terms of the seller’s plan and receives a transfer of assets and liabilities from the seller’s plan. See the discussion at VII.B.
35 Parallel provisions are found in Code § 411(d)(6).
37 221 F.3d 517 (3d Cir. 2000), cert. denied, 121 S.Ct. 843 (2001).
41 As to the second circumstance, Hein, id., distinguished Gillis, noting: “[In Gillis, t]here was no dispute about whether plaintiffs, following the spin-off, would be entitled to credit for service with the new employer. They would be.” . . . In this case, . . . neither the new employer nor the plan administrator made any such promise to [the] employees.” Id. 88 F.3d at 219.
42 Treas. Reg. § 1.411(d)-4. The Secretary of the Treasury has the authority to interpret the provisions of ERISA § 204(g) and Code § 411(d)(6). See ERISA Reorganization Plan, Pens. Plan Guide (CCH) 910, 690.
44 Treas. Reb. § 1.411(d)-4 as amended by Treasury Decision 8900, September 6, 2000. Specifically, the new regulations permit
   • defined contribution plans to eliminate optional benefit forms other than lump sums after 90 days notice to the participant;
   • defined contribution plans that do not provide for an annuity option, to eliminate all distribution options other than lump sums upon plan termination;
   • defined contribution plans to substitute cash for any marketable securities (other than employer securities);
   • defined contribution plans to eliminate the right to a distribution in a medium other than cash (provided the plan preserves the right to a distribution of property in the account at the time of the amendment);
   • any plan that provides a range of three or more actuarially equivalent joint and survivor annuity options to eliminate all survivor annuity options but those with the largest and smallest survivor payments; and
   • any plan to substitute cash for specified property upon plan termination (provided the employer maintains no other plans that permit distributions in the specified property).
45 Treas. Reg. § 1.411(d)-4, Q&A 3 (b) as amended by Treasury Decision 8900, September 6, 2000.
46 ERISA § 645.
47 ERISA § 3(2)(A).
50 Code § 401(a)(26); Treas. Reg. § 1.401(a)(26)-1(b).
51 A qualified plan must (1) benefit at least 70% of the nonhighly compensated employees in the controlled group, (2) benefit a percentage of nonhighly compensated employees in the controlled group that is at least 70% of the percentage of highly compensated employees
benefiting under the plan, or (3) satisfy the “average benefits test.” Code § 410(b). Code §§ 410(b)(5) and 414(r) provide special rules that allow coverage to be tested on a separate line of business basis.

52 Code § 410(b)(6); Treas. Reg. § 1.410(b)-3(f).
53 Treas. Reg. § 1.410(b)-2(f).
54 If the transaction occurs on the first day of a plan year, Code § 410(b)(6) would give relief up to the last day of the next succeeding plan year.
55 For a more complete discussion of this topic, see “Post-Closing ‘Clean Up' Following Mergers and Acquisitions” John L. Utz, presented at the ABA 1999 Annual Meeting, August 7, 1999.
56 Code § 401(a)(4) and the regulations thereunder generally require that a plan not discriminate in favor of highly compensated employees with respect to (1) benefits or contributions under the plan, (2) the availability of benefits, rights and features under the plan and (3) the effect of plan amendments. Treas. Reg. § 1.404(a)(4)-1 to 13.
59 Treas. Reb. § 1.401-6(b); Treas. Reg. § 1.411(d)-2(b).
60 See I.R.S. HB 7753.252(6), See also Matz v. International Tax Reduction Investment Plan, 1999 U.S. Dist. LEXIS 14842 (N.D. Ill. 1999) affirmed by 227 F.3d 971 (7th Cir. Ill. 2000), (holding that a vertical partial termination may occur from a significant corporate event that manifests itself in employer-initiated terminations occurring over a two-and-one-half-year period).
61 Code § 411(d)(3).
63 Code § 412 and ERISA § 302.
64 The IRS Form 5500 for a particular plan year is due by the end of the seventh month after the end of the plan year. An employer may obtain a two and one-half month extension. Code § 6058; Treas. Reg. 301.6058-1 and Instructions to the Form 5500. Thus, the actuarial valuation report for a calendar year plan may not be available until October of the following calendar year. At that point, the valuation information on the report will be dated by about nineteen months.
65 Code § 412; ERISA § 302.
67 Upon a plan termination, all benefits accrued to the date of termination are fully vested. The plan is required to annuitize all benefits valued at more than $5000. Interest rates used by a commercial insurer to annuitize the benefits may be less than the interest rate used for purposes of satisfying the minimum funding rules, which will result in a larger benefit liability. If the plan gives participants a choice of a lump sum benefit instead of an annuity, the plan is required to use the 30-year Treasury rate and the applicable mortality table for the calculation of lump sum payments under the Code and ERISA. Code § 417(e)(3) and ERISA § 205(g)(3)(A)
68 Cite to CODE.
70 For cases awarding surplus assets to participants after concluding that the plans did not provide for distribution to the plan sponsor, see Rinard v. Eastern Co., 978 F.2d 265, 268 (6th Cir. 1992), cert. denied, 113 S.Ct. 1843 (1993); Albedyll v. Wisconsin Porcelain Co., 947 F.2d 246, 254-56 (7th Cir. 1991); Unitis v. JFC Acquisition, 643 F. Supp. 454, 461 (N.D. Ill. 1986); Delgrosso v. Spang & Co., 769 F.2d 928, 935-56 (3rd. Cir. 1985); Bryant v. International Fruit Products Co., 793 F.2d 118, 123 (6th Cir. 1986); Horn v. Berdon, Inc., 938 F.2d 125, 127 (9th Cir. 1991); Parrett v. American Ship Building Co., 990 F.2d 854 (6th Cir. 1993); S. Bruce,

71 Code § 4980(a).
72 Code § 4980(d).
73 ERISA § 4006.
74 Treas. Reg. § 1.411(d)-6; 29 C.F.R. §§ 4041.23 and 4041.43; ERISA § 204(h) also applies to money purchase pension plans. ERISA §§ 204(h)(2), 301 and 302.
76 EGTRA § 659, amending ERISA § 204(h) and adding new Code § 4980F.
77 Code § 4980F(c)(2).
78 Many employers delay making the contribution for any plan year until the due date for the employer’s tax return for the taxable year ending with or within the plan year. Code § 404(a)(6). Although not typically done, employer matching contributions to a 401(k) plan need not be contributed until the last day of the plan year following the plan year for which they are made. Treas. Reg. § 1.401(m)-1(b)(4)(ii).
79 Qualified nonelective contributions and qualified matching contributions are also subject to the distribution restrictions. Code §§ 401(k)(3)(D)(ii) and 401(m)(4)(C); Treas. Reg. § 1.401(k)-1(g)(13). The provisions do not apply to amendments taking effect on or after June 7, 2001 if notice was provided to participants and beneficiaries before April 25, 2001, which was reasonably expected to notify them of the nature and effective date of the amendment.
80 Rev. Rul. 86-142. It is not clear how such a contribution would be allocated. Presumably each employee would be treated as receiving a contribution equal to the employee’s share of the sales charge, which could vary widely. One solution may be to limit payment of the deferred sales charge to the charges that would be made against nonhighly compensated employee accounts.
81 Code § 412; ERISA §§ 301-305.
82 ERISA § 204(h)(2). See also EGTRA §659, amending ERISA §204(h) and adding new Code §4980F.
83 The IRS has recently announced that (in conjunction with Treasury) it is developing guidance regarding the application of the nondiscrimination requirements under Code §§ 401(k) and (m) and the highly compensated employee definition under Code § 414(q) in situations where the employers sponsoring plans subject to those rules are involved in mergers, acquisitions, dispositions or similar transactions. IRS Notice 2000-3.
84 Code § 401(k)-1(2).
85 Code § 401(k)(10)(A)(i); Treas. Reg. § 1.401(k)-1(d)(3).
86 Code § 401(k)(10)(A)(ii); Treas. Reg. § 1.401(k)-1(d)(4).
87 Code § 401(k)(10)(A)(iii); Treas. Reg. § 1.401(k)-1(d)(4).
88 EGTRA § 646.
89 147 Cong Rec H 2726, 2794.
90 Id.
91 Treas. Reg. § 1.401(k)-1(d)(3).
92 Id.
93 Note however that the IRS's position is that upon termination, plan assets must be distributed within one year. Rev. Rul. 89-87.
94 As an extra precaution, the buyer should require the seller to disclose the distribution to employees of the buyer on the IRS Form 5310 filed in connection with the termination of the plan.
95 Treas. Reg. § 1.401(k)(d)(3).
96 Treas. Reg. § 1.401(k)-1(d)(3).
97 Code § 401(k)(10)(A)(ii) before amendment by EGTRA.
98 Code § 401(k)(10)(A)(iii) before amendment by EGTRA.
99 PLR 9848008 (No distributable event under Code §§ 401(k)(2)(B)(ii) and 401(k)(10)(A)(ii) where seller was not a corporation, but rather a partnership).
100 Treas. Reg. § 1.401(k)-1(d)(1)(iv)(A).
101 Such factors included whether the disposed operating unit maintains a separate budget, operates as a separate profit center, owns its own property and assets, operates with its own management and employees, provides its own employee benefits, and is geographically distinct. See PLR 199925045 and PLR 9836028.
102 Treas. Reg. § 1.401(k)-1(d)(1)(iv) and (v).
104 Treas. Reg. § 1.401(k)-1(d)(4)(ii).
105 Treas. Reg. § 1.401(k)-1(d)(4)(iii).
106 Treas. Reg. § 1.401(k)-1(d)(4)(i).
107 Code § 401(k)(10)(B).
108 Treas. Reg. § 1.401(k)-1(d)(5).
110 A change in the legal entity employing the employee is not sufficient to constitute a “separation from service” where the employee continues to work at the same job for the new employer (the “same desk rule”). Rev. Rul. 81-141, 1981-1 C.B. 204; Rev. Rul. 79-336, 1979-2 C.B. 187; Rev. Rul. 80-129, 1980-1 C.B. 86; PLRs 9706017, 9652025, 9443041, 8631103, 9325045, and 8716057.
113 Treas. Reg. § 1.72(p)-1 Q&A 10 and 11.
114 Treas. Reg. § 1.401(a)(31)-1 Q&A 16.
115 See 29 C.F.R. § 2550.408b-1(a)(3).
117 Treas. Reg. § 1.411(d)-4 Q&A 1(d).
118 ERISA § 4203(a).
119 ERISA § 4205(a). For employers in the retail food industry, the plan may provide for partial withdrawal liability if there is a 35% contribution decline instead of a 70% contribution decline. ERISA § 4205(c)(1).
121 Central States, Southeast and Southwest Areas Pension Fund v. Sherwin-Williams Company, 71 F.3d 1338 (7th Cir. 1995), cert. denied, 517 U.S. 1190 (116 S. Ct. 1678, 116 S.Ct. 2550(1996)).
123 Under some limited circumstances, courts have imposed liability on the buyer in situations where the seller has been insolvent or bankrupt. See Chicago Truckdrivers, Helpers and Warehouse Workers Union Pension Fund v. Tasemkin, Inc., 59 F.3d 48 (7th Cir. 1995); Upholsterers’ International Union Pension Fund v. Artistic Furniture of Pontiac, 920 F.2d 1323 (7th Cir. 1990); Stotter Division of Graduate Plastics Co., Inc. v. District 65 UAW, 991 F.2d 997 (2d Cir. 1993); Hawaii Carpenters Trust Funds v. Waiola Carpenter Shop, Inc., 823 F.2d 289 (9th Cir. 1987); Sullivan v. J.S. Sales Plumbing, Inc., 1994 WL 55658 (N.D. Ill. 1994).
124 ERISA § 4203(b) and (c).
125 ERISA § 4203(d).
126 ERISA § 4204(a)(1).
127 ERISA § 4204(c); 29 C.F.R. §§ 4204.11-4204.13. Individual exemptions may be requested in accordance with 29 C.F.R. §§ 4204.21-4204.22.
128 ERISA § 4204(b)(1).
130 ERISA § 4043.
131 ERISA § 4043(a). See 29 C.F.R. §§ 4043.21 – 4043.35 for a description of those events with respect to which post-event notice is required or waived.
132 ERISA § 4043(b)(3). See 29 C.F.R. §§ 4043.61- 4043.68 for a description of those events with respect to which advance notice is required.
133 ERISA § 4043(c)(3); 29 C.F.R. § 4043.23. Notice is waived if (1) the plan has fewer than 100 participants at the beginning of the current or previous year, (2) the plan does not pay variable rate premiums, has unfunded vested benefits of less than $1 million, would have no unfunded vested benefits under certain funding assumptions or the plan’s vested benefits are at least 80% funded, or (3) the active participant reduction would not be reportable if only those active participant reductions resulting from cessation of operations at one or more facilities were taken into account and as of the testing date for the event year, the plan’s vested benefit amounts are at least 80% funded. Extensions are provided.
134 ERISA § 4043(c)(4); 29 C.F.R. § 4043.24. Notice is waived.
135 ERISA § 4043(c)(8); 29 C.F.R. § 4043.28. Notice is waived.
136 ERISA § 4043(c)(9); 29 C.F.R. §§ 4043.29 and 4043.62. Notice is waived if (1) the persons ceasing to be members of the controlled group represent a de minimis 10% segment of the plan’s old controlled group or are foreign entities, (2) the plan does not pay variable rate premiums, has unfunded vested benefits of less than $1 million or would have no unfunded vested benefits under certain funding assumptions and (3) the plan’s contributing sponsor is a public company and the plan’s vested benefits are at least 80% funded. Extensions are provided. Advance notice is waived if the transferred plan has 500 or fewer participants or the persons that will cease to be members of the plan’s controlled group represent a de minimis 5% segment of the plan’s old controlled group.
§ 4043(c)(10); 29 C.F.R. §§ 4043.30 and 4043.63. Notice is waived where (1) the liquidated or dissolved entity represents a de minimis 10% segment of the plan’s controlled group or is a foreign entity, (2) the plans of the liquidated/dissolved company continue to be maintained by the controlled group and satisfy certain funding requirements, or (3) the plan’s contributing sponsor is a public company, the plan is at least 80% funded for vested benefits and each plan of the liquidated/dissolved company remains within the controlled group. Extensions are provided. Advance notice is waived if the liquidated/dissolved company is a de minimis 5% segment of the plan’s controlled group and each member of the liquidating member is maintained by another controlled group member.

§ 4043(c)(11); 29 C.F.R. §§ 4043.31 and 4043.64. Notice is waived if (1) the person making the distribution is a de minimis 5% segment of the plan’s controlled group or is a foreign entity other than a foreign parent, (2) the person making the distribution is a foreign parent and the distribution is made solely to other members of the plan’s controlled group, (3) the plan does not pay variable rate premiums, has unfunded vested benefits of less than $1 million, would have no unfunded vested benefits under certain funding assumptions or the plan’s vested benefits are at least 80% funded. Extensions are provided. Advance notice is waived if the person making the distribution is a de minimis 5% segment of the plan’s controlled group.

§ 4043(c)(12); 29 C.F.R. §§ 4043.32 and 4043.65. Notice is waived if (1) the transfer is a transfer of all of the transferor plan’s benefit liabilities and assets to another plan or (2) if the assets being transferred equal the present value of the benefits transferred (whether or not vested) and in conjunction with other transfers during the year, represent less than 3% of the assets of the transferor plan as of at least one day in that year, (3) the transfer complies with Code § 414(l) using assumptions that would be used by the PBGC to value plan benefits or (4) the transfer complies with Code § 414(l) using reasonable actuarial assumptions and after the transfer both plans are fully funded using assumptions that would be used by the PBGC to value benefits. Advance notice is waived if the conditions described in (1), (2) or (4) are satisfied and the liabilities of 500 or fewer participants are transferred.

§ 4043(c)(13); 29 C.F.R. §§ 4043.34 and 4043.67. Notice is waived if (1) the default is cured or waived by the lender within 30 days or, if later, by the end of any cure period provided by the loan agreement, (2) the debtor is a foreign entity other than a foreign parent, (3) the plan does not pay variable rate premiums, has unfunded vested benefits of less than $1 million, would have no unfunded vested benefits under certain funding assumptions or the plan’s vested benefits are at least 80% funded. Extensions are provided. Advance notice is waived if the default is cured or the lender waives the default within 10 days or, if later, by the end of any cure period. The regulations also provide for extensions of the advance notice period.

§ 4043(c)(13); 29 C.F.R. §§ 4043.35 and 4043.68. Notice is waived if the bankrupt entity is a foreign entity other than a foreign parent. Extensions are provided. The notice date for advance notice is extended until 10 days after the reportable event has occurred.


Id., citing Burns, 406 U.S. at 284 (noting successor not bound by the substantive provisions of the predecessor’s collective bargaining agreement); see also Road Sprinkler Fitters Local Union No. 669 v. Independent Sprinkler Corp., 10 F.3d 1563, 1564 (11th Cir. 1994, cert. denied, 513 U.S. 868 (1994) (same).

Peters v. National Labor Relations Board, 153 F.3d 289, 297-298 (6th Cir. 1998)(noting exceptions to general rule); Hawaii Carpenters Trust Funds v. Waiola Carpenter Shop, Inc., 823 F. 2d 289 (9th Cir. 1987) (finding successor bound to predecessor’s agreement pending bargaining).
Moriarty v. Svec, 164 F. 2d 323 (7th Cir. 1998); Upholsters’ International Union Pension Fund v. Artistic Furniture, 920 F. 2d 1323 (7th Cir. 1990).

Teamsters Pension Trust Fund v. Littlejohn, 155 F. 3d 206 (3rd Cir. 1998); Western States Office and Professional Employees Pension Plan v. Plasterers’ and Cement Masons’ Local No. 300, 1999 U.S. Dist. LEXIS 10789 (N.D. Cal.).

For example, California and Texas require consent to payroll deductions. CAL. LABOR CODE § 224 (West 1989); TEX. LABOR CODE ANN. § 61.018 (West 1998); South Carolina requires notice of payroll deductions. S.C. CODE ANN. § 41-10-30 (Law. Co-op. 1998). Although there is an argument that ERISA preempts state payroll deduction laws, DOL Opinion Letter 96-01A, the issue has not been entirely settled.

A “cafeteria plan” permits employees to reduce their salary to pay premiums on certain welfare benefits and to pay for certain medical expenses and certain dependent care expenses. Code § 125; Prop. Treas. Reg. § 1.125-1, Q&A-2.

Proposed regulations generally limit changes in salary reduction elections during the plan year except in certain circumstances. Prop. Treas. Reg. § 1.125-1, Q&A 15.

Treasury Reg. 1.125-4(f).


Treasury Reg. 1.125-4(f)(5).

Prop. Treas. Reg. § 1.125-2, Q&A 7(b)(2).

ERISA § 3(40).

ERISA § 514(b)(6)(A).

Code § 79 (group term life insurance up to $50,000 is tax free if nondiscrimination requirements are satisfied); Code § 105(h) (benefits provided under nondiscriminatory self-insured medical plans are tax free); Code § 125 (salary reduction and choice of benefits provided under cafeteria plan is tax free subject to satisfaction of nondiscrimination requirements).

Code § 414(t).

Code § 4980B.


Treas. Reg. § 54.4980B-9, Q&A 5. For purposes of the Treasury regulations, a “stock sale” is a “transfer of stock in a corporation that causes the corporation to become a different employer or a member of a different employer . . . [and] . . . [a]n asset sale is a transfer of substantial assets, such as a plant or division or substantially all the assets of a trade or business.” Treas. Reg. § 54.4980B-9, Q&A, 1(b) and (c). The regulations do not address how the obligation to provide COBRA Coverage is affected by the transfer of an ownership interest in a noncorporate entity (for example, a partnership or a limited liability company) that causes the noncorporate entity to cease to be a member of a controlled group. The preamble to the regulations state that “in general, the principles reflected in the rules in the final regulations for transfers of ownership interests in corporate entities should apply in a similar fashion in analogous cases involving the transfer of ownership interests in noncorporate entities.”
170 Treas. Reg. § 54.4980B-9, Q&A 6(a)(1).
171 Treas. Reg. § 54.4980B-9, Q&A 6(a)(2).
172 Treas. Reg. § 54.4980B-9, Q&A 8(c)(1).
173 Treas. Reg. § 54.4980B-9, Q&A 8(a).
174 Treas. Reg. § 54.4980B-9, Q&A 8(b)(1).
175 Treas. Reg. § 54.4980B-9, Q&A 8(c)(1).
176 Treas. Reg. § 54.4980B-9, Q&A 7.
177 Code § 4980B(c)(3).
178 Code § 4980B(e)(1).
179 Treas. Reg. § 54.4980B-9, Q&A 8(a).
180 Treas. Reg. § 54.4980B-2, Q&A 2(c).
181 See Diehl v. Twin Disc, 102 F.3d 301, 305-06 (7th Cir. 1996) (stating Court is to decide the question of whether continuation of retiree benefits was "a mere gratuity, the result of the company's beneficence.").
183 133 F.3d 388, 21 EBC 2267 (6th Cir. 1998).
184 See also Moore v. Metropolitan Life Ins. Co., 856 F.2d 488, 490, 492 n.1 (2d Cir. 1988) (language stated "the Company reserves the right at any time to change or discontinue this [plan]."); Howe v. Varity Corp., 896 F.2d 1107, 1108 (8th Cir. 1990) (plan's broad reservation of a right to "amend or terminate" allowed the employer to terminate benefits); In re Unisys Corp. Retiree Med. Ben. “ERISA” Litig., 58 F.3d 896, 900, 903-04 (3d Cir. 1995) (reservation of right to terminate or amend "at any time" and "for any . . . reason is unambiguous); Gable v. Sweetheart Cup, 35 F.3d 851, 18 EBC 1897 (4th Cir. 1994); Alday v. Container Corp., 906 F.2d 660 (11th Cir. 1990) (language allowed plan administrators to "terminate, suspend, withdraw, amend or modify the Plan in whole or part at any time"); Boyer v. Douglas Components Corp., 986 F.2d 999 (6th Cir. 1993); Gill v. Moco Thermal Indus., Inc., 981 F.2d 858 (6th Cir. 1992); Krishan v. McDonnell-Douglas, 873 F. Supp. 345, 348, 352 (C.D. Cal. 1994); Sengpiel v. B. F. Goodrich Co., 156 F.3d 660, 664 (6th Cir. 1998); Musto v. American General Corp., 861 F.2d 897, 903-05 (6th Cir. 1988). But see Alexander v. Primerica Holdings, Inc., 967 F.2d 90 (3d Cir. 1992); Eardman v. Bethlehem Steel Corp., 607 F.Supp. 196 (W.D.N.Y. 1984); Deboard v. Sunshine Mining And Refining Company, 208 F.3d 1228, 24 E.B.C. 1289 (10th Cir., April 5, 2000).
But see United Food & Commercial Workers, Local 56 v. Campbell Soup, 898 F. Supp. 1118, 19 EBC 1905 (D.N.J. 1995); Murphy v. Keystone Steel & Wire, 61 F.3d 560, 566 (7th Cir. 1995) (agreement said coverage provided only during term of agreement, and “Plan” said that coverage ceases “upon the date the Plan is terminated or amended to terminate the Retiree’s [or his dependent’s] coverage.”); John Morrell & Co. v. United Food and Commercial Workers, 17 EBC 1342 (D. S.D. 1993), affirmed, 37 F.2d 1302 (8th Cir. 1994); American Fed’n of Grain Millers, AFL-CIO v. International Multifoods Corp., 116 F.3d 976 (2d Cir. 1997) (jury issue if there is “written language capable of reasonably being interpreted as creating a promise on the part of the employer to vest the benefits...”); Anderson v. Alpha Portland Industries, 836 F.2d 1512, (8th Cir. 1988), cert. denied sub nom., Anderson v. Slattery Group, Inc., 109 S.Ct. 1310 (1989); 186 U.A.W v. BVR Liquidating, Inc., 190 F.3d 768 (6th Cir. 1999), cert. denied, ___ U.S. ___ (2000) (finding for retirees, even though language did not say explicitly say that benefits were “lifetime,” and distinguishing Sprague on grounds that it dealt with non-union retirees), and Maurer v. Joy Technologies, 212 F.3d 907, 164 L.R.R.M. 2344, 24 E.B.C. 1554 (6th Cir., May 12, 2000) (same). 187 Rossetto v. Pabst Brewing Co., 217 F.3d 539 (7th Cir. 2000), cert. denied, ___ U.S. ___ (2001), finding the language ambiguous. 188 U.A.W v. Skinner Engine Company, 188 F.3d 130 (3d Cir., August 10, 1999) (affirming judgment for employer, even though language did not say explicitly that benefits were terminable), and Joyce v. Curtiss-Wright Corporation, 171 F.3d 130 (2d Cir. 1999) (same). 189 See Curtiss-Wright v. Schoonejongen, 18 F.3d 1034, 1042 (3d Cir. 1993), reversed in part, 514 U.S. 73, 115 S.Ct. 1223 (1995). 190 See, e.g., Armistead v. Vernitron Corp., supra, 944 F.2d at 1298-1300; United Rubber, Cork, Linoleum & Plastic Workers v. Pirelli Armstrong Tire Corporation, 873 F. Supp. 1093, 1102 (M.D.Tenn. 1994). 191 See Bertram, v. Nutone, Inc., 107 F. Supp. 2d 957, 960-73 (S.D. Ohio 2000). (“Plaintiffs allege that they accepted early retirement from NuTone in 1991 in reliance on NuTone's representations that, as retirees, they would be provided with health and other insurance benefits equal to those of active NuTone employees. . . . Unlike the employees in Sprague, plaintiffs' reliance on the misleading information was reasonable since the [company representative] did not negate the company's right to modify or terminate benefits. Rather, he represented to plaintiffs that their health care benefits could be terminated only if and when the benefits of active employees were likewise terminated. Plaintiffs were entitled to rely on this representation despite the company's reservation of its right to amend the Plan.”); Miller v. Taylor Insulation Co., 39 F.3d 1287 (7th Cir. 1994) (affirmed in part, reversed in part by 18 EBC 2363(7th Cir. 1994) (allowing promissory estoppel claim to proceed in retiree insurance dispute where person retiring signed ten-year noncompete and consultation agreement providing for retiree insurance but later was dropped because only full-time employees were eligible - appeal affirmed dismissal of promissory estoppel claim reversed with regard to ERISA claims). 192 For a retiree health case where the court concludes that the unambiguous reservation of rights clauses in the summary plan description made it impossible for retirees to prove “reasonable” reliance, see In re Unisys Corp. Retiree Med. Ben. “ERISA” Litig., 58 F.3d 896, 900, 907-08 (3d Cir. 1995); U.A.W v. Skinner Engine Company, 188 F.3d 130, 152 (3d Cir. 1999) (“there is absolutely no evidence in this record that shows that any of the appellants considered the promise of lifetime health and life insurance benefits in timing their retirements.”). See also Frahm v. Equitable Life Assurance Society, 137 F.3d 955, 961 (7th Cir.
1998) ("none of the elements of an estoppel has been established: no false statements of fact, no reliance, and no detriment.").

193 Kane v. Aetna Life Ins. Co., 893 F.2d 1283, 1286 and n. 4 (11th Cir. 1990); Greany v. Western Farm Bureau Life Ins. Co., 973 F.2d 812, 821 (9th Cir. 1992) (following Kane). In Marx v. Loral Corporation, 87 F.3d 1049 (9th Cir. 1996), retirees asserted an estoppel claim, on the grounds that company representatives informed them that, if they remained with the sold division, their retiree welfare benefits with the buyer would be equal to or better than they had been before. Despite the representations, the buyer later reduced plaintiffs’ benefits. Based on Kane and Greany, plaintiffs lost.

194 “Principles of estoppel . . . cannot be applied to vary the terms of unambiguous plan documents [but] can only be invoked in the context of ambiguous plan provisions” for two reasons: first, “reliance can seldom, if ever, be reasonable or justifiable if it is inconsistent with the clear and unambiguous terms of plan documents available to or furnished to the party[;] second to allow estoppel to override the clear terms of plan documents would be to enforce something other than the plan documents themselves [and] would not be consistent with ERISA”; where plan document and “most” of the SPDs unambiguously reserved the right to amend health care coverage, retirees’ reliance on other statements to the contrary could not be reasonable or justifiable, especially when GM never told the plaintiffs that their benefits were “vested.” Sprague, 133 F.3d 388, 404 (6th Cir. 1998) (en banc).

195 57 F.3d 1255 (3d Cir. 1995).
196 57 F.3d 1255, 1262.
197 516 U.S. 489, (1996), affirming, 36 F.3d 746 (8th Cir. 1994), earlier proceedings, 896 F.2d 1107 (8th Cir. 1989).
198 133 F.3d 388, 405 (6th Cir. 1998).
199 Supra at n. 146 184.
200 133 F.3d 388, (6th Cir. 1998).
201 Sprague, 133 F.3d 388, 406. See also U.A.W v. Skinner Engine Company, 188 F.3d 130, 150 (3d Cir. 1999) (rejecting fiduciary claim, stating: “The problem with this contention is that there is no competent evidence which suggests that the company made any affirmative misrepresentations concerning the duration of retiree benefits. At best, the evidence indicates that there may have been an historical assumption, perhaps by both sides, that retirement benefits would be for life.”); Frahm v. Equitable Life Assurance Society, 137 F.3d 955 (7th Cir. 1998); Devlin v. Transportation Communications International Union, No. 95 Civ. 0742 (JFK) (S.D.N.Y. Sept. 15, 1997), affirmed in part, vacated in part, remanded by 23 EBC 1054 (2nd Cir. 1999)( no fiduciary breach since not acting in fiduciary capacity).
203 156 F.3d 660 (6th Cir. 1998).
204 Clark v. Witco Corporation, 102 F.Supp.2d. 292, 23 EBC 2932 (W.D. Pa. 2000) (employer's denial of severance benefits to employees employed by buyer in a sale of assets was reasonable where plan specifically provided that severance was not available to employees terminated in connection with a sale of stock or assets).
205 For cases decided in favor of employees in the union setting, see LTV Steel Co., 25 Steel Arb. 19,375 (Porter, 1987); Ward Foods, Inc., 61 LA 1032 (Dash, 1973); M&T Co., 51 LA 504 (Carraway, 1968); Stauffer Publications, Inc., 68 LA 1037, 77-1 ARB ¶8314 (Madden, 1977 ); Allied Chemical Corp., 81 LA 514 ( Epstein, 1983); St. Regis Paper Co., 85-1 ARB ¶8106 (O'Connell, 1984); Liberal Market, Inc., 81-2 ARB ¶8443 (Fitch, 1981); International Paper Co., 79-1 ARB ¶8201 (Sander, 1978); MGM Telestudios, Inc., 48 LA 1267 (Wolf, 1967); Wackenhut Corp., 57 LA 205 (Goodman, 1971); Myers Drum Division of Kaiser Steel, 24 Steel Arb. 18,352 (Block, 1985); Taylor Forge Stainless Div., Gulf& Western Mfg. Co., Case No. 84-8777 (Pearce, 1986), enforced, 694 F. Supp. 38, affirmed, 860 F.2d 1074 (3d Cir. 1988); ARCO Metals
Company-American Brass, 8 EBC 2196, 88 LA 1209 (Berkowitz, 1987). Pre-ERISA state law decisions were also generally favorable to employees. Note, “Severance Pay, Sales of Assets and the Resolution of Omitted Cases,” 82 Columbia L. Rev. 593 (1982) (“despite significant variations in circumstances and contract terms, courts have achieved almost uniform results. Asserting that the assets sale is indistinguishable from usual severance-pay-triggering events, courts have nearly always concluded that compensation to the employees in due.”) Id. at 594-95 (footnotes omitted)).

206 86 LA 811 (Tsukiyama, 1986).

207 Id. at 816. The arbitrator found cases such M & T Co., supra, “distinguishable” because, inter alia, in M & T the employees “were in fact terminated before being hired by an entirely unrelated successor.” Id. at 817. See also, American Petrofina, Inc., 63 LA 1300 (Marlatt, 1975).


209 Headrick v. Rockwell Int’l Corp., 24 F.3d 1272, 1276 (10th Cir. 1994); Garvin v. A.T.&T., 174 F.3d 1087, 1095 (10th Cir. 1999) (“Only employees ‘laid off due to lack of work’ were entitled to termination allowances. When an employee retains his or her job despite a transfer, he or she has not suffered for ‘lack of work.’ AT&T’s divestiture of Lucent did not result in any disruption of employment.”); Fuller v. FMC Corp., 4 F.3d 255, 259 (4th Cir. 1993) (plaintiffs not “terminated” and, thus, not entitled to severance benefits where they experienced no unemployment or loss of income by reasons of plant’s transfer in ownership), cert. denied, 510 U.S. 1115 (1994); Allen v. Adage, Inc., 967 F.2d 695, 701-03 (1st Cir. 1992) (“employees who, coincident with their separation from service, began comparable employment at comparable wages” with successor company not entitled to severance benefits for “reduction in force”); Awbrey v. Pennzoil Co., 961 F.2d 928, 931-32 (10th Cir. 1992) (employees not entitled to severance pay where none of them missed any work or suffered any loss of income when accepted comparable jobs with purchasing company); Bradwell v. GAF Corp., 954 F.2d 798, 800 (2d Cir. 1992) (“Where an employee is kept in his or her job because, despite a change in ownership, there is no lack of work, that employee cannot accurately be described as ‘permanently laid off because of lack of work.’”); Rowe v. Allied Chemical Hourly Employees’ Pension Plan, 915 F.2d 266, 269 (6th Cir. 1990); Sejman v. Warner-Lambert Co., Inc., 889 F.2d 1346, 1347 (4th Cir. 1989) (employees transferred to successor corporation were not "terminated by the Company as a result of job elimination"), cert. denied, 498 U.S. 810 (1990); Brandis v. Kaiser Aluminum & Chemical Corp., 47 F.3d 947 (8th Cir. 1995); Kotrosits v. GATX Corp. Non-Contributory Pension Plan For Salaried Employees, 970 F.2d 1165, 1170 (10th Cir. 1993) (employees not entitled to severance benefits); Anderson v. Ciba-Geigy Corp., 759 F.2d 1518 (11th Cir. 1985); Sly v. P.R. Mallory & Co., 712 F.2d 1209 (7th Cir. 1983); Pinto v. Zenith Radio Corp., 480 F. Supp. 361 (N.D. Ill. 1979), aff’d mem., 618 F.2d 110 (7th cir. 1980; Livernois v. Warner-Lambert Co., 723 F.2d 1148 (1983); Petrella v. NL Industries, Inc., 529 F. Supp. 1357 (D.N.J. 1982); Pabst Brewing Co. v. Anges, 610 F. Supp. 214 (D.Minn 1985), aff’d, 784 F.2d 338 (1986); Jung v. FMC Corp., 755 F.2d 708 (9th Cir. 1985); Adcock v. Firestone Tire & Rubber, 616 F. Supp. 409 (M.D. Tenn. 1985).


211 See Litfin Fin. Printing Div. v. NLRB, 501 U.S. 190, 206-08 (1991), held that “contractual obligations will cease . . . upon termination of the bargaining agreement,” but that there are exceptions, and these “[e]xceptions are determined by contract interpretation. Rights which accrued or vested under the agreement will, as a general rule, survive the termination of the
agreement.” (emphasis added) Litton, 501 U.S. at 208. See also Nolde Bros., Inc. v. Local No.
358 Bakery & Confectionery Workers Union, 430 U.S. 243, 248-49 (1977) (depending on
contract’s language, severance pay could be an “accrued” or “vested” right earned during the
life of the contract but payable even after contract expiration); John Wiley & Sons v. Livingston,
376 U.S. 543, 555 (1964) (same).
212 See Bidlack v. Wheelabrator Corp., 993 F.2d 603 (7th Cir. 1993) (rejecting “the extreme
position . . . that the contract must either use the word ‘vest’ or must state unequivocally that it is
creating rights that will not expire when the contract expires”).
213 70 LA 35 (Talent, 1977).
214 Id. at 40.
215 See also Brooklyn Eagle, 32 LA 156 (Wirtz, 1959); Fort Pitt Steel Casting, 76 LA 909, 911
(Sembower, 1981) (“Every reasonable interpretation of the language suggests that it was meant
to carry over. Its whole sense is to provide for a remote contingency, and its purpose fails if the
expiration date of the contract is to fall like a guillotine and cut off coverage at the very moment
when it is needed and makes sense. . . . A time-honored rule of contract language
interpretation provides that when a choice is to be made between a meaning which is rational
and one which is ridiculous, the former is to be chosen.”). See also, Kulins v. Malco, 76 Ill. Dec.
20 N.J. 537, 120 A.2d 442 (1956), affirming, 34 N.J. Super. 203, 111 A.2d 796 (1955); H.K.
Porter Co., 49 LA 147 (Cahn, 1967).
216 See Algie v. RCA Global Communication, Inc., 60 F.3d 956 (2d Cir. 1995) (failure to follow
procedure; seller’s failure to formally terminate its severance pay plan before sale resulted in
severance pay being paid under seller’s plan, citing Curtiss-Wright v. Schoonejongen, 514 U.S.
73 (1995)).
217 Code § 501(c)(9).
218 Code § 505(b).
219 ERISA § 104. Generally the following are excluded from the filing requirements: (1) an
unfunded or fully-insured welfare benefit plan which covered fewer than 100 participants; (2) a
“top hat” welfare or pension plan; (3) plans maintained only to comply with workers’
compensation, unemployment compensation, or disability insurance laws; (4) an unfunded
excess benefit plan; (5) a welfare benefit plan maintained outside the United States primarily for
persons substantially all of whom are nonresident aliens; (6) a qualified foreign plan; (7) an
annuity arrangement described in 29 C.F.R. § 2510.3-2(f); (8) a simplified employee pension
plan; (9) a savings incentive match plan for employees of small employers; (10) a church plan
described in ERISA §3(33); (11) a governmental plan; (12) a welfare benefit plan that
participates in a group insurance arrangement that files for the plan; and (13) an apprenticeship
or training plan.
220 ERISA § 502(c)(2). The maximum penalty for violations occurring after July 29, 1997 is
$1,100 per day. 29 C.F.R. § 2560.502c-2.
221 DOL Procedure, PWBA’s Delinquent Filer Voluntary Compliance Program, 60 F.R. 20874.
222 614 F. Supp. 694 (N.D. Ala. 1985), aff’d, 799 F.2d 1464 (11th Cir. 1986), cert. denied, 481
223 Id. at 722.
225 Id. at 503.
226 998 F.2d 1185, 1191 (3d Cir. 1993).
227 In the case of a transfer of property, for example, restricted stock, the executive is taxed
under Code § 83 on the fair market value of the property transferred in connection with the
performance of services when the property first becomes nonforfeitable or freely transferable.
In the case where no property is transferred, but the executive simply has a contractual right to compensation, the executive is taxed on the compensation when it is made available to the executive. Code § 61.

228 A “rabbi” trust is a grantor trust under Code §§ 671 and 677(a). The assets of a rabbi trust are available to creditors in the event of insolvency. Income on assets of the rabbi trust is taxed to the grantor. The IRS has developed a model rabbi trust. See Rev. Proc. 92-64 (August 17, 1992). The DOL has ruled that rabbi trusts are not “funded” for purposes of ERISA. See Letter from Elliott Daniel, assistant administrator for regulations and interpretations, to Richard Manfreda, Chief of the Individual Income Tax Branch (December 13, 1985), reprinted in 13 BPR 702.

229 Code § 280G.
230 Code § 4999.
231 ERISA § 201, et. seq.
232 ERISA § 301(a)(3). A plan that provides benefits solely to make employees whole for the limitations of Code § 415 is an “excess benefit plan.” ERISA § 3(36). An unfunded excess benefit plan is not subject to ERISA. ERISA § 4(b)(5).
233 Treas. Reg. § 1.425-1.

For more information on employee benefit issues in mergers, acquisitions and dispositions, see the following articles:

