

# BENEFIT *Advisor*

## In This Issue

*Business transactions, including those of mergers and acquisitions, are on the rise. The following Benefits Advisor outlines the importance of the benefits professional in the merger and acquisition process and the need for the benefits professional to play an active role in making the process run as smoothly as possible. We will examine the information required to conduct a successful integration, the effect of COBRA regulations on merger and acquisition activities, and the options available to carry out a painless process.*

*We welcome your comments and suggestions regarding this issue of our technical bulletin. For more information on this Benefit Advisor, please contact your Account Manager or visit the McGraw Wentworth web site at [www.mcgrawwentworth.com](http://www.mcgrawwentworth.com).*

## “Mergers and Acquisitions” - You Make The Difference

In today's fast paced business world, mergers and acquisitions are occurring more and more frequently. A more competitive marketplace and companies with surplus cash flow are two of the reasons for the increase in mergers and acquisition activity. According to a March 2, 1998 article in Fortune, over a ten-year period the volume of U.S. mergers and acquisition activity increased from \$200 billion to \$900 billion. (see chart) This pace does not seem to be slowing down.

The challenge of a merger or acquisition is to successfully integrate organizational cultures. That is where the benefits professional should come into play. Integrating two corporate cultures is a challenge at any time during a merger or acquisition. However, the task becomes more difficult the later a benefits professional is brought into the process. It is important for benefits profes-

sionals to be included in the mergers and acquisitions process from the beginning; otherwise, trying to reconcile

the issues may prove to be a tremendous task.

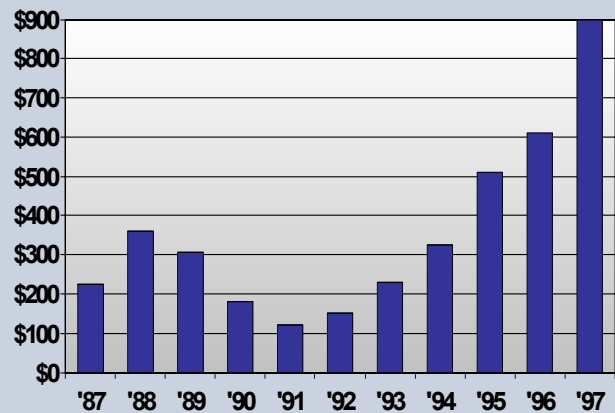
This article provides some background on mergers and acquisitions and some ideas to help integrate the health and welfare plans. If your company is merging with or acquiring another company, there are a number of considerations.

### What You Will Be Up Against

There are two types of transactions: stock purchasing or asset purchasing. The way in which the benefit plans will be handled will depend on the type of transaction (stock or asset) that occurs.

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U.S. M&A Deals Announced (in billions)



A **stock acquisition** typically includes the buyer acquiring the stock of the company to be sold. Therefore all of the assets and liabilities of the selling organization are assumed by the buyer. By assuming the assets and liabilities, the buying organization becomes liable for the selling organization's health and welfare benefit plans.



An **asset acquisition** has the buyer and seller agreeing on which assets and liabilities the purchaser will acquire. Therefore, the buyer may not necessarily have to assume the seller's health and welfare benefit plans, even if this is the seller's desire.

### The Road to Success Begins Here

Once a merger or acquisition target has been identified, the buying organization typically performs "due diligence" on the selling company. This is the earliest and best chance for the benefits professional to prepare for the future. When the due diligence process begins, the buying organization submits a list of the information it wants to review.

You will need to know the type of transaction and gather key benefits information regarding all plans (welfare, pension and fringe benefit plans). Your list may include:

- *Transaction documents (offering memorandum, letter of intent, confidentiality agreement, purchase and sale agreement)*

- *General descriptions of all welfare plans offered*
- *Information about any*

*provider networks (PPO, HMO, POS)*

- *Copies of plan documents*
- *Collective bargaining agreements*
- *Financial summaries for at least three years including current claim liabilities*
- *Compliance materials including any discrimination tests*
- *Description of any retiree welfare benefits, as well as most recent valuations and FAS 106 disclosure statements*
- *List of key contacts*
- *Compensation information (salary structure, employee census, employment contracts etc.)*
- *Copies of other employee communications*

- *Disclosure of existing or potential problems*

### Making It Work for You

What is best for the seller may not always be best for the buyer, and there are always choices to be made. The buyer has several options as to what to do with the group benefit plans when reviewing a seller's plan, even if the seller tries to influence that decision.

#### 1. Assume Seller's Plan With or Without Modifications:

- *Stock Acquisition: There is no opportunity for the buyer to avoid operational or compliance issues with the seller's plans. Therefore, the buyer may request protection by representations and warranties within the purchase and sale agreement.*
- *Asset Acquisition: The buyer can avoid the compliance and operational issues, but the purchase and sale agreements confirm that pre-closing violations are the seller's responsibility.*

*When the buyer is assuming the seller's plans with little or no modifications, the seller may include language in*

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## NOTABLE FACT

*According to a study conducted by Hewitt Associates, merger or acquisition transactions take an average of 9.5 months to complete.*

*the agreement that the buyer offer equivalent benefits. At the same time the buyer may want to include, in writing, details about the intentions they have for continuation of plans.*

**2. Spin-off or Merge Plans:**

*When only a subsidiary or division that participates in the seller's benefit plans is being acquired, the seller can spin off liabilities and assets to the buyer. In addition, the buyer may merge the seller's liabilities and assets into an existing group benefit plan structure.*

**3. Freeze Plans:** *The buyer may choose to maintain the seller's plan separately from their existing plans.*

**4. Terminate Plan:** *The buyer may choose to terminate plans but must remember that run-out liabilities may exist.*

No matter the route you decide to take, a merger or acquisition is a good opportunity to upgrade your current health and welfare benefit options. Ask yourself several questions when comparing the seller's plans with your plans and deciding whether to consolidate plans or maintain separate plans.

- *Are there overlaps in coverage?*
- *Are there gaps in coverage?*
- *Are there unique plans (buyer's or seller's)?*



- *Are there any vested benefits (e.g. written promise of retiree coverage)?*
- *Are there provider network advantages (buyer's or seller's)?*
- *Which plans are most cost effective and why?*
- *Are there special financing arrangements (VEBA's, retro agreements)?*
- *Are there administrative issues (i.e. compatible record keeping systems)?*
- *Are the employees satisfied with the current plan options?*
- *What is the attitude of the employees towards the plans?*

**Sucker Punches**

Hidden promises can have long term cost implications. These hidden liabilities can be a major negotiating issue in regards to the purchase

**NOTABLE FACT**

According to a study of Fortune 500 chief financial officers who had recently merged or acquired, "people problems" represented the top failure factor in a merger or acquisition.

price, or they can lead to a major disaster if they are discovered after the purchase is complete.

The most important issue is to understand completely any retiree benefit liabilities (FAS 106). You should be sure to find out:

1. *What plans are offered?*
2. *What specific promises have been made?*
3. *Are benefits vested (promised for life) or may they be modified?*
4. *What do the most recent FAS106 valuations indicate?*
  - *What are the future liabilities (any changes expected)?*
  - *Are the plan assumptions accurate?*
  - *Did the plan participants actually work here?*
  - *Does census reflect an accurate population (do/did they work here)?*
5. *What are the acquiring company's intentions for the plans?*

In addition, you should be aware of any special financing arrangements that have a run-out liability. These might include:

1. *Pending legal action against plans*
2. *Compliance problems*
3. *Fees and claims to shut down a self-funded plan*

4. *Retrospective premium arrangements that include deficit recoupment*

5. *Multiyear contracts with termination limitations*

when employees and their dependents lose coverage due to the sale because a termination of employment

made available under either the stock or asset acquisition, the regulations can be ignored, as long as the buyer and seller agree to other arrangements.

**The Role of COBRA**

COBRA plays an integral role in the merger and acquisition process as well. The type of acquisition will influence how you should proceed with COBRA administration.



**Appeal to the Masses While Maintaining Costs**

When merging organizations, your best approach is often to attempt to honor existing benefits and blend existing programs. This strategy allows you to take the best practices from all

- **Stock acquisition:** According to the new COBRA regulations issued February 3, 1999, a stock acquisition is not considered a COBRA qualifying event. This is true even if an employee loses coverage, since a termination of employment has not occurred. The seller remains responsible for providing COBRA coverage to the pre-existing and qualified COBRA beneficiaries in connection with the sale. However, if the seller ceases to offer a group health plan, the seller's COBRA coverage terminates and the buyer becomes liable for the merger and acquisition's COBRA beneficiaries.

- **Asset acquisition:** According to the new COBRA regulation, a sale of assets is considered a COBRA qualifying event

has occurred. However, if the transferred employees continue to be offered the seller's plans without a break in coverage, no qualifying event has occurred because no loss of coverage has taken place as a result of the termination of employment.

If the seller discontinues the health plan in connection with the sale and the buyer continues the business operations associated with the purchase of assets without change or interruption, the buyer is considered the successor employer and must provide COBRA coverage for the pre-existing COBRA beneficiaries.

When COBRA coverage is

plans.

A good way to make sure you are offering a fair, cost effective and comprehensive benefit program is to offer a flexible benefits plan. After you have evaluated the seller's plans as well as your own, you can offer the best of both worlds through your flex plan. Offering a flexible benefit plan allows you to maintain benefits that you otherwise would not have provided.

A flexible benefits plan can create benefit consistency and flexibility. Your flex plan may offer a "core" benefit program with "buy-up" options. For example, if the seller's plan has a vacation policy that is richer than the buyer's, you can offer the buyer's vacation policy as the core benefit and build in a buy-up option for those who want to maintain the higher vacation benefit. It may be at a cost, but employees have the choice to keep the plans they had previously. With the proper information, your well-designed flexible benefits program will continue to offer the best of both worlds.

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**NOTABLE THOUGHT**

*The true spirit of conversation consists in building on another man's observation, not overturning it.*

- Edward Bulwer-Lytton

## Communication - A Key to the Success of Mergers and Acquisitions

The main employee concern during the hectic activities of a merger or acquisition is: What will happen to me and my benefits? During the transition, employees have high expectations and anxieties about the future. You can help with clear and complete communications.

You can explain what will happen to the acquired company's existing plan structure, and you can provide information about the acquiring company's benefit plans and corporate culture. In terms of the acquired company, it is important to determine if and when participation in certain plans will be frozen or terminated and how information, such as notification of the transition process and the new plan specifics, will be communicated.

Ofentimes the mergers and acquisitions process takes place under a very tight deadline. How can you effectively communicate with employees with only a couple of weeks to complete the transition process?

### Face-to-Face Communication

When feasible, face-to-face communication goes a long way. It is a means by which the employees of the acquired company can get personal knowledge about the acquiring company. It also helps to avoid

misunderstandings and misconceptions. Problems can often be avoided when employees have the opportunity to express themselves and their worries and receive an immediate response to their concerns and questions.

### Written Communication

When merging organizations, especially those with numerous locations, or when working under a tight deadline, it can be next to impossible to accomplish face-to-face visits. When face-to-face interaction is not a viable option, ongoing communications via newsletters, memorandums and even frequent e-mails can be effective alternatives. By utilizing continuous updates and being open about expected timelines, you are employing an effective approach that illustrates to employees you care.

### An Ending Becomes a New Beginning

Companies continue to realize the important role of the benefits de-

partment in a merger or acquisition. The responsibility of the benefits professional during mergers and acquisitions is not just to participate in the due diligence process but also to effectively assist in the merger of the corporate cultures and communicate the status of the progress on an ongoing basis.

To be effective, the benefits professional must be knowledgeable in several areas including the essentials of plan designs, legislative and compliance issues, and technical information, therefore allowing the benefit expert to

be efficient and creative at the same time.

Although you can't please everyone all of the time, open lines of communication and familiarity with the process will earn you the respect of even those employees who are not in favor of the merger or acquisition. They will understand why you are heading in a certain direction and will appreciate your efforts to include them throughout the process. This should enable you to endure a successful integration.

## NOTABLE FACT

*As stated in an Employee Benefit News article, "corporate marriages often fail because companies paid insufficient attention to what they previously proclaimed the most important asset—their people."*

Our technical bulletins are written and produced by the McGraw Wentworth staff and are intended to inform our clients and friends on general information relating to employee benefit plans. They are not intended to provide either legal or tax advice. Consult your legal counsel or tax advisor in matters that directly affect your benefit plans.

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