



BENEFIT *Advisor*

In This Issue

In this tenth issue of the McGraw Wentworth Benefit Advisor for 2008, we will discuss mergers and acquisitions. Mergers and acquisitions are not nearly as popular today as they were in the nineties. However, as our economy continues to struggle, mergers and acquisitions may occur more frequently as necessity dictates.

The key to a successful merger or acquisition is planning and discussion. Successful mergers require significant effort and communication to merger two organizations with two different corporate cultures. This Advisor provides recommendations every step of the way to help manage the process, pre-acquisition and post-acquisition.

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.

“Managing Mergers & Acquisitions”

In this tough economy, mergers and acquisitions are not as common as they were in the nineties, but they still affect many organizations. They present the dual challenge of not only merging two separate organizations but also merging two distinct corporate cultures.

Mergers and acquisitions can become even more complicated when human resource professionals are brought into the process too late. Your benefit professionals have expertise in the benefits and policies of your organization. These professionals can make sure your organization does not commit to a benefit strategy that may be impossible to provide.

Organizations need to consider a variety of factors when they consider a merger or acquisition. This Advisor discusses the following three issues in depth:

- Pre-Acquisition Issues
- Post-Acquisition Issues
- Administrative Process

A thoughtful approach can ensure good decisions are made throughout the process.

Pre-Acquisition Issues

Evaluate the organization to be purchased using due diligence. The due



diligence process occurs well before the letter of intent and a purchase agreement are signed. The process includes the following procedures to evaluate the potential

benefits or liabilities of the purchase:

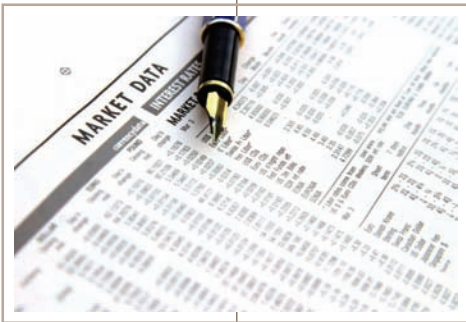
- Identify known liabilities.
- Identify potential liabilities.
- Identify issues that need to be resolved before the sale.
- Ensure the purchase agreement covers all the health and welfare benefit liability issues.
- Create a team to help manage the acquisition process. This team should include many human resource professionals – benefits, payroll, compensation, and so on. It also makes sense to include other disciplines that the acquisition may affect, such as legal or management.

Benefits issues are some of the most time-consuming activities both pre- and post-acquisition. Thoroughly working through the benefit issues in the pre-acquisition process will make the post-acquisition process proceed more smoothly. Post-acquisition is typically more time-crunched, so developing an acquisition action plan in the pre-acquisition process will be essential for a smooth transition.

COBRA

The components of the purchase agreement, for example, the type of transaction, are important. Is the sale a stock or an asset sale? Although the distinction may not seem important, the type of sale determines the COBRA responsibility. COBRA responsibility can be allocated in the purchase agreement; however, if the purchase agreement fails to assign COBRA responsibility, the COBRA regulations spell it out. COBRA defines the types of sale as follows:

- **Stock Sale:** A transfer of stock in a corporation that causes the corporation to become a different employer or a member of a different employer – in other words, the employer transfers ownership interest by selling stock.
- **Asset Sale:** A transfer of substantial assets, such as a plant or a division or substantially all the assets of a trade or a business. This broad definition does not place a value on what might be considered substantial assets.



The COBRA rules spell out the obligations for business reorganizations. The rules can vary depending on the situation, but the general rule of thumb in each type of transaction is as follows:

Stock Sales

Employees that are still working for the acquired organization, even though it is now under new ownership, are not considered to be terminated. This holds true even if the buying organization does not provide health care benefits for their employees. Employees in this case may lose coverage, but without an official termination of employment, there is no qualifying event and COBRA, therefore, does not apply.

COBRA obligations in stock sales apply primarily to qualified beneficiaries who were on COBRA before the sale or employees who lose their jobs because of the sale. In general, if the seller maintains a group health plan, the seller is responsible for offering COBRA coverage to these qualified beneficiaries. The only exception is if the seller no longer offers a health plan, then the COBRA liability for these qualified beneficiaries transfers to the buyer.

It sounds complicated, but once your organization identifies the qualified beneficiaries affected by the sale, all you need to do is determine whether the seller is maintaining a health plan. If the seller does maintain a health plan, your organization does not need to assume the COBRA liability for the merger and acquisition qualified

beneficiaries, unless you agreed to as part of the purchase agreement.

Asset Sales

COBRA responsibilities are different when the transaction is an asset sale.

For the most part, with an asset sale, all employees experience a qualifying event. Therefore, in an asset sale, your organization needs to pay attention to beneficiaries qualified for COBRA before the sale, employees that lose employment because of the sale and any employees that are employed by the buying organization after the sale.

In an asset sale, the seller's health plan is responsible for COBRA-qualified beneficiaries providing the seller maintains a group health plan after the sale. Employers have problems in situations when employees associated with the assets sold are offered group health coverage under the buyer's plan. An employee in this situation will likely not elect COBRA coverage, but the fact the buyer offers health coverage, does **not** waive the requirement of the seller to extend COBRA to these individuals.

The only exceptions to this rule are:

1. The employee does not lose coverage under the seller's group health plan.
2. The buyer is considered a successor employer. To be considered a successor employer, the buyer must continue the business operations associated with the assets purchased **and** the seller must cease to provide a group health plan.

As long as a seller maintains a group health plan, it is responsible for providing COBRA to qualified beneficiaries. In the case of an asset sale, the list of qualified beneficiaries is more comprehensive because all employees associated with the sale are deemed to be terminated.

If the seller terminates all group health plans, then COBRA liability transfers to the buyer. Again, the purchase agreement can assign COBRA liability to specific parties, but if any party defaults on the COBRA obligation, the party deemed responsible under COBRA becomes liable.

Evaluate Cost Issues

Most organizations have a process for evaluating benefit and labor costs. During the pre-acquisition phase, the buying organization should develop targeted budget goals for the acquired organization. In many cases, the two organizations will have very different pay and benefit philosophies. Maintaining separate philosophies will not be productive in the long run – the point of sale is the time to make any necessary adjustments. If the pay and benefit philosophies are wildly different, it may take several years to align them. In any case, the issue should be discussed and a tentative action plan should be developed.

Grandfathering

Grandfathering is an important consideration during the pre-acquisition phase. To understand the differences in benefit provisions between the buying organization and the acquired organization, compare benefit eligibility, labor contracts, retirement plans, vacation policies, sick leave and so on. While it may seem easy to continue the same benefits the acquired organization

already offered, that approach may complicate the benefits and create inequities. Instead, integrate the new organization into your benefit structure. To convince new employees this approach is best, compare benefit structures to see where the new employees are gaining benefits and where they are losing certain benefits. If the new benefit approach can be presented as a tradeoff, it will be more acceptable.

As part of the benefit review, retirement plans should also be discussed. Explain how years of service will be transferred and credited for retiree health care or pension benefits, if applicable.

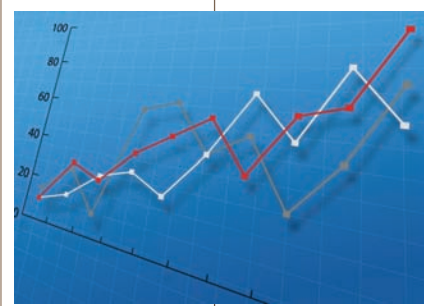
It is common to bring the new employees into the benefit plan as of the date of sale. Most organizations do not require these employees to meet a new hire waiting period. However, an immediate effective date for benefits will cause some challenges which are discussed in the Administrative Process section.

Benchmarking and Benefit Competitiveness

As part of a merger or acquisition, compare the acquired organization's benefit structure to benchmark data. Many organizations use benchmark data as part of their annual planning process to determine how their benefits stack up against other companies in the same area, in the same industry and even across the nation.

Understanding how your benefits compare with others helps your organization in the compensation and benefits planning process. Some organizations want the best in class

benefits but will offer slightly less than benchmark salaries. Other organizations target their benefits to the middle of the road and also set their compensation strategy in the middle of the competition. In order to effectively recruit new hires, your benefits and compensation strategy needs to be attractive enough to entice new employees to



your organization. Comparing your employee benefits and compensation to benchmark data allows you to assess how your plans compare with your major

competitors.

Reviewing benchmark data is an important step in the pre-acquisition process. If the acquired organization is in the same industry and same location as your organization, you can use your data as a benchmark. If the acquired organization is in a different location or in a different industry than your core business, you need to compare the acquired organization's benefits to benchmarks in that area or industry. Benefits may vary widely, so it is important to do some research on what is commonplace. Perhaps, the benefits for the acquired organization need to stay different because changing the benefits may hinder your organization's ability to recruit for the new organization.

The whole point of benchmarking is to have empirical data to start the discussion of benefit planning. These decisions should not be made in a vacuum because they can significantly affect your organization's ability to successfully recruit the best talent.

Liability Exposure: During the due diligence process, you need to assess the potential risk of purchasing the liabilities of the new organization. Liability can be lurking in areas that you may overlook, so it is important to review the organization carefully:

- **Health plan liability:** Are there a significant number of expensive, ongoing medical claims? Did you consider these ongoing liabilities when you set the purchase price?
- **Union agreements:** Are unions involved? If so, have you read the union contract to determine the benefits and compensation strategy? Does this affect your liability assessment?
- **Retiree Health Plan Commitments:** Does the organization have a retiree health plan? What are the commitments of that plan? Can your organization amend the plan? How are these benefits funded?
- **Plan Filings:** Has the organization filed Form 5500 and any other forms required by the federal government? Is your organization at risk for any late plan filing penalties?
- **Current lawsuits or ongoing disputes with employees and former employees:** Is the organization currently embroiled in a lawsuit or working through a difficult situation

with an employee that may turn into a lawsuit? Can your organization place a dollar amount on the potential risk?

- **Review the administrative process:** Does the organization have a systematic approach to benefit administration? Are records you requested during due diligence organized and well-managed? A haphazard approach to administration can spell trouble down the road.

Carefully examine the organization you want to purchase during the pre-acquisition or due diligence phase. Understanding the potential liabilities associated with the purchase is just as important as analyzing the benefits of the purchase. This initial analysis should be fairly detailed. If you merely scratch the surface now, you may be unpleasantly surprised later.



Post-Acquisition Issues

Once the deal becomes final, the hard work begins. Organizations typically focus on the material aspects of the merger; for example, publicity of the acquisition, reworking the organizational chart and integrating the new business functions into the organization. These issues tend to be the easy ones. Typically when an organization is purchased, a plan for using the acquired organization to improve a process or service has already been developed during the pre-acquisition due diligence phase.

During post-acquisition, the two most overlooked issues are people concerns and culture issues. Every merger is unique; however, many mergers fail because they could not integrate the people and the culture. In a very busy time, focusing on people and culture will help ensure the merger has a chance to succeed.

Information is very important during this time of change. Employees are likely to have the following questions:

- **Will my job be part of the new organization?** Your employees' immediate concern will be whether their jobs are

vulnerable. As part of the acquisition team, you may be so wrapped up in the administrative issues, you may not realize the affect this

change is having on your employees. When two organizations merge, various functions are likely to overlap and you may need to streamline both organizations. While the restructuring may only affect a small part of your workforce, all your employees will be concerned. Keeping employees informed is key to making sure they understand what lies ahead. If you are merging departments and functions, make sure employees are aware of that possibility. Let your employ-

ees know as much about the plan as you can. A lack of communication will cause all your employees to worry about their job security, instead of only the few employees that may be affected.

- **How will my benefits be handled?** Benefits are an important part of any employee's compensation. The employees in the acquired organization will have these key concerns:

- **What will happen to the benefits accrued with my employer before the sale?**

At first glance, the basic issue may be retiree plans, but your new employees' concern may not be limited to the 401(k) or pension plan.

Flexible spending accounts, vacation

allotments and accruals will also be on their minds. Research the former employer's benefits and policies in order to understand and explain how the sale will affect each of these programs.

- **What will my new benefits be?** In many cases, the sale will bring new benefits. Your organization may try to match benefits as closely as possible, but new carriers will have different procedures, enrollment requirements and so on. Employees will also be concerned about how their deductibles will be

handled. Will they be required to satisfy a new deductible or will your organization credit them for deductibles they met under their other plan? All of these issues need to be explained clearly and expectations should be set at this point.

For example, if your organization plans to credit deductibles, there is usually some lag time when claims are run out through the former plan before full deductible credits can be applied. In addition, will employees need to provide an explanation of benefits to

prove they have met part of the deductible or can your organization request an electronic file from the former

vendor?

Medical coverage will not be the only concern. Many of the employees may be involved with dental work-in-progress issues; for example, they may have children halfway through orthodontia treatment or adults in the midst of a getting a crown replaced. How should employees submit these claims and which plan will cover them?

- **How will the change in ownership affect my work day?** Will employees continue to work at the same location? Will security procedures be the same? Are there business practices they should be changing with the new organization? Will they receive new business cards and letterhead? How should they answer the phone?

Although some of these questions may seem trivial, your employees need to know as much as possible during the post-acquisition process. Very few employees readily embrace change and change in the organization's ownership is very stressful. Your constant communication throughout the acquisition process along with a plan to focus on employee concerns will alleviate some of your employees' fears. Your organization may not have every issue and concern buttoned down, but demonstrating your willingness to communicate and focus on employee-centered issues will help.

Administrative Process

The success of a merger or acquisition rests on resolving several administrative issues. Create an action plan that covers all the issues your merger and acquisition committee or work team has identified. Each issue or concern should become an action item on the work plan. The plan should assign responsibility and set deadlines for completing each task. The work team should meet often (no less than once a week) following the acquisition.



The administrative process should include:

- **Employee Benefits:** In some cases the buyer may wish to simply continue to offer the seller's plan. This may sound easy because it would only have a minimal affect on the employees. If you take this approach, verify that the carrier will still continue the benefit plan, even though the organization has a new owner. If so, ask whether rates and fees will change. You may need to change the demographic information relating to the account and have contracts and plan documents reissued under your organization's name.

In most cases, you will enroll the new employees into your benefit program. Key issues include:

- **Will your organization need to add a new suffix/account or will the new employees be incorporated into the current structure?** If you need a new structure, start the paperwork with your carrier as soon as possible.
- **Will you waive the new hire waiting period?** If so, you need to work with the vendor to have this requirement waived. If you have a large number of employees to add and coverage is to be effective on the date of sale, ask your health plan vendor whether the enrollment data can be transferred electronically. You'll need to get employees and dependents on the system as soon as possible. Your

organization can always go back and audit the eligibility data once they enroll.

- **Will the addition of new employees affect your rates?** Most insurance carriers reserve the right to amend rates if the population changes by 10%. If your plan is self-funded, check with your third party administrator to see whether your administrative or stop loss fees are affected. Your organization may also want to recalculate the benefit budget for the additional lives.
- Consider credits for deductibles met to date and potential out-of-pocket maximums. Determine the process for applying deductible credits. Will you request a report from the previous carrier or require the employee to submit the most recent explanation of benefits letter? Crediting the deductible is often a messy process. Make sure your new employees understand that delays may occur.
- Determine how any pre-existing condition limitation will be handled for the new group of employees. The Health Insurance Portability and Accountability Act requires your organization to apply any creditable coverage from the previous employer to

your pre-existing condition limitation, providing the break in coverage is no more than 63 days.

- Don't forget dental and vision coverage. For dental, you need to determine how treatment in progress will be handled between the old and new plan.
- Determine how long it will take the plan to send the new employees their ID



cards. In many cases, the timeframes are tight and the new employer may not have ID

cards ready on the first day of employment. New employees need to be in the system so that their medical coverage shows active. If the cards are not available, issue a memo with all the information a health plan provider will need to verify coverage and submit claims.

- Decide how to handle the medical flexible spending accounts. In some cases, employers can continue the seller's accounts; this approach might be helpful for employees that have not yet used all the funds in their accounts. If your plans have the same plan year, you can roll the added employees into your spending accounts at the beginning of the next plan year. If you have different plan years, you will need

to decide the best way to coordinate them. If the plan years are close (maybe a couple of months apart), most employers will simply require the new employees to wait to make an election until the next plan year. If the plan years are very different, you may consider a short plan year to merge the plans.

- Don't forget to enroll the new employees in all benefits. Health benefits are important, but you also need to enroll these new employees in short- and long-term disability plans, employee assistance plans, life insurance plans, and so on.
- As part of the sale process, consider disabled employees not actively working. In general, the carrier in place as of the date of disability holds the risk for the disability. If the employee is not permanently disabled, how will the return to work be handled? Also make sure these employees have life coverage. Your life plan probably requires an employee to be actively at work before coverage goes into effect. If your plan will not cover the added employees, make sure the seller's plan will allow employees not actively at



work to apply for waiver of premium. Ask for continuity of coverage from your organization's life carrier to address any issues that may not be addressed up front.

- Don't forget to evaluate your disability plan. Many long-term disability contracts have pre-existing condition limitations. Will your disability carrier waive the pre-existing condition limitation or apply credit for employees hired as part of the acquisition? Your organization should also compare your disability plan with the seller's disability plan. If there are major discrepancies, your organization should highlight the contractual differences.
- The same recommendations apply to the life insurance plan. Consider how the plan will handle employees not actively at work on the date of sale. It is a good practice to ask the new carrier to waive the actively at work provisions for the added employees to make sure life coverage is continuous.
- If your organization offers various voluntary benefit plans, discuss with the carrier favorable provisions for the new employees to submit evidence of insurability.

- **Payroll Process:** Not only do all the newly acquired employees need to be enrolled in benefit plans, they also need to be added to the payroll system. New-hire paperwork, including W-4s will need to be completed so that the appropriate taxes can be withdrawn from pay. Employees using direct deposit will need to complete the appropriate authorization forms.
- **Legal Disclosures:** Most employers make sure all new hires receive all the necessary information the law requires. Required notices (for HIPAA, COBRA, ERISA and so on) are usually provided as part of the new hire orientation process or once an individual enrolls in the health plan. Don't overlook these disclosure requirements because you have a large number of employees to process quickly as a result of the merger or acquisition. In addition to the legal notice requirements, don't forget to give employees a copy of your employee handbook. There is a good chance your policies and procedures will be different from the seller's. You need to make sure all newly added employees receive this information promptly.

It is a good idea to structure the administrative action plan around the way you process a new hire. Your new hire process, hopefully, covers all the information required to enroll and select benefits as well as a process to provide all the disclosures various benefit laws require.

Concluding Thoughts

A merger or acquisition can be an exciting time for an organization. In today's economy, a growing business is good news for all your employees. However, the transition can cause stress. Employees may worry about the addition because the newly acquired organization may have redundant positions and some employees may lose their jobs. Remember, employees may not voice these concerns but they will be on each employee's mind.



The success of a merger or acquisition is often tied to how the buying organization integrates the new purchase. Because a successful integration depends on many factors, organizations need to manage the process carefully. It makes sense to create a team to work through a merger and acquisition process. The team should include different disciplines including human resources, payroll, legal, finance and any other areas that the acquisition may affect.

Keep your employees informed throughout the acquisition process. Make sure employees understand their new benefits and know the date they become effective. Pay attention to detail when it comes to the benefits aspect of the merger; the employees in the newly acquired organization will want to understand their new benefits and understand what to expect in terms of ID cards, claim submissions and so on. If possible, look at the merger through the eyes of the acquired employees to determine

what issues should be handled promptly.

If you have any questions, please contact your McGraw Wentworth Account Director. **MW**

Copyright McGraw Wentworth, Inc. Our publications are written and produced by McGraw Wentworth staff and are intended to inform our clients and friends on general information relating to employee benefit plans and related topics. They are based on general information at the time they are prepared. They should not be relied upon to provide either legal or tax advice. Before making a decision on whether or not to implement or participate in implementing any welfare, pension benefit, or other program, employers and others must consult with their benefits, tax and/or legal advisor for advice that is appropriate to their specific circumstances. This information cannot be used by any taxpayer to avoid tax penalties.

McGraw Wentworth, Inc.

3331 West Big Beaver Road, Suite 200
Troy, MI 48084
Telephone: 248-822-8000 Fax: 248-822-4131
www.mcgrawwentworth.com

250 Monroe Ave. NW, Suite 400
Grand Rapids, MI 49503
Telephone: 616-717-5647 Fax: 248-822-1278
www.mcgrawwentworth.com