Lowenstein Sandler's Employee Benefits & Executive Compensation Podcast: Just Compensation

Episode 31 – Defined Benefit Plans: Mitigating Pension Liabilities in a Business Transaction

By Andrew Graw, Taryn Cannataro, Jessica Kriegsfield

FEBRUARY 2024

Kevin Iredell: Welcome to the Lowenstein Sandler podcast series. I'm Kevin Iredell, Chief Marketing Officer at Lowenstein Sandler. Before we begin, please take a moment to subscribe to our podcast series at lowenstein.com/podcasts, or find us on Amazon Music, Apple Podcasts, Audible, iHeartRadio, Spotify, SoundCloud, or YouTube. Now let's take a listen.

Jessica Kriegsfield: Welcome to the latest episode of Just Compensation. My name is Jessica Kriegsfield and I'm an associate in Lowenstein Sandler's Employee Benefits and Executive Compensation Practice Group. I'll turn it over to Andy and Terrance to introduce themselves.

Andrew Graw: Hi, I'm Andrew Graw. I'm chair of the Employee Benefits and Executive Compensation Practice Group at Lowenstein Sandler.

Taryn Cannataro: And I'm Taryn Cannataro, counsel in the Executive Compensation and Employee Benefits Group at Lowenstein Sandler.

Jessica Kriegsfield: Today's episode will offer a high-level discussion of some of the considerations related to defined benefit plans in the context of a business transaction. This episode will give an overview of single employer defined benefit plan considerations in the business transaction context, areas of potential liabilities, post-closing considerations and approaches to mitigating these issues. As always, this is not intended to be an exhaustive discussion, so we encourage you to consult with your legal counsel if you are considering a business transaction that involves defined benefit pension plans.

To start, Taryn, what are defined benefit pension plans and what is the difference between single employer plans and multiple employer plans?

Taryn Cannataro: Single employer defined benefit plans are pension plans that provide retirement benefits for their employees based on a fixed formula that typically takes into account factors such as final average compensation and years of service. In contrast, defined contribution plans, such as 401k plans, provide benefits based on the value of a participant's account that accumulates as a result of participant and employer contributions and investment return.

A multi-employer pension plan is also a type of defined benefit plan, but it is established and maintained for the benefit of union employees in particular industries by many unrelated employers. Industry employers contribute to the plan based on the terms of their collective bargaining agreements. We'll touch on these types of plans in another episode. Both single employer defined benefit pension plans and multi-

© 2024 Lowenstein Sandler LLP
The contents of this website contain attorney advertising. Prior results do not guarantee a similar outcome.

employer pension plans can be a significant source of hidden liabilities in the context of a business transaction.

Jessica Kriegsfield: Since today's discussion focuses on single employer pension plans, what is the potential liability associated with these types of plans in the context of a business transaction?

Andrew Graw: Well, there's really two main sources of liability, Jessica. One is for liabilities for maintaining the plan post-closing, and the other relates to liabilities for things that might've happened with respect to the plan prior to the closing. With respect to post-closing liabilities, it's the question of how well-funded the plan is. If the plan is underfunded, then there'll be an obligation to continue to make contributions at required levels over time to avoid minimum funding deficiencies, which can give rise to excise taxes and other grief. Also, if the plan is not maintained at sufficient funding levels, then it could fall into an at-risk status and that has other negative consequences for an employer maintaining the plan. It also places restrictions on plan benefits itself, can increase PBGC premiums and is generally undesirable. So it's important for employers that become liable for a pension plan to make sure that it's kept well-funded, and that certainly is a consideration in the transaction.

Taryn Cannataro: And as Andy said earlier, pre-closing plan violations are often another source of liability for defined benefit plan. So if you're representing a buyer who's assuming a defined benefit plan, the question is to what extent is the buyer going to be responsible for a problem of the plan? For example, if the plan had a disqualification issue or the seller failed to make contributions timely, or timely and completely make required filings, the buyer could be inheriting this issue. If the buyer is assuming a plan, they should do diligence to make sure it's not walking into a problem.

Jessica Kriegsfield: Taryn, who bears the liability for a defined benefit plan at a transaction?

Taryn Cannataro: Depends on what type of transaction it is. If it's an asset deal, it'll depend on the plan's terms. So it could be the acquirer if the plan and all liabilities are being assumed in the transaction, or it could be the seller if the seller's keeping the plan. But there still is a concern that the acquirer could have successor liability even if the seller keeps the plan. In order to determine whether the acquirer could have successor liability, you want to consider whether or not the acquirer could be viewed as having some liability if, soon after the transaction, the seller were to shut down and there are not enough assets to cover the pension liabilities.

There's no real answer to determine whether successor liability will apply, but there is a risk that claims could be made by participants and perhaps the PBGC if the plan's unable to fund benefits following the sale. A potential defense to the success reliability would be that it was an arm's length transaction, and the assets were sold for value. In this case, the company got a reasonable value for the assets and the plan would have been underfunded regardless, and this is why we usually have reps asking you about whether or not there are any pension plans and the extent to which they're funded because of this risk liability.

Andrew Graw: In a merger or stock deal, it's actually fairly easy. The acquirer is always bearing low liability of the plan because it is simply a successor to the seller or target company in a merger or stock transaction.

Jessica Kriegsfield: What should an acquirer do in a transaction to understands and if necessary, mitigate the pension liability?

© 2024 Lowenstein Sandler LLP
The contents of this website contain attorney advertising. Prior results do not guarantee a similar outcome.

Andrew Graw: It depends on the transaction, of course. The approach will be different depending on whether the plans are being assumed or not. As I said, in a stock or merger transaction, the acquirer is automatically taking the plan. In a sale of assets, it's up to the parties as to what's going to happen to the plan, whether or not it will be assumed by the purchaser or not. Certainly, in any transaction, diligence is important to see whether or not the plan has any liabilities, how well-funded it is. That'll drive a determination both as to whether or not the acquirer is willing to take on the plan, or what it can expect in terms of funding obligations or problems with the plan going forward. It's also really important whenever a target company has a defined benefit pension plan for a purchaser or acquirer to engage an actuary to assess the funding of the plan.

There is information that's publicly available about pension plans. They're all in 5500s that are the return reports filed for all plans for defined benefit plans. There's detailed funding information and actuarial valuation information about the plan in the 5500, but it's really important for an acquirer to engage an actuary to review that data and come to its own determination about what the funded status of the plan is.

And it's also important to address what's going to happen to the plan in the purchase agreement or other acquisition agreement. In the case of a seller, it may want some protections for the employees who participate in the plan. It may want to make sure that the acquirer not only funds the plan, but perhaps fully vest the employees for their benefits under the plan. On the other hand, for an acquirer that's leaving the plan behind with the seller in an asset transaction, it's just as important for the acquirer to think about the employees that it's going to be hiring in the transaction. The acquirer doesn't want a lot of unhappy employees who lost benefits under their prior pension plan. So an acquirer may want to negotiate to have the seller fully vest those benefits, fund the benefits, perhaps even terminate the plan, make distributions, perhaps grant additional service to those employees in order that they not lose the opportunities to acquire favorable early retirement benefits.

And then in terms of the transaction documents themselves, depending on what the status of the plan is, a purchaser may want indemnification provisions from the seller; something that's going to cover the acquirer for underfunding of the plan or anything that adversely affected the plan that had happened prior to the closing. And again, that's where diligence comes in order to find out what happened prior to the closing. Diligence may uncover things that happened about the plan that could cause a liability after the closing.

For example, if there was a breach of fiduciary duty that occurred, prohibited transaction or just a violation of the terms of the plan or many of the administrative requirements for operating a plan that occurred prior to the closing, the purchaser would want to know that if it's assuming the plan, because those liabilities could be raised after the closing and there's no one else there to cover that responsibility except the acquirer that assumed the plan. So in that situation, the acquirer would be very interested in getting indemnified for those potential liabilities and perhaps negotiating for an escrow to cover the obligation as well.

Taryn Cannataro: I think it may be worth noting that there are ways to mitigate this liability, so it's worth looking into whether or not you have a defined benefit plan early on in a transaction because some of these steps could take some time.

Jessica Kriegsfield: What are some options for the plan post-closing?

Taryn Cannataro: One option would be to terminate the plan, and this often takes time to implement because you have to meet a number of PBGC requirements to terminate a defined benefit plan, including providing required notices to beneficiaries and the PBGC. This

© 2024 Lowenstein Sandler LLP
The contents of this website contain attorney advertising. Prior results do not guarantee a similar outcome.

is probably the option that we see most often in practice, assuming the defined benefit plan is not very underfunded. If the plan were to be very underfunded, another option would be a plan freeze, which is where you freeze the plan to new participants so that no new participants can enter the plan, and existing participants will not earn any additional benefits, and this gives you a chance to allow the plan to become more funded and reduce the liability.

Another option would be to continue the plan post-closing, and you can either continue the plan in addition to any plan the acquirer might have, in which case non-discrimination issues could arise if the acquirer already sponsors its own tax qualified retirement plan. Or you can engage in a plan merger where you merge the acquired plan into the acquirer's existing plan so that all assets are merged into one plan.

Andrew Graw: That actually can be a good thing to do if the acquirer, say, has an overfunded plan and the plan that it's acquiring is underfunded. By merging them together, the overfunded assets of the existing plan can be helpful in eliminating or reducing the underfunded status of the plan that's being acquired.

Jessica Kriegsfield: Andy, what's the impact of the deal on plan benefits?

Andrew Graw: I touched on this a little bit before, but an acquirer does not want to have an unhappy workforce. So an acquirer might ask and negotiate for benefits of acquired employees to be vested so that they don't lose any significant benefits that they had accrued under the seller's plan up through the date of the closing. Under some circumstances, a seller will be required by law to fully vest employees if there's what's referred to as a partial termination of the plan, which means that there was a significant reduction in plan participation, which could happen as a result of a sale, then the seller would be required to fully vest employees as a result.

But even when there's not a partial termination, a buyer may want to negotiate for its future employees to be fully vested in those benefits. And as Taryn mentioned, if the buyer is assuming the plan, then we have to think about what we're going to do with the plan after the closing. And as Taryn mentioned, we could do a variety of things: terminate it, merge it, freeze it. So there's all of those post-closing choices for a buyer to think about. Fortunately, a buyer doesn't have to make that decision immediately. It could terminate the plan at any time after the closing. It could freeze the plan any time after the closing so it could continue the plan for a time and then make that decision as to what it wants to do with it.

Jessica Kriegsfield: In a business transaction, it's important to understand what types of benefit plans are involved early in the transaction as the types of benefit plans could impact how certain aspects of the deal are approached. Being aware of these nuances and potential issues early on can help you avoid costly liabilities and help the deal progress faster.

We hope that you found today's discussion regarding considerations related to defined benefit plans in the context of a business transaction helpful. Tune into our other episodes to hear about considerations with respect to multi-employer plans and defined contribution plans in the context of a business transaction. This episode is intended to be a high-level overview but is by no means an exhaustive discussion. Thanks for joining us today. We look forward to having you back for our next episode of Just Compensation.

Kevin Iredell: Thank you for listening to today's episode. Please subscribe to our podcast series at lowenstein.com/podcasts or find us on Amazon Music, Apple Podcasts, Audible, iHeartRadio, Spotify, SoundCloud or YouTube. Lowenstein Sandler podcast series is presented by Lowenstein Sandler and cannot be copied or rebroadcast without

© 2024 Lowenstein Sandler LLP
The contents of this website contain attorney advertising. Prior results do not guarantee a similar outcome.

consent. The information provided is intended for a general audience and is not legal advice or a substitute for the advice of counsel. Prior results do not guarantee a similar outcome. Content reflects the personal views and opinions of the participants. No attorney-client relationship is being created by this podcast and all rights are reserved.

© 2024 Lowenstein Sandler LLP
The contents of this website contain attorney advertising. Prior results do not guarantee a similar outcome.