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EMPLOYEE BENEFITS ISSUES

Global M&A

In the growing global economy corporate transactions involving multinational companies spanning multiple jurisdictions have become common place. One often overlooked area in these transactions is the treatment of employee benefits. While many of the benefits issues the parties will face in a global transaction are similar to those found in typical US domestic transactions, many others are not. Some of these issues relate to appropriate planning, while others represent issues that should be negotiated and memorialized in the purchase agreement to avoid ambiguities or disagreement. The issues are influenced not only by the types of benefits involved, but by the structure of the transaction and the countries involved.

TIPS FOR AVOIDING BENEFITS ISSUES IN GLOBAL M&A DEALS

Information Gathering

Certainly, one of the most challenging aspects of global transactions stems from the global nature of the transaction itself. Invariably, buyers will want detailed information about the seller's benefit plans outside the US. For many US multinationals, that can present a vexing problem. True global benefits governance (a topic beyond the scope of this article) remains elusive for many companies. Often there is no central company repository of information about the benefit plans and programs offered around the world.

As a practical matter, potential buyers will push back hard against a lack of information about benefit plans. Thus, a potential seller may have to scramble to round up that information in short order and, depending on the internal relationship between corporate headquarters and the company's local operations, that kind of information gathering may tip off local management (and possibly worse, local works councils or employee representatives) that a transaction may be afoot. That may risk the confidentiality of the transaction and may lead to employee uncertainty about the future.

Any multinational company considering future divestitures would be well served to start gathering information (*e.g.*, plan documents, insurance contracts, funding information) on global benefit offerings well in advance of the potential transaction (possibly as part of a broader governance process).

Benefits to be Offered

One of the key issues for the buyer in a global transaction is understanding what benefits it will be required to provide after closing. In US deals buyers will often try to avoid promises to replicate seller benefits in favor of onboarding new employees onto the buyer's existing benefit plans. However, in global transactions, it is common for the buyer to end up with some obligation to replicate the seller's benefits at some level for some period after closing. In general, that obligation to replicate seller benefits will arise in a combination of three ways.

1. First, there may be benefits that the buyer will be required to offer legally. In many countries, the buyer will be required to offer similar benefits as were provided by seller to avoid employment law issues (*e.g.*, TUPE countries in Europe). If benefits cannot be squarely replicated where required by local law (for example, if the buyer is only taking a small portion of the seller workforce and cannot find an insurer willing to write a group policy for a small risk pool) there may be obligations to consult with work councils or obtain employee consent which can potentially impact a planned timeline to closing.

   Depending on the country, the liability for not providing mandated benefits will fall on the seller. In other countries, the potential liability resides with the buyer and in some cases it is a joint and several liability between buyer and seller. The transaction purchase agreement should include allocation of liability with appropriate indemnities for failing to provide appropriate benefits.

2. Second, there may be benefits that must be replicated as a result of contractual promises in the purchase agreement. In this regard, a buyer needs to be careful what it commits to provide. As noted, in some cases, it may not be possible to provide transferred employees with the same benefits that they had with seller. In other cases, it may just not be desirable to replicate certain benefits (*i.e.*, it may not make sense economically to replicate certain plans, particularly in countries where the acquired workforce is relatively small).

3. Third, there are some benefits that may need to be provided just to keep employees happy. That is, certain benefits may be so key to employee morale that not offering them may result in employee unrest.

From a buyer's perspective, the purchase agreement would ideally limit the replication obligation to only the extent required by law, with the discretion for any non-mandated benefits left to the buyer. If that cannot be negotiated, an alternative would be to limit the replication obligation to the extent commercially reasonable as determined by the buyer. If that is not an acceptable alternative, the agreement should at least leave some flexibility for the parties to agree to changes in the benefits offerings (in all cases subject to applicable law). From the seller's perspective, some level of flexibility should be acceptable provided the seller is adequately protected for violations of law.

Once the parties have a sense of what benefits will be provided there will need to be an understanding as to how those benefits will actually be provided. This can vary depending on whether the transaction is structured as a stock sale or an asset sale. In global transactions, it is not uncommon for the deal to include both types of sales (*i.e.*, a mix of stock and asset sales).

Stock Sale

In a stock purchase or merger, where all of the relevant benefit plans transfer with the acquired seller entities, the benefits transition issues may be nominal. From the buyer perspective, the primary concern is understanding what the buyer is obtaining economically in the way of unfunded liabilities (*e.g.*, unfunded pension liability, retiree medical, etc.) and addressing those liabilities through the purchase agreement (possibly though a purchase price adjustment).

If the buyer is purchasing companies out of the seller's larger group (*i.e.*, purchasing one or more subsidiaries), the benefits issues may be more complicated. If plans covering the subsidiary company employees are maintained at a parent level, the buyer will need a strategy for how it will establish benefit plans to be ready at closing (since the benefit plans will generally not transfer with the acquired entity).

If a buyer already has an entity in the local jurisdiction, it may be able to use that entity to negotiate day one coverage for the acquired company. If the buyer does not have a local entity, it may not always have the power to contract for benefits in the local jurisdiction prior to closing. However, even where the buyer has the power to establish local plans, it still typically will not have all the demographic and coverage information necessary to replicate benefits.

Ideally, any negotiated purchase agreement will include specific information-sharing obligations so the buyer can implement appropriate benefit plans. In some instances, it may be advisable to negotiate an obligation for seller to establish carve out or free standing plans that can transfer along with the acquired entities. Obviously, the buyer has a substantial interest in making sure that is done correctly. In cases where the seller is going to establish new plans before closing, the buyer will want to have some right to be consulted or consent rights with respect to the establishment of any benefit plans to be transferred as part of the purchase transaction.

Asset Sale

In an asset sale, there are a different set of potential issues depending on whether the acquired employees are transferring to a newly established buyer entity or an existing buyer entity. If employees are transferring to a newly established buyer entity, the buyer will need to ensure there are plans in place at closing. At a minimum, that raises the information-sharing issues mentioned previously.

Where employees are going to be migrated to an existing buyer entity, there may be potential harmonization issues. As noted, whether by law or agreement, there will likely be some obligation to replicate seller benefits outside the US for some period after closing. If the existing buyer entity acquiring the employees has plans in place that do not line up with those replication obligations there is a potential problem.

In some countries it is not possible to maintain different plans for different employees within the same entity. As a result, the buyer may be required to provide a sort of "favored nation" status and provide all employees with the better of the two benefit packages. Obviously, that can change the expected cost of the transaction.

If there are going to be changes in order to harmonize benefits, that may involve obtaining employee and/or works council consent. As noted, obtaining that consent may be difficult and will at a minimum involve some lead time (*i.e.*, could impact the expected timeline to closing). If the harmonization issues can't be solved, it may be necessary to set up a new buyer entity in order to separate the two benefit structures.

Transition Services Agreements

In some instances, a buyer may not be in a position to have benefit plans to cover newly acquired employees at closing. Thus, there may be a desire on the buyer's part to have the buyer's newly acquired employees remain on the seller's benefit plans and payroll for some period after closing in order to set up appropriate buyer. In the US, this is often achieved through the use of a transition services agreement (TSA). However, TSAs may be problematic.

In some countries (*e.g.*, Singapore and Canada), TSAs maybe permissible with some basic requirements. However, in other countries (*e.g.*, France), such arrangements are generally prohibited or the status of such arrangements are unclear (*e.g.* India). In some countries, the seller may need to obtain a specific license in order to perform the transition services. Even where TSA type arrangements may be permitted, there may be situations where post-closing continuation in the seller's plans just isn't practical (*e.g.*, in some cases continued participation may require the consent of a regulator or other third party which could delay closing), or would require the seller to amend its plans to permit continued participation (which a seller is not likely to want to do).

When the business teams are negotiating the broad terms of the deal, promises about transition services are often made without knowledge of what can and cannot be provided. Often those issues do not come to light until after the deal is signed and the parties are moving to closing. That may result in delayed closings in some countries, which can carry additional costs for the parties.

If the buyer believes transition services may be needed, it would be advisable to include a covenant in the purchase agreement that seller will provide such coverage (subject to applicable law), particularly if the countries where that type of continuation coverage is going to be needed have not been completely identified before signing. From the seller perspective it may be advisable to limit such commitments to those situations specifically agreed by the parties. In any event, both buyer and seller will want to understand where transition services limitations may exist as early in the process as possible.

Dealing with Unfunded Liabilities

In global transactions the buyer will often be assuming some level of unfunded benefit obligations. In some cases, the liabilities will transfer by law (*e.g.*, in Germany pension liabilities often transfer with acquired employees). In other cases, buyer will accept a transfer of liabilities in order to facilitate the deal.

Depending on the bargaining strength of the parties and the magnitude of the liabilities being assumed, there may be a purchase price adjustment for the unfunded liabilities being assumed by the buyer. As one would expect, that is typically based on the difference between liabilities assumed and the value of any assets transferred in connection with the assumed plans.

Key to any price adjustment is defining what type of unfunded liabilities are going to be included in the adjustment. For example, in some countries like Mexico there are statutory termination indemnity plans where the buyer will typically be receiving an immediate unfunded liability for termination benefits based on cumulative employee service. While not squarely within the concept of a "retirement" plan, the buyer may want some kind of compensation for that liability depending on the overall economics of the transaction. Similarly, liabilities for retiree welfare benefits can represent a substantial unfunded liability. Thus, both parties have an interest in making sure the purchase agreement carefully defines the items going into the purchase price adjustment.

The parties will also need to determine the methodology for calculating liabilities for purposes of the adjustment. The line in the sand is typically the liabilities as they exist as of closing. However, the negotiation issue that often arises is whether those will be determined on a projected benefit obligation basis (*i.e.*, what will the benefit obligations grow to in the future based on assumptions about future employee service, earnings and benefit costs) or on an accrued benefit obligation basis (*i.e.*, the benefit liability as it exists as of closing).

The buyer typically wants to use a projected benefit obligation basis since it will produce a higher unfunded liability number for the adjustment, and thus a larger required asset transfer or purchase price reduction. Conversely, sellers will push for the use of an accrued benefit obligation basis under the theory that the use of projected benefit obligations is too speculative (*e.g.*, the numbers may be different if the buyer changes benefit structures after closing).

Another area of negotiation concerns the actuarial assumptions to be used to calculate the benefit obligations. The determination of the liabilities (and thus the purchase price adjustment) can vary greatly depending on the actuarial assumptions being used. Thus, the purchase agreement should contain an agreed framework for determining the relevant actuarial assumptions.

The Final Word

Global transactions present some unique benefits issues that need to be considered in the deal negotiation process. Ultimately, dealing with employee benefits in global transactions requires a coordinated effort between one buyer and one seller in order to ensure a timely and seamless closing. Addressing potential benefit issues early on in the transaction process is key to achieving that goal.

Guiding Clients Through All Stages of a Transaction

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