

Snake in the grass

EMPLOYEE-RELATED LIABILITIES CAN POISON YOUR DEAL

Overpaying and poor integration planning are frequently cited as major reasons mergers go awry. Discussed less often — but still potentially devastating — is a buyer's failure to consider the seller's employee benefits. For example, who will be liable for the target's employee pension plan? Make sure you consider such issues well before your transaction closes.

Biggest balance sheet liability

Even the most thorough due diligence process won't ferret out every acquisition risk and liability. But involving your human resources team in the process can help you spot and assess employee benefit-related issues that might otherwise elude you.

At the top of your priority list should be employee pensions. They can be the most onerous liability on a company's balance sheet — often amounting to as much as 200% of the company's value. Determining the size of a potential target's pension deficit and corresponding annual contributions with the help of a professional valuator can help prevent you from overpaying, or worse, buying a long-term financial burden.

A healthy company

Next, consider health and welfare benefits. Will your transaction make any of the target company's employees eligible for COBRA (which guarantees employees the right to continue coverage after they lose their job)? Some could be COBRA-eligible independent of the transaction (for example, divorced former spouses), and continue to be so after the deal closes. In these cases, determine whether coverage will be provided under the seller's or your health plan. Although COBRA rules assign responsibility to provide coverage in merger situations, parties are free to change them by mutual agreement.

Also look at any health or other welfare benefits your target offers its retirees and determine what type of postdeal responsibility you'll have for them. If you intend to provide them, be sure you perform thorough due diligence by reviewing all plan documents, including summaries and participant communications. Determine whether these benefits can be modified or terminated, or whether participants are vested and have the right to receive them for life.



Risky vacation policies

If your deal is structured so that the seller must terminate all employees and you immediately hire most or all of them back (which is true in many asset-purchase deals), both parties must decide how to handle employee accrued vacation or paid time off. Because their employment will technically be terminated by the seller, employees may be entitled to payment for accrued vacation, even though they still have a job.

This potential liability can be dealt with in one of several ways:

- ❖ You may choose to accept existing vacation balances under your own policy,
- ❖ The seller may pay out the full vacation balance in cash, or
- ❖ You might assume some or all of the cash-out cost.

In some cases, you might want to ask employees to consent to the transfer of vacation balances or to waive rights to vacation pay.

If you're making a stock purchase deal, pay attention to potential risk in vacation policies that may create contractual liability, or that make it difficult or impossible for you to implement your own policies. Some companies, for example, make written promises in policies that buyers find difficult to keep, such as vacation day accrual policies and expense approvals.

Employment claims

Also obtain information about any pending employee claims or outstanding litigation. Review the target's history of employment-related litigation, searching for trends that suggest habitual noncompliance in areas such as discrimination, harassment and safety violations. Ensure that your purchase agreement includes seller representations regarding compliance with federal and state employment laws.

If you must reduce the workforce you're acquiring, scrutinize your target's severance policies and plans to determine the content of severance packages and whether you or the seller will be responsible for them. Further decide whether the transaction will

trigger change-in-control or other severance that's payable to your target's executives. If payment of such benefits significantly reduces the company's net worth, be sure to include it in the formula you use to determine a starting bid.

Taking responsibility

In any acquisition, buyers must review employment issues and uncover related risks and liabilities, as well as determine how benefit program changes are likely to affect employees and the integration process. Be as knowledgeable about your target's liabilities as you are of its assets and you'll help prevent unpleasant postdeal surprises. ■