

CHAPTER 11

Labor and Employment Matters

An area of high risk is the target company's labor and employee relations, from both a business and a legal perspective. Poor employee relations will adversely affect the profitability of the acquired company, and the legal risks and expense involved in corrective action are increasingly burdensome.

Here, as in other areas of acquisition review, it is critical for the corporate lawyer managing the acquisition review process to involve other experts. The purchaser's human resources and labor relations staff should review the target company's collective bargaining agreements, employment manuals, hiring and firing procedures, training programs, vacation and holiday policies, etc., to determine both consistency with the purchaser's policies and compliance with law. The legal issues involve compliance with federal, state, and local labor laws relating to collective bargaining and unfair labor practices, notice of plant closings or layoffs, antidiscrimination and equal employment opportunity, occupational health and safety (including environmental protection and right-to-know), unemployment and worker's compensation, noncompetition and nondisclosure of proprietary information, substance abuse, and testing and immigration. While union organizing and strikes have decreased in significance in recent years, employment-related litigation has increased dramatically. Complete and expert review and analysis of the target company's employment policies and procedures and the potential liability involved constitute a critical element of the acquisition review process.

LABOR MATTERS

A. Documents Customarily Reviewed

- ___ 1. All collective bargaining agreements currently in effect between the target company and any union, together with any addenda, supplements, memoranda of agreement, or changes thereto
- ___ 2. All bargaining demands on the target company or any of its subsidiaries by any union made during the past three years
- ___ 3. All grievances and arbitrations during the past three years, and pending or threatened matters involving the target company and any of its subsidiaries
- ___ 4. All personnel manuals, employee handbooks, supervisor's guides, and general personnel policies and procedures of the target company
- ___ 5. All significant employment agreements, whether oral or written, to which the target company is a party
- ___ 6. All consulting agreements and other agreements with independent contractors, whether oral or written, to which the target company is a party
- ___ 7. All noncompetition confidentiality, and trade secret agreements to which the target company or its key employees are party
- ___ 8. All development, training, or apprenticeship programs for employees

of the target company or its subsidiaries

___ 9. All affirmative action programs undertaken or maintained by the target company, as well as any documentation concerning any internal compliance review or governmental audit of such programs

___ 10. Wage scales of hourly employees of the target company and its subsidiaries over the past three years, including wage information for each hourly paid job classification and the number of hourly paid employees in each such position at each year end

___ 11. Salary schedules for salaried employees over the past three years, including salary information for each salaried job classification and the number of salaried employees in each such position at each year end

___ 12. Policies and procedures for drug and substance abuse testing, treatment, and discipline; documents to evidence compliance, if necessary, with the Drug-Free Workplace Act of 1988

___ 13. Copies of COBRA notices and list of persons to whom notices were furnished during the past twelve months

___ 14. Copies of Forms I-9 and any correspondence, memoranda of telephone contact, or other communication with the U.S. Immigration and Naturalization Service

___ 15. Copies of Material Safety Data Sheets (MSDS), OSHA 200 reports, and workers' compensation records

B. Procedures to Be Followed

1. Prepare a summary of all collective bargaining agreements entered into between the target company and any union, together with any addenda, supplements, memoranda of agreement, or changes thereto.

2. Prepare a summary of collective bargaining history and collective bargaining demands during the past three years involving the target company and any of its subsidiaries, including any union contract negotiations and any strikes, work stoppages, slowdowns, or boycotts.

3. Prepare a summary of grievances and arbitrations during the past three years and of pending or threatened matters involving the target company and any of its subsidiaries.

4. Prepare a summary of union organizing activity involving the target company and any of its subsidiaries during the past three years, including any NLRB-conducted elections, any demands for recognition, or any evidence of union-organizing activities.

5. Summarize any significant employment agreements, whether oral or written, to which the target company is a party.

6. Summarize any consulting agreements and other agreements with independent contractors, whether oral or written, to which the target company is a party.

7. Summarize agreements with salespersons acting as employees or agents of the target company, including commission or other compensation arrangements, territories and principal customers.

8. Summarize any noncompetition agreements and any confidentiality and

trade secret agreements to which the target company or its key employees are party, and summarize the manner in which such agreements are used.

9. Summarize any development, training, or apprenticeship program for employees of the target company or its subsidiaries.

10. Summarize any affirmative action programs undertaken or maintained by the target company and any internal compliance review or governmental audit of such programs, and describe EEO-1 reports.

11. Summarize wage scales for hourly paid employees of the target company and its subsidiaries during the past three years, including wage information for each hourly paid job classification and the number of hourly paid employees in each such position at each year end.

12. Summarize salary schedules for salaried employees of the target company and its subsidiaries during the past three years, including salary information for each salaried job classification and the number of salaried employees in each such position at each year end.

13. Identify any plant closings or layoffs of fifty or more employees or 10 percent or more of the work force during the past three years. Determine whether the target company is in compliance with WARN requirements and plant-closing notice obligations under state law.

14. Identify and summarize all pending and threatened litigation, claims, protests, grievances, actions, or proceedings, whether judicial, arbitral, or administrative, involving the target company or its subsidiaries and relating to labor or employment matters, including wrongful termination, discrimination, sexual harassment, or intentional tort claims, and all judgments, orders, and decrees entered in any such actions during the past five years. For purposes of this inquiry, all workers' compensation, LHWA, FELA, FLSA, OSHA, MSHA, occupational disease matters, occupational injury matters, DOL, OFCCP, EEOC, IRCA, NLRA, ADEA, and Rehabilitation Act and any equivalent state agency proceedings that have occurred during the past three years, including any settlements of such matters, should be disclosed.

15. Verify existence of Forms I-9 and any notices from the U.S. Immigration and Naturalization Service.

EMPLOYEE BENEFIT MATTERS

The liabilities of the target company for employee benefits and the extent to which accrued liabilities are funded can affect the purchase price of an acquisition. Thus, a review of the target company's employee benefits should take place as early as possible in the acquisition review process. A major impediment to early review is the complexity of the subject. Since the passage of ERISA, the laws and regulations affecting employee benefits have become highly technical, and the lawyer managing the acquisition review process must seek assistance from experts in the area. The help of accountants and actuaries is also required to evaluate the amounts of funded and unfunded liabilities for accrued and future employee benefits. The legal questions regarding employee benefits are most critical in tax-

qualified plans. The income tax liabilities that would result from the disqualification of a qualified plan can be huge. The pitfalls created by ERISA, the numerous amendments since its enactment, and the regulations (or absence thereof) are many and highly technical. The issues that must be investigated relate to the funding of the plans, the administration of the plans, the filings and notices that must be made and given both to governmental agencies and to employees, the termination of plans either before or as a result of the acquisition, and the obligation to continue certain coverage for terminated or retired employees. Participation by the target company in multiemployer plans is a matter to be investigated because of the liability incurred upon withdrawal from those plans. The acquisition itself can affect the plans of both the target company and the purchaser as a result of the rules relating to affiliated groups of employers. Combining groups of employees can adversely affect formulas that relate to nondiscrimination in favor of highly compensated employees. The acquisition review process assists the purchaser in deciding whether to terminate the target company's plans, freeze the benefits thereunder, or merge the plans with its own.

Nonqualified health and welfare plans must also be reviewed to determine consistency of coverage and benefit levels compared to the purchaser's plans. Liabilities to retirees for health care benefits is an area of particular concern and one that is difficult to quantify.

The review process must also include executive compensation and stock option plans to determine the effect of the acquisition in the plans. Change in control provisions may vest benefits or trigger future benefits that are contingent and difficult to evaluate.

Finally, recent cases have increased concern over the liability of employers who modify or terminate employee benefits, particularly those for retirees. The lawyer should help focus the purchaser's attention on its future intentions with respect to employee benefits during the acquisition review process.

A. Documents Customarily Reviewed¹

1. Tax-Qualified Plans

___ a. All qualified plans and trust agreements (whether union, non-union, or multiemployer), annuity contracts and custodian agreements relating thereto and all amendments to such documents (collectively, the "qualified plans")

___ b. All IRS determination letters issued for the qualified plans

___ c. All Form 5500 annual reports (with all related schedules and exhibits) for the preceding five plan years for the qualified plans

___ d. All actuarial reports (for all defined benefit and target benefit plans described in (a) above), accountants' reports, trustee reports, insurance company reports, and financial reports for the qualified plans for the preceding five plan years

___ e. All summary plan descriptions for the qualified plans, substitution

pages therefor, and summaries of material modifications thereto

___ f. Full information concerning funding methods used by the qualified plans, any granting of exemptions to the full funding limitations for such plans, and any accumulated funding deficiencies relating to such qualified plans

___ g. Full information concerning "prohibited transactions" within the meaning of the Internal Revenue Code and ERISA and "reportable events" within the meaning of ERISA with respect to the qualified plans that occurred at any time during the preceding five plan years

___ h. All investment management agreements in effect at any time during the preceding five plan years for any qualified plan

___ i. For each qualified plan that is a multiemployer plan, all documentation and data necessary to calculate the target company's withdrawal liability in the event of a current withdrawal

2. Nonqualified Plans

___ a. All nonqualified pension plans and other deferred compensation plans, programs, or arrangements and all amendments thereto (including complete descriptions of all oral deferred compensation arrangements) (collectively, the "nonqualified plans"), election forms beneficiary designation forms, and available summaries of all such nonqualified plans

___ b. All trust agreements (e.g., Rabbi trust documents), insurance contracts, and other documents that provide a reserve of assets to discharge the obligation to pay benefits

___ c. All disclosures and reports provided to participants in such nonqualified plans

___ d. A statement, certified by the chief financial officer, of the total amount accrued for the benefit of each participant under the nonqualified plans, along with all records and accounting information supporting such statement

3. Stock-Based Plans

___ a. All qualified stock option plans, incentive stock option plans, employee stock purchase plans, restricted stock purchase plans, phantom stock plans, and other stock plans described in Code Sections 421-425 (collectively, the "stock plans")

___ b. All summary plan descriptions and annual reports provided to participants relating to the stock plans

___ c. A statement, certified by the chief financial officer, of the total amount accrued for the benefit of each participant under each stock plan, along with all records and accounting information supporting such statement

4. Welfare Benefit Plans

___ a. All health, medical, dental, vision, disability, or other health plans (funded and unfunded) or policies of the target company and each related entity for active employees and retirees, along with summary descriptions delivered to participants and beneficiaries, all Form 5500 annual reports for the immediately preceding five plan years, copies of any related trust agreements, agreements with third-party administrators,

claims summaries for self-funded arrangements, notices and forms utilized to comply with continuation coverage requirements applicable under federal or state law, and certified statements concerning compliance with such continuation coverage requirements

___ b. All group term life insurance policies of the target company and each related entity for active employees and retirees, along with all disclosures and summary descriptions delivered to participants and beneficiaries, all Form 5500 annual reports for the immediately preceding five plan years, all related trust agreements, and any agreements with third-party administrators

___ c. All severance pay plans, vacation pay plans, group legal service plans, and other "employee welfare benefit plans" or "welfare plans" (within the meaning of Section 3(1) of ERISA) of the target company and each related entity for active employees and retirees, along with all disclosures and summary descriptions delivered to participants and beneficiaries, all Form 5500 annual reports for the immediately preceding five plan years, all related trust agreements, and any agreements with third-party administrators

___ d. With respect to any welfare benefit plan that is subject to a discrimination test under applicable provisions of the Internal Revenue Code, a certified statement and supporting documentation evidencing compliance with such requirements or, in the alternative, appropriate income tax reporting of the value of the benefits under such plans

___ e. Any and all correspondence and other communications with government agencies during the five preceding years relating to any employee benefit plan of the target company and any related entity, including, but not limited to, documents relating to plan audits by the Department of Labor or the IRS and inquiries or claims by the Social Security Administration concerning payment priorities between Medicare and an employer plan

5. Terminated Plans

___ a. All "employee benefit plans" or "welfare plans" (within the meaning of Section 3(1) of ERISA) of the target company or a related entity terminated or frozen within the past two years

___ b. All "employee pension benefit plans" or "pension plans" (within the meaning of Section 3(2) of ERISA) of the target company or a related entity terminated or frozen within the past four fiscal years, IRS determination letters upon termination of such plans, and copies of all filings made with the PBGC for such plans covered by PBGC insurance

B. Procedures to Be Followed

1. Qualified Plans--With respect to qualified plans, carefully review the terms to determine whether they comply with applicable regulations and whether they are administered in accordance with their terms. Compare notices and disclosures given to governmental agencies and employees with provisions of plans. Summarize terms and highlight unusual features.

2. Multiemployer Plans--Identify the multiemployer plans in which the

target company is a participant, and inquire whether withdrawal liability has been determined.

3. Nonqualified Plans--With respect to nonqualified plans, summarize provisions thereof and highlight amendment and termination provisions.

4. Agreements with Individuals or Groups of Employees--Summarize the effect of acquisition and change of control on benefit plans and agreements.

Analyze parachute plans and severance agreements and calculate the cost impact of transaction.

C. Comment

Employee benefit liabilities may not be reflected in the target company's financial statements, but these often unfunded liabilities can dramatically affect the value of the target company to the purchaser. In addition, compliance with ERISA and other federal and state laws relating to employee benefits is difficult for even the best-managed enterprise, and the penalties for noncompliance can be severe. This is an area of acquisition review that is technical and time-consuming, but one for which the consequences of an inadequate review can be costly.

NOTES

1. For the target company and each entity aggregated with the target company under Section 414 of the Internal Revenue Code (a "related entity").