MERGERS AND ACQUISITIONS

Murder on the M&A Express: How Benefits Killed the Deal

"How are we doing resolving the problems with the acquisition"? I asked. Bang! And then a shot rang out. …"The deal is dead," my client told me. "We decided not to pursue it." This was the first time that I had ever witnessed a deal being killed by benefits problems. I'd heard stories. It wasn't pretty.

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How is it possible, I previously thought, when benefits are usually such a peripheral concern in a corporate acquisition, for benefits issues to kill the deal? Aren't the Internal Revenue Service's (IRS's) Employee Plans Compliance Resolution System (EPCRS) [Rev. Proc. 2002-47, 2002-29 I.R.B. 133] and the Department of Labor's (DOL's) Voluntary Fiduciary Correction Program (VFC) [67 Fed. Reg. 15061 (Mar. 28, 2002)] comprehensive enough to handle anything that can arise? The answer to that question is an unqualified no. The situation described in this column is interesting and unique, not just because of the turn of events but also because of the type of benefits problem that arose and our inability to completely resolve it to the buyer's and seller's satisfaction. Furthermore, this case helps to highlight that there are some fatal gaps in the benefits laws that can preclude a concrete assessment and limitation of potential liability attributable to certain problems. In this case, these gaps led to a business owner not being able to sell a business that he believed was a viable ongoing concern to a previously willing buyer that had been looking forward to expanding its business through the acquisition.

The Background: How Due Diligence Normally Works

Due diligence is the term used to describe the investigative activities taken by a buyer to determine whether it should purchase the target. In a benefits context, the due diligence involves a review of the seller's benefit programs to identify whether there are latent liabilities associated with the programs. These liabilities could arise from

- A failure to follow the tax-qualification rules of the Internal Revenue Code (Code),
- A breach of fiduciary responsibilities under the Employee Retirement Income Security Act of 1974 (ERISA),
- A failure to pay appropriate benefits due under the plan terms,
- A failure to fulfill the reporting and disclosure requirements of both the Code and ERISA, or
- A failure to properly fund the plans.

Because benefits plans and the rules that govern them are so complex, due diligence of plans commonly turns up compliance issues, most of which are related to the tax qualification of qualified retirement plans, and most of which can be resolved through the EPCRS options. [Rev. Proc. 2002-47] EPCRS embodies all of the means by which Code-related problems may be corrected without sacrificing the plan's tax-qualified status. Sometimes IRS filings are needed, but often the self-correction procedures under EPCRS are all that is required. Under these procedures, a plan sponsor may self-correct any problem that is discovered within two plan years of occurrence, and minor problems anytime. No IRS involvement or application is required. Generally, the self-correction process can be completed before the acquisition is finalized, eliminating the tax-qualification problem entirely.

Another common plan defect discovered in due diligence is the failure to comply with the reporting and disclosure requirements of ERISA—that is, to file required forms with the IRS or the DOL on a timely basis. This problem can also be resolved in most circumstances in a relatively expeditious manner, either through requesting waiver of late filing penalties due to reasonable cause, or use of the DOL's Delinquent Filer Voluntary Compliance Program (DFVC). Under

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the latter, the forms are filed with payment of a significantly reduced penalty amount.

Finally, some breaches of fiduciary duty may be resolved by filing voluntary compliance applications with the DOL under the VFC. This program permits voluntary correction of only selected problems. VFC is less flexible than the IRS programs, and requires notice to participants and beneficiaries that many are concerned may prove to be more alarming than comforting. In addition, filing under VFC does not preclude participant or beneficiary lawsuits against the fiduciaries.

Because the IRS and DOL offer so many options to enable plan sponsors to correct discovered errors or defects, benefits due diligence is usually an opportunity for an advisor to be a hero—we find the plan's illnesses, identify potential liabilities that would otherwise have been absorbed by the buyer, and then prescribe a cure that makes the problem vanish. The business acquisition ensues, and everyone is happy.

The Motive for the Murder: Due Diligence Discovers a Rat

What kind of benefits problems could possibly be so paramount that they threaten to kill the deal? Not counting situations in which one of the two parties to the deal is unreasonable (an idiosyncratically nervous buyer or a particularly uncooperative seller), there are likely to be only four types of situations in which benefits problems can have that type of power:

1. When the cost of correction is so large that the seller is not willing to fix the problem and the buyer is not willing to assume it;

2. When the benefits problems signal that there might be poor management of the target company in other areas, calling the true value of the target into question;

3. In situations related to employee stock ownership plans (ESOPs), when the deal itself raises fiduciary or tax issues that make the acquisition untenable;

And, the situation that arose in this particular case,

4. When the liability identified in the due diligence process cannot be reasonably contained or limited, or even fully identified, so the parties are effectively prevented from coming to terms.

My firm represented a company (the buyer) seeking to purchase another company (the target) in a stock acquisition. We requested a selection of benefits documents from the target in order to perform a due diligence review.

The target in our case sponsored a money purchase pension plan (MP plan) and a 401(k) plan. One of the documents provided to us in the due diligence package was an amendment to the MP plan. This amendment was dated in late January 1996 and purported to reduce the formula for employer contributions to the plan from 15 percent of pay to 7 percent of pay, effective retroactively to January 1, 1996.

On its face, the amendment violated ERISA Section 204(h) as it had existed in 1996. At that time, ERISA Section 204(h) provided:

> A plan [subject to the minimum funding requirements of Code and ERISA, which includes money purchase pension plans] may not be amended so as to provide for a significant reduction in the rate of future benefit accrual, unless *after the adoption of the plan amendment and not less than 15 days before the effective date of the plan amendment*, the plan administrator provides written notice, setting forth the plan amendment and its effective date to –
>
> (A) each participant in the plan;
>
> (B) each beneficiary who is an alternate payee ... under an applicable qualified domestic relations order
>
> (C) each employee organization representing participants in the plan

[Emphasis added]

It is critical to note the order of events that ERISA Section 204(h) required: first, the adoption of the amendment; second, the notice; third, the passage of 15 days; and finally, the amendment could be effective. The amendment presented in relation to the target's MP plan violated this order *on its face*, as it was adopted after the effective date.

The target told us that it had instructed the third party administrator (TPA), who drafted all plan documentation, to prepare the amendment in late 1995. We asked, had the board adopted the amendment earlier, and then had an officer sign the amendment late? No, there was no board resolution preceding the adoption of the amendment. Had notice been given to participants? We were ultimately provided with a written notice that the target had provided to its employees in April 1996—nearly four months after the purported effective date. We were informed that employee meetings had been held and that PowerPoint presentations had been made in December 1995, so the employees knew that the benefit reduction was taking place. We were never provided with copies of the PowerPoint presentations or other written material that may have been provided at these employee meetings.

What Happens if a Plan Administrator Fails to Provide 204(h) Notice?

Amazingly enough, the answer to this question is not really known. Because the statute states that "a plan may not be amended," one interpretation of the law is that any amendment that fails to meet the Section 204(h) notice requirements is void at its inception. In fact, this was the position taken by the U.S. District Court for the Southern District of Iowa when it reviewed a situation in which Section 204(h) notice was not provided to union employees, despite the fact that the collective bargaining agreement included the reduction in the agreed-upon terms. The court found the amendment to be void, and required that the plan be administered as if the amendment had never occurred. [Abels v. Titan Int'l, 85 F. Supp. 3d 924 (S.D. Iowa 2000)] A district court in New York came to the same conclusion, as did a court in Illinois. [Copeland v. Geddes Fed. Sav., 62 F. Supp. 2d 673 (N.D.N.Y. 1999); and Production & Maintenance Employees' Local 504 v. Roadmaster Corp., 1992 WL 108844, 10 Employee Benefits Cas. (BNA) 2551 (S.D. Ill. 1989)] We could find no other cases that interpreted ERISA Section 204(h) differently.

In the case of our acquisition, voiding the amendment would mean that the target would owe contributions equal to 8 percent of pay (the difference between the original 15 percent formula and the reduced 7 percent formula) for all years from 1996 through 2001, adjusted for earnings. This was a huge amount of money, and not the result that anyone wanted to reach.

Even more important, liability for the improper amendment could arise from any one of three sources. We were fairly confident that if the IRS audited the MP plan for a year prior to the time the plan document in effect in 1996 was restated, the problem amendment would stand out like a sore thumb (it certainly had to us). Therefore, the MP plan could be subject to disqualification for not providing the benefits that the document (coupled with the rules for proper plan amendments) required. Second, any investigation of the plan by the DOL was also likely to raise the issue. Finally, a participant could discover the issue, and make a claim for the differential in benefits (and publicize the issue to other participants). This could occur in the ordinary course of employment. It could also happen because a disgruntled employee retained employment law counsel who then requests all relevant plan documents. If that happened, and if the participant's attorney understood ERISA, the defect in the amendment could be discovered. The last possibility is even more acute in a mergers and acquisitions (M&A) situation, in which it is not uncommon for some executives to leave the company on less than perfect terms. After all, it's not for nothing that executives often desire "change in control" protections in their employment agreements.

Arguments That Section 204(h) Was Not Violated or That the Liability Was Not So Large

It was not too hard to articulate several arguments that could limit the potential liability arising from this amendment. First, if employee meetings were held in December, perhaps those meetings constituted the required Section 204(h) notice. We were not advised, nor provided with any proof, that participants were given anything in writing at those meetings that would qualify as a Section 204(h) notice. Nonetheless, the target argued that the employees received constructive notice of the amendment, even if there was not specific compliance with the law.

Second, notice was ostensibly given in April. The MP plan contained a provision under which a participant earned a right to receive a contribution allocation only if he or she was employed with the target on the last day of the year, (i.e., December 31). An argument was made that the true effective date of the amendment was not its stated date of January 1, 1996, but December 31, 1996 (when the contribution rights accrued). Under that argument, the April notice was given in plenty of time.

Third, it was argued that the effect of the late notice was only that the amendment truly became effective 15 days after the notice was actually provided—in late April or early May. Because the participants in the MP plan did not accrue contribution rights until December, the revised effective date still occurred prior to the contribution rights accrued.

All of these arguments are reasonable and could possibly win the day in an IRS or DOL audit or a lawsuit by participants asserting that benefits had been earned and denied. Nonetheless, these arguments were rejected by the courts in the cases discussed above. There are only two cases we could find in which a court was sympathetic to a plan sponsor that failed to give a Section 204(h) notice, and both of those dealt with a unique situation created by the same vague and difficult-to-understand guidance from the IRS. (In the remedial amendment period following passage of the Tax Reform Act of 1986, the IRS issued model amendments that permitted plan sponsors to hold benefits frozen while awaiting guidance on the new law (the so-called Model Amendment 3 from IRS

Notice 88-131). The IRS extended the remedial amendment period, and required a renewed Section 204(h) notice to be provided to participants in order for these amendments to be continued.) [Rev. Proc. 89-65] The court in each of these cases stretched its interpretation of the Section 204(h) notice rules in combination with the IRS's guidance to find either that notice was given or that it was unnecessary. [Allred v. First Nationwide, 97 F.3d 1456 (9th Cir. 1996); Scott v. Allstate, 113 F.3d 1193 (11th Cir. 1997)]

So, Where Does This Leave Us?

It is important at this point to refocus on the role of the benefits counselor in an acquisition situation. The purpose of due diligence is to identify areas of liability, and to communicate those to the client so that they can be factored into the decision of whether to buy the company and for what price.

When liabilities are identified, the parties to the deal negotiate, usually with one of four results:

1. The seller can resolve the problem and eliminate the liability before the acquisition occurs.

2. The buyer can purchase the company notwithstanding the liability. This can happen in one of three ways. First, the buyer can determine that the liability is sufficiently insignificant that it is willing to purchase the company nonetheless. Second, the buyer can insist that the seller indemnify it for any liabilities that it incurs in resolving the liability after the purchase. In this situation, the buyer must determine the likelihood that the seller will be in existence and in a financial position to make good on the indemnification if it is ever needed. Third, the purchase price can be adjusted to take into account the potential liabilities that were discovered.

3. The parties can restructure the deal so that the buyer does not have to assume the identified liabilities. For example, a stock acquisition or merger may be transformed into an asset acquisition, under which the plan liabilities remain with the seller.

4. The buyer can determine that the liabilities are so large and so unresolvable that it would prefer not to go forward with the transaction.

How to resolve the discovered problem or what arguments can be made to defend the actions of the target are really just factors in the buyer's analysis of the viability of the purchase. The buyer must make the business decision of whether these potential liabilities are small or large, likely to turn into real costs or more likely to never mature into anything of consequence, nonissues, or deal breakers. It is *not* the job of the benefits advisor to make this decision.

In our case, the client wanted the concrete answers necessary to determine which of the above results would occur in our situation: What was the potential cost that it would have to bear, and what were the chances that this cost would arise?

We could not answer those questions definitively. The IRS or the DOL might never audit the plan, and it was possible that no participant would ever sue. Even if the issues are raised, one or more of the arguments discussed above could be successful. If they were, the resulting liability for the violation could be minor in nature.

On the other hand, the worst could happen. Therefore, it became critical to try to identify where the outer signpost stood: What *could* the liabilities be if all hell broke loose?

What Are the Potential Liabilities?

As discussed above, the amendment could be void as of its inception, in which case the liability would be the 8 percent differential in the plan contribution for all years between 1996 and 2001 (assuming that a proper Section 204(h) notice and amendment were put into place in 2002 before the accrual of contributions occurred for this year), plus interest. The seller argued that the differential contribution was due for 1996 only, or only in relation to the employees to whom Section 204(h) notice would have been given. They argued that employees hired after 1996 would not have been given the notice in any event, so they would take the plan as they found it, with the 7 percent contribution.

Attractive though that argument was, we needed to remember that we were trying to identify what the possible liabilities *could be*. If the amendment was determined to be void at inception, that meant it had never taken effect—for anyone. The idea that this was the potential liability was so repugnant to the seller that we could never get them to provide us with sufficient information to match a financial cost to that liability. The seller did admit that the liability for participants who were participants in the plan in 1996 was approximately $2.5 million for 1996 through 2002. The total acquisition price was in the neighborhood of $10 million. The seller's calculation of the potential liability, which we considered to be a very conservative estimate, was 25 percent of the total purchase price.

This was simply the cost of correction of the problem. In addition, if the issue arose in an IRS audit, the IRS could threaten plan disqualification. If a plan is disqualified, the employer loses the deduction for nonvested contributions during tax years that are still open for audit, the employees are taxed on vested contributions made for their benefit, the trust ceases to be tax exempt and owes taxes on net income, and distributions are subject to immediate taxation (and are ineligible for rollover). The draconian impact of plan disqualification is generally avoided in practice by entering into a closing agreement with the IRS. Under this agreement, the employer corrects the problem and pays a fine or sanction in exchange for the IRS permitting the plan to retain its tax-qualified status. That sanction can be quite expensive.

If the problem arises in a DOL audit, rather than an IRS audit, the correction of the amounts due to participants is likely to be part of a settlement with the DOL. Under ERISA Section 502(l), the DOL is obligated to charge a 20 percent penalty on any amounts it recovers through a lawsuit or settlement. If the liability were the $2.5 million that the target estimated, the Section 502(l) penalty would be $500,000.

If the problem is a participant claim, it could be limited to paying off the individual participant. However, how likely is it that the affected participant would not tell others? In addition, it is arguable that the plan fiduciaries, who know that the issue is there, cease to act in the participants' best interests by hiding the possible benefit claims from the other participants.

Are the Liabilities Time-Limited?

Most latent liabilities disappear over time—statutes of limitations close, audits tend to impact only open tax years, documents are restated, and it becomes less likely that someone will look closely at the prior documentation. One of the questions our client asked was, when would the potential liability disappear?

Time Limit on IRS Discovery

The statute of limitations on IRS audits of a plan closes three years after Form 5500 is filed for the year at issue. [I.R.C. § 6501(a)] The 1996 Form 5500 was due to the IRS by July 31, 1997 (or October 15, 1997, if the plan sponsor extended the form filing). Therefore, the statute of limitations on IRS audits for that plan year was closed. However, an IRS audit of a later year for which the same plan documents applied would likely turn up the problem. In its procedures for the correction of plan defects, the IRS requires that such defects be corrected for all years, even those that are closed, and even though the IRS cannot disqualify the plan in the closed years. In a situation such as this, when the cost of making the participants whole is such a large part of the problem, the fact that certain plan years are closed to audit is all but irrelevant.

All plans must be updated during 2001, 2002, or 2003 to conform to changes in the law. (The legislation at issue is the Uruguay Round Agreements Act (also known as the General Agreement on Tariffs and Trade (GATT)), the Uniformed Services Employment and Reemployment Rights Act of 1994 (USERRA), the Small Business Job Protection Act of 1996 (SBJPA), the Taxpayer Relief Act of 1997 (TRA '97), and the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA '98), collectively known as GUST.) Generally, the IRS requires that the plans must be restated in their entirety for GUST. If the IRS audits the plan for a year during which the new document applies, it is unlikely that the IRS will examine the earlier document. As a result, the likelihood of discovery decreases significantly.

Time Limit on Participant Lawsuits

Participants could sue in relation to this matter under two causes of actions: a lawsuit against fiduciaries for breach of duty, or a suit to recover benefits.

Lawsuits for Breach of Fiduciary Duties

ERISA outlines that the statute of limitations for a lawsuit for breach of fiduciary duty expires on the earlier of (a) six years after the date of the last action constituting the breach or (b) three years after the earliest date on which the participant had actual knowledge of the breach. [ERISA § 413] In this case, the issue was, what acts constituted a breach of fiduciary duty? Was it a breach to fail to advise participants of their possible claim to benefits? Was it the denial of the claim for additional benefits, once it occurred?

Because it was unclear which was the "last action constituting the breach," it was similarly unclear when the statute of limitations on any lawsuit in relation to the breach would begin.

Lawsuits to Recover Benefits

The statute of limitations on lawsuits to recover benefits is not specifically stated in ERISA. Generally, the courts apply the state statute of limitations for a cause of action that is considered to be the most analogous to the ERISA cause of action. We reviewed the jurisdictions in which the target had employees, and found that all of the courts at issue considered breach of contract actions to be the analogous lawsuits. The statutes of limitations in the relevant jurisdictions ran from a low of three years to a high of 15 years.

The harder issue is when the statute of limitations *begins* to run. Generally, the cases reflect that a statute begins to run when a participant makes a claim for benefits and the claim is denied. [*See, e.g.*, Cotter v.

Eastern Conference of Teamsters Retirement Plan, 898 F.2d 424 (4th Cir. 1990); Rodriguez v. MEBA Pension Trust, 872 F.2d 69, 72 (4th Cir. 1989); Held v. Manufacturers Hanover Leasing Corporation, 912 F.2d 1197 (10th Cir. 1990), Hemphill v. Unisys Corp., 855 F. Supp. 1255 (D. Utah 1994)] On the other hand, some courts find that the statute does not begin until the participant has exhausted all administrative appeals and received final denial of the claim. [*See* Wexler v. Wex-Tex Mfg. Corp.'s Pension Plan & Trust, 992 F. Supp. 1313 (S.D. Ala. 1997)]

In some cases, particularly those involving health care, it is easy to identify when a claim for a benefit has been made and denied. However, in this case, what would constitute a claim for the 8 percent differential contribution? If a participant was told that he or she was entitled to a 7 percent of pay contribution to the MP plan, and then simply requested payment of his or her account on termination of employment, would there be a "claim" for the 8 percent additional amount—even if the participant did not know that any such claim existed? Or, did the participant need to know that he or she had a claim for the additional amount, and make that specific claim? The law is not clear. In one case, the U.S. District Court for the District of Columbia examined a situation in which employees were told that they were not eligible to participate in the company's plan because of their employment status. Because they were not participants, they were denied access to the plan documents that would have provided the information required to know that they might be eligible to participate. The court found that the statute of limitations did not begin until after the employees were put on notice that the company might have misrepresented their eligibility to participate. [Mayeske v. International Ass'n of Firefighters, 1989 WL 37154 (D.D.C. 1989)] Given the courts' interpretation of ERISA as a highly protective statute, there is a reasonable risk that any court would require that a participant know the nature of his or her claim before finding that a statute of limitations had begun to run on that claim.

If this analysis is taken to its logical conclusion, it appears possible or even likely that the statute of limitations on an ERISA-based claim for the 8 percent differential benefit would not begin until the participant knew of the possibility that such benefits exist. In other words, the statute would be effectively open *forever*.

Can the Liability Be Limited Somehow?

We identified that the amount of the liability was something in excess of $2.5 million. We determined that the liability was potentially alive forever. Was there anything we could do to contain the liability?

Any amendment adopted now (if adopted in compliance with ERISA Section 204(h) and the new Code Section 4980F) would ensure that the formula as modified would apply for the current year and future years. If no such amendment was adopted, and the prior amendment was void, the liability for a 15 percent money purchase contribution would continue to accrue each year.

The target could approach the IRS to try to remedy the problem. This could be done in one of two ways. First, if the target was willing to contribute the differential amount (plus earnings) for all affected years, it could correct the problem under the IRS's EPCRS. This would involve a filing with the IRS, the payment of a relatively inexpensive user fee, and the full correction for all years. Would the IRS consider full correction to be the provision of the differential benefit to all employees for all years? Or, to only those employees who were at the company when the Section 204(h) notice should have been given? Or, to only those employees who were there in 1996 and only to the extent of the decreased contribution for 1996 (giving the amendment effect once notice was given and 15 days expired)?

Alternatively, the target could choose to request that the IRS permit it to reform the original amendment to correct the errors. However, the IRS permits reformation of plan language only under limited circumstances. Several facts weighed in favor of IRS approval of the reformation of the amendment, particularly if the target could prove that employees had been given constructive notice of the amendment. Furthermore, the target in this case could demonstrate that it had advised its TPA on a timely basis of its desire to amend the plan's formula, and that the TPA had erred in its preparation of the amendment documentation. Therefore, the problem was not due to intended inaction on the target's part, but an error by a benefits professional.

To achieve IRS approval of any reformation amendment, the target needed to approach the IRS and disclose the problem. This could be done on an anonymous basis, permitting the target to walk away from the process if the IRS refused the reformation option. However, this would be a time-consuming procedure, and would delay the acquisition for many months.

Even if the IRS were to agree with the reformation solution, it might not completely solve the target's problem. Resolutions under the IRS compliance programs are specifically limited to IRS issues, and are not binding on participants or the DOL. [Rev. Proc. 2002-47, § 6.10] While the DOL has a voluntary compliance program of its own, that program does not encompass breaches of fiduciary duty stemming from a failure to pay benefits to participants. [*See* Voluntary Fiduciary Correction Program, 67 Fed. Reg. 15061 (Mar. 28, 2002)] On the other hand, under Section 101(a) of the Reorganization Plan No. 4 of 1978 [29 U.S.C. 1001nt], the IRS has been delegated authority to issue the regulations relating to ERISA Section 204(h). Arguably, therefore, an IRS resolution of a Section 204(h) issue should be binding on the DOL as well. (Note, however, that the preamble to the temporary regulations issued by the IRS specifies that the DOL retained enforcement authority for these rules, albeit in conformity with the IRS's regulations.) [*See* preamble to Prop. Treas. Reg. § 1.411(d)(4)-6T, T.D. 8795]

Even if the DOL was required to or chose to follow the IRS's lead in this case, the EPCRS resolution would not be binding on participants. Would a court reviewing a participant lawsuit on this matter defer to the IRS resolution of the issue, even if it denied participants benefits under the plan? We could not know what a court would do.

In sum, any attempt by the target to limit its liabilities through use of one of the government programs was equally likely to accelerate such liabilities, and might not be effective for all purposes.

The last possible means of limiting liability was for the buyer to ensure that the target took any and all actions to preserve its cause of action against the TPA who had prepared the amendment for breach of contract and/or professional malpractice. However, in light of the size of the potential liability at issue, the fact that there may be someone else sufficiently at fault to be a defendant in a lawsuit was of relatively little solace to the buyer.

Why the Murder Was Justifiable Homicide

In summary, there was a potential benefits liability in excess of 25 percent of the purchase price of the company. It could not be quantified with any confidence, because no one knows for sure the true effect of violating ERISA Section 204(h), and because the target refused to provide the buyer with sufficient information to perform a true "worst case" numerical analysis. Because the liability could not be fully quantified, it could not be fully resolved unless the target or the buyer paid all potentially due benefits to all potentially affected participants. If the buyer decided not to insist on full correction, the liability would remain in existence forever, although the chances of it arising would decrease over time. If it did arise, however, the cost would be enormous.

Was it reasonable for the buyer to take on that potential risk? It decided it could not.

In a last-ditch effort to keep the deal alive, the buyer asked the seller to change the purchase to an asset deal. The tax impact of an asset sale was too significant for the seller, amounting to near double taxation on the gains realized on the transaction.

At that point, the deal was dead.

Postmortem

Deals fall apart for many reasons, and it is not uncommon for a buyer to find out that the target is not the plum purchase it believed. Books can be cooked, inventory may be less than expected, the company may not be as good a fit for the buyer as anticipated, and even environmental concerns can produce liabilities too great to be absorbed by a buyer. What makes a benefits problem unique is that it is such an unexpected deal breaker. No one—not even the seller in many cases—has any idea that the problem is boiling beneath the surface. In this case, the seller in good faith tried to amend his company's plan. The company's benefits service provider drafted defective documents. Who knew?

Some of the blame for the result in this case has to reside with both Congress and the IRS and DOL for not better clarifying what happens if ERISA Section 204(h) is violated. The inability to properly quantify what the liability was made the resolution of the problem nearly impossible.

Last but not least, we look back on the role we played in the murder. At times during the process, and probably in the final analysis, the buyer's president was hugely grateful for our helping him dodge the bullet that this acquisition represented. At other times, he was furious at us for throwing a monkey wrench into a deal that he had spent months (and significant dollars) trying to put together.

We prefer situations in which our finding a problem is coupled with offering a viable solution. It was very unsatisfying to have to tell our client in no uncertain terms that the liability in this case was huge and that we could find no solution under which the cost was manageable and the resolution complete. On the other hand, our client walked away from this experience having lost only its financial and time investment in the acquisition process. That's better than the position in which it would have been had the deal gone through and the benefits issue erupted. It's also better than being the seller, who must now find another buyer for his company, with its possibly fatal flaws.