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Successor Liability in an Asset Sale: Court Holds Purchaser Liable for Seller's Delinquent Contributions to a Multiemployer Plan

by Jonathan J. Boyles

A federal appellate court recently held that a purchaser in an asset sale was liable for a seller's unpaid contributions to a multiemployer plan. In *Einhorn v. M.L. Robertson Construction Company*, a panel of the U.S. Court of Appeals for the Third Circuit held that liability attached if the purchaser was aware of the liability and there was a sufficient continuity of operations and workforce.

A multiemployer plan is sponsored by a joint board of trustees, which is typically made up of equal numbers of trustees appointed by the union and management. Contributions are made by unrelated employers pursuant to the terms of collective bargaining agreements entered into between employers and the union representing the workforce. The multiemployer plan allows workers to change employers within an industry, where work can be more project based (*e.g.*, construction), but still allow the worker to continue participation in one benefit plan throughout his or her entire career, receiving service credit under one plan for the worker's career with a variety of employers. Employers typically contribute for each hour or week in which a covered employee works for the employer (*e.g.*, $0.50/hour worked). If an employer's contribution obligation to the multiemployer plan ceases, the employer may also be assessed withdrawal liability, which represents a *pro rata* allocation of the plan's funding deficiency.

Liabilities for delinquent contributions can be substantial, as ERISA (the federal law governing employee benefit plans) provides that delinquent contribution collection actions are subject to automatic adjustments for interest, liquidated damages (up to 20 percent of the delinquency), and attorneys' fees.

Under the general common law, purchasers in an asset sale are not responsible for a seller's liabilities, except in cases where:

1. the purchaser agrees to assume the seller's liabilities;
2. the transaction, though structured as a sale of assets, was a *de facto* merger;
3. the purchaser was merely a restructured iteration of the seller's corporate entity; or
4. the sale of assets was a fraudulent transfer intended to relieve the seller of its liabilities.

None of the four exceptions applied in the *Einhorn* case. Instead, the Third Circuit found that the seller was liable by applying a labor law doctrine of successorship. Under the doctrine, a purchaser in an asset sale can be legally responsible for the seller's employment-related liabilities where there is sufficient continuity of operations and the purchaser was aware of the debt prior to the sale. For example, successor liability for employment discrimination violations committed by a seller can attach to a purchaser, even though the purchaser had no role in the illegal discrimination. Courts have found that the purchaser is in a better position to bear the loss after it negotiated the purchase and that it is unfair to otherwise provide no recourse for the employee.

Employee benefit plans are highly regulated under federal law, and there is clear legislative history articulating a policy interest in preserving those benefits for employee participants and their beneficiaries. Nevertheless, it is unclear how this policy interest is served by shifting liability to a purchaser in an asset sale. Employer contributions to multiemployer plans do not have a direct bearing on the benefits provided to employees. Instead, the employer contributions are pooled in a trust and invested. Plans then hire actuaries and other professionals to decide what benefit levels can be sustained based on the size of the trust assets. Contributions are made for all covered employees, including short-tenure employees who may never collect any plan benefits because they terminate employment prior to satisfying the plan's participation and vesting conditions. Moreover, pension benefits are subject to guarantees by the Pension Benefit Guaranty Corporation, which protect plan participants from funding deficiencies. Despite these differences, courts have held successor liability for employment-related claims by individual employees equally applies to delinquent contribution claims by multiemployer plans.

The Court's decision in *Einhorn* highlights the need for comprehensive due diligence and planning when union employees and multiemployer plans are involved in a transaction. Purchasers may consider the following items when a target contributes to a multiemployer plan:

1. *Diligence*. Ensure all multiemployer contribution obligations are identified and that contributions to all plans have been made in a timely manner. Multiemployer plans periodically conduct audits to ensure employers are properly contributing on behalf of all covered employees for all covered hours. Make targeted inquiries regarding the employer's audit history to determine whether discrepancies have

been identified in the past. Note that even if the union collective bargaining agreement has expired, the employer has a legal obligation to continue contributing to a multiemployer plan until the bargaining negotiations reach impasse.

2. *Purchase Agreement Provisions.* Ensure the purchase agreement has strong indemnification language and consider excluding the multiemployer contribution liability (or employee benefit plan representations more broadly) from indemnification caps and baskets/deductibles.
3. *Escrows.* If a delinquency is identified, consider adding an escrow for the liability, a holdback, or a price reduction to account for the liability. This will ensure the purchaser is not left exposed if the seller does not have sufficient assets to perform on the indemnity.
4. *Exercise Caution.* Employers should be aware that union officials do not have authority to bind a multiemployer plan. When it comes to multiemployer plans, most employers' first point of contact is with the union officials with whom the employer negotiates the collective bargaining agreement. Union officials do not have the power to waive the contribution obligation or set a different payment schedule. Multiemployer plans are the third-party beneficiaries of the collective bargaining agreement, but the union parties to the collective bargaining agreement do not have the power to waive the multiemployer plan's independent rights.

The rules governing multiemployer plans are complex. Significant liability can attach to purchasers, notwithstanding the structure of a purchase agreement. Careful due diligence review and consultation with qualified attorneys are essential to manage potential liability.

Increased Occurrence of Split-up of Pension Plans in the M&A Context

by Joseph S. Adams and Maureen O'Brien

Introduction

Parties in corporate transactions have always included standard representations and warranties regarding "big-ticket" employee benefit items such as retiree medical obligations and defined benefit pension plans. In some cases, the purchase agreement language is fairly straightforward—for instance in a stock purchase transaction where the acquired company sponsors the pension plan and is the only company participating in it. In those situations, the focus is on making sure the buyer conducts due diligence to properly value the assumed liabilities.

Recently, however, there appears to be an increase in parties transferring only a portion of a defined benefit as part of a transaction (*i.e.*, a transfer of pension plan assets and liabilities). Such transfers of pension plan assets and liabilities are particularly common where larger corporations with historical pension plan liabilities have contracted with buyers who are purchasing divisions or lines of business and the seller wants to divest itself of all liabilities related to a particular division or line of business. In addition, such transfers may occur if the buyer assumes a collective bargaining agreement from the seller that requires the maintenance of a pension plan for union employees.

Buyer Issues

A buyer that agrees to accept a transfer of pension plan assets and liabilities must agree to establish a pension plan that provides benefits that mirror the seller's pension plan on an active or a frozen basis. Any buyer agreeing to sponsor and maintain a pension plan should be aware of the following liabilities related to pension plans:

- Insurance premiums (based on participant headcount and funded status of the plan) are payable to the Pension Benefit Guaranty Corporation (PBGC).
- Pension plans must be funded annually according to requirements and actuarial assumptions set forth in the Employee Retirement Income Security Act of 1974, as amended (ERISA), and the Internal Revenue Code of 1986, as amended (the Code). The amount of such funding requirements fluctuates with investment returns, interest rate assumptions and future benefit accruals.
- Liabilities for required funding contributions, premium payments to the PBGC and unfunded benefit liabilities upon termination of the pension plan are joint and several liabilities of a buyer and any other member of a buyer's "controlled group." A "controlled group" consists of entities (whether or not incorporated) connected directly or indirectly through common ownership of 80 percent or more, and can include private equity and venture capital funds.
- Lending agreements require specific and often strict representations regarding the value of unfunded pension plan liabilities.

Seller Issues

A seller that agrees to transfer pension plan assets and liabilities should consider the affect of the transfer on the funded status of the seller's pension plan. In some cases, the statutorily required pension plan asset allocation method may result in the amount of assets transferring to the buyer, hurting the overall funded status of the seller's pension plan. A seller should work closely with its actuary to determine if this is the case before agreeing to a transfer of pension assets and liabilities. In addition, if the buyer is undercapitalized or becomes insolvent, and terminates its pension plan within five years of the transfer of the pension plan asset and liabilities, the transferred pension plan liabilities that are unfunded on the date of plan termination may again become the liability of seller under Section 4069 of ERISA if a principle purpose of the sale transaction between buyer and seller was to evade avoid pension liabilities. Further, the transfer of pension plan assets and liabilities requires notice (often advance notice) to the PBGC and the IRS, which may invite increased governmental scrutiny (although depending on the amount of unfunded liabilities of the pension plan, the mere news of the proposed transaction may trigger a PBGC inquiry).

Implementing the Transfer

Once the parties have determined to agree to a transfer of pension plan assets and liabilities, the purchase agreement must be drafted to state the parties' intent. When drafting pension transfer language, both parties should consult with pension actuaries to ensure that the actuarial assumptions used to value the transferred assets and liabilities comply with ERISA and the Code.

The valuation of transferring pension assets is governed by Section 414 of the Code and Section 4044 of ERISA, which sets forth a statutory framework for valuing liabilities and allocating pension plan assets to the various classes of liabilities based on factors such as whether the benefits relate to voluntary or mandatory employee contributions, when the benefits were accrued, whether they are vested, etc. Such sections of ERISA and Code also specify reasonable actuarial assumptions to be used in this process.

Typically, actuaries are not able to complete this type of work in less than 60 days and often, the actual transfer of the assets to the new pension plan is not accomplished until four to six months after the closing date of the transaction. In part, this is because computing and valuing the liabilities often requires calculating and reviewing the benefit of every participant in the plan (both participants' benefits that are being transferred and those that are staying behind).

Because of the lag time, the value of the transferring assets determined by the actuary in accordance with ERISA and the Code should be adjusted for investment experience and benefit payments. The purchase agreement should specify the date on which such liabilities will be valued (often the closing date) and the actuarial assumptions used to value the pension liabilities. In many cases, the liabilities are measured based on the actuarial assumptions used for measuring funding requirements and accounting requirements.

Generally, the seller's actuary prepares statements setting forth the value of the transferring assets and liabilities determined in accordance with ERISA, the Code and the purchase agreement and seller bears the cost of the actuary's services. The purchase agreement should contain a review and dispute mechanism, to provide an opportunity for buyer's actuary to review seller's actuary's work, and any underlying data. In the event that the actuaries do not agree that the amounts have been correctly calculated, the purchase agreement should provide for the review of a third, independent actuary to settle any such disputes. Typically, costs relating to the services of a third, independent actuary are equally split between the parties.

After the method for determining the transferring assets and liabilities has been agreed upon, the parties must negotiate the amount, if any, of a purchase price reduction relating to the difference between the transferred assets and the transferred liabilities. Usually, the transferred liabilities are larger than the transferred assets because pension plans in general carry unfunded liabilities. Moreover, the effect of the recent economic downturn on asset values combined with low interest rates have left most pension plans with significant unfunded liabilities.

The determination of a purchase price reduction varies with the business deal in each transaction. In some transactions, buyers build an estimate of unfunded pension liabilities into the initial purchase price offer thus making a purchase price reduction unnecessary. This approach requires buyer to have had an actuary perform a significant amount of pension asset and liability estimation prior to the signing date of the transaction. Another approach is to provide for a purchase price reduction based on the unfunded liabilities as part of the purchase agreement. This second approach allows the actuarial valuation of the pension assets and liabilities to be performed after signing an agreement, but leaves the parties with an unknown economic term for some period of time after the signing date of the transaction.

A third approach is to allow for the purchase price reduction in the purchase agreement and limit the reduction to amounts in excess of an agreed upon amount of unfunded liability. Under this approach, the buyer estimates the amount of unfunded liabilities that will be transferred to the buyer prior to the signing date of the transaction and builds that amount into the purchase price. If the actual unfunded liabilities are greater than the amount accounted for in the purchase price after the signing date and after the completion of the actuarial valuation of the transferring pension assets and liabilities, there is a purchase price reduction for the amount that the actual unfunded liabilities exceeds the estimated unfunded liabilities. The purchase agreement can also be drafted to provide for a purchase price increase if the pension assets transferred to the buyer exceed the pension liabilities transferred to the buyer by an agreed upon amount.

The parties should expect to work together to establish the new mirror buyer pension plan, agree on the valuation of the transferred assets and liabilities, and agree on the value of any purchase price reduction or purchase price increase for period of four to six months after the closing date of the transaction. Given the complex issues associated with negotiating a transfer of pension plan assets and liabilities, employee benefits counsel and actuarial consultants should be engaged by both parties to aid in drafting the purchase agreement, the new pension plan and valuing the assets and liabilities that are to be transferred.

Conclusion

The transfer of pension plan assets and liabilities raises unique issues in the M&A context. First, the parties must understand the risks associated with agreeing to a transfer of pension plan assets and liabilities. Then, the purchase agreement and the plan documents must be drafted to include valuation and transfer language that satisfies certain governmental requirements. Lastly, the parties must determine whether there will be a purchase price adjustment relating to any unfunded pension plan liabilities assumed by the buyer.

Be Aware of the EU Watch Dog: Commission Blocks Merger Between Aegean Airlines and Olympic Air

by Martina Maier and Philipp Werner

Background

Against a background of the ongoing Greek economic crisis and the increased airline consolidation, in January 2011, the European Commission (Commission) decided that the proposed merger between the two most important Greek carriers, Aegean Airlines and Olympic Air, should be prohibited because it would have resulted in a quasi-monopoly on the domestic Greek air transport market. The case is significant because it is only the second prohibition decision in the last five years. It shows, among other things, that traditional airline merger remedies, such as slot releases, are sometimes insufficient to allay the Commission's concerns. Moreover, the case shows that the Commission will not shy away from blocking a merger, despite the dire economic situation of the parties themselves and strong political pressure to clear the merger for the sake of the domestic economy.

Facts

On June 24, 2010, the Commission received the notification of a proposed concentration whereby the Vassilakis Group of companies, Marfin Investment Group and the Laskaridis group of companies would acquire joint control over a newly merged entity, including the businesses of Aegean Airlines and Olympic Air. Aegean Airlines is a publicly listed Greek airline company, while Olympic is the Greek flag carrier and the successor to state-owned Olympic Airways (later known as Olympic Airlines). Together the two carriers controlled more than 90 percent of Greek domestic air transport.

The Commission's initial investigation revealed that the transaction would have led to very high market shares and even monopolies on many domestic routes in Greece, as well as international routes. A second phase in-depth investigation was thus launched in July 2010. This second phase investigation confirmed the Commission's initial concerns, and the proposed merger was subsequently prohibited on January 26, 2011. In March 2011, the Commission's decision was appealed to the European Courts.

Significant Lessening of Competition on Domestic Routes

According to the Commission, the proposed merger between Aegean Airlines and Olympic Airlines would have led to a quasi-monopoly on the domestic routes, in particular between Athens and Thessaloniki, and between Athens and eight island airports. In defining the relevant market, the Commission used its traditional approach of origin-destination (O/D) pairs. The Commission found that the merged entity would have controlled more than 90 percent of the Greek domestic air-transport market. With respect to intermodal competition on the national O/D pairs, the Commission's investigation showed that ferry services do not as a general rule constitute a sufficiently close substitute to air services so as to discipline the merged entity's post-merger pricing behaviour. The only domestic route where ferry services were deemed to constitute a close substitute to air services was between Athens and the island of Mykonos, in which case the Commission concluded that there were no competition problems. With respect to potential competitors, the Commission found that there was no realistic prospect of a new airline of a sufficient size entering the marketplace and engaging in airline operations on these national routes, and restraining the merged entity's pricing in the future. Therefore, the Commission found that extensive remedies where necessary for it to be able to approve the proposed transaction.

Slot Releases not Sufficient as Remedies

According to the Commission, an acceptable remedy package would have, for example, required the divestment of part of the parties' airline fleet, or even the transfer of one of the brand names of the parties to potential market entrants.

The parties to the proposed merger were unwilling to offer such a broad remedies package. Rather, the parties only offered to release slots at Athens and other Greek airports, as well as other remedies such as access to their frequent flyer programs and interlining agreements. In the past, the Commission has accepted slot releases as an appropriate remedy because they were considered sufficient to attract new competitors to problematic markets. However, in the present case, the Commission found that slot releases would not have removed the competition concerns. Slots were already readily available at Athens airport and at most Greek airports. Indeed, the market test carried out by the Commission showed that the remedies proposed by the parties were unlikely to attract a credible new player who would set up a base at the Athens airport and exert a credible competitive constraint on the affected routes in this case.

Be Aware of the EU Watch Dog

The proposed merger of Aegean Airlines and Olympic Air reflects a growing trend in the airline business towards consolidation. The Commission's decision is the second prohibition decision in the airline sector, following the prohibited merger of Ryanair and Aer Lingus in 2007. Similarities can be drawn with the *Ryanair/Aer Lingus* case in that both cases involved a country's two most important domestic airlines, and in both the airlines' operations were conducted out of a single airport. Moreover, in both cases, the argument that no credible competitor would enter the market proved decisive in the Commission's decisions to prohibit the respective airline tie-ups.

The *Aegean/Olympic* decision also illustrates that the Commission will take a tough stance on competition policy, even when the economic existence of the parties is at stake. The decision also shows that the Commission will not bend to strong political pressure—as was the case with *Aegean/Olympic*, where high ranking officials cited the fact that Greece was (and still is) in the middle of its worst economic crisis in 50 years. This stands in contrast to perceived political weakness on the part of the Commission in transatlantic cases in which the Commission has been accused of folding to pressure from the U.S., such as in the *Oracle/Sun Microsystems* merger.

New Perspectives and Opportunities for Turnaround Investors in Germany

by Dr. Uwe Goetker and Thomas Ammerman

The German Government has introduced a reform of the German Insolvency Code (*Insolvenzordnung–InsO*) in order to further facilitate business restructurings in Germany. Once implemented, the Bill to the Law Regarding the Further Facilitation of the Restructuring of Businesses (*Regierungsentwurf zum Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen*) will open new perspectives and opportunities for turnaround investors in Germany by making insolvency proceedings more predictable and facilitating the implementation of "loan to own" strategies. As a result, German insolvency law will provide an excellent environment to acquire and restructure a business via the equity and/or the debt side.

Self-Administration

At present, "self-administration"—comparable to the "debtor in possession"—is the exception rather than the rule under German law. Under the Bill, this situation will reverse. The debtor's application for self-administration can only be rejected if there is reason to believe that the self-administration may lead to disadvantages for the creditors. Therefore, the debtor has the chance to implement a restructuring that utilises the efficient tools of German insolvency law without losing control over the business and the restructuring process.

Preparatory Insolvency Proceedings

Moreover, as long as the debtor is neither illiquid nor over-indebted, and the pursued restructuring is not obviously hopeless, the Bill entitles the debtor to apply for a protection period of up to three months, which allows for preparation of an insolvency plan for the restructuring of the business. In this case, the management can even propose a preliminary trustee (*Sachwalter*) who can only be rejected by the relevant insolvency court if the proposed candidate is not qualified to hold office. However, the preparatory proceedings do not provide for a mandatory moratorium, and they will be terminated by the court once the debtor is not able to satisfy its debts when due.

Preliminary Creditors' Committee

The German unemployment authorities must pay the net salaries of the workforce for up to three months prior to the opening of the actual insolvency proceedings. As a result, German insolvency proceedings regularly start with preliminary proceedings of up to three months during which the business can be continued at a lower cost. The preliminary proceedings are a decisive stage; the fate of the business is regularly determined during this first phase.

Until now, the creditors have not been represented officially at this stage. The Bill provides for the establishment of a preliminary creditors' committee (*vorläufiger Gläubigerausschuss*), which will represent the creditors during the preliminary insolvency proceedings. For example, the preliminary creditors' committee will be involved by the court in connection with the application for self-administration and the selection of the preliminary insolvency administrator. A preliminary creditors' committee will be established for active businesses that satisfy two of the following criteria: assets with a value of at least EUR2 million, a turnover of at least EUR2 million in the last 12 months or an annual average of 10 employees. The preliminary creditors' committee is therefore applicable to the vast majority of businesses in Germany.

Selection of Insolvency Administrator

Unless the debtor applies for self-administration, the appointment of the (preliminary) insolvency administrator is one of the most important decisions for the success of a business restructuring in insolvency proceedings. Until now, the (preliminary) insolvency administrators were appointed by the insolvency court without the debtor and the creditors being entitled to influence this decision, and, indeed, many insolvency courts would reject a proposal because it was made by the debtor or the creditors. The Bill will change this. A proposal agreed upon by the preliminary creditors' committee will be binding for the court, unless the proposed party is not capable of holding office. Consequently, creditors will be able to choose an insolvency administrator who is competent and qualified for the specific needs of the situation. In addition, the debtor could propose a preliminary insolvency administrator without the proposal being binding for the court. However, the Bill clarifies that persons who were proposed by the debtor, who advised the debtor in general form on insolvency proceedings and their consequences, or who created an insolvency plan for the debtor and the creditors shall not be excluded for these reasons.

Facilitation of Insolvency Plans

A key tool for restructurings of insolvent companies under German insolvency law is the "insolvency plan", which is comparable to US Chapter 11 proceedings, but which can also be applied in very small restructuring cases. The insolvency plan is a flexible and efficient restructuring tool, and allows for a settlement of the creditors' insolvency claims in deviation from the settlement procedure by law. An insolvency plan may be initiated either by an insolvency administrator upon the creditors' request or by the debtor. The insolvency plan remains subject to (i) the approval of the creditors who convene for a discussion and voting meeting docketed by the insolvency court and (ii) the final confirmation of the plan by the insolvency court.

The Bill will eliminate certain obstacles and clarify some uncertainties regarding insolvency plans which previously impeded insolvency plan proceedings. One such impediment is the fact that insolvency proceedings currently do not affect shareholders' rights. As a result, any change to the registered share capital (including debt/equity swaps) requires approval from at least 75 per cent of the shareholders. The necessary consent of the majority currently bears the risk of shareholders demanding compensation for their consent (hold-out value). The Bill now provides for a conversion of debt into equity, capital measures that include a contribution in kind, the exclusion of pre-emptive rights and the payment of compensation to exiting shareholders in an insolvency plan.

The insolvency plan requires confirmation only by the insolvency court and is subject to approval of the various groups of "participants to the proceedings" (*Beteiligte*), as creditors and shareholders are referred to collectively. Each group of participants approves the plan autonomously. The shareholders' potential to obstruct the plan is reduced, as only a majority of the registered share capital, rather than a minority of 25 per cent, can reject the capital measures agreed to in the insolvency plan. Furthermore, even the rejection of the insolvency plan by the majority of a group of creditors or of the shareholders is deemed as approval under qualified circumstances, such as the approval of the majority of participants' groups and the shareholders being in a better position with the insolvency plan than without it.

IRS Provides Safe Harbor for Allocating Success-Based Fees

by Thomas Giegerich and Amy E. Drake

The release by the Internal Revenue Service (IRS) on April 8, 2011 of Revenue Procedure 2011-29 provides a welcome new safe harbor for taxpayers with respect to the deductibility of "success-based fees" paid in connection with business acquisitions and reorganizations. "Success-based fees" are generally fees paid to investment bankers and other consultants that are contingent upon the closing of a transaction. The new safe harbor allows a taxpayer to claim a current deduction for 70 percent of the success-based fees incurred in connection with a covered transaction, while requiring the taxpayer to capitalize the remaining 30 percent.

Under existing Treasury regulations, the portion of a success-based fee that is compensation for "facilitating" a transaction must be capitalized. For example, amounts paid in the process of investigating or otherwise pursuing a transaction generally are deemed to "facilitate" a transaction. Only the portion of a success-based fee that is attributable to activities that did not facilitate the transaction can be deducted currently as an expense. Moreover, the regulations presume that, success-based fees are presumed to facilitate the transaction. The burden is on the taxpayer to rebut this presumption by providing sufficient documentation to the contrary.

With the release of Revenue Procedure 2011-29, the IRS hopes to reduce the large number of disagreements between the IRS and taxpayers about the type and extent of the documentation needed to prove that success-based fees are deductible. For taxpayers opting for the safe harbor, the need to make a factual showing (and hence to establish and maintain documentation) is eliminated.

Revenue Procedure 2011-29 states that the IRS will not challenge a taxpayer's allocation of a success-based fee between activities that facilitate a transaction (which must be capitalized) and activities that do not facilitate a transaction (which may be deducted) if the taxpayer:

- treats 70 percent of the amount of the success-based fee as an amount that *does not* facilitate the transaction;
- capitalizes the remaining 30 percent as an amount that *does* facilitate the transaction; and
- attaches a statement to its original federal income tax return for the taxable year the success-based fee is paid or incurred, stating that the taxpayer is electing the safe harbor, indentifying the transaction, and stating the portions of the success-based fees that are deducted and capitalized.

The new Revenue Procedure is effective for success-based fees paid or incurred in taxable years ending on or after April 8, 2011. The election under Revenue Procedure 2011-29 is made on a transaction-by-transaction basis and is irrevocable once made. Use of the election in connection with a transaction does not constitute a change in method of accounting for success-based fees generally, and therefore an Internal Revenue Code §481(a) adjustment is neither permitted nor required.