Warner Norcross & Judd
Employment Seminar Series
Employee Benefits
Employer Stock in 401(k) Plans
OVERVIEW

- Fiduciary considerations under ERISA – deciding to offer, keep or eliminate employer stock, and disclosure obligations
- Taxation of distributions
- Considerations under the Securities Acts, including the Rule 701 exemption from registration and S-8 registrations
- Diversification requirements under the Internal Revenue Code
- Employer stock in mergers and acquisitions
FIDUCIARY CONSIDERATIONS
Decision to Offer Employer Stock

- Reasons to offer employer stock as an investment option in a retirement plan
  - Align interests of employees and shareholders
  - Enhance productivity
  - Employees know more about the company in which they are investing than they do about other options
  - Improve cash flow for the employer
  - If matching in company stock, increase in plan participation
Decision to Offer Employer Stock

- Reasons to offer employer stock as an investment option in a retirement plan (cont’d)
  - Congress provided certain incentives to encourage employee ownership
    - Duty of diversification generally inapplicable
    - Tax advantages to employees upon distribution
    - Exempt from the prohibition against sale or exchange of property between a plan and a party-in-interest, provided fair market value is paid, and no commission is charged
Decision to Offer Employer Stock

- Reasons to not offer employer stock as an investment option in a retirement plan
  - Employees may place “too many eggs in one basket”
  - Single stock option reduces diversification within the plan (although ERISA provides an exemption for employer stock)
  - Investment of elective deferrals in employer stock is limited to 10% if any deferrals are required to be invested in employer stock or if the plan does not provide for investment in employer stock and thus is not an “eligible individual account plan”
  - Increases liability exposure of fiduciaries in the event the company stock drops in value
  - Raises conflict issues -- disclosure, decision to sell
Decision to Offer Employer Stock

- Reasons to not offer employer stock as an investment option in a retirement plan (continued)
  - Participants have less than full shareholder rights if they cannot vote or are restricted from diversifying out of employer stock
  - Increases complexity and requires compliance with securities laws
  - Repurchase obligations may cause cash flow issues
  - Difficulty of division under QDROs
  - ERISA bond requirement increases to $1,000,000
  - Additional 404(c) disclosure (confidentiality procedures, voting rights, etc)
Stock Drop Litigation

- **Imprudent Investment**: Should a fiduciary offer stock or continue to offer stock if he knows that the company is failing and stock prices are dropping, or will drop?

- **Failure to Disclose**: Should a fiduciary disclose information known to him regarding the company’s failure or potential losses?

- **Conflict of Interest**: Can a fiduciary make prudent decisions when they have separate interests in the performance of the stock?
Stock Drop Litigation - Background

• In 2009, courts handed down dozens of decisions discussing employer stock and 401(k) plans
• Approximately 2/3 of the cases went in favor of the employer defendants
• Settlement range - $300,000 - $70.5 million
• Case law is fact specific and both claims and analysis vary on a case by case basis
Stock Drop Litigation – Imprudent Investment Claims

- Imprudent investment claims challenge the act of offering company stock as a plan investment when it was not prudent to do so
- Theories of why it was imprudent to offer company stock include:
  - Knowledge of impending company collapse,
  - Knowledge of serious company mismanagement, and
  - Knowledge that the price of the stock is inflated due to fraudulent activities
Stock Drop Litigation – Imprudent Investment Claims

• If a fiduciary offers an investment that is not in the governing documents, the fiduciary is held to the prudence standard.
  – **Prudence Standard**: A fiduciary must act “with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent [person] acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.”
    • Known as the “Prudent Expert” standard and referred to as “the highest standard known to law”
    • Objective standard
    • Good faith is not a defense.
Stock Drop Litigation – Imprudent Investment Claims

• If the governing documents require investment in employer stock, the fiduciary is held to a more lenient, abuse of discretion, standard.
  – Presumption that a fiduciary's decision to remain invested in employer securities is reasonable;
  – A plaintiff may rebut this presumption of reasonableness by showing that a prudent fiduciary acting under similar circumstances would have made a different investment decision. *Kuper v. Iovenko*, 66 F.3d 1447, 1459 (6th Cir.1995).
**Stock Drop Litigation – Imprudent Investment Claims**

- **Sixth Circuit standard** -
  - An investment ceases to be prudent when “holding it becomes so risky . . . that the problem could not be fixed by diversifying into other assets....The presumption of prudence ends at the point at which company stock becomes so risky that no prudent fiduciary reasonably aware of the needs and risk tolerance of the plan’s beneficiaries, would invest *any* plan assets in it, regardless of what other stocks were also in that plan’s portfolio.” *In re Ford Motor Co. ERISA Litigation*, 590 F. Supp. 2d 883, 892-93 (E.D. Mich. 2008) (emphasis added)

- **DOL view** -
  - Each investment must be prudent and suitable on a stand-alone basis, and the investments must be prudent in the aggregate.
Stock Drop Litigation – Imprudent Investment Claims

• S.D. Ohio: Court found that employer had no duty under ERISA to divest its Section 401(k) plan of company stock because the employer’s financial struggles were part of the “unprecedented, ongoing credit crisis.” In re Huntington Bancshares Inc. ERISA Litigation, 45 EBC 2773 (S.D. Ohio 2009).

• Minority of courts have held that if the plan requires employer stock to be offered, the fiduciaries have no discretion to remove it; it is inherent to the plan design. See In re Citigroup ERISA Litigation, 47 EBC 2025 (S.D.N.Y. 2009)
Stock Drop Litigation – Imprudent Investment Claims

- S.D.N.Y.: In holding for the employer, the court stated that eligible individual account plans and employee stock ownership plans that invest in employer stock are “not intended to guarantee retirement benefits,” but are instead designed to give employees an ownership interest in their employers. *In re Citigroup ERISA Litigation*, 47 EBC 2025 (S.D.N.Y. 2009).
Stock Drop Litigation –
Imprudent Investment Claims

• D. Minn.: While refusing to dismiss employees’ breach of fiduciary duty claims, the court adopted an “excessive risk” standard under which the presumption of prudence could not be overcome by proof that the fiduciary invested “too heavily” in the employer stock. Instead, there must be proof that the fiduciary should not have invested in the employer’s stock at all. *Morrison v. MoneyGram Int’l Inc.*, 46 EBC 1673 (D. Minn. 2009).
Stock Drop Litigation – Failure to Disclose

• ERISA makes no mention of “failure to disclose” – duty derives from ERISA’s “duty of loyalty” and common law of trusts

• Selling 401(k) plan’s company stock based on insider information is a crime

• ERISA provides liability for making misleading statements only if they are made in fiduciary, not in corporate, capacity
Two part analysis to determine whether facts support fiduciary breach claim:

– Was the person an ERISA fiduciary when the alleged breach occurred?
– Were ERISA’s standards violated?
Stock Drop Litigation – Failure to Disclose

• Burden is on Plaintiff to establish the following for a breach of fiduciary duty claim:
  – The defendant’s status as an ERISA fiduciary acting as a fiduciary;
  – A material misrepresentation on the part of the defendant; and
  – Detrimental reliance by the plaintiff on the misrepresentation.
Stock Drop Litigation –
Failure to Disclose
Fiduciary Status

- Fiduciary status is a factually intensive inquiry
- According to ERISA, a person is a fiduciary to a plan to the extent he or she:
  - Exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets,
  - Renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or
  - Has any discretionary authority or discretionary responsibility in the administration of such plan.
Stock Drop Litigation –
Failure to Disclose

Fiduciary Status

• In the 6th Circuit, “anyone who exercises authority over an employee benefit plan can properly be held an ERISA fiduciary because that term was intended to be interpreted broadly by Congress . . . .” In re AEP ERISA Litigation, 327 F. Supp. 2d 812, 826 (S.D. Ohio 2004) (internal citations omitted).
Stock Drop Litigation –
Failure to Disclose

Misrepresentation

- Misrepresentation examples:
  - “[Plan participant] asks a plan provider about the possibility of the plan changing and receives a misleading or inaccurate answer or
  - [A] plan provider on its own initiative provides misleading or inaccurate information about the future of the plan or
  - ERISA or its implementing regulations required the employer to forecast the future and the employer failed to do so.” *James v. Pirelli Armstrong Corp.*, 305 F.3d 439 (6th Cir. 2002) (citations omitted).

- “A fiduciary breaches his duty by providing plan participants with materially misleading information, ‘regardless of whether the fiduciary’s statements or omissions were made negligently or intentionally.’” *Id*
**Stock Drop Litigation – Failure to Disclose**

**Materiality**

- **Materiality:**
  - A misrepresentation is material if there is a "substantial likelihood that it would materially mislead a reasonable employee in making an adequately informed [plan investment] decision." *See Pirelli Armstrong Corp.*, 305 F.3d 439.
  
  - Information that, when revealed, has no effect on a stock’s price cannot be deemed “material” to investors’ decisions.
Stock Drop Litigation – Failure to Disclose

Reliance

• ERISA plaintiffs usually argue that their reliance must be presumed
Stock Drop Litigation – Failure to Disclose

- Per the Sixth Circuit, the duty to disclose is limited to only those disclosures required under ERISA. *Sims v. First Horizon Nat. Corp.*, 2009 WL 3241689 (W. D. Tenn. Sept. 30, 2009)

- A fiduciary does not have an affirmative duty under ERISA to provide participants with nonpublic information regarding a company's financial condition. *Id*

- Requiring disclosure to participants of non-public information could violate the SEC insider trading rules; the courts have not as a whole resolved this issue
Stock Drop Litigation – Conflict of Interest

- Claim is that fiduciaries whose compensation is partially paid in Company stock have an inherent conflict of interest and should appoint an independent fiduciary on account of the fiduciary duty to act for the exclusive benefit of participants (duty of loyalty).

- Courts have held that presumption of prudence should apply and ERISA specifically allows officers to be fiduciaries. Amgen, Inc.

- Selling on inside information would be a criminal violation of securities laws.

- Fiduciaries cannot be expected to predict the future of stock performance.
Stock Drop Litigation – Managing the Risk

- Once the decision is made to include employer stock, make sure the plan has a strong statement of intent.
- Make other, well diversified, investment options freely available.
- Clearly define and limit fiduciary roles with respect to the stock.
- Reduce exposure to inside information and consider appointing an independent fiduciary.
- Fiduciary should keep a record of what it knows and why disclosure is or is not appropriate.
- Communicate to participants the long-term nature of investment in company stock, the intent of the company to provide the option as long as the company is viable, the importance of diversification, and the inherent risk associated with investing too much in any single security fund (as now required for the quarterly statements).
TAXATION OF DISTRIBUTIONS OF EMPLOYER STOCK
Net Unrealized Appreciation

- Average cost basis of the shares is included in income at distribution, at ordinary income tax rates

- Income inclusion of the net unrealized appreciation (NUA) may be delayed until the shares are sold and 72(t) tax on early distributions does not apply on the NUA portion

- NUA is taxed at long-term capital gains rates upon sale of shares, regardless of how long the employee has held them

- Additional appreciation is taxed at short or long-term capital gains rates, as applicable

- At death before sale, NUA is income in respect of a decedent
Net Unrealized Appreciation

- Net Unrealized Appreciation = Difference between the average cost basis and the stock’s fair market value when the shares are distributed
- Average cost basis = the amount the 401(k) plan paid for shares
- Additional appreciation: difference between market value of company shares at time of distribution and price participant receives when disposes of shares
Net Unrealized Appreciation

• Conditions:
  – Employee must receive an in-kind, lump sum distribution (a complete distribution of the participant’s entire account balance in a single calendar year).
  – No withholding on the employer stock portion of the distribution; 20% withholding will apply if other assets are distributed, but only with respect to and withheld from the other assets.
Net Unrealized Appreciation

- Four methods for plan to track plan’s cost of shares
  - Earmarking method
  - 12 month method
  - Single security method
  - Average cost method

- Regardless of method, employee’s basis is averaged over all shares received in the distribution
Net Unrealized Appreciation

- If company is not publicly traded, a put option should be offered, although not required for a profit-sharing/401(k) plan
- Technical Advice Memorandum 200841042: Stock distributions from employer’s ESOP to participants should not be treated as cash distributions when participants sell their shares immediately back to the company
Net Unrealized Appreciation
Illustration

- 5,000 shares of employer stock acquired by 401(k) account for $10 per share.
- Shares currently valued at $50 per share.
- If employee receives a cash distribution of $250,000 (and does not rollover to an IRA) will report the total amount as ordinary income.
- If employee elects to take stock →
  - $50,000 will be reported as ordinary income ($10 cost basis to the 401(k) x 5,000 shares).
  - Even if employee immediately sells the shares, the “net unrealized appreciation” of $200,000 is taxed as a long-term capital gain ($40 x 5,000 shares).
Securities Acts Generally

- Securities Act of 1933
- Securities Exchange Act of 1934

The Acts regulate the offer, purchase, and sale of securities. It is illegal to offer or sell securities not registered with the SEC, unless an exemption applies.
Securities Acts Generally

- Do the Securities Acts apply?
  - Is the interest or asset a **security**?
  - If so, is the transaction an **offer** or **sale**?
  - If so, is there an applicable **exemption** from registration?
Securities Acts Generally

- **Security** = “any note, stock, any interest or instrument commonly known as a security”
- **Sale** = “disposition of security for value”
- **Exemption**: Rule 701 – provides exemption for offers and sales of securities made pursuant to most employee benefits plans
Rule 701 Exemption

• Rule 701 security offerings must comply with the following conditions to be exempt from registration:
  – Securities must be offered by an eligible issuer;
  – Securities must be issued in a specified type of transaction;
  – Offering must comply with limitations on the amount of securities that may be offered; and
  – Company must make certain disclosures to participants in the plan
Rule 701 Exemption

- Eligible Issuer
  - Issuer is not subject to the reporting requirements of § 13 or 15(d) of the Securities Exchange Act of 1934
    - § 13 – “issuer” includes every issuer of a security registered on a national securities exchange
    - § 15(d) – “issuer” includes any broker or dealer who effects any transactions in, or induces or attempts to induce the purchase or sale of securities
  - Issuer is not an investment company registered under the Investment Company Act of 1940
Rule 701 Exemption

• Types of Transactions
  Securities offered or sold must be issued
    – Under a written “compensatory benefit plan;”
    – Established by the issuer; and
    – For the participation of the issuer’s current employees, directors and officers.
    – A “compensatory benefit plan” includes, but is not limited to, profit sharing, pension and similar plans
**Rule 701 Exemption**

- **Limitation on Amount of Securities Offered or Sold**
  Aggregate sales price or the amount of securities sold during any 12-consecutive-month period must not exceed the greater of:
  - $1 million;
  - 15% of the total assets of the issuer (or issuer’s parent in cases where the issuer is a wholly owned subsidiary and the securities represent obligations that the parent fully and unconditionally guarantees), as determined on the issuer’s recent balance sheet; or
  - 15% of the outstanding amount of securities of that class, as determined on the issuer’s most recent balance sheet date.
**Rule 701 Exemption**

- **Disclosures to Plan Participants**
  Companies must provide disclosure needed to satisfy antifraud provisions
  - Obligation to provide full, fair and complete disclosure of all "material" facts about the solicitation and the Company, its management, business, operations, finances, and most importantly, the risks associated with an investment in the Company’s securities.
  - Information is deemed "material" if a reasonable investor would consider the information important in making an investment decision.
  - Omissions, even inadvertent, of material facts can lead to liability.
Rule 701 Exemption

• **Disclosure to Plan Participants**

  If more than $5 million in securities are expected to be sold in a 12-month period, additional disclosure requirements apply:
  
  – A copy of the compensatory benefit plan or contract;
  – A copy of the summary plan description required by the ERISA;
  – Risk factors associated with investment in the securities under the plan or agreement; and
  – The financial statements required in an offering statement on Form 1-A under Regulation A.
Registration on Form S-8

- Where no exemption applies, companies registering under the ’34 Act can register on Form S-8 shares offered under an employee benefit plan (including where shares are available through a brokerage window).
- “Participation interests” in plan allowing elective deferrals to be invested in employer stock in an amount in excess of employer contributions should also be registered.
- A 401(k) plan would be an employee benefit plan for this purpose.
- Can be used for stock of employer of participating employees or the employer’s parent or subsidiary (but not brother –sister corp.s).
- Not limited to current employees for transfers between funds.
The number of shares to be offered must be listed.

Number of shares (participation interests) is generally based on the value of account balances permitted to be invested in employer securities on a valuation date divided by the value of a share or stock.

Additional shares on account of stock splits or stock dividends are deemed to be part of the original registration if the plan provides for an adjustment in those cases.

Limited scope audit under ERISA not permitted if plan has an S-8.
Registration on Form S-8

• S-8 consists of:
  – Registration statement
    • Provided to SEC
  – Prospectus
    • Provided to employees
Registration on Form S-8

- Registration Statement
  - Facing page must include employer and plan names, and number of shares registered
  - Documents incorporated by reference
  - Interests of any expert or counsel named in the statement must be disclosed
  - Insurance or indemnity of any controlling person, director or officer must be disclosed
  - Exhibits must include documents defining shareholders’ rights, a legal opinion, and the plan’s favorable determination letter, and consents of experts and counsel to use their opinions
  - Undertakings to file information and documents on subsequent events, removal from registration of unused shares, indemnity
  - Signatures of employer and plan (trustee or administrator)
Registration on Form S-8

• Prospectus
  • May consist of one or more documents, as long as they provide specified information about the plan and the issuer and the availability of certain reports, and any documents incorporated into the registration statement
  • All incorporated documents must bear a legend that the document is part of a prospectus covering securities that have been registered under the ’33 Act
Registration on Form S-8

- Use of the plan’s Summary Plan Description (or Summary of Material Modifications) as part of the prospectus is common
  - Must bear the appropriate legend
  - Timing of distribution is much quicker than ERISA – must be delivered when offer to sell employer stock is made
  - A summary prospectus may be provided that refers participants to an internet web site where the full prospectus is available

- Other participant disclosure required
  - A copy of the company’s annual report with audited financials
  - All reports, proxy statements and other communications distributed to shareholders when distributed to shareholders
**Registration on Form S-8**

- Document retention is generally required for five years following the last date the documents were used as part of the prospectus.
- All reports and proxy materials provided to other shareholders must be provided to participants, even if they do not vote the shares.
- The plan must file the annual report on Form 11-K within 180 days of the end of the year (unless the plan’s audited financial statements are filed with the employer’s 10-K annual report generally within 120 days of the end of the plan’s fiscal year).
- All documents are effective immediately upon filing.
- The filing fee is $92, as adjusted, per $1,000,000 of the maximum offering.
Tracking Shares

- Shares “sold” against the number authorized under an S-8 registration statement should be tracked
- No clear method has been established
- Employers prefer “net accounting” – offset for shares forfeited and recycled
- SEC informally prefers “gross accounting”
- RiskMetrics will apply its own method for determining burn rate
- Methodology must be set out in the proxy statement and 10-K
- Resales generally will not require registration
Insider Trading

• Section 16 of the ’34 Act prohibits trading on material non-public information at any time

• **Blackouts**
  – Blackout periods on trading are near-universal, considered best-practice and expected by investors
  – Typical policy prohibits executives, directors, and other insiders from trading in company stock for a period beginning 1-4 weeks before the end of a quarter and ending 3 trading days after the release of quarterly financial information
  – These are not the blackouts that are implemented when certain plan transactions take place
Insider Trading

• **Blackouts cont’d**
  – Ongoing elective deferrals are not affected
  – Transactions that are affected include:
    • an election to begin or terminate investing in the Company stock fund of the 401(k) plan
    • an election to increase or decrease the percentage of periodic contributions that will be allocated to the Company stock fund
    • an election to make an intra-plan transfer of an existing account balance into or out of the Company stock fund
    • an election to borrow money against a 401(k) plan account if the loan will result in a liquidation of some or all of the stock fund balance
    • an election to pre-pay a plan loan if the pre-payment will result in allocation of loan proceeds to the Company stock fund
Insider Trading

**Short-Swing Recovery Provisions**
- Insider (officers, director, or certain owners) must pay to the issuer profits from matching purchases and sales within a six month period.
- Several exemptions apply, including nondiscretionary transactions in tax-qualified plans. A transaction is discretionary if it:
  - is at the volition of the insider
  - is not made in connection with the insider’s death, disability, retirement or termination of employment
  - is not required to be made available by the Internal Revenue Code (apparently NOT including the PPA diversification requirements), and
  - Results in an intra-plan transfer involving issuer stock funds, or a cash distribution funded by a volitional disposition of the issuer stock fund.
- If the exemption doesn’t apply, directions must be made six months in advance.
DIVERSIFICATION RIGHTS
2006 PENSION PROTECTION ACT
Publicly Traded Securities

• Participants and beneficiaries have diversification rights with respect to publicly traded employer securities held in a 401(k) plan

• An employer is publicly traded if its securities are readily tradable on an established securities market, even if foreign (does not extend to over-the-counter market)
  – Also applies if any member of the controlled group (using a 50% standard) is publicly traded
**Amounts Subject to Diversification**

- Diversification rights apply to elective deferrals, employee contributions and rollovers (and earnings thereon); available to:
  - Any participant
  - Any alternate payee who has an account under the plan
  - Any beneficiary of a deceased participant

- Diversification rights apply to other employer contributions (and earnings thereon); available to:
  - Any participant who has completed at least three years of service
  - An alternate payee who has an account under the plan with respect to a participant who has completed at least three years of service
  - Any beneficiary of a deceased participant
Diversification Rights

• “Applicable individuals” must have the option to divest any employer securities in their accounts and to reinvest an equivalent amount in other investment options offered under the plan

• Requirements:
  – At least three alternative investment options
  – At least quarterly direction
  – Each investment option must be diversified and have materially different risk and return characteristics
  • Compliance with 404(c) requirements satisfies this requirement
Other Restrictions

- Plans cannot impose restrictions or conditions with respect to the investment of employer securities that are not imposed on the investment of other assets of the plan
  - This includes conditioning a benefit upon investing in employer securities

- Restrictions imposed by securities laws or restrictions designed to comply with securities laws are permitted
Plans must provide participants and beneficiaries with notice setting forth diversification rights and the importance of diversifying investment of retirement assets

- Due 30 days before the first date on which the individuals are eligible to exercise their rights
- A model notice is provided in IRS Notice 2006-107
- Penalty can be $100 per day per participant
- The notice can be made with the required quarterly statement
MERGERS AND ACQUISITIONS
Stock Acquisition and Mergers

- Each shareholder decides whether or not to sell (or to approve the merger)
- The plan will be one of the selling shareholders and should be included in the purchase agreement as a party
- The trustee (or whoever directs the trustee) will represent the plan and must behave prudently and in the best interest of the participants
- The Trustee must determine that:
  - The price is fair (may need an appraisal if the stock is not publicly traded)
  - The transaction as a whole is fair to participants
Stock Acquisition and Mergers

- Even a directed trustee must disregard directions that are contrary to ERISA, and so may need to ask questions if available information raises concerns.
- An independent fiduciary may be needed if the trustee is also a shareholder or has any other interest in the sale – interests may conflict.
- The executives may want a “fairness opinion” from the independent fiduciary.
Stock Acquisition and Mergers

• The plan or trust documents may pass down voting rights to the participants, so the provisions on voting must be reviewed
• The trustee may voluntarily pass down the voting rights, but will remain responsible
• Proxy rules apply to solicitation of votes from the participants as shareholders and Target must inform participants of their voting rights
• The trustee or other fiduciary still must determine that the deal is fair, particularly with respect to shares that are not voted
• Fiduciaries must make sure that participants receive sufficient disclosure to make a decision
Stock Acquisition and Mergers

- The purchaser will end up with the plan (unless it is maintained by a parent of Target)
- The Target could buy out the shares before the transaction, but an independent appraiser would be needed (for non-publicly traded shares) and any difference in value from what the Buyer pays would cause problems
Asset Purchase

• Corporate proceeds will likely be used to repurchase stock from the plan or from the terminating employees or will be distributed to shareholders (including the plan)

• Plan will continue to be Seller’s responsibility unless Buyer agrees to adopt it

• If substantially all of the business assets are sold:
  – The stock will become worthless after distribution of the sale proceeds
  – Seller will likely terminate the plan
  – The corporation cannot be dissolved until all participants have been paid and the plan has terminated
If Seller was part of larger controlled group that maintains the 401(k) plan:

- Plan will likely continue to be maintained
- Plan to plan transfer with respect to employees hired by Buyer can be negotiated
- Participants whose employment is terminated from the controlled group may request distributions like any other terminated person
- Parties should agree on whether Buyer’s plan will accept transfers or rollovers of Target’s stock or will replace with Buyer securities
Buyer Responsible for Plan

- Through stock purchase or merger, or by asset purchase agreement
- Any disqualifying defects of acquired plan should be identified during due diligence
- Plan may need amendment to reflect new sponsor, shares offered, administrator, exclusion of Buyer’s employees, power to amend
- New plan administrative committee members or a new trustee may need to be appointed
Buyer Responsible for Plan

- If Target employer securities are replaced with Buyer securities (assuming publicly traded):
  - Shares being substituted for Target’s shares would be registered on the Form S-4 used for the transaction
  - The Buyer should file an S-8 if additional Buyer shares can be acquired in the future (unclear if this can apply to former Target employees)
  - If employees did not receive Buyer information upon a vote to sell or exchange shares, Buyer’s prospectus must be delivered to participants
  - New purchasers can receive prospectus within 2 days after purchase
  - Short-swing profit restrictions should be reviewed
**Buyer Responsible for Plan**

- Buyer’s plan provisions should also be reviewed to determine that the right people are covered and excluded.
- The effect of the transaction on 410(b) coverage testing for both Target’s and Buyer’s plans should be reviewed:
  - Transition period is available up through the second plan year following the year of the transaction.
  - Coverage cannot be changed during the transition period.
Buyer Responsible for Plan

- Buyer’s choices with respect to Target’s plan –
  - continue it
  - terminate it
  - merge it into Buyer’s plan

- Target’s plan must continue to be updated for changes in the law through termination and 5500s must continue to be filed for all periods until all assets are distributed
Merger of Target’s Plan into Buyer’s Plan

- A year-end plan merger is better for nondiscrimination testing, identifying HCEs, allocations, 415, etc.
- Remedial amendment period cycle of merged plan sponsor governs
- The plans’ differing features, such as distribution timing or match rates, should be identified
  - Buyer can decide to unify provisions, subject to anti-cutback rules
  - Different rules can be continued for the Target employee group, subject to nondiscrimination rules
Merger of Target’s Plan into Buyer’s Plan

- Loans can be transferred
  - Target plan may have defaulted loans upon termination of employment under an asset sale - address before the transaction
  - Loan terms may have been different under Target’s plan, so Buyer’s loan procedures may need to be amended to accommodate old loans

- A decision will have to be made on surviving investment options and mapping from to Buyer’s investment options, including employer stock, and a blackout period may be needed
  - Sarbanes Oxley rules may restrict insider trading on shares held outside the plan during this period if it exceeds three business days and affects more than 50% of all participants in all dc plans