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The M&A Tax Report

JANUARY 2012 VOLUME 20, NUMBER 6

The Monthly Review of Taxes, Trends & Techniques

Can Acquisition Agreements Amend Employee Benefit Plans?

By Robert W. Wood • Wood LLP • San Francisco

Employee benefits may have been a legal specialty before, but it was the enactment of ERISA in 1974 that revolutionized that area of legal and consulting practice. With the inevitable amendments to the pension and welfare benefit plan laws that have cascaded down on businesses almost annually since then, the area is usually regarded as a minefield. Lawyers, accountants, actuaries and consultants address these rules and the volumes of data that must be analyzed.

In fact, while tax specialists may be regarded as navigating nuances and complexity, many tax lawyers seem to think that employee benefits are more complex still. The fact that HR professionals try to deal with some of this may make the area better or worse, depending on your perspective. In any case, the consequences of mistakes can be high.

And then there are plan and benefit considerations in the dynamic context of acquisitions. Integrating the benefits of companies post-acquisition can seem like something worthy of Harry Potter. The buying company in a recent Fifth Circuit case probably wished they had Harry Potter to help them.

Chemical Potion

In *Evans v. Sterling Chemicals, Inc.*, 2011 U.S. App. LEXIS 20746 (5th Cir. Tex. Oct. 13, 2011), the Fifth Circuit Court of Appeals faced the question whether a retiree benefits-related provision included in an asset purchase agreement amended the acquiring company's ERISA retiree benefits plans. That mattered because there were transferred employees of the selling company. This is deceptively important, involving a seemingly fundamental question: could increased health insurance premium costs be passed along to the retirees?

The district court had answered this question in the affirmative. The Fifth Circuit, on the other hand, answered no. As a result, the acquiring company could not increase the health insurance

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premiums of the retired transferred employees without the seller's permission. In the process of this holding, the court should inspire worry in corporate lawyers drafting deal documents that could by any stretch of the imagination be viewed as—intentionally or not—amending an ERISA plan.

This drama started in 1996 when Cytec sold the assets of its acrylic fibers business to Sterling Fibers, Inc. Sterling Fibers was a wholly owned subsidiary of Sterling Chemicals, Inc., a unit of Sterling Chemicals Holdings, Inc. The December 23, 1996, Asset Purchase Agreement (APA) was authorized by the boards of the companies. It was then signed by the chairman of the three Sterling companies and representatives of the three Cytec companies.

Sterling offered to employ certain Cytec employees ("Acquired Employees"). The APA covered continued medical benefits for Acquired Employees upon retirement. Sterling guaranteed its Acquired Employee retirees a certain level of benefits and a certain level of premiums. Notably, benefits could be reduced and premiums could be increased only if Cytec gave Sterling its prior written consent to those changes.

Cytec promised to notify Sterling and provide Sterling with prior written consent if Cytec reduced its own retiree benefits or raised its own retiree premiums. This feature of the case alone may cause some practitioners to be more careful about lists of following items post-closing.

That Was Then …

After the 1996 deal, things didn't go so well. In fact, in July 2001, Sterling filed for Chapter 11 bankruptcy protection. Retired Acquired Employees' benefits and premiums under Sterling's retiree medical plan did not change during the bankruptcy proceedings.

However, in October 2002, Sterling filed a motion seeking the bankruptcy court's authorization to reject certain executory contracts, including the APA. The bankruptcy court granted the motion. Then, freed of the terms of the APA, Sterling raised retirees' health insurance premiums without Cytec's approval.

In fairness, it should be noted that these premium increases to retirees were commensurate with premium increases imposed on Sterling retirees who *were not* Acquired Employees. In other words, there was no discrimination going on here. Still, the Acquired Employee retirees were not happy with the increases.

They sued Sterling under ERISA to clarify their right to unchanged health insurance premiums and benefits by virtue of APA §5.05(f). The retirees claimed that the APA had effectively amended the Sterling plan. That amendment, they claimed, locked Sterling into the fixed premium/benefit arrangement Sterling had made with Cytec as part of the acquisition back in 1996.

The district court first held that §5.05(f) of the APA had indeed amended the Sterling plan. However, the court chose to defer a decision on the consequences of the amendment, requiring that the retirees should exhaust their administrative remedies. Administrative appeals then followed.

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EDITOR-IN-CHIEF
Robert W. Wood

MANAGING EDITOR
Kurt Diefenbach

COORDINATING EDITOR
Tara Farley

THE M&A TAX REPORT (ISSN 1085-3693) is published monthly by CCH, 4025 W. Peterson Ave., Chicago, Illinois 60646.
Subscription inquiries should be directed to 4025 W. Peterson Ave., Chicago, IL 60646.
Telephone: (800) 449-8114. Fax: (773) 866-3895. Email: cust_serv@cch.com.

These administrative appeals were handled by a committee appointed by Sterling, which denied the retirees' claims in April 2008. The administrative appeal concluded that (i) the APA didn't amend the Sterling Plan; (ii) Sterling's contractual obligation to Cytec was terminated when the APA was rejected in bankruptcy; and (iii) the increases in premiums that began in 2003 were allowed by the Sterling Plan. This took the case back to the district court.

Amendment Valid?

The district court and the respective parties all seemed to agree that one precedent was particularly important: *Halliburton Co. Benefits Committee v. Graves*, DC-TX, 463 F3d 360 (2006). In that case, the Fifth Circuit had found that a provision in a merger agreement had been a valid amendment to an ERISA plan. In contrast, here the district court agreed with the plan administrator and found that the APA back in 1996 had *not* amended the plan.

Thus, notwithstanding the importance of *Halliburton*, the court found this case distinguishable. Besides, said the court, the contractual limitation imposed by §5.05(f) was extinguished once the Sterling entities rejected the APA during their bankruptcy proceeding and decided to increase premiums thereafter. Thus, even if the APA had operated to amend the Plan to lock in the premium cost, the bankruptcy had upended it. However, the retirees appealed.

To Amend or Not to Amend

The Fifth Circuit turned back to reexamine the *Halliburton* case, one of its own precedents. The court found it critical that in that proceeding, the Fifth Circuit had determined that a corporate agreement *could* amend an ERISA plan. Indeed, that was so even though the agreement might not have *expressly* been intended to be an amendment.

As the court saw it, any provision of the APA that was *directed at* a provision of an ERISA plan may be *deemed* to be a "plan amendment." It did not matter whether the provision did not purport to amend the plan and was not included in a plan document. Indeed, according to the Fifth Circuit, as long as the agreement (i) is written, (ii) contains a provision directed to an ERISA plan, and (iii) the plan amendment formalities are satisfied, that agreement or other document *will be* a valid plan amendment.

Eye of the Beholder

These three simple thresholds were met in this case. The APA was a written corporate agreement. Check. Plus, §5.05(f) was directed to provisions of both Cytec's and Sterling's ERISA plans. Check. But what about the third condition regarding the plan amendment formalities?

This third condition refers to having a procedure for amendment and a procedure for identifying the persons authorized to amend the plan. On this point, the appellate court stated that the formal documents constituting the terms of the Sterling plan allowed periodic amendments or modifications by the committee. Moreover, various Summary Plan Descriptions that described the terms of the Sterling plan were not *themselves* part of the plan.

However, these Summary Plan Descriptions stated that the Sterling plan *could be* amended at any time by the committee or by the company's board of directors. Had the APA been approved with that level of formality? Yes, said the court: the APA was approved by Sterling's boards of directors.

It was even executed by Sterling's chairman. To the Fifth Circuit, this satisfied both plan amendment formalities within the meaning of its prior Halliburton decision. As a consequence, the court held that §5.05(f) of the APA became a valid amendment to the Sterling plan.

Sterling made another argument that this was simply a contractual obligation allowing one party to the acquisition to sue the other. That may be, said the court, but that did not negate the fact that this corporate agreement—duly voted on by the board and signed by the chairman—*amended* the plan, whether it meant to or not.

Words that Count

Employers are generally free under ERISA to modify or terminate welfare benefit plans. But be careful that you don't give up that right. Here, by contract, Sterling voluntarily gave up its right to modify the retirees' premiums when it entered into the APA and approved the terms of APA §5.05(f). That was key here, regardless of whatever may have been intended.

In fact, the Fifth Circuit held as a matter of law that this provision of the APA was a valid amendment to the plan, that it was *assumed* (and not rejected) in bankruptcy, and that it was *still* enforceable. Since Sterling was required to obtain Cytec's written consent *before* raising premiums on retirees, the retirees' were entitled to unchanged premiums.

This decision should underscore the need for caution in drafting. One has to take into account the employee plans. One has to integrate employees. But what may seem like short-term commitments that can be changed post-acquisition may turn out to be covenants that cannot be broken.

Finally, don't forget that documents you may not regard as legally controlling can be considered legally controlling. Even if they are not terribly clear, they may be considered sufficiently in conflict with other documents that a court may view them as more important than you think. Of course, it makes sense that a complicated employee benefit plan must be summarized for a lay audience in a summary plan description. But if you aren't careful, a somewhat more liberally worded summary plan description might end up being used against you, stripping away more cautious language from your plan document itself. That's a frightening prospect.