Deal Playbook Section 6:

Dealing with MEWA Liability in Mergers & Acquisitions

December 2023

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Offering affordable and competitive medical coverage to employees can be a challenge for many companies. One way to achieve this is by joining a Multiple Employer Welfare Arrangement (MEWA). A MEWA is a single health plan covering multiple employers who do not meet common control and ownership thresholds as regulated by Section 414(b)&(c) of the tax code. There may also be circumstances where a MEWA is unintentionally created by a buyer or seller during the purchase or sale of a company. If not properly handled, this can lead to significant liabilities for the buyer and possible loss of coverage.

IN THESE SITUATIONS, IT IS CRITICAL TO DO TWO THINGS:

01 Identify any MEWA liability that may exist or be created due to the transaction; and

02 Determine how to structure the post-close employee benefits program in a compliant manner.

This article will discuss three transaction scenarios involving MEWAs and provide advice on how to avoid potential liabilities and compliance failures.

What a MEWA means for M&A

An inadvertently created MEWA that is not quickly identified can lead to severe financial liabilities. As of 2023, the administrator of a MEWA may be subject to penalties of up to $1,881 per day for failure to file Form M-1 with the Department of Labor (DOL). Filing Form M-1 is an annual requirement. Form M-1 is also required to be disclosed on Form 5500.

Thus, filing Form M-1 necessitates filing Form 5500, even if the plan would normally qualify under the standard Form 5500 exemption by covering less than 100 employees. Improper filing or outright failure to file Form 5500 for health and welfare coverage will cost up to $2,586 per day. Combined with the daily penalties for failing to file Form M-1, the total annual penalty would equate to **$1,630,455**.

To make matters worse, Form M-1 filing failures are not eligible for the DOL's Voluntary Delinquent Filer Program. Thus, **$686,565** of the total penalty would be ineligible for a reduction.

Most states prohibit self-insured MEWAs, and many states also heavily regulate fully insured MEWAs. The lack of ERISA preemption means that the plan sponsor and plan fiduciaries can be sued under state law and plaintiffs (likely employees, their dependents, or employers participating in a MEWA) can recover compensatory and punitive damages. In a worst-case scenario, the state can force the MEWA to terminate operations if licensing, insurance mandates or reserve requirements are unmet.

Hypothetical M&A Scenario #1:

The target is an Affiliated Service Group with a single medical plan covering all members.

An Affiliated Service Group (ASG) can be formed when the activities of multiple legal entities are so closely integrated that they effectively operate as a single company, but there is not enough common ownership to establish a "controlled group." Often, ASGs are created by doctors, lawyers, and engineering firms, among other groups in defined professional service industries under the Internal Revenue Code. For health and welfare plans, a controlled group must be established to avoid the creation of a MEWA. In this scenario, an ASG with a single medical plan is a MEWA.

DUE DILIGENCE CONSIDERATIONS

01

Confirm Filings

Determine whether a plan has been operating in accordance with federal and state laws. This includes disclosing its MEWA status within the required Form 5500 filing. In addition, the plan must annually file Form M-1 and may need to be registered with the state.

02

Carrier Approval

Determine if the benefits carrier is aware of the MEWA or if it believes it is covering a single-employer controlled group. The existing insurance contract may not permit MEWA coverage.

03

Verify Requirements

Verify if the plan has fulfilled all state requirements to ensure compliance.

04

Red Flags

If any red flags are identified, consider terminating the health and welfare coverage pre-close in favor of a new plan (once controlled group status is established).

05

Separate Plans

Consider establishing separate plans per legal entity to avoid MEWA status if controlled group status will not be created due to the transaction.

Hypothetical M&A Scenario #2:

The target has a self-funded medical plan that provides coverage to non-employee members of the board of directors and/or independent contractors.

Under this scenario, the health and welfare plan is a MEWA. Outside directors and independent contractors are considered self-employed individuals and not plan sponsor employees.

Any self-funded MEWA is an automatic red flag. This is because self-funded MEWAs are illegal in most states or have extremely high barriers to entry. Without meeting significant state registration, eligibility, financial reporting, and reserve requirements, self-funded MEWAs are considered unlicensed insurance companies.

DUE DILIGENCE CONSIDERATIONS

01

Consider Fully Insured

Consider establishing a fully insured plan. While this would still result in a MEWA, it would resolve the potential liability of coverage under an illegal self-funded MEWA.

02

Review Eligibility

Review the eligibility requirements of the existing self-funded plan and stop-loss contracts to see if non-employee board members and independent contractors were eligible for coverage in the first place.

03

Remove Members

Remove these non-employee members and obtain separate coverage for this category of individuals.

Hypothetical M&A Scenario #3:

The target is a carveout of a larger parent company. The buyer wants to keep the target population on the parent company's medical plan post-close until new plans can be established.

Both buyer and seller should be aware that proceeding under such an agreement would create a MEWA, since the seller's plan would be covering employees that work for a company outside the controlled group. Short-term MEWAs formed after merger and acquisition activity, such as when a seller continues to cover employees of a recently sold subsidiary for a few weeks or months as part of a transition services agreement, are not required to file Form M-1.

Here, the probability of the state learning of the creation of a MEWA is low. However, the risk could be significant if uncovered, depending on the state and the plan structure being utilized. It is best to check applicable state laws which may prohibit even a temporary MEWA.

DUE DILIGENCE CONSIDERATIONS

01

Plan Sponsors

Plan sponsors willing to risk MEWA status should amend their plan documents to reflect this eligibility, and the insurer should be consulted to confirm it has no objection.

02

Covered Members

Covered members who are no longer employees of the plan sponsor cannot continue to pay their portion of plan costs on a pre-tax basis because they're not allowed to participate in the plan sponsor's cafeteria plan. The carved-out entity would need to establish its own separate Section 125 plan to maintain the tax-free status of employee plan contributions.

Under all these hypothetical scenarios, it is recommended the Buyer negotiate additional purchase protections from Seller for potential MEWA violations, should the plan ever come under regulatory audit. In addition to taking the necessary steps to ensure proper plan administration, consider purchasing fiduciary liability insurance, employee benefit liability (part of general liability), and an ERISA bond to add a potential layer of protection against noncompliance penalties, legal defense costs, settlement costs and/or damages awarded in court.

How Lockton Can Help

The corporate structure of companies can be complicated. The ownership of current and future legal entities and their relationship to each other can significantly impact the employee benefits program. Conducting due diligence on possible MEWA status and deal implications of each M&A transaction is extremely important.

Companies can more effectively take these steps by choosing the right risk advisor. Lockton's Transaction Advisory Practice is ready and able to assist in sorting through these and other critical issues to help ensure a successful outcome.

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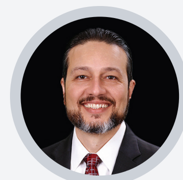

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