

**SPECIAL ISSUES IN MERGERS AND ACQUISITIONS:  
EMPLOYEE BENEFITS IMPLICATIONS**

Caryn Coppedge McNeill

*Smith, Anderson, Blount, Dorsett, Mitchell & Jernigan, L.L.P., Raleigh,*

**I. INTRODUCTION**

Employee benefit plans and compensation arrangements have important implications for both buyers and sellers in mergers and acquisitions. The purpose of this outline is to provide an overview of the major considerations with regard to employee benefits and compensation issues in corporate transactions. This outline treats these considerations in the same order in which they tend to arise in a transaction, discussing in turn: (1) the significance of the transaction structure; (2) the due diligence process, including plans to watch out for; (3) the role of representations and warranties; and (4) techniques for dealing with some of the most common benefits arrangements, including qualified retirement plans and stock options. Various sample forms are attached as addenda to this outline as follows:

Addendum A	Sample employee benefits due diligence request list
Addendum B	Sample COBRA provision from an asset purchase agreement shifting to seller financial responsibility for any losses buyer incurs as a result of having to offer COBRA coverage to certain “M&A qualified beneficiaries.”
Addendum C	Sample employee benefits reps and warranties, plus a covenant about terminating a 401(k) plan.
Addendum D	Sample resolutions terminating a 401(k) plan.
Addendum E	Sample provision regarding assumption of stock options.

**II. SIGNIFICANCE OF TRANSACTION STRUCTURE**

A. Stock Sale or Merger

In a stock sale or a merger of a seller into a buyer (or buyer acquisition subsidiary), the buyer steps into the shoes of the seller and generally assumes the seller’s employee benefit plans and plan liabilities as a matter of law.

B. Asset Sale

In an asset sale, unless a buyer affirmatively adopts or continues a seller’s plans, the buyer usually does not assume any plans or plan liabilities. (See, however, the discussion below regarding liability for offering COBRA to “M&A qualified

beneficiaries.”) But because of a “successor employer” concept that courts and regulators sometimes apply in the benefits area regardless of the deal structure, the buyer will generally still want to conduct due diligence and negotiate protection for itself.

C. Significance of Context

Generally, the structure of the deal will dictate what happens to employee benefit the plans and plan liabilities, and not the other way around. However, there are a few exceptions – a few instances where the plans and plan liabilities may dictate the structure (for example, a seller that faces a potentially large withdrawal liability with respect to a collectively-bargained multiemployer pension plan may insist on a sale of stock rather than a sale of assets, or a buyer that does not want to inherit a burdensome plan may insist on a sale of assets).

### III. CONDUCTING DUE DILIGENCE

A. Goals of Due Diligence Generally

The term “due diligence” refers to the investigation of the business, legal and financial affairs of a company in connection with a corporate transaction. There are several reasons buyers conduct due diligence:

- To understand the seller’s business;
- To evaluate the transaction, including the fairness of the purchase price;
- To identify, understand and quantify any problem areas, obstacles or “deal breakers” associated with the seller’s business, including any consents that will be required; and
- To verify the accuracy and completeness of the seller’s representations and warranties and the seller’s disclosures.

B. Goals of Benefits Due Diligence

The goals of benefits diligence are consistent with these overall goals. Buyers conduct benefits diligence:

1. To understand the seller’s benefits, including what, if anything, the governing plan documents and agreements have to say about what happens to these benefits in the event of a change in control (“CIC”);
  - Some plans are silent about CIC
  - With others, a CIC may “trigger” more or different benefits

2. To find any hidden or contingent liabilities that may need to be reflected in negotiations of reps and warranties and the development of appropriate indemnification provisions or other protections; and
3. To begin designing the post-closing benefits structure as reflected in decisions regarding the treatment of seller's benefit plans and any covenants about future benefit plans.

C. Getting the Necessary Information

The legal due diligence process begins when the buyer furnishes the seller with a due diligence request list. Attached at Addendum A is an example of such a list.

D. Plans to Watch Out For

The information and documents obtained will be reviewed for completeness, consistency and legal sufficiency. Areas of significant, potential liability to watch out for include:

1. Qualification defects. Qualified retirement plans are subject to a myriad of tax rules governing both the form of the document and the operation of the plan.

It is not unusual for the parties to discover one or more qualification defects relating to the seller's retirement plans. Left uncorrected, the sanctions and penalties for these defects are harsh. Solutions may range from attempting to correct the defect through the IRS's voluntary correction program, the Employee Plans Compliance Resolution System ("EPCRS"), or restructuring the transaction so that the buyer does not adopt or assume a particular plan.

2. Single employer pension plan termination liability. If the seller maintains a defined benefit ("DB") pension plan, the buyer will want to examine the value of the liabilities of the plan as compared to the value of the plan assets. From the buyer's perspective, because a sale may trigger liability under ERISA's plan termination provisions, the transaction should be structured to minimize those liabilities. Possible options include: (1) adjusting the purchase price to reflect any underfunding, (2) obtaining broad representations and warranties and (3) structuring the transaction as a purchase of assets, rather than stock.
3. Multiemployer withdrawal liability. Where the seller is a party to a collective bargaining agreement under which the seller is obligated to contribute to a multiemployer pension plan, the buyer should determine the plan's unfunded vested liability and the share of such liability that is

allocable to the seller under special regulations applicable to multiemployer plans. Because a sale may trigger liability under ERISA's employer withdrawal provisions, the transaction should be structured to minimize these liabilities.

4. Severance liability. Severance benefits, if provided, are usually an unfunded liability of the seller. In the context of a corporate transaction, there may be a question about whether the sale of the business triggers the payment of severance pay to all the employees of the seller -- even those who will continue to work for the buyer. Although most courts have held that severance pay plans do not apply to employees who continue to work for the buyer, a few courts have held that sales do trigger severance benefits. For this reason, the buyer will want to carefully review and perhaps clarify any applicable severance pay plans or programs. Because severance pay plans are not covered by the vesting provisions of ERISA and the Code, it is generally possible to amend a severance pay plan immediately before a corporate transaction to clarify that payment of severance benefits will not be triggered by the transaction.
5. Retiree health and welfare liability. Some employers have promised their employees post-retirement medical and life insurance benefits that can represent large unfunded liabilities of these employers. In some cases, sellers will claim that such liabilities are not true liabilities since the arrangements can be terminated at any time. This may or may not be true. Generally, only where the seller has expressly retained the right to terminate such benefits will the courts uphold such a right. In any event, the right to terminate these benefits may not be relevant -- unless both parties want to terminate such rights, it may be better to structure the transaction so that the benefits will continue. Where the sale is a sale of assets and the seller is a continuing enterprise, it will be necessary to negotiate the benefits for which the seller will remain liable.
6. COBRA liability.
  - a. Liability for offering COBRA coverage to "M&A qualified beneficiaries." Provisions in IRS COBRA regulations provide rules for determining COBRA liabilities of buyers and sellers, unless, as is permitted by the regulations, the parties reallocate these liabilities by agreement. Absent such reallocation, the regulations make it clear that:
    - In a stock sale or an asset sale in which the seller or any other entity within its controlled group does continue to maintain a group health plan after the sale, the selling group, not the buyer, is obligated to offer COBRA coverage to any "M&A qualified beneficiaries."

- In an asset sale in which the selling group does not continue to maintain a group health plan after the sale, the buyer's obligations turn on whether it is a "successor employer" to the seller in connection with the sale and whether there are any "M&A qualified beneficiaries." If the buyer is a successor employer, then it must make COBRA coverage available to any "M&A qualified beneficiaries." The analysis is the same in a stock sale in which the selling group does not continue to maintain a group health plan, except that the "successor employer" issue drops away – the buyer is clearly a successor.

For these purposes, "M&A qualified beneficiaries" include (1) persons already on COBRA under the seller's plan who used to be employed (or who had a spouse or parent who used to be employed) in connection with the assets being sold and (2) persons who lose coverage as a result of the sale. A buyer is a "successor employer" if it "continues the business operations associated with the assets purchased from the selling group without interruption or substantial change."

Consequently, in an asset sale in which the seller does not continue to maintain its plan, unless the parties otherwise agree to the contrary, the regulations require the buyer to offer COBRA coverage to persons who were not actively employed by the seller at closing and persons who were actively employed but whom it does not elect to employ.

Typically, in such a situation, the buyer will agree to offer the COBRA coverage but the parties will agree that the seller will assume responsibility for any losses the buyer may incur as a result. Attached at Addendum B is an example of such a provision.

- b. Liability for pre-acquisition violations of seller. The penalties for seller's failing to comply with COBRA are potentially quite large (\$100 per day for each employee and qualified beneficiary). Accordingly, the buyer should make every effort to ensure that the seller has complied with COBRA in all respects or has corrected any violations. In addition, where possible, the buyer should require the seller to give a warranty to the effect that it has complied with COBRA.

7. Nonqualified deferred compensation liability. Although nonqualified deferred compensation benefits are always unfunded in a technical sense,

they are often unfunded in a practical sense as well. Consequently, they may represent potentially large unfunded liabilities.

- a. 409A. The tax issues involved with nonqualified deferred compensation arrangements have gotten more complex since the advent of Code section 409A. The historic principles of constructive receipt have not changed. But since January 1, 2005, nonqualified deferred compensation arrangements – a term defined broadly to include traditional nonqualified plans as well as arrangements that formerly were not thought of as deferred compensation (e.g., severance payments, discounted stock options) – have generally been required to be operated in keeping with 409A. Employers have until December 31, 2008 to conform the actual terms of these arrangements, as well. The risk of nonconformance is largely born by executives, who face a 20% excise tax. Buyers should be watchful for the possibility that a seller has agreed to “gross up” affected executives for the 20% excise tax and, if such arrangements are to be assumed, review them for conformity with 409A.

#### **IV. NEGOTIATING REPS AND WARRANTIES**

##### **A. Why reps and warranties?**

Representations and warranties have three basic functions:

- To assist the buyer in understanding the seller’s business and in conducting due diligence;
- To allow the buyer to refuse to close the deal if the representations and warranties are not true at closing; and
- To enable the buyer to recover damages if a representation turns out to be false when made.

Seller’s representations may also function as a substitute for further due diligence where the information to be verified is unavailable or cannot be confirmed in a cost-effective manner.

##### **B. Indemnification**

Acquisition agreements typically provide for contractual indemnities by the seller for breaches of the seller’s representations. Such indemnities (subject to the scope of the representations) give the buyer comfort that it will have a contractual remedy if material information with respect to the seller’s business, ownership or

other matters customarily covered by the seller's representations turns out to be false or misleading.

Negotiation of the seller's representations and warranties and indemnities are typically among the more important and complicated tasks in a transaction.

Attached at Addendum C are sample employee benefits reps and warranties.

C. What else is the agreement likely to say about employee benefit plans?

Often the parties' intent with respect to employee benefit plans is not addressed in the merger or purchase agreement. Although these issues are almost always discussed before closing, the need for exhaustive due diligence usually prevents the parties from making any irrevocable commitments along these lines.

1. Status quo. Agreements often contain language requiring the parties to maintain the status quo with respect to their benefit plans prior to closing (e.g., benefit plans may not be established or terminated after the agreement is signed and before the deal closes).
2. Benefits offered to transferring employees. Also typical are covenants regarding the benefits to be offered to transferring employees. Typically, where the seller's benefits are as or more generous than those of buyer, seller will ask for benefits substantially similar to those that the transferring employees have had. Most buyers won't agree to this, but they usually will agree that transferring employees will be given benefits substantially similar to those of similarly situated employees of buyer.
3. Credit for prior service. It is also common to see sellers ask for and receive credit for prior service with seller for purposes of participation and vesting in buyer's plans. This service credit transfers as a matter of course in a stock deal. In an asset deal, this is negotiated.

## V. **TECHNIQUES FOR DEALING WITH QUALIFIED PLANS**

### A. Techniques

There are many techniques for dealing with sellers' qualified plans, including:

- Adoption/continuation of the plan as is or with modifications
- Plan spin-off
- Merger of plans
- Non-adoption of plan
- Freezing old plan
- Termination or partial termination of plans
- Adoption of a clone-offset plan

- Transfer of assets and liabilities
- Inclusion of acquired employees in buyer's plan

The techniques available to a given buyer depend, in part, on whether the deal has been structured as a stock deal or merger or an asset deal. In a stock deal or merger, the buyer automatically assumes the seller's liabilities and will also become the sponsor of the seller's plans unless some affirmative action is taken to either terminate or freeze the plan, transfer the plan out of the acquired entity (e.g., to the parent prior to the sale of a subsidiary) or have the seller specifically retain the plan. In an asset deal, the buyer generally only becomes the sponsor of those seller's plans it affirmatively assumes.

What follows is a discussion of the three most common techniques for dealing with qualified plans.

1. Continuation of the plan as is or with modifications. Where the buyer continues the plan of the seller, both the buyer and the seller should review their plans to determine what coverage and discrimination problems may exist. (For example, if the seller's plan qualifies because it covers more than 70 percent of the seller's NHCEs, the sale of a subsidiary might result in the plan covering less than 70 percent and being disqualified. Similarly, the addition of a new group of employees to the buyer's workforce may create coverage problems for the buyer's plan, especially if the buyer's plans have better benefits than the seller's plans). Under the nondiscrimination rules, the buyer is given until the end of the following plan year to meet the coverage requirements going forward.

Where modifications are made to a plan, care must be taken to comply with the anti-cutback rules of IRC § 411(d)(6) (although these rules are not as rigorous as they once were, which helps streamline payment options) and the restrictions on amending the vesting schedule under IRC § 411(a)(10). In addition, any reduction in benefit accruals of a defined benefit or money purchase plan requires 15 days notice under ERISA § 204(h).

2. Merger. Where a seller's plan is consistent with the buyer's approach to employee benefits, the buyer may choose to merge the seller's plan into its own plan. Such a merger can occur at closing but more typically occurs afterward. Plan mergers must meet the requirements of IRC § 414(l). For defined contribution ("DC") plans these requirements are not burdensome -- the benefits immediately after the merger must be at least equal to the benefits participants would have received immediately before the merger had the plan then terminated (the "no-reduction rule"). For DB plans a special schedule, or data sufficient to complete such a schedule, must be maintained for 5 years. In addition to satisfying the no-reduction rule, a plan merger must satisfy the anti-cutback rules of IRC § 411(d)(6) (which,

again, now have recently changed to permit streamlining of payment options). Finally, a plan merger may require the buyer to credit prior service with the seller under IRC § 414(a).

Under IRC § 6058(b), IRS Form 5310-A must generally be filed 30 days before the merger of two DB plans. The form is not required for the merger of two DC plans that satisfy the no-reduction rule. Where a determination letter is sought, the merger should occur after the favorable letter is received.

3. Termination. Qualified plans or welfare plans can be terminated before or after closing. Termination will result in the employees becoming fully vested in their accrued benefits. They may receive annuities or, in many cases, lump sum payments which can be rolled into IRAs or the buyer's plan.

The termination of a qualified plan after closing may defeat the expectations of the employees or one of the parties. It is for this reason that some commentators urge drafters to include in the purchase agreement detailed provisions regarding the handling of employee benefits.

#### B. Caveat: Terminating 401(k) Plans

Under the 401(k) distribution rules, in a stock deal, if a buyer that maintains a “successor plan” wants to terminate a seller’s 401(k) plan and distribute the plan assets to employees, the seller must take steps to begin the termination process (e.g., pass a board resolution resolving that the plan is terminated) before closing. If the seller does not take such steps before closing, the funds cannot be distributed because, under the “successor plan rule,” the employees will not be deemed to have separated from service within the meaning of IRC § 401(k)(2)(B) and the plan will not be deemed to have terminated without the establishment or maintenance of another plan within the meaning of IRC § 401(k)(10). See Treas. Reg. § 1.401(k)-1(d).

Recent relaxation of the same desk rule makes these same concerns inapplicable in most asset sales, since most asset sales are likely to come within either (1) the sale-of-85%-of-the-assets exemption to the same desk rule (which requires, among other things, that both the buyer and seller be corporations, that the buyer be selling 85% of the assets used in the trade or business, and that the seller continue to maintain the plan after the sale) or (2) the auspices of Revenue Ruling 2000-27 (in which sales of less than 85% of the assets are sufficient to trigger distribution rights if, among other things, the parties are unrelated and the seller does not receive services from the terminated employees hired by the buyer).

Attached at Addendum D are sample board resolutions terminating a 401(k) plan.

## VI. THE OPTIONS FOR OPTIONS

### A. The Two Most Prevalent Approaches

A seller's outstanding options (or other equity awards) tend to be handled in one of two ways. Either they are assumed by buyer or they are cashed out. The place to start when trying to figure out what will happen to equity in a corporate transaction is with the terms of the equity plan and related agreements. But the documents really serve as just a jumping-off point. The parties sometimes negotiate treatment of equity that is different than what the documents call for, although in certain circumstances different treatment may require optionees' consent.

1. Assumption/Substitution. Assumption preserves outstanding options of seller, so that they continue to be subject to their pre-closing terms and conditions but are exercisable post-closing for shares of buyer rather than seller. The same exchange ratio used to exchange shares of seller's stock for that of buyer is used to adjust the number of shares subject to the option and the exercise price so that the aggregate deal is preserved. The assumed options continue to be granted under, and governed by, the terms of seller's equity plan. Sometimes the number of shares reserved under the assumed plan is reduced to the number of assumed shares outstanding to help buyer with issues of overhang. Typically, a unilateral notice is used to communicate option assumption to optionees.

Substitution is a variation on assumption. As with assumption, the options remain outstanding and the aggregate deal is preserved, but the buyer substitutes its own options for those of seller. The substitute options come out of the buyer's plan and are typically communicated by means of a new option agreement on buyer's form.

Buyers like assumption/substitution because it:

- Preserves existing incentives
- Avoids the need to get additional shareholder approval

Optionees like assumption/substitution because it:

- Preserves their ability to participate in the future upside potential of buyer

2. Cashout. Cashout occurs when outstanding options are cancelled in exchange for a payment equal to the aggregate "spread" on the options – the difference between the aggregate exercise price and the aggregate deal price. Sometimes a premium is paid to compensate optionees for the lost opportunity to participate in the future upside potential of buyer.

Buyers like cashouts because they:

- Wipe the slate clean; this is especially attractive where the seller's approach to equity – in terms of to whom awards have been granted, or the amounts of such awards – seems inconsistent with that of buyer

Optionees like cashouts because they:

- Are often accompanied by accelerated vesting
- For privately held companies, constitute a sometimes long-awaited liquidity event

B. Incentive Stock Options (“ISOs”)

1. IRC 424 adjustments. If ISOs are assumed or substituted for in a merger, one issue to be concerned about is whether they can remain ISOs. Under IRC § 424(a), ISOs may be assumed or substituted for without destroying the special ISO status of the option, so long as certain requirements are met. The assumption or substitution will not be deemed to be the grant of a new option.

In order for IRC § 424(a) to apply, (1) the spread between the aggregate fair market value and aggregate option price must not be increased by the substitution or assumption (for example, if an optionee could acquire \$100 of the stock of Company A for \$10 immediately before the substitution, he or she must be able to acquire \$100 of the stock of Company B for \$10 immediately after the substitution) and (2) the new option or the assumption of the old option must not give the employee additional benefits.

These requirements are satisfied in practice by providing that the assumed options continue on the same terms and conditions as the old options, except that the exercise price of the old ISOs and the number of shares subject to the old ISOs are adjusted by the exchange ratio for the merger and the shares subject to the new ISO are those of the acquiring company. Typically, the merger agreement will provide that this will be the case.

Attached at addendum E is a sample provision providing for the assumption of stock options.

2. ISO \$100k rule. Any time ISOs are accelerated, there is a risk they may fail to qualify for ISO treatment because of a special ISO rule that provides that only \$100,000 worth of options may become first exercisable in a given year. As a practical matter, however, optionees may prefer vested NSOs to unvested ISOs.

C. Nonqualified Stock Options (“NSOs”).

In practice, NSOs that are assumed are treated like ISOs, not because of the ISO rules but because of the negative accounting consequences that can result from modifications of NSOs.

In addition, since the advent of 409A, adjustment in any other manner risks running afoul of 409A. Adjustments other than in the manner prescribed by the ISO rules create the possibility that the option will be deemed to have been modified in such a way that the modification constitutes the grant of a new option. The grant of a new option with an exercise price less than the FMV of the stock at the time of grant would be a discounted option. Discounted options are subject to 409A. Discounted options that do not comply with 409A are subject to immediate taxation and a 20% excise tax.

**REQUEST FOR EMPLOYEE BENEFITS DOCUMENTS**

*Date: [Date]*

*Please return the original of this form with copies of documents to [Buyer's counsel]*

*Note: Please verify the accuracy of the information provided by dating and signing this form. Please check "N/A" if no such documents or plans exist.*

Dated: \_\_\_\_\_

By: \_\_\_\_\_

***I. Employee Handbook***

N/A       Employee handbook or manual.

***II. Current Profit Sharing, 401(k) or Other Tax Qualified Retirement Plan***

A.     N/A       Plan documents, including amendments, administrative service agreements, trust agreements, and collective bargaining agreements as they pertain to retirement plans.

B.     N/A       Summary plan description(s) and all summaries of material modifications thereto.

C.     N/A       IRS Determination Letters (or Notification Letters, if standardized prototype plans).

D.     N/A       Form Series 5500 filings for last 3 years (and all schedules and financial statements attached thereto) or, if the plan has been in existence less than 3 years, the number of years that the plan has existed.

E.     N/A       Board Resolutions adopting the plan(s) and any amendments thereto.

F.     N/A       Discrimination tests for last 3 years, including ADP/ACP and Section 415 tests or, if the plan has been in existence

less than 3 years, the number of years that the plan has existed.

- G.  N/A  If retirement plan investments are provided through an insurance company, group annuity or insurance company contracts.
- H.  N/A  If retirement plan allows participants to self-direct salary deferral contributions into employer stock, all registration statements (Forms S-8), annual reports (Forms 11-K), and prospectuses.
- I.  N/A  Fiduciary liability insurance policy.
- J.  N/A  Qualified Joint Survivor Annuity and Qualified Preretirement Survivor Annuity forms.
- K.  N/A  If pension (defined benefit) plan, information pertaining to funding status.

**III. Terminated Profit Sharing, 401(k) or Other Tax Qualified Retirement Plan**

- A.  N/A  IRS Determination Letter on termination.
- B.  N/A  Final Form Series 5500 filing (and all schedules and financial statements attached thereto).
- C.  N/A  Board Resolutions terminating the plan.

**IV. Flexible Benefits Plan/Cafeteria Plan**

- A.  N/A  Plan documents, including administrative service agreements.
- B.  N/A  Summary plan descriptions and all summaries of material modifications thereto.
- C.  N/A  Board Resolutions adopting the plan(s) and any amendments thereto.
- D.  N/A  Form Series 5500 filings for last 3 years (and all schedules and financial statements attached thereto).

E.  N/A  Enrollment forms.

**V. Group Welfare Health Plan**

A.  N/A  Forms of initial and qualifying event COBRA notices and related forms.

B.  N/A  Written COBRA procedures.

C.  N/A  Insurance contracts (including stop-loss policies) for health, life, dental, vision, accidental death & dismemberment, long-term and short-term disability, etc.

D.  N/A  Summary plan description(s) and all summaries of material modifications thereto.

E.  N/A  Form Series 5500 filings for the last 3 years (and all schedules and financial statements thereto).

F.  N/A  Form of HIPAA (Health Insurance Portability and Accountability Act) certificate provided to employees whose health insurance ceases.

G.  N/A  If self-insured plan, information relating to claims experience.

**VI. Change of Control Arrangements**

N/A  Plans, agreements or arrangements providing benefits contingent upon a change of control.

**VII. Employment Agreements**

N/A  All Employment Agreements (or, if appropriate, forms of employment agreement).

**VIII. IRS or DOL Correspondence**

N/A  Any correspondence, inquiries or examinations to or from the Internal Revenue Service (IRS), Department of Labor (DOL), Public Benefit Guaranty Corporation (PBGC) or

any other governmental agency regarding any of the Company's pension or welfare benefit plans.

***IX. Equity Compensation Plans***

- A.  N/A  All equity compensation plans, including stock option plans, director option plans, and employee stock purchase plans, and forms of agreement used with such plans, as applicable.
- B.  N/A  Board consents adopting such plans.
- C.  N/A  Shareholder consents approving such plans.
- D.  N/A  Non-qualified profit sharing plan documents.
- E.  N/A  Blue Sky Compliance

***X. Severance and Deferred Compensation Plans***

- A.  N/A  Plan documents.
- B.  N/A  Insurance policies.
- C.  N/A  Rabbi Trust Agreements or other funding arrangements.
- D.  N/A  Schedule of employees terminated in the past two years and the amounts of severance paid to them.

***XI. Bonus and Incentive Plans***

- N/A  Plan documents.

***XI. Section 16 Filings***

- N/A  Copies of filings for last three years.

***XII. 280G Information***

- A.  N/A  List of Disqualified Individuals, Service Start Dates and copies of Form W-2 for the past five years with the present employer (and including predecessor employer).

- B.  N/A  Option Spreadsheet for D/Is - to include the Grant Date, Strike Price, Vesting Schedule, and Number of Shares Subject to Option.

***XIII. Worker Classification***

- A.  N/A  List of consultants, independent contractors, leased employees and temporary employees working at least six months solely for the company and including length of time worked and summary of their duties.

- B.  N/A  Forms of all agreements used for consultants, independent contractors, leased and temporary employees.

***XIV. Foreign Employees***

- N/A  Schedule, by country, of all employee benefit plans including stock options, pension plans, fringe benefits and ESPP participation.

**COBRA PROVISION**

**2.4 Employees.** If the Closing occurs, the Purchaser shall be free to hire such persons, whether or not employees of the Seller or the Business, on such terms and conditions of employment as the Purchaser shall determine in the exercise of its sole discretion, and nothing in this Agreement shall establish any enforceable rights, legal or equitable, in any Person other than the parties hereto, including, without limitation, any employee of the Seller or the Business or any beneficiary of such employee. Any claim, including any claim for benefits, asserted by or on behalf of any Person with respect to such Person's employment by the Purchaser shall be governed solely by applicable employment policies and employee benefit plans, if any, which the Purchaser may adopt after the Closing, as construed in accordance with applicable Federal and state law. Schedule 2.9 provides a true and complete list (including names, titles, job descriptions, compensation, date of hire, and full vs. part-time status) of all employees of the Business as of the date indicated. At least seven (7) days prior to the Closing Date, the Purchaser shall notify Seller in writing which of such employees (if any) the Purchaser does not intend to hire after the Closing. The Seller shall be fully liable for the employment (or termination or severance thereof) of any persons listed in such Purchaser's notice. In addition, the Seller shall be liable for, and shall pay, all wages, salaries, payroll taxes and employee benefits, including without limitation, Accrued Vacation Pay, due, owing or accrued for all employees of the Business through the Closing Date. **In particular, Seller shall provide and continue to provide all continuation coverage under its, or its Affiliates', group health plans required by ERISA, the Code and applicable Law for (i) Seller's employees who terminate employment with Seller before the Closing Date and (ii) Seller's employees who terminate employment with Seller as of the Closing Date and whom Purchaser does not immediately employ; provided, however, that if Seller or its Affiliates do not continue to maintain a group health plan after the Closing Date, and Purchaser is required by ERISA, the Code or applicable Law to provide continuation coverage under its group health plans to any of such Seller's employees, Seller shall indemnify Purchaser for any costs, claims or liabilities incurred by Purchaser in connection with its providing such coverage.** All claims incurred or liabilities asserted under Seller's Employee Benefit Plans shall be the responsibility of Seller, and Purchaser shall not have any liability with respect to such claims or liabilities.

**EMPLOYEE BENEFITS REPS AND WARRANTIES**

2.20 Employee Benefits.

(a) Section 2.20 of the Schedule of Exceptions sets forth all Company Plans. There are no other Plans under which the Company has any liability. The Company has no contract, plan or commitment, whether legally binding or otherwise, to create any plan or arrangement other than as listed on Schedule 2.20 or to modify any existing Company Plan.

(b) All Company Plans listed on Section 2.20 of the Schedule of Exceptions are legally valid and binding and in full force and effect.

(c) Except as set forth on Section 2.20 of the Schedule of Exceptions, the Company has furnished a true, correct and complete copy of the document for each Company Plan and all related materials that it has, including but not limited to, trust agreements, insurance contracts, policies and related insurer documents, determination letters from the Internal Revenue Service (and, if a request for such a letter is pending, a copy of such request), summary plan descriptions, the last three years' Form 5500s, written summaries of any non-written Company Plan and the most recent actuarial statements and financial statements, as applicable.

(d) Each of the Company Plans listed on Section 2.20 of the Schedule of Exceptions has been and presently is in material compliance, both in form and operation, with the applicable provisions of ERISA, the Code and all other applicable laws and the regulations issued thereunder, and each of the Company Plans has been and presently is being operated in material compliance with the terms of the operative plan documents.

(e) Except as set forth on Section 2.20 of the Schedule of Exceptions, the Purchaser shall not have any obligation or liability of any kind or nature for any compensation or benefits of any kind or nature to the employees or consultants of the Company for services rendered prior to the Closing.

(f) Each of the Company Plans listed on Section 2.20 of the Schedule of Exceptions that is intended to be a qualified plan pursuant to Code Section 401(a) is so qualified and either has received a favorable determination letter to such effect, or is in the form of a prototype, master or volume submitter plan document that has a current letter from the Internal Revenue Service stating that the language of such plan document meets the qualification requirements of Code Section 401(a) and the Company is entitled to reliance on such letter with regard to such Company Plan, and no action or amendment has been taken or made to adversely affect such determination letter or reliance on such letter.

(g) All reports required by any governmental agency and disclosures required to be made to participants and beneficiaries with respect to the Company Plans listed on Section 2.20 of the Schedule of Exceptions have been timely filed or made.

(h) All contributions, premiums or other payments for the Company Plans listed on Section 2.20 of the Schedule of Exceptions attributable to all periods prior to the Closing have been made on a timely basis and within the time limits prescribed by ERISA or other applicable Law.

(i) Neither the Company nor any other corporation, trade or business under common control with the Company (as determined under Code Section 414(b) and (c)) has established, maintained or contributed to, or had any obligation to establish, maintain or contribute to (i) any plan or arrangement that is subject to Title IV of ERISA or the funding requirements of Section 412 of the Code; (ii) any multi-employer plan as defined in Section 4001(a)(3) of ERISA; or (iii) any multiple employer plan as defined in Section 413(c) of the Code.

(j) The Company has not established, maintained or contributed to, or had any obligation to establish, maintain or contribute to (i) a multiple employer welfare arrangement within the meaning of Section 3(40)(A) of the Code; or (ii) a voluntary employees beneficiary association within the meaning of Section 501(c)(9) of the Code.

(k) There is no outstanding request for information or litigation concerning any of the Company Plans listed on Section 2.20 of the Schedule of Exceptions by participants, beneficiaries or governmental agencies.

(l) Neither the Company nor, to its knowledge any Company Plan fiduciary (as defined in ERISA Section 3(21)), has engaged in any transaction in violation of ERISA Section 406(a) and (b) (for which no exemption exists under ERISA Section 408) or any “prohibited transaction” (as defined in Section 4975(c)(2) or Section 4975(d) of the Code).

(m) The Company has not provided, and the Company has no obligation to provide, any medical, life, or similar benefits to current or future retired or terminated employees, their spouses or dependents following termination of employment except as required in ERISA Section 601.

(n) The consummation of the transactions contemplated by this Agreement and the other Transaction Documents will not (i) entitle any current or former employee, officer, director or independent contractor of the Company to severance pay, unemployment compensation or any other payment, (ii) accelerate the time of payment or vesting, or increase the amount of payments or compensation due any such individual or (iii) result in any prohibited transaction described in Section 406 of ERISA or Section 4975 of the Code for which an exemption is not available.

(o) The execution or performance of the transactions contemplated by this Agreement will not create, accelerate or increase any obligations under the Company Plans, including any obligation to make any payment that would not be deductible as an excess golden parachute payment under Section 280G of the Code.

(p) Each Company Plan that is a “nonqualified deferred compensation plan” (as defined in Code Section 409A(d)(1)) has been operated since January 1, 2005 in good faith compliance with Code Section 409A and Internal Revenue Service Notice 2005-1. No Company

Plan that is a “nonqualified deferred compensation plan” has been materially modified (as determined under Notice 2005-1) after October 3, 2004. No stock option granted under any Company Plan has an exercise price that has been or may be less than the fair market value of the underlying equity units as of the date such option was granted or has any feature for the deferral of compensation other than the deferral of recognition of income until the later of exercise or disposition of such option.

(q) The Company will work with the Purchaser in good faith subsequent to Closing to take any and all corrective action as the Purchaser may in good faith require in connection with the Company Plans.

### **COVENANT REGARDING TERMINATING 401(K) PLAN**

5.1 401(k) Plan. Prior to Closing, the Company shall take all necessary and appropriate actions to terminate the Company’s 401(k) plan (the “401(k) Plan”) effective prior to Closing. Prior to Closing, the Company shall provide the Purchaser with copies of all proposed documentation relating to the termination of the 401(k) Plan and shall work with Purchaser to ensure that the termination is properly effected prior to Closing.

**ADDENDUM D**

**RESOLUTIONS TERMINATING 401(K) PLAN**

**WHEREAS**, the Corporation has maintained the [NAME OF COMPANY] 401(k) Plan (the “Plan”);

**WHEREAS**, the Corporation desires to terminate the Plan effective as of [TERMINATION DATE] and to take such steps as are appropriate in connection with such termination;

**NOW, THEREFORE, BE IT RESOLVED**, that the Plan be, and it hereby is, terminated effective as of [TERMINATION DATE] (the “Termination Date”);

**FURTHER RESOLVED**, that accounts of participants in the Plans as of the Termination Date be, and they hereby are, determined to be one hundred percent (100%) vested; and

**FURTHER RESOLVED**, that the officers of the Corporation be, and they hereby are, authorized to do and perform any acts necessary to give effect to the foregoing resolutions and ensure that the Plan is terminated and all plan assets distributed, including, without limitation: (1) the preparation and submission to the Internal Revenue Service (the “IRS”) of an application for a determination that the termination of the Plan shall not affect the qualified status of the Plan under the Code; (2) the preparation and adoption of any amendments to the Plan the IRS may require as a condition for the issuance of a favorable determination letter on the termination of the Plan; and (3) the filing of Annual Returns/Reports for the Plan until such time as all assets are distributed.

**PROVISION REGARDING ASSUMPTION OF STOCK OPTIONS**

(a) Each outstanding option to purchase shares of Company Common Stock (a “Stock Option”) under the Stock Plan, whether vested or unvested, shall be assumed by the Purchaser. All restrictions and limitations (including vesting provisions) applicable to such Stock Options shall remain in place following the Closing, without giving effect to any acceleration or other changes resulting from the Merger. As part of such assumption, each assumed Stock Option shall be converted into the right to acquire, on substantially similar terms and conditions as were applicable under such Stock Option immediately prior to the Effective Time (including without limitation any repurchase rights), the number of shares of Purchaser Common Stock (rounded to the nearest whole share) determined by multiplying the number of shares of Company Common Stock subject to such Stock Option by the Common Exchange Ratio, at a price per share (rounded to the nearest whole cent) equal to the exercise price per share of Company Common Stock immediately prior to the Effective Time under such Stock Option divided by the Common Exchange Ratio. As soon as practicable after the Effective Time, the Purchaser shall deliver to each holder of Stock Options a notice confirming the foregoing assumption and setting forth such holder’s rights pursuant thereto, including the number of shares of Purchaser Common Stock purchasable under the assumed Stock Option and the corresponding exercise price thereunder. It is the intention of the parties that the Stock Options, or portion thereof, assumed by the Purchaser that qualified as incentive stock options as defined in Section 422 of the Code immediately prior to the Effective Time continue to qualify as incentive stock options for Purchaser Common Stock following the Effective Time to the extent permitted by Law. The Purchaser shall take all necessary corporate action to reserve for issuance a sufficient number of shares of Purchaser Common Stock for delivery upon exercise of the Stock Options assumed in accordance with this Section.