



**Lowenstein Sandler's Employee Benefits & Executive Compensation Podcast:  
Just Compensation**

**Episode 24 -  
Acquiring a Company with a PEO? What Buyers  
Need to Know.**

By [Megan Monson](#), [Taryn E. Cannataro](#), [Jessica Kriegsfeld](#)

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**Jessica Kriegsfeld:** Welcome to the latest edition of Just Compensation. My name is Jessica Kriegsfeld and I'm an associate in Lowenstein's Executive Compensation and Employee Benefits Group. I'll turn it over to Megan and Taryn to introduce themselves.

**Taryn Cannataro:** Hi, I'm Taryn Cannataro. I am counsel in Lowenstein's Executive Compensation and Employee Benefits Group.

**Megan Monson:** I'm Megan Monson, a partner in the same practice group as Terran and Jessica. Thank you all for joining us today.

**Jessica Kriegsfeld:** Today's discussion will be focused on some high-level benefits related considerations for transactions that involve a seller utilizing a professional employer organization, more commonly known as a PEO. A PEO can be a useful tool for companies to be able to outsource many of their HR and payroll responsibilities, as well as to offer certain benefits to employees. However, there are additional considerations and complexities to be aware of in the context of M&A transactions when the seller has a PEO, as the buyer develops a post-closing transition plan.

Today we will discuss at a high level some items to be mindful of as you navigate a transaction that involves a PEO, including specific considerations with respect to retirement and health and welfare plans, and some potential pitfalls of having a PEO sponsored benefit plan. As always, this is not intended to be an exhaustive discussion, so we encourage you to consult with your legal counsel if you are looking for more information regarding PEOs or are involved in a transaction where a party utilizes a PEO. Taryn, Megan, can you set the stage for us and give us some background on what a PEO is and why companies would utilize one?

**Megan Monson:** Yeah, of course. Happy to. A PEO is an outsourced service provider that a company will contract with to really handle HR related obligations on the company's behalf. By virtue of using a PEO, that creates a co-employment relationship. If a company utilizes a PEO, the company will remain the common law employer of the employees, but the employees are also co-employed by the PEO. That's kind of an interesting dynamic and something to be aware of.

PEO responsibilities typically include managing payroll, dealing with income and employment tax withholding and reporting, providing health and welfare and sometimes retirement benefits, managing unemployment and workers' comp claims, and kind of dealing with a whole host of compliance with employment laws. If an employee's onboarded, they typically have an offer letter, they review their worker classification for purposes of whether they are exempt or non-exempt from overtime, and things like that.

Most companies tend to utilize a PEO really as a function to outsource these various payroll obligations and HR obligations because they can be burdensome for, in particular, smaller companies that really don't have the infrastructure in place to handle these types of administrative aspects of onboarding employees and ensuring compliance in-house. Utilizing a PEO can also be helpful in being able to offer more fulsome benefits or benefits at a lower price point to employees. Again, sometimes in particular for smaller organizations that may otherwise not be offering medical benefits or retirement benefits, this is a really streamlined way for them to do so.

It can also be helpful if nowadays we see a lot of companies that are having remote workers, and so they have employees across a multitude of states. By utilizing a PEO, again, for doing a lot of this HR administrative related items, it can help ensure compliance and managing various state payroll obligations. Another thing to point out is you don't have to handle internally sponsoring and administering the employee benefit plan. Again, especially in smaller organizations where they don't have a person dedicated to doing that, because that role can be pretty involved and require a lot of time and attention.

**Taryn Cannataro:** One instance where I've seen PEOs be particularly helpful recently was in a deal where a foreign corporation was selling off a US subsidiary. That US subsidiary was on the parent plans and needed to set up its own plans pretty quickly. With the help of the PEO, they got all of their HR and payroll and benefit plan functions in place pretty quickly without having to take on the entire burden themselves.

**Megan Monson:** Yeah, that's a great point, Taryn. I tend to see it a lot in similar circumstances, where you have a company that's just onboarding one or two employees but wants to be attractive in the market and also be offering these benefits to employees. Utilizing a PEO can be a pretty streamlined and easy way to do that in a relatively time efficient manner.

**Jessica Kriegsfeld:** Thanks, Megan. Are there any other points to highlight with respect to having a PEO sponsored benefit plan?

**Taryn Cannataro:** The one difference between a PEO sponsored benefit plan and sponsoring your own benefit plan is that in a PEO benefit plan, the company is not the sponsor of the plan. The PEO is, which means that PEOs can't be terminated, the company can only withdraw participation in the PEO plan. This is really notable when it comes to 401(k) plans because it means that there is no distribution event for 401(k) plan participants if the company is withdrawing participation in the plan. This means that the company either has to allow participants to keep an account with the PEO, or the buyer's plan will have to accept a trustee-to-trustee transfer. That also includes any possible benefits, rights, and features and plan loads that come with them.

Depending on the PEO, there could also be less flexibility over the benefits offered and the cost of benefits, although that does vary from PEO to PEO. We have seen PEOs with a wide range of benefit plans offered. Like Megan mentioned earlier, the PEO does handle a lot of the compliance aspects of employment and benefits laws, but ultimately, it's the responsibility of the company to ensure compliance with employment and benefits laws.

**Megan Monson:** I just want to mention that there are a lot of different PEOs out there. Just to name a few in case you're hearing these names in the marketplace, TriNet, Paychecks, Justworks, ADP are some that we commonly see, but there's a lot that are out there. If that is something that you're interested in pursuing, make sure to coordinate with your benefits broker and they can let you know what PEOs available and figure out what is the best fit for your organization.

**Jessica Kriegsfeld:** Shifting gears to PEO sponsored benefits in an M&A transaction, this is a stock deal, a merger, or an asset sale. What are some initial things to be mindful of when navigating a deal, generally?

**Megan Monson:** Yeah, so that's a great question, Jessica. One of the first considerations is you're going to approach deal documents typically different than you would in a traditional stock deal, merger, or asset sale when there's not a PEO benefit plans involved. For example, you're making certain representations in the deal documents, and it might not be appropriate to be able to make representations on behalf of plans that are sponsored by the PEO. You would want to potentially have some sort of knowledge or materiality qualifiers.

One other point to mention is something Taryn touched on before is that you can't terminate the PEO plans, although subject to the terms of the contract, you can terminate participation. Typically, in M&A deals, you may have a buyer requesting termination of a 401(k) plan or termination of certain health and welfare plans. You would have to be careful that in the context of involving a PEO, if there are those type of covenants, you would have to tweak the language to make it clear that you can terminate participation but not actually agree to terminating the plans themselves.

Another common thing in M&A transactions is that a buyer's going to want to see certain documentation related to the benefit plans. Anytime you have to get documents from another service provider, in particular a large vendor such as a PEO, it just may take more time. It's really important to be aware of that if you're on the sell side and ask for those documents upfront, because you never want to be in a scenario where not having a health and welfare plan or a copy of the 401(k) plan is becoming a gating item for the deal.

Another thing to consider is there needs to be potentially coordination with the PEO regarding go forward plans in terms of whether you're going to keep the PEO in place, whether you're going to terminate participation, and we'll get into some of those specific considerations for both health and welfare plans and 401(k) plans a bit later. But again, it's just really making sure that everyone's kind of aligned in terms of what the go forward plan is and making sure that all parties are involved in those discussions.

One other item, as I alluded to before, is typically a services agreement with the PEO. It's important to review that to see if there are any sort of advanced notice requirements if there is going to be termination of the PEO arrangement generally, if a buyer doesn't want to completely outsource the functions, or termination of even just specific benefits under that arrangement. As a buyer, you need to think about whether or not you want to leave the PEO plan in place post-closing. Again, this varies, but typically it's going to depend on what type of buyer is involved in the deal. If there's a strategic buyer, if they have their own PEO plan, they may want to transition to their own arrangements post-closing, versus if a private equity buyer is involved, it's much easier for them to just say, we're going to keep everything status quo, we just want to onboard this company into our platform, and they may leave the PEO plan in place on a go forward basis.

- Taryn Cannataro:** As Megan mentioned, a PE firm specifically may want to keep a PEO in place, especially when it's a new portfolio and they don't have any benefits set up on their own. It may help to streamline the process of getting benefits started post-closing.
- Megan Monson:** To the point that we talked about earlier, again, having that whole HR function in place. Just as a PE buyer, they really want to tend to take a business that's ready to go and continue operations as is. It's just one tool in their toolbox to not have to worry about this aspect of things.
- Jessica Kriegsfeld:** What are some health and welfare plans specific considerations to be mindful of in the context of a transaction?
- Megan Monson:** One of the first things to think about is, one, whether or not you're going to terminate the PEO arrangement. If you are, whether or not to terminate it mid-year. In terms of employee relations, there can be considerations of, people have already been paying into their benefits for purposes of meeting their out-of-pocket maximums and deductibles. There are considerations of people who have upcoming doctors or surgeries planned. That's just in general, whether you're dealing with PEO or not, considerations to think about whether you're going to change any sort of health and welfare benefits mid-year.
- There are also some challenges if the PEO offers an FSA and it's being terminated mid-year, because employees may not be able to access or roll over those funds. They really could be out of pocket for money they've put into the FSA that they're now no longer being able to use. If you are going to be shifting to another provider mid-year, the buyer would need to request accumulation reports from the PEO. Again, just with anything else, as I mentioned before, getting documents and data from a larger service provider can be difficult and take time. That's just another consideration to have.
- As a related item, it can be difficult to get claims and utilization data if you're trying to understand and evaluate the really underlying costs and medical expenses, especially if you're looking at offering any sort of self-insured plan on a go forward basis. All the things that I mentioned are just things to keep in mind as you're deciding, one, whether to terminate the relationship at all, or two, whether or not to at least keep it in place through the end of the year that the transaction happened to have a more seamless transition for employees.
- Jessica Kriegsfeld:** What about any 401(k) plan considerations?
- Taryn Cannataro:** When there's a 401(k) plan that's sponsored by PEO, there are a few things to keep in mind. As we mentioned earlier, you can't terminate a PEO 401(k) plan itself, so you have to withdraw as a participating employer. This is the option that we see utilized most frequently in the context of an M&A deal. However, it's not the only option. You also could spin off the company's plan into a new plan and terminate that plan. That's a little bit more administratively difficult. But, a termination of the plan would be a distributable event, so it will allow employees to roll over their balances out of the plan rather than have to leave it in the plan or have a trustee-to-trustee transfer into the buyer plan. You also could have the accounts transferred from the PEO plan to the buyer plan, but we see that option utilized least frequently.
- PEO plans also have specific requirements, especially 401(k) plans when we're talking about withdrawing participation. From a legal perspective, all that's needed is usually just a set of board resolutions withdrawing participation in the plan before closing. However, PEO providers sometimes have their own administrative requirements. Sometimes it's notice, sometimes it's extra paperwork explaining why they're withdrawing participation. It varies from PEO provider, but it's just something

to keep in mind as it could add some time to the deal. You obviously don't want the 401(k) plan to be something that's holding up closing.

**Megan Monson:**

Yeah, so I think this just goes back to the point that we've reiterated a couple of times, is that it's really important to know and think about early on in the deal process what's going to be done with the various benefit plans, and making sure that there's an open line of communication both with all parties involved, and to the extent appropriate, PEO provider, so that you are getting ahead of these various potentially administrative requirements.

The PEO providers that we've worked with, again, and there's a number of them out there, they regularly are involved and see clients that are dealing with M&A transactions, so it's not unfamiliar to them to be getting requests for documents or termination of participation in the arrangements. I'll also give a plug for a prior episode of our podcast that talks about 401(k) plan considerations more generally in M&A transactions, so if you want more information or more details about the implications and how that process works, please check out that episode.

**Jessica Kriegsfeld:**

Thanks, Megan. In an M&A deal, it's important to understand if a seller utilizes a PEO early in the transaction to avoid delays and administrative burdens. As mentioned, it has an impact on how certain aspects of the deal are approached. Being aware of these challenges and suggestions on how to navigate can make you more apt in addressing any issues that may arise.

This episode is intended to give you some high-level food for thought but is in no means a comprehensive discussion of all considerations, and these may not apply to your particular situation. If your company could be engaging in an M&A transaction in the future, whether as seller or acquirer, and there is a PEO involved, we encourage you to consult with counsel. Thank you very much for joining us today. We look forward to having you back on our next episode of Just Compensation.

**Kevin Iredell:**

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