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2025

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**HR Network:
From Startup to Exit –
Legal Considerations for
Employee Benefits**

Roadmap

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- Phase 1: Under 50 employees
 - Establish basic health and retirement offerings
 - Implement core compliance processes
 - Consider PEO arrangement if administrative burden is high
- Phase 2: 50 – 100 employees
 - Conduct PEO cost-benefit analysis
 - Evaluate direct vendor relationships
 - Strengthen fiduciary governance processes
 - Explore self-funded health plan transition
- Phase 3: 100+ employees
 - Transition to self-funded health arrangements
 - Implement comprehensive fiduciary protection program
 - Develop strategic vendor management capabilities
- Fiduciary protection strategies
- Exit considerations

Phase 1: Under 50 Employees

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Phase 1: Under 50 employees

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- Available options for health and retirement benefits
 - Health insurance
 - Small-group health plans
 - Health reimbursement arrangements (HRAs)
 - Association health plans
 - Cash stipends
 - Retirement benefits
 - Simple IRA plans
 - SEP-IRAs
 - Small business 401(k) plans
 - State-sponsored plans
 - Provider solutions
 - Benefits platform
 - PEO partnerships
 - Pooled employer plans (retirement)

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Key compliance concerns at foundation stage

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- Contracting with legitimate vendors
- State-specific mandates (paid leave, disability, retirement)
- Basic legal obligations
- Documentation, participant notices, payroll and record-keeping requirements

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The PEO Decision Point

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Dangerous approaches for small employers

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- “We’re still a startup and don’t have HR resources, so can we instead ...”
 - Engage all service providers as independent contractors and pay on a 1099 basis?
 - Defer salary until we’re bigger or let people work for free?
 - Compensate employees through equity only?
- **All these approaches present significant risk!**

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What is a PEO?

- A professional employer organization (PEO) is a co-employer (share legal responsibilities and liabilities pertaining to employees)
- Services vary, but a PEO often handles HR aspects like payroll, health and welfare benefits, insurance, and workers' compensation
- PEO and company responsibilities are allocated in a service agreement between the PEO and company
- The company continues to control day-to-day operations (recruiting, hiring, discipline, compensation)

How does a PEO compare to an ASO?

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- An administrative services organization (ASO) is **not** a co-employer
- An ASO oversees the day-to-day administrative aspects of managing various HR functions, but the company is ultimately running the processes:
 - ASO cannot report payroll taxes under its own federal employer identification number (FEIN) but helps the company with payroll tasks
 - ASO cannot sponsor health and welfare benefits for company's employees but can assist in arranging coverage

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When PEOs may make sense

- Limited internal HR resources
- Need for economies of scale in benefits
- Complex multistate compliance requirements
- Desire to offer competitive benefits without administrative burden

PEO concerns

- Shared liability – employers retain ultimate legal responsibility
- Tax classification issues and potential dual liability
- Due diligence for PEO selection
- Lack of control and visibility limitations
- One-sided contractual provisions
- Cost

Phase 2: 50 – 100 Employees

PEO cost-benefit analysis

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- Optimal exit size: Between 50 – 100+ employees when economies of scale favor direct relationships
- Internal HR resources available
- Broker assistance

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Exit strategy considerations

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- Timing is critical – year-end exits minimize complications
 - Tax restart issues – possible Federal Insurance Contributions Act (FICA)/Federal Unemployment Tax Act (FUTA) wage base resets mid-year depending on the PEO; look for a certified professional employer organization (CPEO)
 - Benefits disruption – deductibles and out-of-pocket maximums reset
- Exiting PEO retirement plans can be complicated
 - Challenges arise in the M&A context – be prepared

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Fully insured plans and pitfalls

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- Fully insured health plans provide some advantages over PEO plans
 - Direct carrier relationship
 - Greater customization and flexibility
 - Vendor independence
- Fully insured plans also have disadvantages (many of which also apply to PEO plans):
 - Rising premium costs
 - No refunds for unused benefits (except medical loss ratio rebates)
 - Limited claims management capability
 - Narrow provider networks
 - Regulatory compliance complexity

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Level-funded plans and pitfalls

- A level-funded health plan is a hybrid approach that combines elements of both fully insured and self-funded health insurance
- Advantages include:
 - Fixed monthly premiums
 - Stop loss coverage for catastrophic losses
 - Possibility of refund depending on claims experience
- Disadvantages include:
 - High fixed costs
 - Maximum funding requirements
 - Limited plan design flexibility
 - Claims surplus forfeiture upon exit
 - Minimal transparency and control
 - Additional compliance requirements

Individually sponsored retirement plans and pitfalls

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- Individually sponsored retirement plans offer several advantages over multiple employer plans sponsored by PEOs:
 - Plan design flexibility
 - Investment control
 - Cost management
- Disadvantages include:
 - Greater plan complexity and potential for operational or documentary errors
 - Increased administrative burden
 - Fiduciary oversight over plan and investment alternatives
 - Third-party administrator and advisor oversight, evaluation and contracting

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Key compliance concerns at optimization stage

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- Contracting
- Plan documentation
- Affordable Care Act employer mandate and reporting
- Form 5500 obligations
- Employee Retirement Income Security Act (ERISA) fiduciary duties
- Documentation, notice, payroll and record-keeping requirements
- Processing of participant claims
- Compliance considerations

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Phase 3: 100+ Employees

Self-funded transition triggers

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- Employee count: 100 – 200+ employees
- Financial capacity: Sufficient cash flow for claims volatility
- Risk tolerance: Comfortable with monthly variability
- Administrative and legal capability: Internal and external resources for oversight
- Cost/benefit: More favorable than insured products

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Self-funded plans and pitfalls

- Self-funded health plans provide significant flexibility to customize benefits, coverage levels and plan features:
 - Cost savings potential
 - Claims data access
 - Stop-loss flexibility
 - ERISA preemption
 - Plan design flexibility
- Some considerations when evaluating:
 - Financial exposure
 - Cash flow requirements
 - Sophisticated contracting for third-party administrators (TPAs) and other vendors
 - Adequate reserves and stop-loss coverage
 - Claims and appeal administration
 - Compliance considerations
 - Data privacy

Health Insurance Portability and Accountability Act (HIPAA) compliance

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- Covered entity status for most self-funded arrangements
- Privacy and security officer appointments required
- Privacy and security policies required
- Business associate agreements with all vendors
- Strict protected health information (PHI) access controls separating health and employment functions
- Electronic PHI security and audits
- Periodic training

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Common legal risks

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- 401(k) litigation – excessive fees, investment performance, forfeiture use
- Health plan fee challenges – emerging litigation area
- Wellness program compliance – tobacco surcharge violations
- Claims administration disputes

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Fiduciary Protection Strategies

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ERISA fiduciary obligations

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- Duty of loyalty – act solely in participants' interests
- Duty of prudence – informed decision-making process
- Investment oversight – regular monitoring and benchmarking
- Service provider management – competitive selection and monitoring
- Documentation requirements – detailed records of fiduciary decisions

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Essential protections

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- Fiduciary liability insurance – covers personal liability exposure
- ERISA fidelity bond – mandatory theft/dishonesty protection for funded plans
- Employer indemnification – structured to comply with ERISA Section 410
- Professional support – 3(21)/3(38) investment fiduciaries, consultants, legal, broker

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Best practices

- Formally delegated committee structure with documented procedures
- Periodic fiduciary meetings with minutes
- Regular education and training for fiduciaries
- Investment policy statements and monitoring protocols
- Fee benchmarking and vendor performance reviews
- Claims procedure to address participant claims

Exit Considerations

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Exit considerations

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- Employee benefit considerations in exit transactions are complex and require careful planning to protect both the company and employees while preserving employee goodwill to ensure deal success

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Form of the transaction

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- The form of a transaction has a significant impact on how employee benefits are handled
 - Stock sale – step in to benefit plans, assets and liabilities
 - Asset sale – benefit plans generally stay behind and need to be wound up
 - Carve out transaction – consider the entity that is the plan sponsor of the benefit plans

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Post-closing covenants

- Maintenance of benefit levels
- Service crediting
- Deductible and out-of-pocket crediting
- Benefit plan transition

Plan terminations

- Individually sponsored versus PEO sponsored 401(k) plan
- Health and welfare benefits
- COBRA considerations

Thank you!

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Stacey focuses on retirement plan and health and welfare plan requirements for a variety of clients, including small startup enterprises, publicly traded companies, private equity firms, and tax-exempt organizations. She advises clients with respect to benefit plan matters in mergers, acquisitions and other transactions, as well as day-to-day issues concerning design, implementation, maintenance and administration of tax-qualified employee benefit plans and compliance with ERISA requirements. She assists clients with drafting plan documents and participant disclosures, responses to participant claims, annual compliance testing, IRS and Department of Labor filings and audits, correction matters, benefit plan issues arising in mergers and acquisitions, plan terminations, and controlled group and affiliated service group analyses.

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