



| PRIVATE EQUITY |

## So Your Employer Is Being Acquired?

Consideration for the management team in a sale to a private equity buyer



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Being acquired by a private equity firm is both a stressful and exciting time for the management team of any business. In addition to your traditional duties of actually running a successful company, you will also be called on to keep the deal process moving forward, which is itself a full-time job. And all the while, you will need to strike a careful balance between the expectations of the current and future owners.

In all that chaos, it is easy for some C-level executives to lose sight of the fact that a PE acquisition is, in part, a negotiation about their individual interests as well (which interests may not be perfectly aligned with those of the business owners). In most of these transactions, the management team will be asked to sign employment agreements, equity award documents, and other agreements in connection with the closing. Three common areas of negotiation in these arrangements are:

1. Your go-forward employment contract;
2. your rights with respect to "equity" you held in your employer prior to closing that you will continue to hold after closing (often called "rollover equity"); and
3. compensatory equity grants made to you on or after closing of the transaction.

### Employment Terms

As an executive, you are no doubt familiar with the process of negotiating

employment agreements for others by now. You may be less familiar, however, with negotiating your own.

As with any employment agreement, salary, bonus, benefits, length of the agreement, and most importantly, severance rights upon termination will be key topics. Although you will remain employed by the same company, you will have a new "boss" after closing. You will need to consider what happens in the event things don't go as you had hoped. What happens if the company reduces your salary or changes the benefits programs? If your duties or title are changed, will you be able to walk away? What about a relocation of the business or a change in the reporting structure? What are your rights if your employment is terminated without "cause" and how should that term be defined?

These items should be addressed early before they are faits accomplis.

### Rollover Equity Terms

If you are fortunate enough to have "equity" in your employer, you will need to negotiate how much and on what terms you are asked to roll that interest over. Tax consequences will be a key element. Even if you do not have "equity," executives are increasingly being asked to purchase equity in the new company to ensure management has "skin in the game" going forward. Either way, the main topics of consideration with respect to this equity will include the following:

- If and on what terms the PE firm

can exercise its call right (and how the equity will be valued in such an event);

- what happens in the event you experience a separation of service;
- what, if any, voting and information rights you will have; and
- whether the equity will be subject to a drag-along, tag-along, preemptive, or registration rights.

### Compensatory Equity Terms

Perhaps the most complex area of negotiation, however, will center on the options or profits interests you get in the new company. Generally speaking, these awards have no sale or cash-out value on the date of grant, but grow in value as the company grows. Traditional employee stock options (or profits interests in LLCs) are the most typical form of these awards.

Because these awards are subject to vesting, they are one of the primary tools PE firms use to incentivize management. An equity pool is commonplace in most deals.

But what should you think about when negotiating your own award? Besides the amount of the awards, the main area for your consideration will be how those awards vest. In general, there are two

types of vesting: time and performance. In time vesting, generally speaking, if you are employed on the vesting date the awards become exercisable. Time vesting awards also may be subject to partial or full acceleration of vesting in certain instances. Awards that vest based on performance may vest upon the achievement of certain financial benchmarks following the closing by the company, the achievement of goals personal to the individual (such as individual sales targets), or a combination of the two. Financial benchmarks can be based on the company's earnings, financial return to the PE firm, or any number of other metrics. You will need to take time to make sure you fully understand how your awards work. Consider asking the buyer (or if there is one, the company's investment banker) to prepare models showing the distribution of cash to you on a future exit event at various hypothetical valuations.

Other areas of consideration with respect to options include whether and on what terms these options will be subject to future dilution, what happens to vesting in the event that the PE firm sells the target during the vesting period, and what happens if your employment ends.

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### Challenge and Opportunity

Steering your company through a PE acquisition is one of the hardest professional challenges you and the management team will face. You will be expected to work hard in the months prior to closing to make the deal a success for the selling owners and to immediately hit the ground running after the closing to make the investment by the PE buyer a successful one. But, do not forget to look out for yourself during this process. Experienced transaction professionals can help you take care of yourself while doing the right thing for your employer and future owner.

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