

[Podcast]: Nuts and Bolts on a Management Buyout - Part 2

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In this episode of The Proskauer Benefits Brief, partners [Michael Album](#) and [Josh Miller](#) return to discuss the nuts and bolts on a management buyout. As part of their discussion they highlight the different types of transactions (single bidder vs. multi-bidder) and the various tasks that management faces in handling the process and as a first step inventorying their own compensation arrangements. Be sure to tune in and listen for the latest insights and perspective on management buyouts in this second of a seven part series.

Mike Album: Hello. Welcome to the Proskauer Benefits Brief. This is a presentation on the nuts and bolts of a management buyout; what management needs to know, and today I'm joined by Josh Miller. I'm Mike Album. We're both partners here at Proskauer, and we're going to discuss the second part of our series on the nuts and bolts of a management buyout. We're going to go focus today on the terms and process of the transaction. So the transaction; obviously the transaction starts when the PE sponsor thinks that the value is right and the time is right to have different bidders look at the company and consider buying the company. And the process can include one on one negotiations, or it can include an auction process.

Josh, talk a little about how, if there's a one on one process taking place, what are the elements of that, such as letters of intent, things like that? Then we can move to the auction process.

Josh Miller: Sure. Often you'll see a term sheet, or a letter of intent, usually not binding, between management and the potential buyer. It'll outline key terms of the rollover, and the equity structure from and after the investment. And typically the letter will lay out other terms and conditions for management. Those would include the incentive equity pool, terms and conditions of employment, treatment of retention bonuses, governance rights, and so forth. We're going to get into some of the more specific terms that we would typically see in such a terms sheet, in a later podcast in this series.

Mike Album: Right, so I think what we'll call the one on one process approach may result from personal contacts management has, perhaps with other PE firms, or a PE firm selling to a PE firm may have contacts at the sponsor level. The key is generally it's a one on one process, and the auction process in contrast is a multi-ringed circus, frankly. It can have three, four, five PE firms, often being run by investment banks, submitting all types of documentation. Often at the same time, they can have different timetables. The auction process is a real challenge for management. And Josh, why don't you talk about some of the things that management has to balance in an auction process, because it's very different from a one on one negotiation.

Josh Miller: As you said, there are multiple bids, and the bidders are submitting various types of documentation, from a letter of intent or general term sheet, to full markups of a purchase agreement, fund documents, equity compensation and employment terms sheets for management. Really as much as they're willing to prepare, in some cases, sellers will like to see as much detail as possible. And in other cases, they're willing to move forward on a more general, high-level term sheet, particularly where the price is right.

Mike Album: Right. So the challenge for management in these situations; one, the prospective bidders on the company want to learn as much as they can about the company, as fast as they can, so there will be a document room set up, management is going to have to spend time getting all the documents together, and overseeing production of all the documentation that the buyer's going to need to do for diligence. At the same time, there will have been prepared perhaps, a merger agreement or the transaction document that then will be put out to all the parties in the auction, and they're going to look at that, and they're going to mark it up. So management and the outside lawyers are going to have to be focusing on comments that are coming in, working with the investment bankers, and corporate counsel, the counsel that is to the company and the sponsors, to determine whether the legal changes that are being made are consistent with the way they want to sell the company.

And now finally we get to the point Josh, where management starts to say, hey, what about my own situation? What about my own economics, what about my future here, after the closing? How do I and when do I start to address those within the context of this very busy activity that's taking place?

Josh Miller: Right. That's a critical question for management. Typically, management's going to want to retain and engage outside counsel, as soon as possible. Now management counsel can stay behind the scenes, do its work with management, without engaging bidders, or their counsel, and surface at the right time. This gives management an opportunity to be out in front, and address key terms, and set management's expectations of positions, early. The attorneys also can help manage the seller in the exit. There might be issues that still need to be addressed as part of the exit, and that can include anything from a negotiation of transaction bonuses, the seller making good on promises or expectations that the management team had, or allocating equity compensation that had been reserved but never issued.

Mike Alburn: All right. Let me just jump in. I just want to make one observation. We as counsel to management, one of the first threshold issues we deal with is who is our client, who is management. And that goes back to which group are we going to be advising, and that's again a threshold issue for the CEO and his team. Usually, we have represented a team. That team has consisted of the CEO, a CFO, a GC, perhaps a senior marketing person. But the people we represent, the team generally, it's not a large broad-base team, and the decisions we make often have ramifications for other executives, lower down the food chain. But the important point is our group will be a smaller group who we are advising, and they will be the ones who have the ears of the sponsors selling, as well as the buyers negotiating. So that first threshold issue is to figure out who your management group is that your outside counsel will be representing.

Josh Miller: That's right. The broader the team, certainly there are issues that come about. Internal conflicts, dealing with potential holdouts, individuals who won't agree to roll over, enter into new contracts such as non competes or other restrictive covenants. There might be other people, particularly in a strategic transaction, whose positions are redundant or will be eliminated. In that case, the team is going to have to deal with those conflict issues. It could be challenging for management counsel.

Mike Album: It's a challenge. Josh is right, but we try to be as transparent as we can, and we try to deal with the core members of our team in a strategic way. That goes back to the issue we raised earlier, in one of the earlier pod casts. Which is the earlier we can get involved, the better, so we can work through these types of time lines, and we can work with the senior management team to understand a range of things. I mean even something as simple as, what is their own inventory of compensation arrangements now? That is a very critical issue, to determine what they now have, so they can understand their tax treatment when payment comes in on what they have, as well as structuring their future arrangements with the buyer. So again, timing is critical, and getting your outside counsel involved with the management team early, is critical.

Josh Miller: As we talked about earlier, management can't do it all. They have to manage the day to day operation of business in the ordinary course. They have to tend to matters related to the transaction itself; the documentation, the financing, the communications, road shows, and so forth. And of course their individual compensation. And that can't be something that distracts from the deal, and their operational responsibilities, which is why having competent outside counsel is really so critical. It keeps the ball moving, you can leverage their expertise, and focus on the key management responsibilities as they apply to the company itself.

Mike Album: We'll close this podcast with this, the practical observation. Who pays the fees of management's outside counsel? That's a matter frankly that can vary from deal to deal. Often the case is that the corporation will pay, it'll come out of the corporations general assets, as part of the closing. Whether that covers all the fees or not, and whether management is also putting some money in the pot to cover out-side fees is another matter, but there are a lot of creative ways to structure the fees incurred by management, and management should not expect to cover it all by them-selves, out of their own pocket.

So that'll end this podcast, and this again is part of a series, so we'll be coming back with another podcast shortly. Thank you for joining the Proskauer Benefits Brief, stay tuned for more insights on the latest hot topics in management buyouts and executive comp, in our subsequent pod casts. And be sure to follow us on iTunes. Thank you.

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