



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

**Episode 44 –
Preparing for an M&A Transaction from an
Employment and Executive Compensation
Perspective**

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

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Megan Monson: Welcome to the Lowenstein Sandler Podcast Series. Before we begin, please take a moment to subscribe to our podcast series at lowenstein.com/podcasts or find us on Amazon Music, Apple Podcasts, Audible, iHeartRadio, Spotify, SoundCloud or YouTube. Now, let's take a listen.

Jessica Kriegsfield: Welcome to the latest episode of Just Compensation. My name is Jessica Kriegsfield and I'm an associate in Lowenstein Sandler's Executive Compensation Employment and Benefits Practice Group. I'm joined today by two members of my group, Megan Monson and Taryn Cannataro.

Megan Monson: Hi, I am Megan Monson, a partner in our practice group. Pleasure to be here.

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

Jessica Kriegsfield: Today's discussion will focus on key employment and executive compensation considerations for companies who expect to undergo a transaction. This episode will start with a discussion of considerations at the beginning of a transaction, including diligence, important elements of a purchase or merger agreement like representations and covenants and employee retention tools such as retention bonuses.

As always, this is not intended to be an exhaustive discussion, so we encourage you to consult with your legal counsel if your company is or expects to undergo a transaction. Jumping right in, what are some key executive compensation and employment considerations to keep in mind if you anticipate an M&A transaction in your company's future?

Taryn Cannataro: There are a number of important executive compensation and employment related considerations to keep in mind if you anticipate an M&A transaction in your future. But at a high level, it really all boils down to preparing for diligence, and this could happen even before an LOI is signed. Preparing to make typical representations in a definitive transaction document and putting together and retaining the right team and knowledge group to get the transaction over the finish line. And we'll talk about each of these in more detail throughout today's podcast.

Jessica Kriegsfield: Let's start with preparing for diligence. What does that entail?

Megan Monson:

So, there's a lot involved with preparing for diligence and often one area of concern for buyers is making sure that the target company has proper employee documentation in place, such as offer letters, covenants, agreements, and employee handbooks. So, this can be an opportunity for a seller in a transaction to essentially do some sell side diligence and see one, do they have these documents in place and use this as an opportunity to get them in place if they do not already.

And kind of in that group of documents I mentioned, there's a couple of things that buyers are particularly concerned about. So the first is, one, making sure that all employees have offer letters, and if they do, they have standard provisions such as base salary, specifying that employment is at-will, which is very important, and also that benefits, offerings and the terms and conditions of employment can be changed in the employer's discretion, as often unknown what a transaction's going to do and how that's going to impact the current employees.

Buyers also have an interest in knowing what restrictive covenants current employees are subject to and the enforceability of those agreements. In particular, if there are senior folks in the company who are going to be vital to the go-forward business or could really pose an issue to them if they leave and compete with the business.

Additionally, buyers often look for a fulsome employee handbook that includes the company's current practices and policies, as well as state specific requirements. And all of these items are going to typically be relevant, irrespective of the structure of the transaction.

Another thing that is important to start doing early is gathering all of your benefit plan documents since typically you're going to be required to provide them to a buyer in the course of diligence, and you may also be required to furnish them as part of the transaction agreement. And sometimes getting those documents can be challenging, whether it's from your benefits provider, maybe you have to request them from a broker. And if you use a professional employer organization, often referred to as a PEO, it can take even longer to get those documents. And so, the earlier you can start in that process, the better.

Another thing that it's helpful to start evaluating early on is if the company has any off-balance sheet liabilities, such as withdrawal liability, if there's participation in a multiple employer pension plan or severance obligations that could be triggered in connection with a transaction. With respect to withdrawal liability, often in a stock deal, this will not be triggered and the liability will just continue with the business on a go-forward basis. But a buyer could require termination of a collective bargaining agreement that would trigger withdrawal liability from the pension plan. Or if it's at an asset deal again and they don't want to do a 4204 transfer of that pension plan liability, again, that could be another situation where the liabilities triggered and now the company's having to come out of pocket to pay what could be a pretty significant amount. So just understanding whether that's something you have at play and how that could impact the value of the transaction is important.

And similarly, with respect to severance, whether somebody's going to be terminated in connection with the deal, who's responsible for that cost, whether it's a seller or a buyer, and just accounting for those items as you're starting to negotiate the transaction and the purchase price.

The last piece I'll mention in terms of preparing for diligence is making sure that your equity plan documents, and cap table are in order, as this is one of the areas that I see most heavily scrutinized by a buyer. So, the things to look at is, one, making sure your equity plan documents and ancillary agreements, such as board resolutions, are in good order, all awards are validly approved, and all options were granted with an exercise price that is at least the fair market value of the company as of the date of grant.

It is also best practices to have a valid 409A valuation to correspond with each of the option grants that were made. Something else to look at is your plan's change of control provisions to see what is permissible and whether you have flexibility under the plan, such as requiring award holders to sign a release or cancellation agreement, as those are things that may be requested by the buyer.

And all of the things with respect to treatment of outstanding equity awards is going to be negotiated in the context of the transaction. So, you want to go into any conversation with a buyer well-armed to know what is or is not permitted under your plan.

It's also important to think about any sort of accelerated vesting that may occur with respect to outstanding awards. We're not going to get into this in significant detail on this episode, but there is a provision of the tax code called 280G and any sort of accelerated vesting will be relevant and need to be considered there to the extent that 280G applies to your transaction.

You also want to make sure that the company has an accurate cap table, whether any options are expiring soon, whether options are in the money or underwater, and whether any 83(b) elections were made with respect to restricted stock awards. All of these things go in the bucket of good cap table diligence and are going to make your life much easier when the buyer is asking for these documents and you've already identified any areas of deficiency, if there are any.

Jessica Kriegsfeld: You mentioned that preparing for representations was another area to prepare for. How would a company do that?

Taryn Cannataro: As part of the transaction document, the seller is going to be required to make certain representations related to its operations, and you want to make sure that you will be able to make those representations that are typically asked of sellers in connection with the M&A transaction. From an employment perspective, this can include looking into items such as worker classification, meaning whether individuals were properly classified as independent contractors or employees and also as exempt or non-exempt from overtime under the Fair Labor Standards Act and also state law.

Confirming that all employees' eligibility to work in the United States and I9 compliance is in good shape, making sure payroll was done correctly. For example, wage withholding, overtime payments, and unemployment insurance. And again, this sometimes often requires looking into both federal and state laws for compliance, and also making sure that you're generally compliant with employment laws.

Some areas of potential non-compliance that we see include compliance with Federal and State Warrant Act, issues with wage and hour laws or harassment or

discrimination laws. And if you identify an issue early, you can address it before the buyer even uncovers it in diligence. From a benefits' perspective, you'll want to make sure that your employee benefit plans are compliant with ERISA, Section 49A, and the Affordable Care Act. Companies sometimes choose but are not obligated to engage counsel to do an employment or benefits audit or even sell side diligence prior to a sale to help get ahead of any potential issues that could arise in the transaction.

Megan Monson: And I just want to add onto what Taryn said, that while we've highlighted some areas that we know are focal points of buyers and transactions, this is not an exhaustive list. But in looking at some of these critical areas where we have seen there be potential non-compliance, it helps you get ahead of any issues, as Taryn mentioned.

Jessica Kriegsfeld: You mentioned earlier that it's important to have the right team and knowledge group retained through the transaction. How do you make sure that you have that?

Megan Monson: Yeah, so that's a great question, Jessica, and any M&A transaction requires a lot of information about the company being sold, getting a lot of documents, and so trying to navigate obtaining what you need in the deal process, but also keeping that group kind of tight to the vest is really important.

So early on in the stages of a sale, you generally want to keep the knowledge group small, people that are really going to be critical to either negotiating the terms of the transaction or gathering information that you need. And so, as you're thinking about who is the right group, really think about who needs to know? That again is going to be people who are going to be typically involved in the negotiation process. Think about who is necessary to gather information and can you get that information from them without alerting them that there's a deal? If not, again, that might be somebody else who needs to be part of that knowledge group.

And third, who may be needed to help navigate the deal process? So, in addition to gathering information, you may need other people involved to help keep the deal moving, help talk to employees as you get further along. And so, while early on you keep that knowledge group small, it may grow as the transaction progresses, and you get closer to a signing or closing.

The next aspect is to think about how and when to advise most of the employees, A.K.A. anyone who's not in that knowledge group of the potential transaction. So often companies wait until there's a definitive agreement that's either signed or about to be signed to inform the general employee population. And the messaging is going to be critical at that point, right? The transaction is typically going to be well received if it's something where, "Hey, we're really excited about this," you make it clear in communications on how people are going to be treated.

And so, you want to be progressed along enough in the transaction so you can have the discussions and be able to level set with employees and want to be doing it in a way that's going to be best perceived by the workforce because often that workforce may be a critical component to either getting the deal done if you advise them prior to signing or part of the go-forward business. And so, it's

important from both the buyer and the seller side to make sure that messaging is done properly.

And some companies may also use retention tools such as management carve-out plans or retention bonuses for people that are either being advised of the transaction in advance and they really need them there to get to the finish line, or that may be, again, integral to the post-closing business. And as part of the decision between the buyer and the seller, they need those people to stick around. They may offer them a retention bonus or a management carve-out bonus that pays post-closing as a tool to continue to have those employees have an incentive to continue working for the company.

Jessica Kriegsfeld: Megan mentioned some retention tools, but what are other retention tools to ensure that employees in the working group are incentivized to stay with the company through the consummation of the transaction?

Taryn Cannataro: There are a number of retention tools that you can use to provide financial incentives to individuals needed for the transaction. One example that we see frequently is a retention or stay bonus, which is typically a cash payment, but it could also be an equity award that is provided to the individual if they stay employed through consummation of the transaction or even for a period of time post-closing.

These bonuses are typically paid in a lump sum, but they can also be paid out over time or even subject to a hold back, which would keep the individuals employed after the closing of the transaction. The bonuses can be especially helpful if these people are needed to help achieve any earn-out. The terms of these bonuses can be pretty flexible, but the bonuses need to comply with or be exempt from section 409A, which is a complex provision of the tax code that governs the time and form of payment of deferred compensation. We've discussed the intricacies of 409A in prior episodes.

Another retention tool that we see, typically geared towards key individuals, is a management carve-out plan. And a management carve-out plan carves out a portion of the sale proceeds to pay certain individuals and motivate them to stay with the company through the transaction. This could be a kicker for key individuals who already hold equity or a way to incentivize those whose equity may be underwater. You could offset payment by the amount of equity proceeds individuals receiving if you're concerned with avoiding double-dipping as well.

These plans also have significant flexibility. For example, participants can get a fixed amount. The company can allocate funds to a pool where participants can receive a fixed sum from the pool or a percentage of the pool in exchange for continued employment through the consummation of transaction. And you can also tie a portion of the payments to the contingent proceeds in the deal or condition payment on execution of release. Like the retention bonuses, these plans also need to be exempt from or subject to section 409A. There are a number of various retention tools that you can use to provide financial incentives to your employees, but these are just the ones that we see used most often.

Jessica Kriegsfeld: Megan, is there anything else to consider?

Megan Monson: There are a number of planning opportunities to think about. You can certainly think about planning opportunities as it relates to potentially section 280G. Again,

using some of the tools that Taryn mentioned, you can structure different incentives based upon what you're looking to achieve and just want to mention that there will always be other things to consider or navigate once a transaction is actually certain. But these things that we're raising are just items that are commonplace in most transactions, and so they're things that you can try to get ahead of in advance of a transaction.

Jessica Kriegsfeld: As you heard today, there are many considerations and processes for a company undergoing a transaction. Companies should be careful to disclose the proper documents and diligence, review the representations, and ensure that any employee retention tools are structured to be compliant with Section 409A. This episode is intended to be a high-level overview but is by no means an exhaustive discussion. Thanks for joining us today. We look forward to having you back for our next episode of Just Compensation.

Megan Monson: Thank you for listening to today's episode. Please subscribe to our podcast series at [Lowenstein.com/podcasts](https://www.Lowenstein.com/podcasts) or find us on Amazon Music, Apple Podcasts, Audible, iHeartRadio, Spotify, SoundCloud, or YouTube. Lowenstein Sandler podcast series is presented by Lowenstein Sandler and cannot be copied or rebroadcast without consent. The information provided is intended for a general audience and is not legal advice or a substitute for the advice of counsel. Prior results do not guarantee a similar outcome. Content reflects the personal views and opinions of the participants. No attorney-client relationship is being created by this podcast and all rights are reserved.