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47th Annual Advanced Business Law Conference 2021: Back to Business as Unusual – Legal Issues Impacting Businesses in 2021 (That Have Nothing to Do with COVID-19)

BUSINESS SUCCESSION PLANNING: An Old Topic Gets a 21st Century Makeover

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I. INTRODUCTION – HOW BUSINESS SUCCESSION PLANNING HAS EVOLVED

Prior Annual Advanced Business Law Conferences have covered a wide variety of topics related to business formations, founder equity ownership and employee equity incentives, venture capital and private equity financings, and mergers and acquisitions. These topics have been addressed in the contexts of the life cycle of a private company and the evolution of the economy brought about by technological innovation, globalization, outsourcing, data and information technologies, and the entry of many new types of private company investors and buyers into the deal economy. ***Traditional "business succession planning" focused on leadership succession, optimal company capital and tax structures, and ownership retention and business preservation.*** These planning considerations are still critical to positioning a company for success in an increasingly competitive and unpredictable business climate. A "business succession plan" is perhaps most appropriately viewed as a company

roadmap and business and legal structures designed to help company management and ownership improve performance and profitability in the near term, enhance company value in the mid and long terms, and pivot when advisable or necessary to seize new opportunities or confront unplanned events along the road. ***This business succession plan "roadmap" need not, and should not, limit the company to one particular ownership and management succession destination; rather, it should permit the company to keep all potential strategic options open.*** In the current innovation economy and active capital and merger and acquisition markets, an eventual sale of the company should always be left on the table. And with early and focused attention on an ongoing, changeable business succession plan, a company will always be in a stronger position to either stay the course or, if and when advisable, consider a significant capital raise or sale. Private company owners and management are, today, much more aware of and open to the possibility that a long-term business succession plan may eventually lead to development and execution of a company "exit plan".

A. "**Business succession planning**" used to be the purview of estate planning lawyers, tax accountants and family business consultants, and its focus was on preserving management and ownership continuity (control) and planning for an eventual transfer of company ownership (often "inside" to management or family members) in as tax-efficient a manner as possible.

B. Today, against the backdrops of retiring baby boomer founders and a hot mergers and acquisitions (M&A) market, "**business (or owner) exit planning**" has taken center stage, and wealth management, investment banking, private equity and other professionals are encouraging a "what if we sold" or "strategic options" approach to planning for a company's and its owners' future.

C. Owners of family and closely-held businesses essentially own **private equity** – a relatively illiquid asset that usually constitutes the most substantial part of their personal balance sheet. Owners often do personal financial and estate planning tailored around this reality, but often without serious consideration of how they can eventually maximize, realize and diversify the equity value of their business.

D. Businesses often have business, marketing and strategic or growth plans, may have a business continuity or ownership preservation plan typically memorialized in a shareholder or buy-sell agreement, and perhaps supplemented by an employee equity incentive or stock option plan. The **strategic and growth plans are externally focused** on the company's market, suppliers and customers. The **continuity or ownership (and employee) preservation plan is internally focused** on maintaining ownership control in the founder or management and retaining employee talent through a combination of compensation, benefits and, in some cases, participation in equity ownership.

E. Business succession planning has become an even more multidisciplinary and sophisticated process than it was in the past due primarily to the realization that, in an

increasingly competitive and constantly changing business environment, **business preservation is not about sitting still but, rather, constantly improving the business to sustain growth and profitability and hedge competitive risks.**

F. Entrepreneurs and founders, perhaps even more than other people, do not enjoy financial and estate planning. They are focused on their business. And while they may engage in valuable business operations improvement and growth planning, and perhaps even in strategies to transform their companies to seize new opportunities and ward off competitive and technological threats, they are often not comfortable thinking about or discussing **the end of their careers or an eventual transfer of leadership and ownership**. Their personal identity and satisfaction are often closely tied to their ownership and control of their business.

G. Increasingly, however, private company founders and management are thinking about and planning for **an eventual transfer of ownership and management**, whether to a younger existing management team, to a financial (e.g., private equity or family office) or strategic (e.g., a corporate competitor or partner) buyer, or perhaps some combination of these strategic options. This "exit" orientation can be driven by unanticipated company challenges or the desire to eventually liquidate the company value they have built.

H. Legal and other advisors to private companies and their owners are tasked with educating their clients about the real value of an ongoing business succession planning analysis and process. Having a business succession plan, which should include an owner life, financial and estate plan, and a company strategic growth and options plan, should not be viewed as restricting or tying the owners' hands. Rather, having a plan, whether long or shorter term, which can be reassessed at critical points in the company's life cycle, **will ensure that the company's owners, and not others, can control their and their company's future** and pivot in response to certain changes in personal, business, industry and market circumstances.

I. Regardless of the owners' near-term goals and objectives, approaching business succession planning as a company market and talent preservation, growth and a **"keeping our options open" plan** will add immediate and future value to the company and provide security for its owners and employees. Operating and growing a business with a "what if we sold" perspective in mind can also dramatically improve the company's current performance and value.

II. MAKING SUCCESSION PLANNING AN INTEGRAL PART OF BUSINESS OPERATIONS AND STRATEGY

A. The National Association of Corporate Directors reports that fewer than 1 in 4 companies have a formal succession plan. http://www.nacdonline.org/AboutUs/PressRelease.cfm?ItemNumber=4699.

B. The main reasons companies fail to establish a succession plan are perceived lack of time, aversion to complexity and, perhaps most common, the founder's or entrepreneur's deeply emotional ties to the business, including its impact on employees, customers, suppliers and the community.

C. But with the current **substantial and persistent wave of private company transfers** promising to continue over the next 5 to 10 years, a company's long-term survival (and preservation of the owners' equity value) will depend more than ever on earlier and ongoing business succession planning.

D. These have become well-known statistics – that only 30% of family-owned businesses survive into the 2nd generation, only 12% into the third, and only about 3% into the fourth. Technology, mobilization and constantly changing business models, risks and competition will likely continue to increase these figures.

E. Depending on the founder's or CEO's age and personal goals and their tolerance for the risk in missing an opportunity to maximize sale value in an active M&A market, many companies and their owners would be well-advised to consider or at least assess the benefits of a company sale. **But even if they are comfortable putting an ownership transition off for several years, having a plan will add immediate value to their company due to the byproducts of the planning process**: operational improvements, business growth initiatives, talent retention, adoption of new business models, and, most important, the ability to retain control of the process through a plan that will allow the company to pivot in response to unanticipated future events.

F. Business succession planning (i) develops a better understanding of the value drivers, future growth potential and risks of a company, (ii) preserves company value by addressing and enabling pivots to counter competitive and unplanned risks and events, and (iii) provides a structure for passing that value to new owners intact.

III. SELECT COMPONENTS OF AND STAKEHOLDERS IN A BUSINESS SUCCESSION PLAN[1]

A. **Business Strategic (Preservation, Growth and Options) Plan**

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[1] See *Business Succession Planning, Cultivating Enduring Value*, Deloitte, www.deloitte.com/us/dges/BusinessSuccessionPlanning.

1. Business strategy (products, services, technology and competitiveness), growth, profitability (operations and performance) and needs (talent, advisers, systems and capital) assessment and actions.

2. Management and employee talent and needs assessment and retention programs (including recruiting, time management and benefits of tying compensation to owner or "shareholder" value).

3. Company capital (optimal mix of cash on the balance sheet, equity, debt and other capital sources), legal entity and tax structuring.

4. Business valuation, quality of earnings (QofE), SWOT (strengths, weaknesses, opportunities and threats) and market positioning analysis.

5. Leadership transition and retirement planning.

6. Strategic (capital raising, joint ventures or other partnerships, or company sale) options analysis, including market conditions and timing.

B. **Owner (Shareholder, Member or Partner) Plan**

1. Shareholder, "buy-sell" or operating agreement governing equity allocations, transfers and company governance.

2. Compensation, retirement, disability and life insurance benefits, and financial and investment, planning.

3. Personal, retirement and tax-planning goals and expectations around equity ownership and transfer.

4. Personal objectives regarding the interests of other company stakeholders, including employees, customers, suppliers and their communities.

5. Preferences regarding future ownership of the business, including cultural and stakeholder impacts.

C. **Management Team and Employees**

1. Vision and goals communication.

2. Talent retention (including before and after a potential sale or change in ownership).

3. Job security and incentives.

4. Base and bonus compensation, and longer-term phantom equity or equity incentives.

5. Securing team buy-in to company strategic plan and owner plan.

D. <u>Prioritizing and Tailoring These Three Areas</u>

1. The **business strategic plan** is paramount because the owner's objectives can only be realized if the business succeeds (whether as a going concern or via a sale).

2. The **owner's personal succession (ownership and management), financial and retirement plans** are critical because he or she controls the company.

3. The **management and employee retention plan** is, on the one hand, the third priority, but, on the other hand, is critical to the business strategic plan and to some extent the accomplishment of the owner's objectives – thus, each of these 3 planning areas relies on and expedites the others.

4. Business succession planning is not just business, it's personal, and achieving potentially conflicting goals and securing buy-in from all stakeholders is critical to successful execution of the plan.

IV. CLASSIC OWNERSHIP SUCCESSION (OR LIQUIDITY) OPTIONS

A. <u>Maintain Current Ownership</u>

1. Owner not close to retirement age and set on building the business may choose to limit outside financing to debt and equity transfers to minority stakes for management share purchases, awards or options (talent retention focus), or family or family trusts (gift and estate tax planning focus).

2. Possibility of early death or disability makes leadership succession and estate planning critical (including perhaps authorizing the executor to work with an existing or designated advisory team to manage a company sale either to management or an outside buyer).

3. Business succession planning still valuable to address unforeseen events or eventual exit opportunities.

B. <u>Dividend Recapitalization</u>

1. Although not always considered a mechanism for carrying out a change of ownership or management control, a "recapitalization" can provide current owners with the ability to turn a portion of their ownership into liquid investment assets.

2. One of the most common forms of a recapitalization is a so-called "dividend recapitalization." The company typically borrows money from a bank or other

debt provider and uses all or a portion of the loan proceeds to pay a cash dividend to the current owners. As an alternative to paying a cash dividend to all owners, the loan proceeds might be used to redeem or buy out a portion of the equity of certain owners. A recapitalization might also involve a new equity investor in combination with or as an alternative to funding the dividend or redemption with new debt.

3. Upsides are owner liquidity and wealth diversification; downsides include increasing the company's debt load (and, it follows, risk) and required bank negotiations and terms, and perhaps tax implications for dividends, particularly if the company is a C corporation.

C. Management Buyout

1. Transaction or series of transactions pursuant to which key management team members acquire equity control over time or in one transaction, financed through combination of personal funds and future installment payments funded by the business, or bank or mezzanine lender financing.

2. Employee stock ownership plan (ESOP) is a popular transaction structure more typically designed to afford the owner a tax efficient sale of equity to an ESOP plan to be allocated to company employees and funded with bank financing. There are private equity funds that specialize in sponsoring ESOP transactions.

3. Upsides include providing employee ownership in the business and availability of bank financing; downsides include legal and tax compliance costs and expenses and, in cases where bank financing is not available, owner risk in receiving all or portion of his or her sales proceeds through future company profits (resulting in continuing investment risk).

D. Venture Capital or Minority Growth Equity Financing

1. Usually entails sale of 10% to 40% of company common or preferred equity to outside individual angel investors, a venture capital or private equity fund, or a family office, and typically is a precursor to a later second-step sale of control.

2. Upside is ability to fund company growth without immediately giving up company control; downsides include legal and compliance costs and some loss of control due to investor voting or consent rights around major company actions or transactions and investor involvement in operations and management through representation on the company board.

E. <u>Sale of Company Control and/or Owner "Exit"</u>

1. Buyer can be a strategic corporate acquiror or "financial" buyer such as a private equity fund or operating company owned by private equity fund, and can include a buyer consortium comprised of a lead or independent sponsor, one or more private equity funds and/or family offices, and often is financed in part with senior bank debt and mezzanine debt and/or equity financing.

2. Can involve sale of assets and business by the company and/or sale of equity by owners to a "newco" buyer entity.

3. Owner sales consideration often includes closing cash, a seller note, an earn out schedule, and (particularly in sales to financial buyers) the opportunity (or requirement) that the owner leave some portion up to 20% of his or her equity in the business going forward.

4. Upside is owner liquidity and investment diversification; downsides include need for adherence to a multi-month sales, and legal and tax planning, process, reputational and operational risks associated with a failed transaction or "busted deal", managing confidentiality (employees, customers and others), complexity around retaining or terminating some employees, and negotiating purchase price adjustments, earn outs, and post-closing indemnifications, all of which can be managed more effectively with earlier business succession planning and experienced investment banking, legal, accounting and other advisors.

F. <u>Going Public</u>

1. Particularly if the business operates in an industry such has healthcare or healthcare technology, business services (including SAAS), energy services or technology, media or consumer technologies, services or products, or other sectors that are attractive for an initial public offering (IPO), the owner might consider this path.

2. Upsides include owner liquidity and growth capital; downsides include substantial legal and accounting compliance costs and expenses, some loss of control and significant loss of privacy due to public disclosure obligations.

3. Going public is not an option or advisable for the vast majority of private companies.

V. "STAGING" THE COMPANY – EVEN IF A SALE IS NOT PLANNED NEAR-TERM

A. Structuring and operating a business as if it were "on the block" or may eventually go on the block for a sale can add immediate and near-term value to the company from operational, technological and corporate finance improvements. Think of it as "**dressing the company up for SUCCESSion**."

B. Beyond a company's basic business plan, developing a growth and strategics options plan that can be periodically reviewed and re-assessed based upon company performance and market conditions can provide company ownership and management with valuable insights into the company's value drivers, growth opportunities, operational improvements and competitive and market risks.

C. Company housekeeping and systems improvements related to legal and tax structure, equity ownership, debt and equity capitalization, human resources and other legal compliance, information systems (including accounting and data privacy and security controls), customer retention and supply chain, third party contract management and other areas not only improve company performance and mitigate risk, thereby adding immediate value, but also better prepare the company for a possible future financing or sale transaction.

D. Retaining an investment bank, and experienced attorneys and accountants, years ahead of a potential financing or sale transaction will allow the company to develop and eventually execute on a comprehensive succession plan that provides flexibility and allows the company to keep its strategic options open.

E. Potential investors in or buyers of a company will perform substantial due diligence around the company's ownership and capital structure, debt, third party contracts, intellectual property, tax compliance, legal risk mitigation, and potential growth opportunities and markets, as well as accounting and "quality of earnings" reviews, so strengthening all of these areas well in advance of a planned or unanticipated event or transaction will enhance profitability and growth and position the company for a financing or sale if that becomes advisable.

F. Classic legal considerations to consider in advance of a financing or sale include the company's and its subsidiaries' choice of entity (C corporation, S corporation or LLC, and the use of multiple entities, holding companies or subsidiaries), founder and controlling owner equity and management rights (many companies pay too little attention to the optimal equity allocation among founders or key owners, and often these allocations should be changed based upon the owners' differing contributions or personal plans), employee equity incentive or stock option plans, employee and independent contractor relationships, third party contract (including customer, supplier, landlord, technology licensor and industry partner) assignability and issues that might arise in a company sale, intellectual property and trade secret protections, among many others depending on the nature of the business, industry and operations.

VI. WHEN BUSINESS SUCCESSION PLANNING BECOMES EXIT PLANNING

A. M&A is the Most Common Form of Successful Exit

1. The current and expected continuation of the active M&A market for private companies, coupled with the reality that most near-retirement company owners or founders will not have the option to leave their business to family or sell it to their key employees, means that **most will ultimately plan for and consummate a sale of their company**.

2. The "exit planning" or company sale process will almost always be more smooth and successful if it is preceded by business succession planning, as **the planning process and resulting action steps will have increased the value of the company, made it a more attractive acquisition target for a buyer, and position the company for a more efficient due diligence and sale process**. Having, and having executed on various parts of, a business succession plan will make the transaction process less time consuming and expensive.

3. IPOs, management buyouts and ESOPS will continue to be much less common than sales to strategic or financial buyers.

4. **A company sale or "exit" may, or may not, involve the complete "exit" of the principal owner or owners**. Particularly in M&A transactions with financial or private equity buyers, buyers frequently ask certain key management team members to stay with the business for a few years post-closing, and often the founder or key owners are invited or encouraged to rollover or retain a portion of their equity in the business going forward, with the promise that they will receive another substantial payment for their rollover equity upon a second sale of the business.

B. The M&A Process: Assembling the Team and Avoiding an Ambush at the Finish Line

1. *The Seller's Advisory Team*. Ideally years or at least months in advance, the company should assess the capabilities and capacity of its internal company team (CEO, COO, CFO, GC, HR head, CTO, etc.) and its outside advisors (lawyers, accountants and investment banker) to guide the company through a sales process. The company may not have to replace its law and accounting firms, but it may want to consider supplementing them.

2. *Developing the Transaction Objectives.* With the support and input of the team, the company should develop a set of goals and objectives with respect to the transaction, including issues to address and desired outcomes (company story and

growth opportunities, transaction timing, valuation range and factors, owner plans, employee retention and other desired outcomes).

3. *Identified (Preemptive) Buyer Versus Buyer Search Process*. Some companies will be approached by an obvious buyer and may engage in a deal with that buyer. **The company may often secure the best or highest deal price after engaging in discussions and a process with multiple competitive buyers**. This process is often handled by an investment banker in cooperation with the company's management team and legal and accounting advisers. If the company chooses to run a sales process with multiple potential buyers, it will usually enter into an engagement agreement with a selected investment banker pursuant to which the investment banker will receive fees which include a contingent success fee or commission tied to the ultimate sales price of the company. Investment bankers are highly skilled at developing the company's "story", preparing financial projections and sales information, and managing the entire process from selection of a buyer through the closing of the transaction. **The best investment bankers, lawyers and accountants work collaboratively with each other and the company's management to see the process to a successful closing for the sellers**. Perhaps the biggest issue in conducting a sale process with multiple potential buyers is properly managing the confidentiality of the process, with particular focus on proper planning around disclosure of the process and an eventual sale to employees, customers, suppliers and other stakeholders.

4. *Process Phases and High Points*.

   a. The investment banker, with the support and input of legal counsel, will typically prepare a sale memorandum and supplemental financial information to be provided to select buyer prospects subject to a **confidentiality or non-disclosure agreement designed to protect the company from disclosure of the sales process or its confidential and proprietary information**. The investment banker or the company will also establish an electronic data room to be accessed by prospective buyers in performing their due diligence investigation of the company. Company information will usually be uploaded to the data room in stages so as to delay the disclosure of particularly sensitive information such as customers, pricing, intellectual property or technology, and the like.

   b. With guidance from the investment banker and the company's other advisors, company management will eventually select one or a few preferred buyer prospects based upon their respective initial **indications of interest (IOI)**, including their purchase price range and terms of a potential transaction.

   c. Most often, the company will select a winning buyer and enter into a **letter of intent which subjects the company to a "no-shop" or exclusivity period** of

60 or 90 days, or longer, during which time the company is prohibited from communicating with other prospective buyers. **The letter of intent should, from the seller's perspective, be detailed and specific regarding the terms and structure of the transaction**, the purchase price and payment terms (including cash, seller notes, earn outs and any seller equity retention or rollover), purchase price adjustments relating to working capital or other factors, and the seller's indemnification obligations post-transaction for breaches of representations and warranties and other specified liabilities of the company (including any escrows or holdbacks of a portion of the sales proceeds to secure the seller's indemnification obligations or purchase price adjustments). Earn outs, seller notes, and purchase price adjustments, if necessary (as they present risk to the seller and usually require significant additional attorney negotiating and drafting time) should be clearly set forth to minimize the risk of transaction-stalling issues during negotiation of the definitive purchase agreement. Today, it is increasingly common for sellers and buyers to agree that buyer will obtain representations and warranties insurance to cover certain of the seller's indemnification obligations under the definitive purchase or merger agreement, which can provide significant protection to the seller and the buyer and reduce the amount of any closing escrow or holdback to secure seller's indemnification obligations. The importance of the letter of intent to the seller cannot be over emphasized, as the seller loses some leverage and control over the process once it enters into a no-shop or exclusivity period with one prospective buyer. Some more attractive companies are able to continue negotiating with multiple buyers without exclusivity for some period or up to the execution and delivery of a definitive agreement with a winning buyer, but this is unusual.

d. In selecting the buyer, **the seller should consider the buyer's sources of financing of the sale, including equity commitments (and whether the buyer is an "independent sponsor" that will rely on other investor groups to provide the equity financing for the sale), any debt financing contingencies**, sale leasebacks of real estate and other factors that may result in more delay, complexity or seller risk, as well as the buyer's plans and intentions regarding continuation of employees and other closing and post-transaction terms. The "best buyer" may not be the buyer offering the highest price. Price is key, but terms are equally (and may be more) important. And depending on the company and the seller, the buyer's "cultural" fit with and plans for the company may be important factors.

e. Prior to the expiration of the letter of intent exclusivity period, as may be extended by mutual agreement of the buyer and seller, the buyer and seller will enter into a **definitive share or asset purchase or merger agreement** setting forth the financial terms of the deal, extensive representations and warranties of the seller, conditions to closing (e.g., third party contract assignments, and employment agreements with key personnel), covenants of

each party prior to and following the closing, and indemnification provisions which obligate the seller to reimburse the buyer for losses relating to breaches of representations and warranties or specified company liabilities. The definitive purchase or merger agreement is heavily negotiated by seller and buyer legal counsel, but experienced counsel and accepted "market" terms should make the lawyer negotiation process more efficient today than twenty years ago. The purchase price of a deal should be considered in light of, and perhaps should be adjusted for, the payment terms (closing cash, seller note, earn out, equity rollover), the relative risks being assumed by the seller and the buyer in connection with the transaction, including post-closing indemnification obligations, as well as the tax benefits of the transaction structure to the buyer.

f. The process of negotiating the definitive purchase or merger agreement and closing the transaction is always met with surprises and substantial work on ancillary documents such as employment agreement, equity rollover agreements, option plans and agreements, and non-competition and other seller covenants.

g. Sellers are usually unpleasantly surprised to learn that, following weeks of responding to buyer diligence requests and providing substantial information, they have to prepare **extensive disclosure schedules to the definitive agreement** which respond to or modify the sellers' representations and warranties in the agreement. This is one of the most time-consuming aspects of a transaction closing, and can require significant work and time on the part of company management. Legal counsel can guide and support the company's management in the preparation of the disclosure schedules, which are typically reviewed and revised by buyer's counsel. Ultimately, the disclosure schedules provide the sellers with significant protection from claims for breaches of representations and warranties, so the work and effort are worthwhile. The definitive agreement terms and disclosure schedules are also helpful when representations and warranties insurance is being purchased, which is a substantial protection to the seller and buyer.

h. The company's legal counsel will usually be involved in issues that arise post-closing, including the resolution of any purchase price adjustments relating to a post-closing audit of the company's closing working capital and transaction expenses, as well as any disagreements regarding the calculation of any earn out payments.

i. The buyer will also have its own accounting and insurance advisors conduct due diligence reviews of the company's financial statements and "quality of earnings" ("QofE"), insurance and employee benefit plans, which may be continued or replaced in connection with the closing of the sale. Depending on the nature of the seller's business and assets, the buyer may also engage

consultants to perform technology (including proprietary software), real estate and environmental due diligence. Some company sellers elect to do their own "self-due diligence" and preemptive QofE work prior to the transaction process to better prepare them for buyer negotiations and expedite the transaction.

5. *The Ultimate Benefit of a Business Succession Plan.* If and when the company ultimately engages in a sale process, its operations, legal protections, strategic options and value in the eyes of prospective buyers will have been enhanced by a comprehensive and flexible business succession plan.[2]

VII. THE BUSINESS LAWYER'S ROLE IN BUSINESS SUCCESSION PLANNING

A. **Strategic Business Counsel**

1. First and foremost, a company's outside or in-house corporate attorney should constantly improve his or her understanding of the company client's business, industry, competitive opportunities and challenges, as well as the differing goals, objectives and incentives of its principal owners, board, investors, key management and external stakeholders (all of which will evolve and frequently change).

2. The business lawyer should advise the company on appropriate steps to preserve and enhance company value, including for example through proper structuring of owner equity, key employee equity and incentive plans, and shareholder, buy-sell or operating agreements designed to preserve ownership and management continuity, key owner estate plans, strategic partnerships and outside financing, real time awareness of strategic and exit options, and protections against unanticipated events such as the loss of key people, customers, vendors or competitive advantages.

3. The business lawyer should encourage the company to periodically engage in a "what if we sold" discussion as a check on the adequacy of company structure, legal compliance and risk mitigation, and the terms of contracts with employees, customers, suppliers and strategic partners that may be impacted by or create issues for a company sale, to ensure the attractiveness of the company to potential investors or buyers.

[2] For an insightful discussion of how an established company can improve performance, enhance value and make itself a more attractive target for acquisition by a private equity (or arguably any) buyer, see *If Private Equity Sized Up Your Business*, Robert C. Pozen, Harvard Business Review, November 2007, hbr.org.

4. The business lawyer should serve as a "quarterback" in coordinating company management and other advisors to develop and constantly rethink its business succession plan, which should be flexible enough to allow the company to pivot and take advantage of multiple strategic options when they arise or become necessary.

B. **Team Player**

1. Business succession planning is a multidisciplinary process that requires the active involvement and input of company management and ownership, lawyers, accountants, consultants (technology, insurance, industry, benefits) and, when appropriate, investment bankers.

2. The ability to work as a member of team, and to welcome and cooperate with the contributions and expertise of different specialists, is perhaps the most valuable attribute of a business lawyer advising business clients on business succession planning.

C. **Legal Protections with Future Flexibility in Mind**

1. Business lawyers are lawyers - trained and focused on protecting company clients from legal risks and uncertainty, and assisting companies in developing entity and capital structures, employee incentives and third party arrangements and contracts that will preserve and enhance the growth of the business.

2. Legal advice around everything from entity and capital structure, to owner and key employee equity, to strategic partnerships, vendor and customer contracts and appropriate legal compliance, should always be shaped and provided with uncertain future events in mind. The business succession plan should be viewed as a basic protective structure and a process which enables changes to the structure and plan to address unexpected opportunities and challenges.

3. The business lawyer should encourage clients to think of the business succession plan as a "keep your options open" and "maintain process control" plan, as opposed to a structure that will tie the company's and owners' hands.

D. **Legal Process Management in Business Succession Planning**

1. Legal work to implement a business succession plan years prior to a major financing or sale will be more efficient if performed with early input from the client's management team, accountants and financial advisers, and the support of specialist attorneys in areas such as corporate, tax, employment, intellectual property and equity compensation.

2. The scope of the outside corporate counsel's role will be dictated by various factors, including the in-house legal capabilities of the client, whether the client works with one or multiple law firms for different legal needs, and the client's access to good accounting, tax, financial and other advisers. The business lawyer can play an important role in helping clients select and supplement its advisory team.

3. Potential company buyers usually have a team of in-house and outside legal and other advisers, so beginning the business succession planning process with a good company advisory team in place will serve the company well if and when a company financing or sale occurs.[3]

4. If an M&A transaction becomes advisable for the company, legal process management takes on a new level of importance, especially in the new millennium.

   a. Selling companies and buyers are now more sophisticated buyers of legal services, and a dramatic rise in legal fees has resulted in increased focus on efficiency and alternative fee arrangements.

   b. Legal process management ("LPM") is a "framework that enables the lawyer and the client to better plan, manage, facilitate and effectuate transactions." But LPM is a huge challenge in actual execution, as every client and transaction is different. Clients now, and should, demand clearer communication and greater transparency and predictability around legal services and fees, but clients should also share the responsibility for advisory team selection and running a transaction process that ensures team coordination and professional service provider efficiency.

   c. Put somewhat simply, LPM should at least include (i) initial planning conferences regarding business objectives, timing, scope of work, risk factors, closing obstacles and mechanics, and allocation of responsibilities, (ii) a lawyer engagement letter (and, if applicable, engagement letters with the investment banker and accounting firm) which clearly define the scope of the lawyer's, accountants' and investment banker's roles and work, (iii) consensus on protocols for communications, confidentiality, and the use of other professionals, and (iv) user-friendly transaction schedules and task lists updated with status reports, as well as closing document and tasks checklists.

   d. LPM for small law firms will obviously be less robust and standard than the LPM practices of large law firms. Small law firms will frequently work as co-

[3] See *M&A Teams: When Small is Beautiful*, McKinsey & Company, https://www.mckinsey.com/business-funtions/strategy-and-corporate-finance/our-insights (9/24/2018)

counsel with other firms providing lead M&A transaction expertise or necessary support in areas of importance to an M&A transaction, such as tax, benefits, employment, intellectual property, international, data privacy and security, environmental, real estate and securities law, among many others.

e. Particularly for small and lower-middle-market companies that engage in a financing or sale process, tailoring the business lawyer's role and services around the client, its management, in-house counsel, if any, and other outside professional advisers will ensure a positive client experience, enhance M&A process efficiency and value, and help manage transaction expenses.

f. Perhaps the most important benefit of a business succession plan that is implemented well before a financing or sale event is in the ability of a company to commence a financing or sale process with most of its "ducks in a row", which should certainly lead to better legal process management.[4]

E. **<u>Additional Tips Around Lawyer Work Scoping and Management of an M&A Process</u>**

1. In scoping out his or her work and fees, the business lawyer should first assess the basics of the transaction, the seller's objectives and process efficiency risks:

   a. What are the seller's (and the most likely buyer's) objectives (Seller – retirement, liquidity, "fire sale", lack of resources, price, terms and other? Rick tolerance? Buyer – talent or technology acquisition? Customer base? Risk tolerance?)

   b. What's being sold and bought (All of the business? Part of the business? Assets or equity? Control or minority equity sale?)

   c. Who is included on the seller's deal team (In-house GC with M&A experience and other capable officers? Other specialist or regular general corporate counsel law firms who will work as co-counsel with the lead deal lawyer? Outside accountants' accounting and tax planning capabilities? Investment banker?)

   d. What's the deal timeline (Investment banker-supervised sale process? Deal structuring, due diligence and LOI? Definitive agreement negotiation and execution (sign before or sign and close)?

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[4] For a helpful discussion and collection of form lawyer letters and checklists for use in M&A LPM, see Guidebook *Legal Project Management in M&A Transactions – A Process for Closing Deals More Smoothly and Efficiently,* ABA Task Force on Legal Project Management, Mergers & Acquisitions Committee (1/23/14).

e. What client or transaction variables could decrease transaction process efficiency or increase legal fees (Little prior planning and disorganized client seller? Over-lawyering (buyer's counsel) including excessive due diligence? Re-trading of LOI terms by buyer? Unnecessary deal structure complexity? Seller counsel lack of experience with current market deal terms?

f. Is the seller client fee sensitive and/or interested in alternative fee arrangements such as a flat fee, "busted deal" discount, or discounted hourly rates? And how can the deal mechanics and work be allocated to the client's internal team and other advisers to help manage legal fees?

2. Seller and seller counsel responses to and management of buyer due diligence requests and preparation of disclosure schedules can absorb a large portion of the business lawyer's time and fees, so discussing the due diligence process with the client and using due diligence checklists, status reports and easy-to-access and indexed (to the due diligence checklists) data room will be critical to LPM in and M&A transaction.

3. Make sure the LOI is clean, comprehensive and robust. This will result in fewer surprises during definitive agreement negotiations

4. Understand going in that transaction structure terms such as earn outs and seller equity rollovers add complexity and will add lawyer time and increase fees.

5. Further understand that buyer financing sources or contingencies (e.g., senior bank debt, mezzanine debt and buyer "sponsor" need for co-equity investor funding may extend the transaction closing timeline and the expand the scope of the seller's business lawyer's work.

6. The business lawyer to the seller should educate the client on the more material issues that will come up in the sale process, and discuss which ones are important and which ones may not be as important (have a plan on which "battles to pick" or on what issues the seller should push back)