



**Pearl Meyer**

## Structuring Change-in-Control & Transaction Bonuses for Maximum Effectiveness

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## Today's Discussion

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- Change-in-Control (“CIC”) Arrangements
  - Purpose
  - Elements
- Typical Pre-CIC State
- Actions to Take at Deal Time
- Retention Bonus Plan Considerations
- Transaction Bonus Plan Considerations
- 280G
- Market Practices (Say-on-Golden-Parachute Disclosures)

## CIC Agreements

- Like severance, compensates executives for job loss (if CIC)
  - Mitigates the conflict of interest: shareholder interests vs. job loss
  - Act as retention tool: executive remains until and/or post-CIC
  - Protects shareholder value: executives remain focused regardless of whether deal occurs or not
  - Encourages hiring: incoming executive has reduced risk accepting position

## Equity

- Generally accelerates upon CIC or termination post CIC: acts as a retention tool

## Severance / Benefits

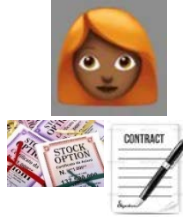
- Broad coverage provides benefits under broad range of circumstances

## Retention/Transaction Pay

- Targeted payments to mitigate retention risk and/or maximize shareholder value

# Typical Pre-CIC State

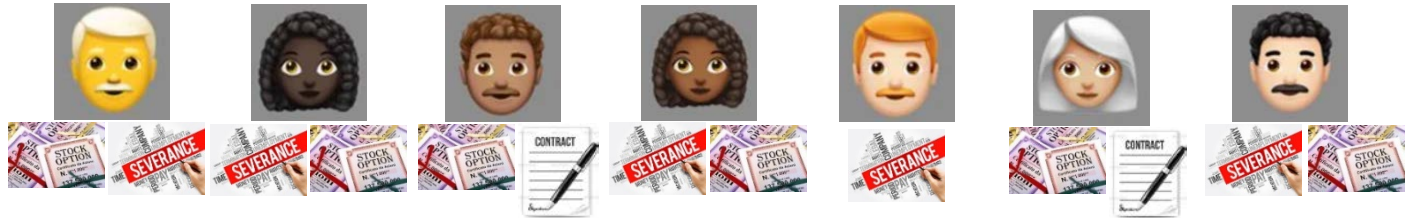
CEO



Reports



Mgmt



Staff



# Typical Pre-CIC State

## CEO

	<\$1B Assets.	\$1B - \$5B Assets.	\$5B - \$10B Assets.
<b>Pay Multiple</b>			
<2	15%	11%	6%
2.0-<2.5x	45%	22%	37%
2.5-<3.0x	15%	27%	21%
3.0-<3.5x	20%	38%	32%
>3.5x	5%	1%	0%

## Reports

Pay Multiple	<\$1B Assets.		\$1B - \$5B Assets.		\$5B - \$10B Assets.	
	Low	High	Low	High	Low	High
<1.0x	25%	13%	4%	2%	2%	0%
1.0-<1.5x	25%	19%	26%	12%	19%	5%
1.5-<2.0x	19%	25%	12%	8%	10%	5%
2.0-<2.5x	13%	25%	44%	43%	52%	63%
2.5-<3.0x	6%	6%	7%	16%	11%	16%
3.0-<3.5x	13%	13%	5%	17%	5%	10%
>3.5x	0%	0%	0%	1%	0%	0%

## Mgmt

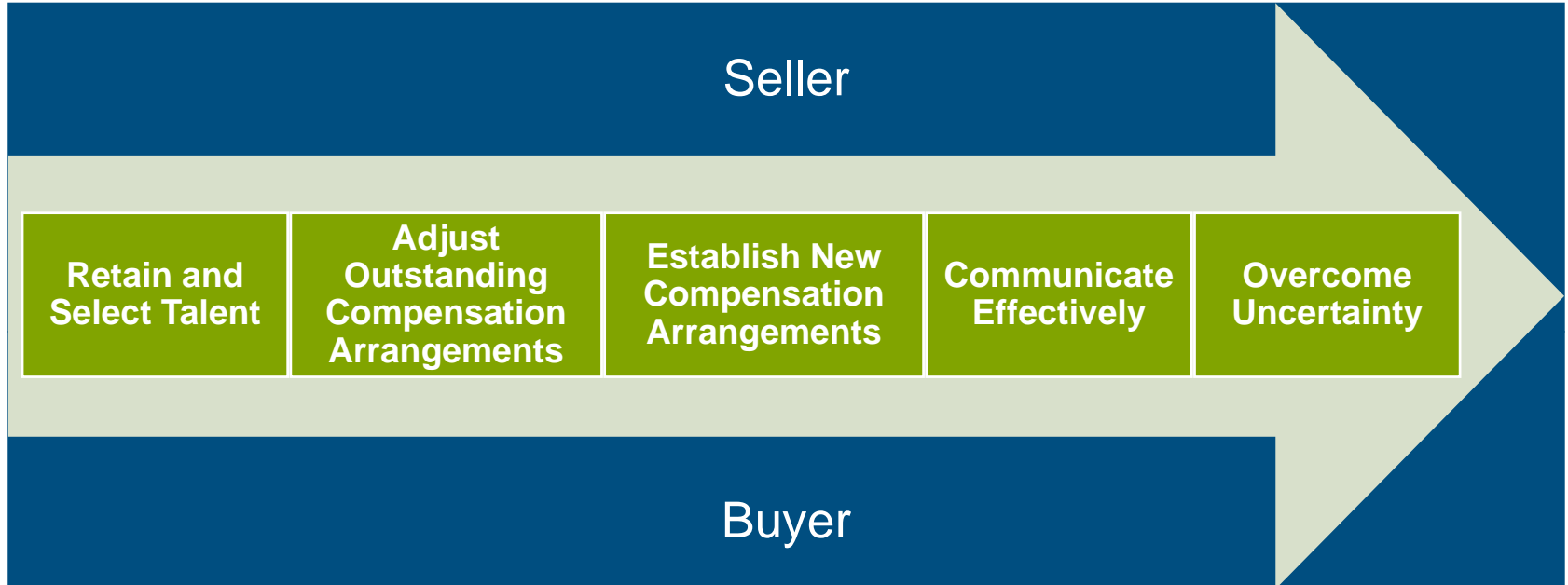
### Multiple of Weeks-Based Severance Benefits

Level	Weeks Per Year of Service			Minimum Benefit (weeks)			Maximum Benefit (weeks)		
	25th %ile	Median	75th %ile	25th %ile	Median	75th %ile	25th %ile	Median	75th %ile
Tier 2	1	2	2	3	6	16	26	52	52
Management	1	2	2	2	4	8	26	28	52
Professional	1	2	2	2	4	5	24	26	52
Para-Professional	1	1	2	2	4	4	20	26	52

## Staff

Sources: CEO/Direct Reports: proxy disclosure from Main Data; staff: 2017 Mercer Severance Survey

# When a Deal Occurs



## Seller – Illustrative M&A Related Board Topics

<b>Committee Activity</b>	<b>Timing During CIC</b>
Severance Assessment/ Program Design	Begin prior to deal announcement
Retention/Transaction Bonus Planning	Begin prior to deal announcement
CIC Payment/280G Quantifications and Review	From deal negotiation through transaction close
Say-on-Golden-Parachute (SOGP) Disclosures	Required for transaction proxy materials
Year-End CIC/Transaction Pay Planning	Prior to year-end Evaluate planning actions to reduce IRC Section 280G excise tax exposures

# Retention Programs: Primary Rationale

## Delivering on Expectations

Deliver the business in a form and value expected by both parties

## Keeping the Right People

Motivates covered population to stay and do the job required

## Distinct Programs

### Critical for a successful short-term integration

- This is the group that's essential for "Delivering on Expectations" above
- Cash-based awards for 90 day to 6 month periods are usually the cornerstone retention incentive

### Critical for the long-term success of the business

- This is the group that constitutes the "Right People" above
- Longer-term programs



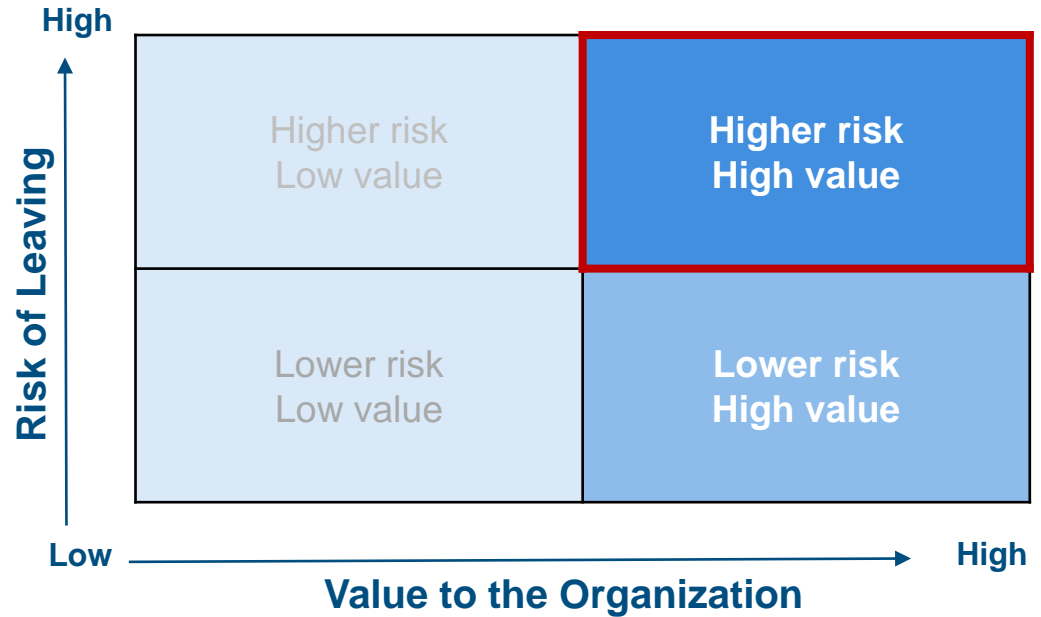
# Retention Program: Design Considerations

Considerations	Key Questions
1. Eligibility	<ul style="list-style-type: none"><li>Who is critical to the success of the transaction...or to the resulting companies over the longer term?</li><li>Who is likely to leave if a retention award is not provided?</li></ul>
2. Retention Period	<ul style="list-style-type: none"><li>How long are the critical employees integral to the success of the combined entity...or how long is the expected transition period until the “dust” settles and employees can feel comfortable with their new organization?</li></ul>
3. Method & Timing	<ul style="list-style-type: none"><li>Should the award be granted in a single lump sum or in installments?</li></ul>
4. Form of Payment	<ul style="list-style-type: none"><li>Should the retention incentive be awarded in cash or equity?</li></ul>
5. Conditions for Payout	<ul style="list-style-type: none"><li>Typically only a service-based component</li><li>Performance may be included, but this can undermine retention</li></ul>
6. Level	<ul style="list-style-type: none"><li>What award level is necessary to retain key employees?</li></ul>

# Retention Programs: Eligibility

## Default Approach:

Participation focused on employees critical to the success of the business who are also most at risk.





## Transaction Incentives

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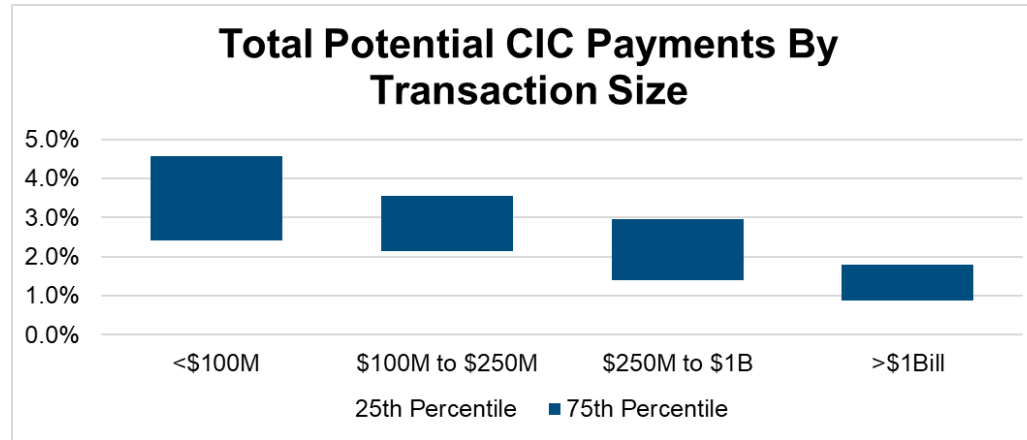
- Transaction incentives or transaction bonuses can mean different things depending upon the goal of the program
- **Deal support bonus:** reward for significant workload in bringing the transaction across the finish line and those responsible for post-deal integration work
  - These two work streams may have separate incentive plans/pools
  - Participation in the first piece would be restricted to the deal team and would have target payouts as a percent of salary with metrics tied to a successful close
  - Paid entirely in cash the vast majority of the time
- **Value sharing:** reward key senior managers for maximizing shareholder value realization in the deal
  - Structured as a percent of the deal value or flat \$ amount and restricted to senior management, including the CEO, who can have a more direct impact on that value

### **Understand the role of change-in-control (CIC) provisions**

- CIC provisions exist to protect executives in the event of a transaction – they ensure focus and support even when a job loss post-closing may be likely
- If golden parachute liabilities under Internal Revenue Code (IRC) Section 280G and 4999 are triggered, anticipated CIC benefits can be significantly eroded. Typical plan provisions include:
  - Best-after tax
  - Scaleback
  - Silent
  - Gross-Up

# Total Potential CIC Payments to Executive Officers By Transaction Size

Total payments vary based on deal size, declining as a percentage of the deal

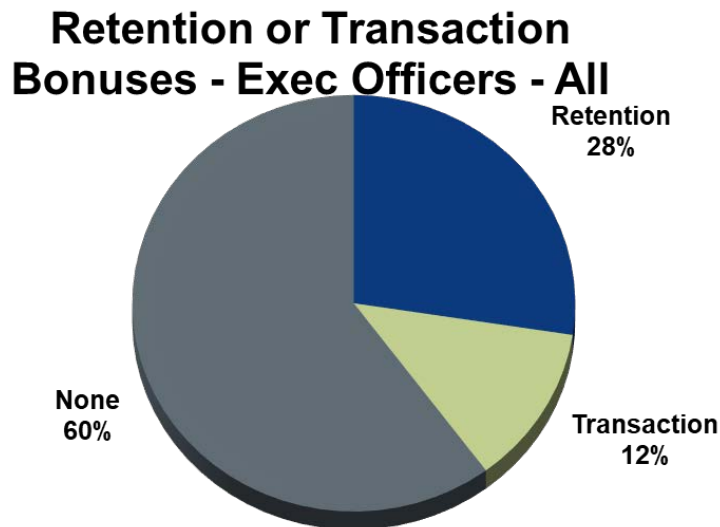



Based on 109 deals from 2016-2019; source 

- Assumes all exec's terminate: includes severance, retention/transaction bonuses, enhanced pension, perquisites, tax reimbursement, and equity acceleration
- For all executive officers identified (typically 3-7 executives)

## Retention/Transaction Bonuses

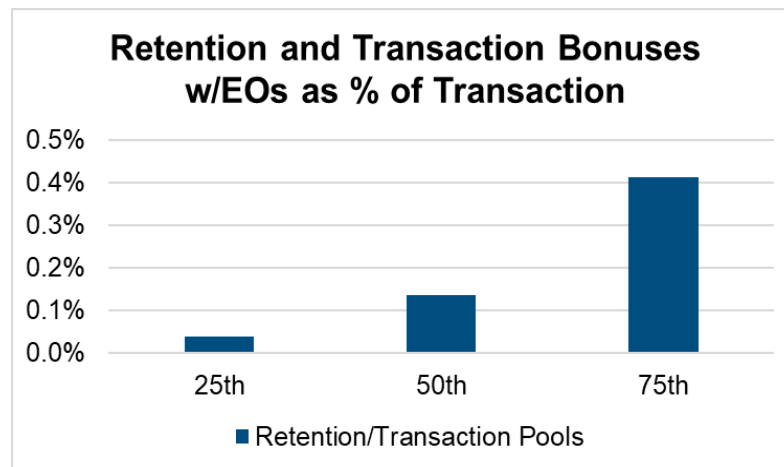
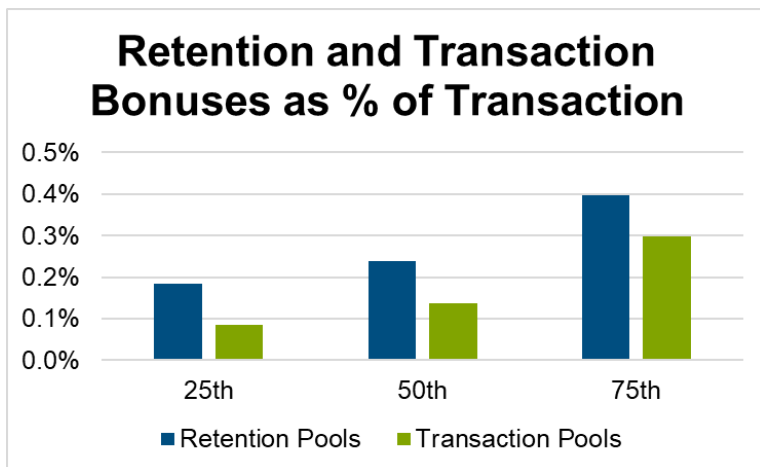
While retention pools are common, about 40% institute retention/transaction bonuses which include executive officers



Based on 109 deals from 2016-2019; source  main data group

# Retention/Transaction Bonuses

Retention Pools are more common and generally higher value than transaction pools

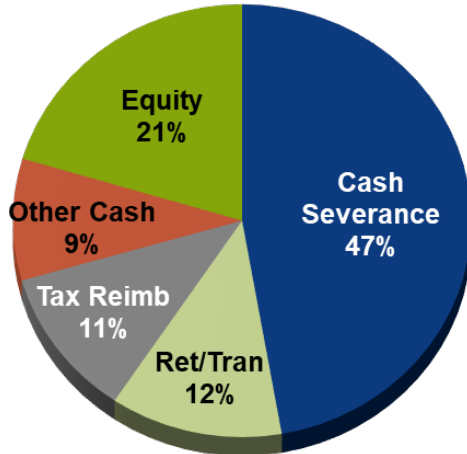


All pools based on 151 deals from 2011-2019 from Main Data Group; pools with EO's based on 109 deals from 2016-2019

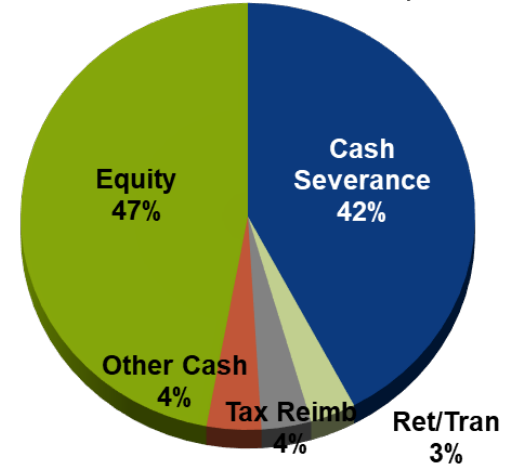
# Total Potential CIC Payments By Transaction Size


Severance is primary vehicle among smaller transactions

**Retention or Transaction Bonuses  
- Exec Officers - All**



**Retention or Transaction Bonuses  
- Exec Officers - >\$1B**



Based on 109 deals from 2016-2019; source  main data group



A decorative graphic on the left side of the slide. It consists of a large blue square in the top-left corner. A horizontal green line extends from the right edge of this square across the width of the slide. Below this line, there is a smaller blue square, and below that, a small green square. The text 'CIC Common Mistakes' is centered to the right of the top-left blue square.

# CIC Common Mistakes

## Review CIC Plans and Payouts Regularly

- Quantifying CIC packages and 280G exposures on a regular basis can help boards identify trouble spots in advance
- Fixing programs on the eve of a deal is more difficult when boards are under a heightened level of scrutiny to demonstrate prudence

## Consider the Impact of Non-Competition Provisions

- Payments proven to be “reasonable compensation for post-CIC services” are not considered CIC payments and can be excluded from the 280G calculations
- Refraining from performing services through covenants not to compete can be considered post-CIC services
- Must be demonstrated with clear and convincing evidence

### Identify Other Areas Where Post-CIC Reasonable Compensation Might Apply

- If executives are expected to work post-closing, post-CIC reasonable compensation can be considered for pay such as:
  - Performance awards (short- and long-term)
  - Retention awards
  - Consulting agreements

### Understand the Impact of Performance-Based Awards on 280G Results

- The full value of an award subject to performance-based vesting conditions payable as a result of a CIC is included in the 280G calculations
- Awards vesting with time-based conditions only can take advantage of a special rule that significantly discounts the value of the payout

## Guaranteeing Bonus Levels and Performance-Based Awards in Anticipation of a CIC

- Taking action to guarantee payout levels can result in pay being considered contingent on the CIC and included in the 280G calculations in full
- However, there may be practical difficulties to continuing performance-based metrics post-closing

## Assess Pre-CIC Reasonable Compensation

- Payments for pre-CIC services must generally be included in the 280G calculations
- However, treating the payments as reasonable compensation for pre-CIC services can reduce the excise taxes and lost tax deductions associated with that payment
- This is often applied to performance-based pay

### Avoid “Do it Yourself” Calculations

- 280G computations are complicated, fact-specific, and data-driven
- Costly errors can result when companies try to run the calculations on their own or don't have experienced advisors
- A single \$1 change can result in millions of dollars of excise tax penalties
- Bring in outside expertise with substantial experience with 280G matters to assist with the effort

## Post-CIC Reasonable Compensation

- Illustration: allocating value to non-competition provisions
  - CIC severance = \$4,000,000
  - Value of two-year non-competition restrictions = \$2,000,000
  - Base amount = \$1,000,000
  - Safe harbor = \$2,999,999

		CIC Payments (W/O Non- compete)	CIC Payments (W/Non- compete)
CIC Severance Payment	[1]	\$4,000,000	\$4,000,000
Allocation to Non-competition Restrictions	[2]	n/a	\$2,000,000
Total CIC Payments	[3]= [1]-[2]	\$4,000,000	\$2,000,000
Base Amount	[4]	\$1,000,000	\$1,000,000
Safe Harbor	[5] = [4] x 3 - \$1	\$2,999,999	\$2,999,999
Excess Parachute Payments	[6]= If [3] is > [5], then [3]-[4]	\$3,000,000	\$0
Excise Taxes (20%)	[6]=[5] X 20%	(\$600,000)	\$0
Income Taxes (40%)	[7]=[4] x 40%	(\$1,600,000)	(\$1,600,000)
Net After-Tax Benefit	[8]=[1]+[6]+[7]	\$1,800,000	\$2,400,000
Additional Benefit to Executive		<b>\$600,000</b>	

# Pre-CIC Reasonable Compensation

- Illustration: treating a bonus as pre-CIC reasonable compensation
  - CIC bonus = \$4,000,000
  - Pre-CIC reasonable compensation = \$2,000,000
  - Base amount = \$1,000,000
  - Safe harbor = \$2,999,999

		W/O Pre-CIC Reasonable Compensation	W/ Pre-CIC Reasonable Compensation
CIC Bonus	[1]	\$4,000,000	\$4,000,000
Base Amount	[2]	\$1,000,000	\$1,000,000
Initial Excess Parachute Payments	[3]=[1]-[2]	\$3,000,000	\$3,000,000
Pre-CIC Reasonable Compensation	[4]	\$0	\$2,000,000
Reasonable Compensation in Excess of Base Amount	[5]=[4]-[2]	\$0	\$1,000,000
Final Excess Parachute Payments	[6]=[3]-[5]	\$3,000,000	\$2,000,000
Excise Taxes (20%)	[7]=[6]x20%	(\$600,000)	(\$400,000)
Income Taxes (40%)	[8]=[1]x40%	(\$1,600,000)	(\$1,600,000)
Net After-Tax Benefit	[9]=[1]+[7]+[8]	\$1,800,000	\$2,000,000
Additional Benefit to Executive		<b>\$200,000</b>	



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# Thank You





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