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Retaining employees below the c-suite during a merger

By Simone S. Hicks, Esq., and Alison E. Buckley-Serfass, Esq., Debevoise & Plimpton LLP*

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As the gap between the signing and closing of many public company M&A transactions continues to lengthen, merger partners should consider how best to face new challenges retaining crucial talent that inevitably arise. The problem may only get worse: The FTC's recent proposal[1] to overhaul the Hart-Scott-Rodino (HSR) process could lead to even lengthier pre-closing periods even in deals without substantive antitrust issues; the FTC's proposed rules could quadruple the time required to prepare HSR filings, with complex filings taking even longer.

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Business combinations can be distracting and generate uncertainty for employees on both sides of the deal, affecting productivity or even causing employees to pursue other employment opportunities. High turnover can drain institutional knowledge, decrease productivity, and increase recruitment costs. Both the risks and the costs of this phenomenon heighten over time.

Executive-level retention programs have been a staple of public M&A transactions but have typically been limited to the C-suite. However, in this new paradigm, merger parties have more recently been adopting broader retention programs to retain critical talent, promote deeper workforce engagement, and safeguard institutional knowledge and expertise during the expanding pre-closing period and beyond.

We are seeing businesses go beyond the standard onetime transaction awards and offering additional retention incentives with a variety of structures and layering in other retentive devices, such as enhanced severance programs.

Below, we outline some key timing and structure considerations and alternative retention devices for public companies looking to retain talent below the C-suite.

Timing

Executive-level retention programs may be introduced during the pre-signing phase, while retention programs for non-executive employees tend to be established following the deal announcement. This timing avoids bringing too many employees "over the wall" prior to signing. For buyers, it allows sufficient time to identify critical employees and functions necessary for deal completion and successful post-closing integration and performance.

Retention objectives

The structure of any retention program is based on the objectives of the seller, the buyer, or both. The primary goal is to retain key employees through or beyond the deal closing. The parties may also seek to incentivize employees to achieve individual or company performance goals during the pre- or post-closing periods.

Target companies may have minimal post-closing retention structures in place for their employees, requiring a greater focus by the buyer on establishing a retention program. The buyer may need to replace seller incentives that will not continue following the closing of the transaction or, alternatively, establish a new retention program to account for seller awards that will pay out on an accelerated basis on closing.

In a volatile market, equity awards held by employees may be underwater or have otherwise experienced a significant decline in value, diminishing the retentive value of these awards.

Structuring considerations

When structuring a retention program, the timing, form, and amount of the awards require careful consideration.

The most common structure for non-executive employees remains fixed-amount stay bonuses for remaining employed until a specified date or dates — typically the closing or a defined period after. Retention awards can be paid as a lump sum or in installments on specified dates or milestone events.

However, for transactions where antitrust or other regulatory concerns may delay the closing by a year or more, we have seen retention awards structured to pay a portion on the first anniversary of the signing date, with the remainder to be paid on or after the closing date. Retention awards often pay out as well if the employee is involuntarily terminated before the payment date. A clawback obligation may be included in the retention award to deter resignations within a specific period and enhance retention benefits to the buyer beyond the closing.

As a supplement to traditional retention programs, performance-based retention awards tie incentives to individual or company-based metrics. These programs can be designed to retain employees who stay through the transaction with meaningful

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upside for exceptional individual or company performance, which can help keep employees focused on business performance in a longer pre-close period. These programs require careful consideration of the appropriate metrics, targets, amounts, and timing of payments to ensure the objectives of the program are met.

The form of retention awards may be cash- or equity-based, with the latter inherently being performance-based. In cases where equity awards are granted, a portion may vest based on continued employment with the buyer for a period of time following the transaction. The parties may also decide a mix of cash and equity awards is appropriate.

Even where sellers have put in place a cash retention program payable at closing, we have seen buyers establishing additional retention pools awarded in the form of equity with time- or performance-based vesting conditions.

The amount of retention awards varies based on program objectives but is often calculated as a specified multiple of base salary, with higher amounts for more senior positions or employees in key functions. For employees at or below the vice president or director level, we have seen retention awards between 25% and 100% of base salary, with higher amounts for the senior vice president level and above.

Alternatives

An alternative retention approach involves establishing a change-in-control severance program, which offers severance (or enhanced levels of severance) in the context of a qualifying termination by reason of the transaction. A qualifying termination will typically include a termination by the company without cause and may also include a termination by the employee for "good reason." Change-in-control severance programs typically provide these severance benefits for up to 90 days before a transaction closing and between one and two years after the closing.

Sometimes in the public M&A context, we see a shorter period of enhanced severance benefits (*e.g.*, three to six months) tied to post-closing integration periods. A commitment to paying enhanced severance, on a stand-alone basis or alongside more traditional retention programs, can reassure employees in the uncertain business environment of a prolonged pre-closing period.

Although noncompetes are another potential retention tool, employees generally view them unfavorably. Moreover, federal and state law increasingly limits or prohibits noncompete clauses, potentially diminishing their ultimate retentive value.

Instead of relying solely on a single retention tool, a comprehensive strategy combining multiple approaches can create a more robust retention program. For example, integrating cash-based bonuses with enhanced severance programs can address diverse employee concerns and motivations synergistically during the extended period between signing and closing.

Key takeaways

- Delays in public company M&A transactions may be increasing due to regulatory approval processes, affecting employee engagement and retention.
- Expanding retention programs to include nonexecutive employees is becoming more common to safeguard institutional knowledge and talent.
- The structures of these programs differ based on seller and buyer goals. Retention awards can be payable on fixed dates or include performance elements and may be granted in cash or equity. We are seeing a variety of structures in recent transactions, including having a portion of payments being made before closing. Alternative strategies such as change-in-control severance programs can also play a role in retaining talent during longer pre-closing periods.

Notes

[1] https://bit.ly/48kECwh

About the authors

Simone S. Hicks (L) is a partner in **Debevoise & Plimpton LLP**'s executive compensation and employee benefits group. She focuses on benefits and tax issues that arise in public and private mergers and acquisitions and other corporate transactions and on the design, negotiation and implementation of employee agreements and equity and cash-based incentive and other compensation programs for public and private companies, management groups and individual executives. She can be reached at sshicks@debevoise.com. **Alison E. Buckley-Serfass** (R) is counsel in the firm's employee benefits and executive compensation group, where she focuses on the design and negotiation of equity and cash-based compensation, employment, severance, change in control, deferred compensation and other compensation-related agreements and arrangements. She can be reached at aebuckleyserfass@debevoise.com. The authors are based in Washington, D.C. This article was originally published Dec. 14, 2023, on the firm's website. Republished with permission.

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