



VLP LAW GROUP LLP

Acqui-Hire Transactions: Recruitment Mixed with M&A

David Goldenberg and Martin H. Levenshick

Corporate Counsel, March 31, 2014

In Silicon Valley and in other markets where there is an intense competition for technological innovation and an equally intense demand for a limited pool of highly sought-after talent, companies are increasingly pursuing nontraditional pathways to hire that talent when a mere offer of employment may not suffice.

One approach that has gained increasing traction in the tech community is the so-called "acqui-hire" transaction. An acqui-hire is in essence an M&A transaction, the principal objective of which is to hire the core team of talent residing inside a startup or early-stage private company, as distinguished from the more typical objective of an M&A transaction, in which the goal is principally to acquire an ongoing business and/or its assets.

The acqui-hire provides a chance for the buyer to unlock the talent and trump the competition via a generous offer in the form of an acquisition purchase price. This makes it of interest not only to the talent, but to their company's investors, whose support will ultimately be required for the deal to proceed.

More Than a Series of Offer Letters

The acqui-hire transaction presents both opportunity and risk beyond that involved in a simple hiring decision. As the hiring decision is now wrapped inside a much larger M&A transaction, the buyer is necessarily presented with the same kinds of risks that are inherent in all M&A transactions: The buyer may inherit liabilities, obligations and other unattractive attributes of the seller's business.

Even when there is no intent to acquire any operations or continue the seller's business, the buyer may still face liability from the seller's creditors or contractual counterparties, and needs to consider how it (or the selling company) will wind down the seller's business. This may include dealing with expenses associated with terminating employees who are not joining the buyer, and terminating or modifying third-party contracts, licenses, leases and the like. Thus, even when the buyer's sole interest is hiring the seller's employees, the buyer is still faced with acquisition-level due diligence, consistent with a traditional M&A transaction.

Some acqui-hire transactions are even more limited and seek only certain of the selling company's employees. If the buyer wishes to take only key employees who constitute the core talent, the parties will generally need to analyze the severance and separation obligations attendant to post-closing termination of employees who are not coming over, which can add to the transaction's cost. There is also a risk to the buyer and seller of claims for wrongful termination, WARN Act violations and other litigation if the wind-down is not conducted properly.

The selling company is similarly faced with a range of issues that normally arise in the context of a change-in-control transaction. The transaction should be analyzed from the buyer's, seller's and seller's investors' perspectives, and needs to be structured to satisfy each of these constituencies. It must pass as an independently sustainable and defensible transaction, and not simply as a hiring tool accomplished via an acquisition.

With a view to limiting the buyer's exposure for liabilities and obligations, acqui-hire transactions are often structured as asset purchase transactions rather than as a merger or purchase of stock. In this kind of transaction, the buyer has the opportunity to acquire those assets of interest to it and to cherry-pick only those liabilities and obligations that it is prepared to assume and leave behind liabilities it does not wish to take on.



VLP LAW GROUP LLP

This may create tension between the buyer and seller. Not only do the seller and its investors want to minimize their exposure, the acquired company and its investors may also want to structure the acquisition as a tax-free transaction or obtain capital gains treatment. The seller should seek tax advice to determine whether the structure for the proposed acquisition will be taxable, and be mindful of the possibility of a double layer of taxation with an asset acquisition. The seller may thus prefer to be acquired by way of merger or stock purchase.

In addition, in an asset sale the selling company remains in existence post-closing, and the seller is left with the responsibility of completing a formal liquidation under applicable law, which may involve appointing a trustee to monitor the company post-liquidation for claims by creditors and others.

If liquidated, the selling company may need to hold back distributions to investors to provide an appropriate reserve for contingent liabilities and third-party claims that may arise post-sale. And the buyer may require the seller to remain in existence and not effect liquidation in order to be answerable for indemnification claims by the buyer. These holdbacks may potentially lock up the sale proceeds and delay the seller's ability to return capital to its investors. By way of contrast, in a statutory merger or stock sale, the seller is absorbed by, or becomes a subsidiary of, the buyer.

In an acqui-hire transaction, the buyer is not only subject to the usual risks inherent in an acquisition, it remains subject to the business risk that the talent which it sought to bring on board ultimately doesn't stay or simply doesn't perform as hoped, rendering the acquisition potentially more expensive and with greater consequences than a mere poor hiring decision would have caused.

Fiduciary Issues

In an acqui-hire, the seller is likely engaged in a change-in-control transaction. As such, its board of directors is duty-bound under applicable law to carefully evaluate the proposed sale and determine whether it is in the best interests of the company and all of its stockholders—not merely the talent.

The seller's board will need to carefully analyze all aspects of the proposed transaction consistent with its fiduciary duties in a change-in-control context. In addition, significant portions of the consideration may be paid directly to the employees rather than to the company's shareholders, and that must be carefully analyzed by the board. In particular, care must be taken to avoid conflicts or the appearance of conflicts of interest—for instance, when one or more directors may also be employees who are being offered significant nonacquisition compensation or other inducements intended to ensure support of the transaction.

The potential for conflicts of interest between management and the investors is also significant. Where appropriate, interested directors may be advised to recuse themselves from the deliberations. With the assistance of skilled counsel and other advisers, the seller's board will need to navigate carefully this and other potential areas of conflict.

As an acquisition, the seller's shareholders generally will also need to properly approve the sale. For venture-backed companies, there often will be additional investor-required approvals. As such, support for the transaction among the seller's investors, who are likely to be keenly focused on the consideration payable to them, will be critical.



VLP LAW GROUP LLP

Issues in Completing the Hiring Process

In many instances, the buyer will work with the seller and the talent to put in place post-sale retention or similar bonus or incentive compensation plans. While these types of arrangements are present in M&A transactions, what distinguishes the acqui-hire is that very often these arrangements represent a significant percentage of the total payments being made by the buyer.

Depending on the total amounts paid to the selling company (as opposed to the selling management team), there may be tension between the talent and the investors in the seller as to allocation of the total deal consideration. Conversely, there may also be an earn-out component to the purchase price, payable to all stockholders, that includes a condition that the talent continue to remain employed with the buyer for a certain period of time. Such arrangements may raise tax, accounting and other issues.

As noted above, the seller's board is duty-bound to act in the best interests of the company and its shareholders. As such, it is especially important that the purchase price and other terms of the transaction be determined after careful consideration to be fair and in the best interests of all shareholders. Depending on the circumstances, the seller might be advised by its legal counsel to conduct a market check to consider other potential buyers and sale opportunities; and to consider other potentially more favorable alternatives to a sale (one of which could be to remain independent and continue to build value for investors in anticipation of a later sale or public offering).

The goal of the acqui-hire transaction is to acquire the talent. However, the deal should not be structured with only that in mind. Obviously, it must be sufficiently attractive to employees to assure that they join the buyer, and to management in order for them to push it through. But the deal needs to satisfy the interests of ownership as well. What may be thought best for the employees is not always what is best for the investors and vice versa. The parties must come up with terms that meet the needs of all constituencies, and the seller's board must be prepared to walk away from an offer that is not in the company's best interest, even if the talent is anxious to proceed.

Of course, this is a very delicate matter. The talent can always decide that if the company elects not to proceed with the transaction, they are prepared to join the buyer in any event (thus leaving the seller at risk that its most important assets may be lost).

In conclusion, acqui-hire transactions present an increasingly popular pathway to attract sought-after talent in a very competitive environment. But as with corporate acquisitions generally, they can be far more complex and nuanced, and present more risk, than simply hiring talent in the traditional way. As such, an acqui-hire should be carefully constructed and thoughtfully executed, with the guidance and advice of skilled legal counsel and other advisers, to maximize the likelihood for a successful outcome.

[Martin H. Levenslick](#) is a partner in the corporate practice group with VLP Law Group. He has practiced for more than 30 years as a business and transactional lawyer, advising a broad array growth companies and investors in financing, M&A and other transactional matters. [David Goldenberg](#) is a founding partner of VLP. His practice includes a broad range of clients, many of which are growth-oriented technology companies. He counsels his clients on contractual and corporate matters throughout their life cycle, as well as individual executives on employment matters.