ECHELON PARTNERS

The Deals & Deal Makers Summit

“The Nexus of Entrepreneurship and Deal Making”

Mastering the Key Legal Decisions Facing Deal Makers

Panel

Moderator

Mike Wunderli
Managing Director

ECHELON PARTNERS

Panelists

David Mainzer
Partner

COHEN/MAINZER LLP

Patrick Burns
Managing Attorney & President

Law Offices of Patrick J. Burns, Jr., P.C.

ARC Advanced Regulatory Compliance, Inc.

Mike Wunderli

- Managing Director at ECHELON Partners
- Managing Partner at Connect Capital Group LLC
- Experience helping private companies navigate through critical stages and engineer appropriate liquidity strategies such as: IPOs, succession plans, full and partial sales, LBOs
- MBA, Wharton Business School

Managing Director

ECHELON PARTNERS

Los Angeles, California

David Mainzer

Partner

- Partner at Cohen/Mainzer since 2006
- More than two decades of experience advising clients in the investment management industry
- Experience focused on corporate, securities, tax, employment, and regulatory compliance and reporting issues
- Member of the State Bar of California and the American Bar Association
- MBA, Columbia University & LLB, University of New South Wales

COHEN/MAINZER LLP

Los Angeles, California

Patrick Burns

- Managing Attorney with The Law Offices of Patrick J. Burns, Jr., P.C. - a law firm dedicated to assisting breakaway brokers transitioning to independence
- President of Advanced Regulatory Compliance, Inc. which provides ongoing compliance assistance to registered investment advisers
- Member of the California, New Jersey, New York, and Texas Bars
- JD, Southwestern University

Founder & CEO

Los Angeles, California

Key Legal Decisions Facing Deal Makers

AGENDA

- **Legal Entity Selection**
  - Evaluating pros, cons, and implications of LLCs vs S-Corps
- **Protective Covenants**
  - Protecting value and control for owners
- **Buy/Sell Agreements**
  - Providing frameworks and rules for specific scenarios
- **Client Agreements**
  - Utilizing negative consent to maximize flexibility
- **Takeaways and Recommendations**
  - Preparing your company for growth, smooth operation, and liquidity
- **Q & A**

S-Corps vs. LLCs – Choice of Entity

LLCs vs. S-Corps

Similarities	Differences
“Pass-through” entities	**Tax rules**
	Division of Enterprise Value, Profits & Governance
	Ownership ***and much more…***

S-Corps vs. LLCs – Ownership

Capitalization Table

	S-Corps	LLCs
Share Class	Can only have one class of stock.	No restrictions on classes of equity.
# of Owners	Limited to only 100 stockholders.	No limit on number of owners.
Type of Owners	Only U.S. individuals can be stockholders.	No restriction on type or residency of owners.

> **LLCs have better transferability and a more flexible capitalization table.**

S-Corps vs. LLCs – Operation of the Business

Division of Profits

	S-Corps	LLCs
Profit Sharing	**Must divide profits according to share ownership.**	**Divide profits in any way it chooses.**
Employment Tax	**Only the compensation income is subject to employment tax.**	**All business income is self-employment income.**
Stock Options / Profits Interest	**Can issue incentive stock options.**	**Cannot issue incentive stock options but can use a profits interest for tax benefits.**

> **LLCs have more flexibility in division of profits.**

S-Corps vs. LLCs – Transactions

- Buyers generally prefer to buy assets instead of stock.
- Sellers generally prefer to sell stock instead of assets.
- In the case of a partial acquisition, it is only possible to structure transaction as stock acquisition.

SALE OF THE BUSINESS

S-Corps	LLCs
Stock sale often not possible if buyer is not a natural person, making partial sales rare.	Stock sale possible and partial transactions common.

> **LLCs have advantageous transaction optionality.**

Protective Covenants

HEDGING YOUR OPTIMISM

- **Owners of businesses are generally optimistic risk takers.**
- **They should think of protective covenants as a business prenuptial.**

1. Safeguard original owners. e.g. Voting vs. Non-voting share classes in an LLC structure.
2. Ensure that future owners can take over business.
3. Specifically for RIAs, ensuring that Advisors just can’t leave via shareholder agreements (corporations), operating agreements (LLC), or partnership agreements (partnership).

> **Protective covenants are restrictions designed to protect stakeholders.**

Protective Covenants

PREVENTING OWNERS FROM LEAVING

1. **Non-Competes -** Owners who cash out their equity or units may need to sit on the sidelines for a pre-set period of time

2. **Non-Solicitation -** Spells out how clients and employees should not be solicited, encouraged or otherwise contacted by a withdrawing owner for the purpose of terminating their relationship with the business.

3. **Liquidated Damages -** a well drafted clause attempts to define in dollar terms what will be owed to the business if an owner causes damage to the business.

4. **Confidentiality & Trade Secrets -** this clause should be broadly drafted to ensure all customer records, business records such as financials, employee files, etc. belong to the firm.

5. **Non-Disparagement**

Buy/Sell Provisions

Form Of Agreement

A buy/sell agreement generally provides for:

- **Ownership interest transfer restrictions.**
- **The purchase and sale of owners’ interests in the company in the event of certain specified occurrences.**
- **The sale of the company or part of the company.**

Buy/Sell Provisions

Ownership Transfer Restrictions

- **A buy/sell agreement will generally seek to prevent an owner from disposing of any of their ownership interest**
- **LLCs and S-Corps have different rules**
- **Ownership transfer restrictions will apply to:**

  a) sales by the owner for cash or other consideration

  b) transfer of the interest to the owner’s heirs or personal representative on death or disability

  c) in community property states, transfers to a former spouse

Buy/Sell Provisions

PURCHASE OF FORMER OWNER'S INTEREST

- **The buy-sell agreement will generally provide that an owner's interest be repurchased by the company or the other owners**
- **Events that cause repurchase are generally:**

  a) termination of employment

  b) death

  c) disability

  d) in community property states, divorce (only the part awarded to the ex-spouse is generally repurchased

Buy/Sell Provisions

SALE OF THE COMPANY OR PART OF THE COMPANY

- **The agreement provides instructions for the sale of a company to;**
  1. Third Parties (will generally have a drag-along clause)
  2. Existing Owners (i.e. a succession plan)
- **There are a number of options for this, including:**
  1. Put options
  2. Baseball options
  3. Call options

> **A good buy/sell agreement will make a transaction go much more smoothly because the sale proceeds that each owner will receive are spelled out in advance.**

Client Agreements

TRANSACTION CONSIDERATIONS

- Client agreements should always be written with a negative consent clause included.

- Failure to include a negative consent assignment clause can hold up a sale or merger, and ultimately drive down the valuation.

- Ideally, client agreements should be drafted correctly with a negative consent form when the firm is launched.

> **Negative consent clauses should be a top priority in drafting client agreements in preparation for an eventual transaction.**

Partner Expectations

WHAT HAPPENS WHEN PARTNERS' EXPECTATIONS CHANGE ?

- **Heart to heart conversation and mutually agree.**
- **Emotions get in the way of a smooth separation.**
- **Horror stories due to a poorly drafted ownership agreement.**

> **A well drafted ownership agreement can aide when expectations change, however there is no perfect way to prepare.**

Key Considerations

When Setting Up An RIA Firm Hire A Lawyer!

But Seriously…

- **Set up the documents correctly so that problems can be avoided down the line.**
- **Amend the ownership document at least annually so that it is kept current as the business grows and evolves.**
- **Make sure the ownership document is clear about respective levels of ownership, non-dilution of founding owners, voting rights, revenue and expense splitting, expulsion of an owner (especially a founder), protective covenants, etc.**

Recap

David Mainzer
Partner

COHEN/MAINZER LLP

Patrick Burns
Managing Attorney & President

Law Offices of Patrick J. Burns, Jr., P.C.

ARC Advanced Regulatory Compliance, Inc.

- **Legal Entity Selection**
- **Protective Covenants**
- **Buy/Sell Agreements**
- **Client Agreements**

Q & A

Entity Selection

Buy/Sell Agreements

Protective Covenants

Client Agreements

Q & A

ECHELON PARTNERS

888-560-9027

www.echelon-partners.com

Member: FINRA/SIPC