Hiring a Professional To Serve as Stockholder Representative

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In most sales of privately-held companies, the buyer and seller encounter a variety of post-closing issues such as:

- working capital adjustments
- indemnification claims
- escrow holdbacks
- earn-outs.

Where the seller has multiple shareholders, the buyer will often require that the seller appoint a **stockholder representative** to act on behalf of all former stockholders to address post-closing matters. The stockholder representative is often a senior officer (i.e. CEO) or a major investor (i.e., a representative from a venture capital or private equity firm) of the selling company. The role of the stockholder representative can differ widely based on the deal terms and the issues that arise post-closing. In the past several years, a market has developed to outsource the stockholder representative function to a professional service provider. The question arises as to whether a seller should consider engaging such a service provider to fulfill the stockholder representative role?

Reasons To Consider a Professional Stockholder Representative

As a result of the myriad issues that may surface post-closing, there are a number of reasons why the seller may want to appoint a professional to be the stockholder representative.

1. The senior officer or investor of the seller may not have the expertise to address the type of issues that may arise post-closing. For example, does such individual have the financial acumen necessary to resolve matters related to working capital adjustments or disputes regarding pre-closing tax matters?
2. Such individual may face conflict of interest questions. If the stockholder representative is now an employee of the buyer, he or she may be placed in the awkward position of negotiating on behalf of the former employees against the current employer. Where such individual is a large/majority stockholder, the stockholder representative may face situations in which he or she has to decide how to proceed in matters that may place his or her interests counter to the interests of other shareholders.
3. To the extent that several complicated issues arise post-closing, the stockholder representative may face the prospect of devoting significant time and resources in dealing with those issues.
4. There is risk involved in performing the duties of a stockholder representative. Such

individual could potentially face liability based on the negligent performance of his or her duties. In the case of a limited partnership acting as the stockholder representative, the risk could flow through the limited partners.

5. Finally, there is an administrative burden that falls upon the stockholder representative. The stockholder representative may spend a significant amount of his or her time communicating with the former stockholders and periodically must send out update notices.

In light of the drawbacks associated with performing the tasks of a stockholder representative, it may make sense to consider outsourcing the function due to the fact that the professional stockholder representative:

- is arguably more properly equipped to handle post-closing matters
- has the resources and experience necessary to deal with most post-closing contingencies including the in-house expertise necessary to address financial and legal issues
- has dealt with and addressed similar issues on numerous prior occasions and can impart that learning to the task at hand
- has a singular focus — addressing post-closing matters;
- has no conflicts of interest nor other competing interests for his or her time
- possesses administrative resources necessary to communicate/update former stockholders
- has no difficulty in taking a position adverse to the buyer or playing the role of the bad cop (without impacting continuing job obligations or relationships)
- may not be materially expensive depending upon the size of the transaction and the number of former stockholders involved.

Of course, there may be competing reasons not to hire a professional stockholder representative such as cost. Generally, if the stockholder representative is an employee of the seller or a stockholder, no fee will be paid to the stockholder representative (although fees may be required to pay outside advisors such as attorneys and accountants). Also, the size of the transaction may not justify engaging a professional stockholder representative. Furthermore, due to the nature of the transaction, there may not be significant post-closing issues (i.e., no earn-out, no escrow retention, no adjustments, etc.) that weigh in favor of hiring a professional.

Each transaction will have different factors affecting the decision of whether to hire a professional stockholder representative. Given the advantages associated with retaining a professional stockholder representative in certain situations, sellers should at least consider the possibility of such an engagement.

For more information on using a professional stockholder representative for a specific transaction, please contact the author **Joseph C. Marrow**.