

ENTRY PHASE

The documentation you need to set up a MIP correctly, what closes the deal, and what actually runs the plan

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Most MIP documentation is written to do one thing: close the deal. It is drafted to a transaction timeline, signed, filed, and rarely opened again until exit. But the documents are not the finish line. They are the instructions for everything that has to happen in the five years in between, and most are not written with those five years in mind.

This article is about the documentation that sets up a management incentive plan, and specifically about the gap between two things that are easy to confuse: documentation that is legally complete, and documentation that is operationally usable. They are not the same, and the difference rarely shows up at signing. It shows up later, one event at a time.

The setup phase is almost always compressed. The plan is one workstream inside a larger transaction, and it competes for attention with everything else that has to close. Advisers produce a set of documents, the parties sign, and the file is considered done. The documents are, in the great majority of cases, correct. The problem is not that they are wrong. The problem is that "correct" and "ready to run" are different standards, and only the first one gets tested before signing.

What follows is the documentation set as it actually functions: the three layers it consists of, the handful of definitions inside it that get invoked at every later event, and where setup documentation quietly fails, seeding precisely the drift we described in the companion article on the holding period.

What "the documentation" actually includes

People refer to "the MIP documents" as though they were a single deliverable. In practice the documentation is a layered set, and each layer does a distinct job. Understanding the layers matters, because most setup failures happen at the seams between them, where one document assumes something another document was supposed to define.

LAYER	WHAT IT DOES	TYPICAL DOCUMENTS
Governing	Sets the rules of Plan rules / MIP terms; the the plan and the relevant provisions of the rights attached to constitutional documents and the instruments	shareholders' arrangements, transfer restrictions, leaver provisions, drag and tag
Participant	Brings each individual into the Award or subscription agreements; the vesting plan on defined, schedule; any side letters or individual terms	individual variations
Structural	Determines how the instruments are actually held and moved	The constitutional documents of the warehouse or management vehicle; nominee, custody, or depositary arrangements

THE GOVERNING LAYER

The governing layer is where the plan's rules live: who can participate, what they receive, how it vests, what happens on departure, and how the instruments behave at a liquidity event. Some of this sits in a dedicated plan document; much of it sits in the company's constitutional documents and the shareholders' arrangements, which is exactly why MIP terms cannot be read in isolation. A plan document that is silent on a point the shareholders' agreement governs is not incomplete on paper, but it is incomplete in practice, because the person administering the plan now has to read two documents together and reconcile them. Every place where the governing layer is split across documents is a place where the answer to a later question depends on reading all of them correctly.

THE PARTICIPANT LAYER

The participant layer is what brings each individual in. It is where the abstract plan becomes a concrete position: this person, this number of instruments, this vesting start, these specific terms. How large the pool is to begin with, and how those allocations are sized, is the question we covered in Beyond MIP vs MEP, terminology and sizing → It is also where individual variation creeps in. A side letter for one senior hire, a different vesting start for a later joiner, a bespoke leaver treatment agreed in a hurry, each is reasonable on its own, and each is a deviation from the standard terms that someone, later, has to remember exists. The participant layer is the most numerous, the most varied, and the easiest to let drift out of alignment with the governing layer above it.

THE STRUCTURAL LAYER

The structural layer determines how the instruments are held and how they move. Whether participants hold directly or through a warehouse or management vehicle changes how every later event is executed, a leaver's repurchase, a new issuance, a recycling of forfeited instruments. The structural documents are usually the least revisited of the three, because they feel like fixed plumbing once they are set. But they define the mechanics that every administrative event has to run through, and a structure chosen for one set of assumptions at setup can become awkward when the plan grows in ways the setup did not anticipate. We covered how that structure behaves over the hold in Pool design over time →

The definitions that decide everything later

The real power of the documentation is not in its structure but in its definitions. A small number of defined terms get invoked at every subsequent event in the plan's life. If they are precise, the plan more or less runs itself. If they require interpretation, every event becomes a small negotiation, and the same ambiguity gets re-argued each time it comes up.

VESTING COMMENCEMENT, AND THE GAP BETWEEN GRANT AND ISSUANCE

Vesting almost always runs from a defined commencement date, but that date is not always the date the instruments are actually issued. There is frequently a gap between the two, and if the documents do not pin down which date governs, the vested balance becomes a matter of opinion at exactly the moments it needs to be a matter of fact. This is the single most common source of vested-balance uncertainty, and it is entirely avoidable at the drafting stage. We set out the mechanics of that gap in Pool design over time →

LEAVER CLASSIFICATION

Almost every plan distinguishes between a good leaver and a bad leaver, and the consequences of the classification are significant, they typically determine whether a departing participant keeps vested value or forfeits it, and at what price their instruments are repurchased. The documentation has to do two things here: define the categories with enough precision that a classification can be made without re-opening the negotiation, and define what happens to the instruments in each case. Many documents do the first reasonably well and leave the second underspecified. Leaver classification is a large enough topic that it has its own article later in this series; for setup purposes, the point is narrower: the definitions and their consequences both belong in the documents, written tightly enough to be applied rather than argued.

HOW FAIR MARKET VALUE IS DETERMINED

At some point a value has to be put on the instruments, when a participant joins partway through, when a leaver is repurchased, when the plan needs to mark where it stands. If the documentation defines fair market value clearly, the methodology, who determines it, how disputes are resolved, those events are routine. If it does not, each one becomes a fresh exercise in working out what the instruments are worth, often under time pressure and sometimes between parties whose interests now diverge. How that value ultimately flows to participants at a liquidity event, the waterfall, is covered in What is a management incentive plan → A vague valuation clause is the kind of thing that looks harmless at signing and turns into friction at every event thereafter.

Where setup documentation quietly fails

LEGALLY COMPLETE VERSUS OPERATIONALLY USABLE

A documentation set can pass legal review and still be hard to operate. It is legally complete when it covers the necessary points and holds up to scrutiny. It is operationally usable when someone who was not in the room at setup can pick it up, understand what governs each event, and administer the plan from it without re-litigating what the words mean. The first standard is the one the setup process is built to meet. The second is the one that determines how the next five years go, and almost nothing in a standard setup process tests for it.

The tell is simple. If running a routine event, a leaver, a joiner, a value determination, requires reading several documents together and exercising judgment about how they interact, the documentation is complete but not yet usable. That judgment is fine when the people who drafted the plan are still close to it. It becomes a liability the moment they are not.

THE DOCUMENTS AND THE RECORD DRIFT APART FROM DAY ONE

At signing, the documents and the live record agree perfectly. The cap table reflects exactly what was just signed. That is the last moment at which they are guaranteed to match without effort. From the first event onwards, the first joiner, the first leaver, the first time vesting accrues, the documents describe what should happen and the record is supposed to capture what did. Keeping the two aligned is work, and if no one is clearly responsible for it, the gap opens immediately. The setup is where this is either made easy or made hard: documentation written with the live record in mind makes alignment a routine task; documentation written only to close the deal makes it an act of reconstruction later.

The drift between documents and record does not start during the hold. It starts at setup, in the decision, usually an implicit one, about whether the documentation was built to be administered or merely to be signed.

An honest opinion: the documents aren't the deliverable, they're the instructions

There is a tendency to treat MIP documentation as an output: a set of papers produced, reviewed, signed, and ticked off. That framing is the root of most of the trouble. The documents are not the output. They are the input to everything that follows, the instructions a plan is run from for years after the people who wrote them have moved on.

Seen that way, the test of good MIP documentation changes. The question is not only "did this survive legal review and close the deal?" It is "can a competent administrator who joins in year three pick this up and run the plan from it, without having to call the original lawyers to find out what a clause was meant to do?" Most documentation is never measured against that second question, because the second question does not get asked until long after the people who could answer it have lost interest in the file.

Documentation written to close the deal optimises for getting to signing. Documentation written to run the plan optimises for the hundred small events that come after it. They look almost identical on the page. The difference only becomes visible when someone has to use the documents to do something, and by then, changing them is far harder than getting them right would have been at the start.

None of this is a criticism of the advisers who produce the documents. They are engaged to get a transaction done to a deadline, and they do that well. But "get the deal closed" and "make the plan easy to run for five years" are different briefs, and unless someone explicitly asks for the second one, the documentation will be optimised for the first. That is a gap in the brief, not a failure of drafting.

What it costs to get the documentation wrong at setup

The cost of weak setup documentation is rarely a single dramatic failure. Documents are seldom simply missing or void. The cost is subtler, and it compounds.

It is, first, ambiguity that has to be resolved repeatedly. A vesting commencement that could mean two things, a leaver category that needs interpretation, a valuation method that is open to argument, each of these is not resolved once. It is resolved again at every event that invokes it, and each resolution carries a small cost in time, in adviser involvement, and occasionally in goodwill between parties whose interests have started to diverge.

Second, it is the slow divergence of the documents from the record, which begins at setup and is only made worse by every event handled without a clear owner. The longer it runs, the more expensive it is to put right.

And then it all crystallises at exit. Due diligence is where vague documentation finally has to give precise answers. The buyer's advisers ask exact questions, and the ambiguities that were tolerable for years because no one was forcing the issue now have to be settled, all at once, under time pressure, at the point of maximum stress. The work that a clear set of documents would have made routine becomes a reconstruction exercise instead.

The honest summary: getting the documentation right at setup costs a little more attention at a moment when attention is scarce. Getting it wrong costs more, repeatedly during the hold, and acutely at exit, and the bill arrives precisely when it is least welcome.

What this means in practice

FOR FUND MANAGERS

Brief the documentation for the hold, not just the close. The single most valuable instruction you can give at setup is that the documents must be usable by someone who was not there when they were drafted. That brief changes what gets produced. Without it, you get documents optimised for signing.

Insist on the three definitions being unambiguous. Vesting commencement, leaver classification, and the valuation mechanism are invoked at every later event. Time spent making these precise at setup is repaid many times over across the holding period.

Make the documents map to a live record from day one. Decide, at setup, where the authoritative record will live and how the documents feed it. The point is not the tool; it is that alignment between documents and record is designed in, rather than left to be reconstructed later.

FOR CFOS AND COUNSEL

Read the plan rules as an operating manual, not a legal artefact. Ask the practical question of each clause: when this event happens, can I act on this wording, or do I need to interpret it? Anywhere the answer is "interpret," flag it before signing, not after.

Pin down the valuation mechanism before the first award, not the first dispute. A clear method, a named determiner, and a resolution path turn every future valuation into a routine step instead of a fresh negotiation.

Keep one authoritative document set, and track every variation against it. Side letters and individual terms are fine, provided there is a single place that records they exist. The danger is not variation; it is variation that no one remembers when the relevant event finally arrives.

One last thought

A management incentive plan is set up once, and run for years. The documentation produced at setup is not the conclusion of that work, it is the start of it. Every leaver, every joiner, every value determination, and ultimately the exit itself will be run from the documents drafted in the compressed weeks around closing. Whether that is straightforward or painful is decided then, in a choice that is rarely made consciously: were the documents built to be signed, or built to be used?

The plans that are easy to administer, and easy to exit, are the ones whose documentation was written with the next five years in view. That is not an accident of good lawyering. It is the result of someone asking, at the start, the question that otherwise does not get asked until it is too late to change the answer cheaply. That is the work we do at MIP Desk.

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