

ParallaxesCapital TRAILblazing



A Parallaxes Capital Podcast

S01 E07 – How to Get Value for the TRA in a Private Company Context (March 26, 2024)

Rachel Cantor



Host – Saish Setty



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00:00

Welcome to TRAIblazing: capitalizing on Tax Receivable Agreements. A Parallaxes Capital podcast that is here to guide you through the world of tax receivable agreements. It's time for TRAIblazing.



Intro – 00:14

Welcome to another episode of TRAIblazing, the Parallaxes Capital Podcast on Tax Receivable Agreements and everything else in the world of tax. In today's episode, we have the honor of hosting an expert in the realm of tax law, Rachel Cantor, a partner at Kirkland and Ellis with the practice finely tuned to the complexities of business transactions. Rachel focuses on the tax aspects of domestic cross-border mergers, acquisitions, LBOs, joint ventures, and really most everything under the sun. She's been recognized by Chambers USA for years and the guide quotes, one of her clients is saying that she is "one of the smartest tax attorneys I've ever known". So join us as we delve into the wealth of Rachel's experience, insights, and accomplishments in the ever fascinating world of tax law. So thanks for joining us today, Rachel. I'd love to start at the beginning of your journey. So what got you interested in doing a clerkship? What initially sparked your tax law? Would like to hear the whole story.



Rachel's background – 01:27

The whole story? Okay. Well, you started with clerkship. That one's kind of an uninteresting answer, which is you go to law school and people say that a clerkship is a good thing to do, and so I applied for a clerkship. So that's really all that it was just-



01:40

All the right reasons. Yeah



01:42



All the right reasons. I also look, the other reasons were the reasons people like to have a clerkship are you get exposure to the inside of a court and how that works. You have access to a judge, you learn, you see all sorts of different cases no matter what area of law you're going to go into. I remember I had a co-clerk, who at the time when we were interviewing the next year's clerks would get a little bit...what's the word that I'm looking for? I actually clerked, by the way. I know you lived in Colorado. I clerked in the 10th circuit and lived in Denver.

02:10

I know, right in our backyard.



02:11



Yep, exactly. I loved it. I had a co-clerk who thought anytime somebody came in who wanted to do transactional, he didn't think that they should be clerks. I thought at the time was a narrow-minded and not a very good position. And having clerked and even though I went into a transactional tax practice, I will tell you I learned a lot about how to think about the law and how to apply that when I help my clients out. And I think that working at a court was a fairly invaluable experience, even though a lot of the cases that we looked at don't have anything to do with what I do now.

02:43

Yeah and I mean, I have to think at the very least, just becoming a more complete lawyer. I feel like I've been on a number of deals where you have to bring a litigator in sometimes and maybe that makes you question what you're doing on some level, but it always feels like the more of a background you have, the better.



Why Rachel became a tax lawyer – 03:00



Right, exactly. And then in terms of why I'm a tax lawyer, that's kind of an interesting story. When I went to law school, like everyone, I thought I was going to be a litigator. You watch it on TV and that's what lawyers do. I didn't really understand the world of transactional. And then I spent a summer, I actually, I worked at Bachtel and I loved it and transactional was super interesting and I thought I was going to be a transactional lawyer. And then the summer after my third year of law school, I worked at a law firm. Again, happened to be Kirkland, although I didn't start out here, but I ended up back up at Kirkland and during that summer I went to this presentation. They had each one of the groups come and explain, this is what it's like to be a corporate lawyer. This is what it's like to be a funds lawyer.

03:43



And then there was one that this is what it's like to be a tax lawyer. I didn't take really any tax classes until my third year of law school and I really liked them, but I'd never thought about being a tax lawyer and the guy who gave the, this is what it's like to be a tax lawyer speech as Todd Mains who is still at Kirkland who, I owe my career to him, he got up there and he didn't talk about tax law. I always tell this story. He talked about one of his children and he seemed like such a nice guy. And so I went up to him after and I asked him for a project and I worked with Todd and the members of the tax group for the rest of the summer and just really loved it. So that's why I'm a tax lawyer is because of Todd Maine

04:20

Got well, a bit of serendipity then, which is always a great, yeah



4:24



Exactly.

04:25

So I guess then in an alternate universe where you're not a tax expert, what profession do you think you'd have pursued then? Is there a totally different career path or I hope you're not about to say tax accountant, no



Rachel is an excellent skier – 04:39



Extreme skier. So that is what I would've been, I'm serious between college and law school. I was a ski instructor in Colorado, which I loved and I knew, I knew I wanted that. That's not what I wanted to do for the rest of my life. But had I gone onto the extreme skiing circuit, maybe I would've liked that and could have done that for the rest of my life.

04:58

I feel like my takeaway is that you're a much better skier than my blue black self. So certainly a point of pride



05:05



Since you are also sometimes my client, I shouldn't tell you this, but I always joke about this, I'm a way better skier than I am tax lawyer. So

05:13

Maybe a professional skier was the path then. So then I guess over your career then, what would you say is the most exciting or memorable transaction you had the opportunity to work on? Certainly doesn't have to be a tax receivable agreement. Just curious, what's that one deal that really stood out?



05:34



In many ways, all of the deals stand out in their own ways, and I find the small deals are often the most complicated ones because people care about them.

05:42

I mean, maybe shifting gears a little to tax receivable agreements, what would you say was your earliest experience with TRAs and in your view, has there been a change in time over how clients actually viewed these instruments?



05:54



Yeah, so I do remember my early experience with TRAs. I don't know if you've heard of National CineMedia? Yeah, right. Well, you have all the TRAs in the-

06:05

World.



06:07



Fingers.

06:07

Crossed. Would hope I have.



National CineMedia – 06:08



Yeah. This was one of those another moments by judging my career and the worth of my career by what my children know and what National CineMedia is for people listening to this, and I believe it still exists, is so when you go to the movies, there's all these advertisements before the movies, and it was a conglomerate or a joint venture between cinema, which at the time was owned by one of my clients and a couple other big movie chains. And together they had this joint venture and they worked on putting together stuff that you would show before a movie. And I remember I would go to the movies, I'd be like, Hey, to my kids, my client owns the company that invests in that. They didn't care at all, but National CineMedia, they had a TRA I remember this was probably, I want to say like 2006 or something.

06:54



And that was my first experience with it. And I remember the senior partner with whom I was working telling me, okay, go out there and look at all of, and he called them exchangeable share structures. I mean, we all call them up-Cs now. And at the time you called up-Cs or Exchangeable Shares and because a lot about how these things work. But that's actually, exchangeable shares is actually a fairly good description of how it works. You can exchange your shares and an entity that's taxed as a partnership for stock a public company. And in connection with that, you get rights under the tax receivables agreement. So, he told me to go out there and pull up all of the TRA, all the exchangeable share deals that have been done and create a chart of the different terms on all of the various aspects of a TRA. So that was my first experience with a TRA.

07:39

Got it. I can see why that would be memorable. Maybe not for the best reasons.



07:44



Well, there weren't that many, so going to the market has really changed. I mean you may say there are not enough yet, but there are, sure, a ton more than there were 20 years ago.

National CineMedia Bankruptcy – 07:53

No, definitely. And just for our listeners too, I think National CineMedia actually went back or went into bankruptcy recently, but they're coming out with another TRA, which is



08:04



Oh, are they?

08:04

Yeah. So always nice to see it in different contexts. And I guess maybe more specifically, you touched on this a little in terms of these exchangeable shares or the up-C, IPO, have you noticed any specific challenges or considerations that arise when you're advising clients on that type of structure? Or do they kind of get it now?



Rise of TRAs – 08:24

I would say they don't all get it in so far as my clients are primarily private equity funds. Although I've had plenty of clients take companies public, that's not the exit they do every day. They don't do it that frequently. And so a lot of times when they take 'em public, it's a C corp. Only a few times are they flow throughs. And obviously you can have a TRA arise in cases that are not flow through deals. Like you could have an NOL TRA for example. It doesn't have to be in connection with a up-C. So the answer is, I think my experience the last two decades is that while people have a little more name recognition with the idea of a tax receivables agreement, a lot of them have never done it. So I guess there's a little more familiarity, but not that much.



09:07

And so where do you see TRAs going from here then? It's certainly grown a lot as a market since the time you probably put together that chart. What do you see the next decade or two looking at? And I know you just mentioned something like NOL TRAs. Is that something you see more of happening as people get more comfortable with this?



NOL TRAs – 09:26



Yeah, I think, and speaking of the NOL TRAs, of which I've seen a few in my career, we see more of those. Originally when we did up-Cs, it wasn't that often that you would have a TRA for the blocker tax attributes because frequently a private equity fund will have a portion of its fund that invests directly in the flow through if you have a flow through deal and a portion of its fund because it has tax exempt and non-US investors invest through a blocker. The first couple that I saw in my career, the blocker holders didn't get anything. But now I think it's fairly common to see, and this I would say is in the last five years really, that it's very common to see a TRA for the blocker attributes. If they're material, sometimes they're not material, it's just not worth the extra complexity.

10:09



So the blocker may have NOLs, it may have step up from its original transaction. The other thing that I hope to see, one of my partners and I have been talking about this, and we started a process to do one of these, although our client didn't ultimately sell the company yet, but hopefully they will do this when they do is instead of right now, you primarily, I think I've really only seen TRAs in a public company context. And we can talk about why that is if it's helpful. But I would like to see TRAs in a private company context. And in particular what we've talked about is, and we did start to run this process, but the company didn't get sold where you have a flow through deal and you can go to the buyers and you can say, okay, you can buy this company and pay us for the tax attributes based on a TRA, or you can buy this company and we will sell the TRA to somebody else. And so you'd be buying the company burdened by the TRA. It would be a liability. But one of the reasons people private equity funds in particular like to do flow through deals is I think that the next buyer values the step up. I have never other than in a TRA deal, seen the next buyer specifically allocate an amount to the step up. And so if you could run a process like I just described, you could definitely get value for the TRA.

11:23

Yeah, internally, at least that's certainly been a theory that we've had that you're going to start seeing this in more private market transactions. It's almost akin to something like rep and warranty insurance in the sense that, well, to the degree that there's an asset or a risk that's being undervalued in the deal, you're shifting that onto a party that's better able to value it. Correct. Just out of curiosity then, what do you think are the biggest impediments to seeing that happen more often in the private market side? Because as you said, yeah, this is getting fairly common in public markets, but there's still room to grow on the private side.



TRAs in private market side – 12:00



Yeah, I mean, I think the impediments are that people don't want to pay for that, right? And if they don't have to, they're not going to. Right? And it's just, I think in order to create that market, you've got to have a company that's so hot that have an auction process where people so much want the asset that they're willing to engage in this discussion about the attribute. Like I said, we did start to run a process like that, and I'm hopeful that it will happen. It was an asset that market change, whatever. I think they will eventually sell it hopefully for lots of money and either sell the TRA separately or get paid a lot for the step up.

12:37

Fingers crossed.



12:38



Yeah, exactly.

12:40

And so then do you have any predictions for TRAs or tax generally for 2024?



Predictions for TRAs – 12:46



No, I think one of the other interesting things I would note about TRAs is now that they've been out there for longer, so we go back to my 2006 story when I could go out and survey all the TRAs because there just weren't that many and now there are loads more of them. The other thing that I am noticing in my practice is when a company that's done an up-C is taken private again, or it doesn't even have to be private, it could just be they're bought by another public company and what happens to the TRA, right? And so what happens in that process? So there are at least three options. One is the holders get paid nothing for the TRA, which is sad. Another would be that they get paid out fully based on the, as you well know in the TRA, you're paid if as and when realized for the value of the tax attributes in certain events including a change of control, there are assumptions that are hardwired into the agreement that are made, which basically say you assume that all of the attributes are used and then the holders of the TRA get paid under the contract based on those favorable assumptions to the holder.

PubCo – 13:49



So you could have a company, for example, and I'm sure you've seen this, where nobody has ever received a payment on the TRA because the PubCo is in a loss position. So they can't use the step up and somebody goes to take them private and they need to buy out the TRA because contractually they're required to do so. If they paid a hundred cents on the dollar for the attributes that the company isn't even using now, that would be great for the TRA holders. But, you see, I've been involved in these negotiations between the buyer of the PubCo and the holders of the TRA and there's an all, you get paid for everything option. They get paid for nothing option, and there's a negotiated position in the middle. And so I think given the higher the greater prevalence of TRAs in the market, we're just going to see more and more practice and experience based on buying out TRAs. I'm sure that's extremely relevant to you guys as a TRA holder.

Sculptor – 14:43

No, certainly. And I think we even saw a lot of that, at least getting some press recently in the sculptor situation. It certainly feels as though TRAs as a consideration in acquisitions. Let me know if you disagree here, are being more recognized for the role they play or the impact they have in the ultimate acquisition price because ultimately it is another liability.



GoDaddy – 15:03



Exactly. Right. And it's carried on the balance sheet, right? It's publicly disclosed. So I mean, then there's another interesting with the buyouts, like the GoDaddy one that got just bought out by the company during the hold, and then there were all sorts of interesting questions and litigations about fiduciary duties. That's another kind of TRA buyout consideration,

15:24

The buyouts by the company themselves. And I think we're all very vested in seeing how those litigations actually end up playing out ultimately.



GoDaddy Lawsuit – 15:33



Right. And presumably the theory on that one from the company's perspective was that right? They wanted to get rid of the liability, but there were other accusations. So-

15:43

For all our listeners would recommend reading those suits because they are pretty interesting reads on some level. Yes. And I guess, do you see any major challenges in the TRA space today then you kind of touched on some of the litigation activity. Curious if there was anything else you had in mind?



15:59



I really do think there's a question right about that is the biggest one that I see, which is the question of what happens after your TRA is long in the tooth or because they're often held by private equity sponsors. You guys are a great solution to that, right? Maybe you could come buy them from the private equity

16:16

That's the hope



Liquidity – 16:18



Right? And presumably from your perspective, and I know we've talked about this, but having a bigger market, you want to get the best ones at the best prices, but to some extent, having more buyers out there would make the market more liquid. So I do think that liquidity in the secondaries market is something that needs to be developed to continue to grow that market.

16:39

Got it. And maybe just shifting gears a little, so on a more personal note then, like, what would you say is the trickiest part of your job today?



16:46

The trickiest part of my job today... So it's probably the trickiest part of being a job tax lawyer since the beginning of time. So my friend and mentor, Bill Welke was working at another large law firm, I think Sidley, and she quit doing it after I think two years. And the reason she quit doing it, she is a law and history professor, extremely brilliant person, but she didn't like the tax law. And this is where I'm getting sued, to answer your question, she felt like it was walking through a field of landmines. And I think that that continues to be the case now, 20, 30 years later, 40 years later, whatever it is, that the practice of tax in particular, it's hard to know everything. It's hard to remember everything. And even if you do, you might miss one landmine and you're going to walk into another. And then I would say our practice has become, there's so many rules, right? But there's also, we're international now as well, and it's just impossible to keep it all in your head.



17:38

Definitely. I will say whenever I talk to you guys or your colleagues or other tax lawyers, the quickness with which these vague regulations are mentioned and high level terms, I'll admit often just flies right over my head. So I think I understand the difficulty there



17:54

So much.



17:55

Would love to close with a lighter question. If you could hop back into a time machine and give your younger self one piece of advice, professional, personal, whatever it is, what would that be?



18:07



One piece of advice. Okay

18:10

Or many? Yeah, no reason to limit yourself.



Rachel's advice – 18:14



So thinking about this, I think I was really fortunate enough to get a lot of really good advice along the way. And so starting with the following, and somebody did tell me this when I was very junior and I took it to heart: first impressions matter. If you make a good first impression, you get a lot of leeway. If you make a bad first impression, it's very hard to get somebody to allow you to change that impression. So that would be the one piece of advice if it was one.

18:41

It's certainly good advice for everybody. Well, very much enjoyed our conversation, Rachel. Thank you for taking the time.



18:49



Yeah, me too. Thank you for having me. Take care. Bye.

18:52

You too.



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Further Reading

National CineMedia – 06:08

[National CineMedia](#)

National CineMedia Bankruptcy – 07:53

[National CineMedia Bankruptcy](#)

Sculptor – 14:43

[Sculptor Buyout](#)

GoDaddy – 15:03

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