THE INTERNATIONAL COMPARATIVE LEGAL GUIDE TO: PRIVATE EQUITY 2021

7TH EDITION

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1 Overview

1.1 What are the most common types of private equity transactions in your jurisdiction? What is the current state of the market for these transactions?

U.S. private equity ("PE") deal activity faced turbulence in early 2020 as a result of the onset of the COVID-19 pandemic in the United States, with a dramatic slowdown experienced during Q2 2020, but deal activity rebounded strongly in the second half of 2020. Both deal volume and deal value for 2020 ultimately finished below the near record-setting levels observed in 2019, but the rapid recovery in activity through the end of the year generated significant optimism in the industry, and deal activity has since hit record levels in the first half of 2021. Commitments in respect of PE fundraising decreased during 2020 compared to 2019 but rebounded during the start of 2021.

Since the dramatic market recovery experienced in the second half of 2020, PE sponsors have continued to be confronted with highly elevated valuations for new platform companies and seller-friendly terms created by expedited, competitive auctions. These valuations, coupled with record levels of dry powder and the lack of suitable targets, have continued to create a challenging investment environment for buyers who are looking to quickly deploy capital. As a result, there has been a continued focus on portfolio company add-ons and alternative transactions, such as carve-outs, strategic partnering transactions, minority investments, club deals, growth investments, structured equity investments, private investments in public equity ("PIPEs") and take-private transactions. In addition, PE sponsors have focused significant attention on readying existing portfolio companies for exits in order to take advantage of the robust market, and they have increasingly been eyeing strategic buyers and public markets for exits. Investments in the healthcare and technology industries fared particularly well during the COVID-19 pandemic, but sponsors have also been making opportunistic investments in industries that were hard hit by the pandemic, such as hospitality and retail.

1.2 What are the most significant factors currently encouraging or inhibiting private equity transactions in your jurisdiction?

Over the last few years, the dearth of suitable targets has resulted in extremely competitive auctions, which in turn has resulted in historically high selling multiples and seller-favorable terms. Successful bids often include "walk-away" terms with few conditions and recourse limited solely to buyer-obtained representation and warranty ("R&W") insurance. With bankers and sellers focused on certainty and speed to closing, transactions are often required to be signed and closed within days or a few weeks. While it initially seemed like the COVID-19 pandemic would challenge some of these patterns, after a brief slowdown in activity early in the pandemic, these trends have generally continued unabated. In addition, recent regulatory reforms involving the Committee on Foreign Investment in the United States ("CFIUS") have led to increased timing delays and deal uncertainty for transactions involving non-U.S. investors that might raise U.S. national security issues.

1.3 What are going to be the long-term effects for private equity in your jurisdiction as a result of the COVID-19 pandemic? If there has been government intervention in the economy, how has that influenced private equity activity?

Given the trends observed since the early days of the COVID-19 pandemic, it seems unlikely that COVID-19 will have significant long-term effects on the U.S. PE industry. However, parties have developed an increased level of comfort with conducting processes in a virtual or partially virtual setting, including fundraising.

U.S. government intervention in the economy in response to the COVID-19 pandemic has included a number of facets, including, among other things, loan programs targeted at small businesses, such as the Paycheck Protection Program ("PPP"), payroll tax deferrals and payroll tax credits under the CARES Act, and temporary modifications of certain aspects of the Tax Cut and Jobs Act of 2017. Stimulus has not been aimed at PE, although PE funds and their portfolio companies have been able to take advantage of certain benefits. They have also had to navigate stimulus programs through the acquisition of targets that have availed themselves of benefits – particularly PPP loans, which were generally unavailable to PE funds and most portfolio companies as a matter of law. PPP loan recipients face additional scrutiny and hurdles when undergoing a transaction, but, given the life cycle of PPP loans and the related government funding, few are expected to remain outstanding by this time next year.

1.4 Are you seeing any types of investors other than traditional private equity firms executing private equity-style transactions in your jurisdiction? If so, please explain which investors, and briefly identify any significant points of difference between the deal terms offered, or approach taken, by this type of investor and that of traditional private equity firms.

Over the past several years, the concentration of capital in large, multi-strategy asset managers has increased, leading to a

corresponding increase in the number of deals consummated by such managers. We expect this trend to continue, as large, multi-strategy asset managers may be better positioned than some others to take advantage of opportunities available in the current market.

Non-traditional PE funds such as sovereign wealth funds, pension plans and family offices continue to extend investments beyond minority positions and are increasingly serving as lead investors in transactions, which has created additional competition for traditional PE funds.

In addition, pension funds, insurance companies and other investors of large pools of capital will likely continue increasing their allocation to alternative investments, including PE, private debt, real estate and infrastructure.

2 Structuring Matters

2.1 What are the most common acquisition structures adopted for private equity transactions in your jurisdiction?

The most common acquisition structures are mergers, equity purchases and asset purchases in the case of private targets, and one-step and two-step mergers in the case of public targets.

Historically, most PE sponsors have prioritized control investments, but the current market has increased focus on alternative investment structures, including structured equity.

2.2 What are the main drivers for these acquisition structures?

The primary drivers include tax considerations, stockholder approval, speed and certainty of closing and liability issues.

Mergers offer simple execution, particularly where the target has numerous stockholders, but buyers lack privity with the target's stockholders, and the target's board may expose itself to claims by dissatisfied stockholders. Buyers often seek separate agreements with stockholders that include continued support during the period between signing and closing, releases, indemnification and restrictive covenants. However, depending on the applicable state law, enforceability issues may arise.

Stock purchases require all target stockholders to be party to and support the transaction. These agreements avoid privity and enforcement concerns that arise in a merger but may be impractical depending on the size and character of the target's stockholder base.

Asset purchases provide favorable tax treatment for acquirors because buyers can obtain a step up in tax basis in acquired assets. See section 9. Depending on the negotiated terms, buyers also may leave behind existing liabilities of the target. However, asset purchases (especially carve-out transactions) can be difficult and time-consuming to execute because third-party contract consents may be required. For certain regulated businesses, permits and licenses may need to be transferred or reissued. In addition, buyers need to carefully review the business' assets and liabilities to ensure that all necessary assets are acquired and that liabilities that flow to buyers as a matter of law are not unwittingly inherited.

2.3 How is the equity commonly structured in private equity transactions in your jurisdiction (including institutional, management and carried interests)?

U.S. PE returns typically arise from management fees and returns on equity investments. Equity structuring varies depending on the PE sponsor involved, the portfolio company risk profile and the IRR sought. Equity most often comprises preferred and/or common equity interests held by the PE sponsor. Often, some or each type of equity is offered to existing or "rollover" target investors. Preferred equity can be used to set minimum returns and incentivize common or other junior security holders to drive portfolio company performance. PE funds often offer portfolio company management equity-based incentive compensation in the form of stock options, restricted stock, phantom or other synthetic equity or profits interests, each of which is subject to vesting requirements. Carried interests are typically found at the fund level and do not directly relate to the structuring of the equity investment at the portfolio company level.

The main drivers for these structures are: (i) alignment of interests among the PE sponsor and any co-investors, rollover investors and management, including targeted equity returns; (ii) tax efficiency for domestic and international fund investors and other portfolio company investors, including management; and (iii) incentivizing management.

2.4 If a private equity investor is taking a minority position, are there different structuring considerations?

Minority investments create financial and legal issues not often encountered in control investments. Unlike control transactions, where the PE sponsor generally has unilateral control over the portfolio company, minority investors seek to protect their investment through contractual or security-embedded rights. Rights often include negative covenants or veto rights over major business decisions, including material M&A transactions, affiliate transactions, indebtedness above certain thresholds, annual budgets and business plans, strategy, senior management hiring/firing and issuances of equity. In addition, PE sponsors will seek customary minority shareholder protections such as board and committee representation, information and inspection rights, tag-along and drag-along rights, registration rights and pre-emptive rights.

For transactions subject to CFIUS review, non-U.S. PE investors taking a minority position might be required to forego certain rights that they otherwise would seek (e.g., board representation and access to non-public information) in order to avoid triggering CFIUS review or to otherwise facilitate obtaining CFIUS clearance.

2.5 In relation to management equity, what is the typical range of equity allocated to the management, and what are the typical vesting and compulsory acquisition provisions?

Management equity is typically subject to time- and/or performance-based vesting. Time-based awards vest in specified increments over several years (typically four to five years (in the Eastern United States) and sometimes less (in the Western United States)), subject to the holder's continued employment. Performance-based awards vest upon achieving performance goals, often based on the PE sponsor achieving a certain IRR or multiple on invested capital upon exit. Time-based awards typically accelerate upon the PE sponsor's exit. Forfeiture of both vested and unvested equity in the event of a termination for cause is not uncommon.

Compulsory acquisition provisions are not typical, but portfolio companies customarily reserve the right to repurchase an employee's equity in connection with the employee's termination at fair market value or the lesser of fair market value and the original purchase price, depending on the timing and reason for termination.

The proportion of equity allocated to management (as well as the allocation among executives) varies by PE fund and the capital structure of the portfolio company, but management equity pools for portfolio companies typically range from 7.5–15% of equity on a fully diluted basis, with the higher end of that range being more common with smaller equity investments and equity structures where the PE sponsor holds more preferred equity.

2.6 For what reasons is a management equity holder usually treated as a good leaver or a bad leaver in your jurisdiction?

Management equity holders are typically treated as good leavers if their employment is terminated without cause, they resign with good reason after a specified period of time, upon normal retirement, or their employment terminates due to death or disability. Bad leavers are commonly those who are terminated for cause or who otherwise resign without good reason.

3 Governance Matters

3.1 What are the typical governance arrangements for private equity portfolio companies? Are such arrangements required to be made publicly available in your jurisdiction?

PE sponsors generally form new buyer entities (most often corporations or tax pass-through entities such as limited liability companies ("LLCs") or limited partnerships ("LPs")) through which they complete acquisitions and maintain their ownership interest in underlying portfolio companies. Governance arrangements are typically articulated at the portfolio company level where management holds its investment but may also be found at the buyer level if co-investors or management investors hold equity interests in the buyer. For control investments, PE sponsors will often control the manager and/or the board of both the buyer and the portfolio company.

Governance agreements among PE sponsors, co-investors and management will most commonly be in the form of a shareholders' agreement, LLC agreement or LP agreement, depending on the form of the entity. These agreements ordinarily contain, among other things: (i) transfer restrictions; (ii) rights of first refusal or first offer; (iii) tag-along and drag-along rights; (iv) pre-emptive rights; (v) rights to elect the manager or board of directors; (vi) information rights; (vii) special rights with respect to management equity, including repurchase rights; and (viii) limits on certain fiduciary and other duties to the extent permitted by state law. For larger portfolio companies contemplating exits through IPOs, registration rights may also be sought. Governance arrangements are not generally required to be made publicly available unless the portfolio company is a public reporting company. Charters are required to be filed with the state of organization but generally do not include meaningful governance provisions.

3.2 Do private equity investors and/or their director nominees typically enjoy veto rights over major corporate actions (such as acquisitions and disposals, business plans, related party transactions, etc.)? If a private equity investor takes a minority position, what veto rights would they typically enjoy?

For control investments, PE sponsors will often control the portfolio company through their rights to appoint the manager or a majority of the directors. As a result, major corporate actions are ultimately indirectly controlled by the PE sponsor. If a PE sponsor takes a minority position, veto rights will generally not be included in underlying governance arrangements unless the sponsor owns a substantial minority position. See question 2.4.

3.3 Are there any limitations on the effectiveness of veto arrangements: (i) at the shareholder level; and (ii) at the director nominee level? If so, how are these typically addressed?

Veto rights are typically contractual rights in favor of specified shareholders or classes of equity contained in a shareholders' agreement or LLC agreement if applicable, and are generally enforceable. For corporations, although less common, negative covenants can also be included in the charter, which would render any action taken in violation of one of those restrictions *ultra vires*. Although shareholder-level veto rights are sometimes employed, director-level veto rights are less common, as veto rights exercised by directors will generally be subject to their overriding fiduciary duty owed to the portfolio company, unless such duties have been validly disclaimed. See question 3.6.

3.4 Are there any duties owed by a private equity investor to minority shareholders such as management shareholders (or *vice versa*)? If so, how are these typically addressed?

Whether a PE investor owes duties to minority shareholders requires careful analysis and will depend upon several factors, including the legal form of the entity involved and its jurisdiction of formation.

Several jurisdictions hold that all shareholders in closely held companies owe fiduciary duties to each other and the company. In other jurisdictions, such as Delaware, only controlling shareholders owe fiduciary duties. In this context, the ability to exercise dominion and control over corporate conduct (even if less than 50% of the equity is owned) will be determinative.

Delaware is frequently chosen as the state of organization in PE transactions due to its well-developed business law and sophisticated judiciary. Under Delaware law, duties include fiduciary duties of care and loyalty and other duties such as those arising under the corporate opportunity doctrine. The duty of care requires directors to make informed and deliberate business decisions. The duty of loyalty requires that decisions are made in the best interests of the company and its shareholders and not based on personal interests or self-dealing. For Delaware corporate entities, these duties may not be waived.

For PE sponsors organizing their investment vehicles as LLCs or LPs in Delaware, the underlying LLC or LP agreement will often include an express waiver of fiduciary duties owed to minority investors. Absent an express waiver, courts will apply traditional corporate-like fiduciary duties. Other duties deemed included in LLC or LP agreements such as duties of good faith and fair dealing may not be waived. In addition, shareholders', LLC and LP agreements often include express acknowledgments that the PE sponsor actively engages in investing and has no obligation to share information or opportunities with the portfolio company. These agreements also typically provide that portfolio companies (and not PE sources) serve as the first source of indemnification for claims against PE sponsor employees serving on the portfolio company's board.

3.5 Are there any limitations or restrictions on the contents or enforceability of shareholder agreements (including (i) governing law and jurisdiction, and (ii) non-compete and non-solicit provisions)?

Shareholders', LLC and LP agreements are generally governed by and must be consistent with the laws of the state of the entity's formation. LLC and LP agreements, which are contracts among the company and its members or partners, provide greater flexibility than shareholders' agreements. Although governing law and submission to jurisdiction provisions may refer to the law of other states, or may apply the law of two or more states through bifurcation provisions, this approach is unusual and should be avoided, as it is unduly complicated and references to state laws outside the state of formation may render certain provisions unenforceable.

Non-competition and non-solicitation provisions in shareholders', LLC and LP agreements generally restrict management and non-PE co-investors, but not PE investors. These provisions are subject to the same enforceability limitations as when contained in other agreements. Enforceability will be governed by state law and must be evaluated on a case-by-case basis. The agreements must be constructed to protect the legitimate interests of the portfolio company and not violate public policy. Unreasonable temporal and/or geographic scope may render provisions unenforceable or subject to unilateral modification by courts. Other contractual provisions such as transfer restrictions, particularly for corporate entities, are subject to public policy limitations.

3.6 Are there any legal restrictions or other requirements that a private equity investor should be aware of in appointing its nominees to boards of portfolio companies? What are the key potential risks and liabilities for (i) directors nominated by private equity investors to portfolio company boards, and (ii) private equity investors that nominate directors to boards of portfolio companies?

There are no meaningful legal restrictions applicable to PE investors nominating directors to private company boards, other than restrictions under applicable antitrust laws. For example, the Clayton Act generally prohibits a person from serving as an officer or director of two competing corporations. In 2019, the U.S. Department of Justice ("DOJ") expressed a desire to extend the scope of these restrictions on interlocking directorships to non-corporate entities and entities that appoint directors to competing entities as representatives or "deputies" of the same investor. If the Clayton Act is expanded in such a manner, PE funds may need to reevaluate their existing corporate governance arrangements with their portfolio companies. PE investors should also be aware that some U.S. states have been enacting gender diversity requirements for the boards of companies organized and/or headquartered in the applicable state, and NASDAQ has proposed new listing rules regarding board diversity and related disclosure.

Potential risks and liabilities exist for PE-sponsored directors nominated to boards. Directors appointed by PE investors should be aware that they owe fiduciary duties in their capacity as directors (subject to certain exceptions in the case of an LLC or LP where fiduciary duties of directors are permitted to be, and have been, expressly disclaimed). Directors of corporations cannot delegate their decision-making responsibility to or defer to the wishes of a controlling shareholder, including their PE sponsor. In addition, conflicts of interest may arise between the PE firm and the portfolio company. Directors should be aware that they owe a duty of loyalty to the company for the benefit of all of its shareholders (absent a waiver under the circumstances discussed above) and that conflicts of interest create exposure for breach of duty claims. Finally, while the fiduciary duties to the company remain the same, the ultimate stakeholders might change when a company is insolvent or in the zone of insolvency – in such situations, directors may also owe fiduciary duties to certain creditors of the portfolio company.

3.7 How do directors nominated by private equity investors deal with actual and potential conflicts of interest arising from (i) their relationship with the party nominating them, and (ii) positions as directors of other portfolio companies?

See question 3.6. Under the duty of loyalty, directors must act in good faith and in a manner reasonably believed to be in the best interests of the portfolio company and may not engage in acts of self-dealing. In addition, directors appointed by PE firms who are also officers of the PE firm itself owe potentially conflicting fiduciary duties to PE fund investors. Directors need to be cognizant of these potential conflicts and seek the advice of counsel.

4 Transaction Terms: General

4.1 What are the major issues impacting the timetable for transactions in your jurisdiction, including antitrust, foreign direct investment and other regulatory approval requirements, disclosure obligations and financing issues?

The timetable for a transaction generally depends on the due diligence process, negotiation of definitive documentation, and obtaining debt financing, third-party consents and regulatory approvals.

Antitrust clearance is the most common regulatory clearance faced. Generally, only companies that meet regulatory thresholds are required to make filings under the Hart-Scott-Rodino Act ("HSR"). The most significant threshold in determining reportability is the minimum size of transaction threshold (2021: US$92 million). In most circumstances, the HSR process takes approximately one month and is conducted between signing and closing. Parties can expedite review by filing based on executed letters of intent or by requesting early termination of the waiting period; however, the U.S. Federal Trade Commission and the DOJ have recently been applying greater scrutiny to early termination requests, including by issuing a temporary suspension of early terminations in early 2021 that was still in effect at the end of Q2 2021.

Transactions raising anticompetitive concerns may receive a "second request" from the reviewing agency, resulting in a more extended review period.

In addition, parties to transactions potentially affecting national security may seek regulatory clearance from CFIUS. Given recent political developments and regulatory changes, buyers should expect enhanced scrutiny by the U.S. government of certain foreign investments in the United States, particularly in the technology and defense-related industries. Recent CFIUS reforms that have been implemented pursuant to the Foreign Investment Risk Review Modernization Act of 2018 ("FIRRMA") have expanded CFIUS' powers and also now require mandatory submissions to CFIUS for certain types of transactions that are more likely to raise U.S. national security

concerns – previously, CFIUS was typically a voluntary process. Prudent buyers seek CFIUS approval to forestall forced divestiture orders.

Other contractual or government approvals relating to specific sectors or industries (e.g., the Jones Act or FCC approval) may also be necessary or prudent depending on the nature of the business being acquired or the importance of underlying contracts.

4.2 Have there been any discernible trends in transaction terms over recent years?

Over the past few years, competitive auctions have become the preferred method for exits by PE sponsors and other sellers in the United States. As a result of these competitive auctions, the scarcity of viable targets and the abundant availability of equity financing and debt financing, transaction terms have shifted strongly in favor of sellers, including the limiting of conditionality and post-closing indemnification obligations. Transactions are generally being consummated with "public"-style closing conditions (i.e., representations subject to MAE bring-down), financing conditions have virtually disappeared, and reverse break fees are increasingly common. The use of R&W insurance has been implemented across transactions of all sizes and is now used equally by PE and strategic buyers. Transactions are being structured more frequently as walk-away deals, with the insurance carrier being responsible for most breaches of representations between the retention (which refers to the self-insured deductible) and insured limit under the policy. It also is becoming more common to include terms regarding CFIUS in transactions involving non-U.S. investors.

5 Transaction Terms: Public Acquisitions

5.1 What particular features and/or challenges apply to private equity investors involved in public-to-private transactions (and their financing) and how are these commonly dealt with?

Public company acquisitions pose a number of challenges for PE sponsors. The merger proxy or tender offer documents provided to target shareholders will include extensive disclosure about the transaction, including the buyer and its financing, and a detailed background section summarizing the sale process and negotiations. These disclosure requirements are enhanced if the Rule 13e-3 "going private" regime applies to the transaction.

A public company acquisition will require either consummation of a tender offer combined with a back-end merger or target shareholder approval at a special shareholder meeting. In either case, there will be a significant delay between signing and closing that must be reflected in sponsor financing commitments, with a minimum of six weeks for a tender offer (which must remain open for 20 business days) and two to three months for a merger that requires a special meeting.

Absent unusual circumstances, there will be no ability to seek indemnification or other recourse for breaches of target representations or covenants, but R&W insurance may be obtained.

5.2 What deal protections are available to private equity investors in your jurisdiction in relation to public acquisitions?

Generally, the acquisition of a U.S. public company is subject to the ability of the target's board to exercise a "fiduciary out" to pursue superior offers from third parties until the deal is approved by the target shareholders or a tender offer is consummated. A PE buyer typically negotiates an array of "no shop" protections that restrict the target from actively soliciting competing bids, along with matching and information rights if a third-party bid arises. If a target board exercises its fiduciary out to terminate an agreement and enter into an agreement with an unsolicited bidder, or changes its recommendation of the deal to shareholders, break-up fees are customary. Fees typically range from 2–4%.

6 Transaction Terms: Private Acquisitions

6.1 What consideration structures are typically preferred by private equity investors (i) on the sell-side, and (ii) on the buy-side, in your jurisdiction?

U.S. PE buyers typically purchase companies on a cash-free debt-free basis. As opposed to a locked-box approach, U.S. transactions typically involve a working capital adjustment where the parties agree to a target amount that reflects a normalized level of working capital for the business (often a trailing six- or 12-month average) and adjust the purchase price post-closing to reflect any overage or underage of working capital actually delivered at closing. Depending on the nature of the business being acquired and the dynamics of the negotiations, the price may also include earn-outs or other contingent payments that provide creative solutions to disagreements over the target's valuation.

6.2 What is the typical package of warranties / indemnities offered by (i) a private equity seller, and (ii) the management team to a buyer?

With the prevalence of R&W insurance, post-closing indemnification by sellers, which was once intensely negotiated, has become less important for allocating risk between buyers and sellers. Historically, sellers would indemnify buyers for breaches of representations and warranties, breaches of covenants and pre-closing tax liabilities, and the parties would carefully negotiate a series of limitations and exceptions to the indemnification. When buyers obtain R&W insurance, sellers typically provide only limited indemnification for a portion of the retention under the policy (e.g., 50% of a retention equal to 1% of enterprise value). Public-style walk-away deals where sellers provide no indemnification are increasingly common, and proposing a walk-away deal provides bidders an advantage in competitive auctions.

For issues identified during due diligence, buyers may negotiate for special indemnities, with the terms depending on the nature and extent of the exposure and the parties' relative negotiating power.

Management team members typically do not provide any special indemnification to buyers in their capacity as management.

6.3 What is the typical scope of other covenants, undertakings and indemnities provided by a private equity seller and its management team to a buyer?

Historically, U.S. PE sellers typically have not agreed to non-competition covenants, and restrictive covenants were limited to employee non-solicitation covenants. Conversely, selling management investors and certain co-investors typically agree to non-competition and other restrictive covenants. Recently, limited non-competition covenants by PE sellers have become more common given the high valuations paid by buyers. However, these covenants are typically very narrow and may be limited to restrictions on purchasing enumerated target

companies. Restrictive covenants by PE sellers tend to be intensely negotiated, and the terms, including the length of the restrictions, any exceptions and their applicability to PE fund affiliates, depend on the parties' negotiating strength and the nature of the PE seller and the business being sold.

Counsel should ensure that non-selling members of the target's management team continue to be bound by existing restrictive covenants.

6.4 To what extent is representation & warranty insurance used in your jurisdiction? If so, what are the typical (i) excesses / policy limits, and (ii) carve-outs / exclusions from such insurance policies, and what is the typical cost of such insurance?

PE and other sophisticated sellers routinely request that recourse be limited to R&W insurance obtained by buyers.

Policy terms commonly include coverage limits of 10–15% of target enterprise value, a 0.75–1% retention (stepping down to 0.5% after one year), six years of coverage for breaches of fundamental representations and three years of coverage for breaches of other representations. Exclusions include issues identified during due diligence, certain liabilities known to the buyer, benefit plan underfunding and certain environmental liabilities, and may also include industry and deal-specific exclusions based on areas of concern arising during the underwriting process. In addition, exclusions have recently been expanded to include COVID-specific exclusions and liabilities related to PPP loans.

Despite competition among R&W insurers, consistent with other insurance markets, pricing of R&W insurance policies has tightened, with premiums and broker fees commonly around 3.25% of the policy limit, and underwriting due diligence fees of US$25,000–US$50,000. In addition, the premium is subject to taxation under state law.

6.5 What limitations will typically apply to the liability of a private equity seller and management team under warranties, covenants, indemnities and undertakings?

Representations and warranties typically survive for 12–24 months post-closing, with 12 months increasingly becoming the norm, although certain specified representations may survive longer. For example, tax, employee benefit and fundamental representations often survive until expiration of the applicable statute of limitations. Fundamental representations typically include due organization, enforceability, ownership/capitalization, subsidiaries and brokers. For walk-away R&W insurance transactions, representations and warranties typically do not survive the closing.

For transactions without R&W insurance, indemnification caps typically range from 5–20% of the purchase price, whereas a significantly lower cap (e.g., 1%) is typically negotiated when the buyer is obtaining R&W insurance. Liability for breaches of fundamental representations, breaches of covenants and fraud is often uncapped. Sellers will often only be responsible for damages above a deductible amount.

6.6 Do (i) private equity sellers provide security (e.g. escrow accounts) for any warranties / liabilities, and (ii) private equity buyers insist on any security for warranties / liabilities (including any obtained from the management team)?

With the continuing increase in usage of R&W insurance, escrows and holdbacks to cover indemnification for representation breaches are becoming less common. However, for non-walk-away deals, sellers generally place 50% of the retention under the R&W insurance policy in escrow. Escrows for post-closing purchase price adjustments remain common, as do special escrows to address issues identified during due diligence.

6.7 How do private equity buyers typically provide comfort as to the availability of (i) debt finance, and (ii) equity finance? What rights of enforcement do sellers typically obtain in the absence of compliance by the buyer (e.g. equity underwrite of debt funding, right to specific performance of obligations under an equity commitment letter, damages, etc.)?

U.S. PE buyers typically fund acquisitions through a combination of equity and third-party debt financing. The PE sponsor will deliver an equity commitment letter to the buyer under which it agrees to fund a specified amount of equity at closing, and the seller will be named a third-party beneficiary. In a club deal, each PE sponsor typically delivers its own equity commitment letter.

Committed lenders will deliver debt commitment letters to the buyer. Often, PE buyers and their committed lenders will limit sellers' rights to specifically enforce the debt commitment. See question 6.8.

6.8 Are reverse break fees prevalent in private equity transactions to limit private equity buyers' exposure? If so, what terms are typical?

In the current market, closings are rarely, if ever, conditioned on the availability of a buyer's financing. In certain circumstances, PE buyers may accept the risk that they could be forced to close the transaction by funding the full purchase price with equity. However, buyers seeking to limit such exposure typically negotiate for a reverse break fee, which allows termination of the transaction in exchange for payment of a pre-determined fee if certain conditions are satisfied. Depending on the terms, reverse break fees may also be triggered under other circumstances, such as a failure to obtain HSR approval. Typical reverse break fees range from around 4–10% of the target's equity value, with an average of around 6–7%, and may be tiered based on different triggering events. Where triggered, reverse break fees typically serve as a seller's sole and exclusive remedy against a buyer. Given that PE buyers typically have no assets prior to equity funding at closing, sellers commonly require PE sponsors to provide limited guarantees of reverse break fees.

7 Transaction Terms: IPOs

7.1 What particular features and/or challenges should a private equity seller be aware of in considering an IPO exit?

Exits through IPOs will often be at higher multiples and more readily apparent market prices than exits through third-party sale transactions. However, exits through IPOs are subject to volatile market conditions and present other significant considerations. IPOs accomplished through acquisitions by SPACs (i.e., de-SPAC transactions) have become increasingly common.

Unlike third-party sales, PE sponsors continue to own significant amounts of portfolio companies' equity following an IPO or de-SPAC transaction. As a result, PE sponsors' ownership interests and rights and the nature of any affiliate transactions

with portfolio companies will be subject to public disclosure and scrutiny. PE sponsor management and monitoring agreements commonly terminate in connection with IPOs.

Seeking to retain control over their post-IPO stake and ultimate exit, PE sponsors often obtain registration rights and adopt favorable bylaw and charter provisions, including board nomination rights, permitted stockholder action by written consent and rights to call special stockholder meetings. Because many U.S. public companies elect board members by plurality vote, PE sponsors often retain the right to nominate specific numbers of directors standing for reelection following the IPO. Absent submission of nominees by third-party stockholders through proxy contests, which are unusual in the United States, PE sponsors can ensure election of their nominees. As these favorable PE rights are unusual in U.S. public companies, the rights often expire when the sponsor's ownership falls below specified thresholds.

Unlike private companies, most U.S. public companies are subject to governance requirements under stock exchange rules such as independent director requirements.

7.2 What customary lock-ups would be imposed on private equity sellers on an IPO exit?

The underwriters in an IPO typically require PE sellers to enter into lock-up agreements that prohibit sales, pledges, hedges, etc. of shares for 180 days following the IPO. After the expiration of the lock-up period, PE sponsors will continue to be subject to legal limitations on the sale of unregistered shares, including limitations on the timing, volume and manner of sale, and in club deals they may remain subject to coordination obligations with other sponsors.

7.3 Do private equity sellers generally pursue a dual-track exit process? If so, (i) how late in the process are private equity sellers continuing to run the dual-track, and (ii) were more dual-track deals ultimately realised through a sale or IPO?

Depending on market conditions, PE sponsors may simultaneously pursue exit transactions through IPOs and private auction sales. Dual-track transactions often maximize the price obtained by sellers (through higher IPO multiples or increased pricing pressure on buyers), lead to more favorable transaction terms and provide sellers with greater execution certainty. The path pursued will depend on the particular circumstances of the process, but ultimate exits through private auction sales remain the most common, although exits through SPAC IPOs have become increasingly common.

Dual-track strategies have historically depended on the size of the portfolio company and attendant market conditions. Dual-track approaches are less likely for small- to mid-size portfolio companies, where equity values may be insufficient to warrant an IPO. In addition, such companies are less likely to have sufficient resources to concurrently prepare for both an IPO and third-party exit. As volatility in IPO markets increases, PE firms generally focus more on sales through private auctions where closing certainty and predictable exit multiples are more likely.

8 Financing

8.1 Please outline the most common sources of debt finance used to fund private equity transactions in your jurisdiction and provide an overview of the current state of the finance market in your jurisdiction for such debt (particularly the market for high yield bonds).

The most common debt sources are bank loans, private debt (known as "direct lending") and high-yield bonds. Debt is categorized by its place in the capital structure and the associated risk to the lender. Senior debt ranks above all other debt and equity of the business and is first in line for repayment. Senior secured debt includes revolving facilities, with advances made on the basis of borrowing bases (asset-based loans) or cash flow, and term debt. Second lien or junior lien loans are equal in right of payment to holders of senior secured debt but rank behind such holder's security in the assets of the business. Mezzanine and other subordinated debt is subordinated in right of payment to senior debt, often unsecured and sometimes includes equity kickers. Unitranche facilities combine senior and subordinated debt in one facility, typically with a blended rate of interest.

Leveraged loans are currently favored over high-yield bonds due to competitive pricing, similar flexible covenant terms, ease of amendment and limited prepayment premiums, although notably high-yield bond issuances increased substantially year over year from 2019. Query whether an anticipated future environment of rising interest rates in the United States may tilt borrowers back slightly, towards fixed-rate bonds that continue to be available at historically low coupons, potentially allowing them to avoid the effects of rising interest rates and floating rate instruments.

Direct lenders continue to be important market players and have competitive advantages over traditional bank lenders. Those advantages initially stemmed from constraints on traditional bank lenders imposed by capital requirement guidelines and from regulatory restrictions affecting loans exceeding certain leverage thresholds. While those guidelines and restrictions have been pulled back for now, borrowing from direct lenders has continued to be a trend in light of the amount of money in the market generally and such lenders' flexibility in commitment amounts, loan terms and speed of execution.

8.2 Are there any relevant legal requirements or restrictions impacting the nature or structure of the debt financing (or any particular type of debt financing) of private equity transactions?

The push for deregulation in the United States continued with a rollback of Dodd-Frank Act regulations, including the Volcker Rule, a regulation that was meant to prohibit banks from making speculative bets with their own capital. The result was a final Volcker Rule in October of 2020, which increased potential transactions that would be permitted by covered funds or exempted from covered funds restrictions, addressed extraterritorial treatment of certain foreign funds, eliminated the 3% cap on ownership of a venture capital fund and allowed banks to invest in credit funds, among other changes. With a new administration in 2021, there has been discussion that leveraged lending restrictions may increase by instituting mandatory limitations (rather than mere guidance) on leverage ratios and implementing regulatory oversight over direct lenders.

8.3 What recent trends have there been in the debt financing market in your jurisdiction?

The most important trends in the U.S. loan market relate to the after-effects of the COVID-19 pandemic on the credit facilities of portfolio companies and include the following:

- Despite disruption to the loan markets due to the lockdowns across the United States, loan markets have proved resilient, benefitting from low interest rates and pent-up demand in the mergers and acquisitions market. Generally, borrowers are obtaining favorable terms and loan documentation in line with what was available in the borrower-friendly, pre-COVID-19 market. PE sponsors are taking advantage of this market buoyancy by working on a record number of dividend recapitalizations.
- PE sponsors and management have carefully reviewed the definition of "EBITDA" in credit facilities and have pushed to have specific addbacks attributable to the health crisis and attendant costs and expenses that may be incurred in connection therewith. These addbacks have tended to be relatively circumscribed.
- With government-mandated lockdowns lifting, PE sponsors, management and lenders are seeking to enter into longer-term solutions for businesses affected by the pandemic. In addition, borrowers with less certain credit quality are facing a hangover of terms that were implemented in the COVID era, including "anti-hoarding" provisions that would require the regular repayment of cash over an agreed-upon threshold or a prohibition on borrowing when cash balances exceed an agreed-upon level.

9 Tax Matters

9.1 What are the key tax considerations for private equity investors and transactions in your jurisdiction? Are off-shore structures common?

For non-U.S. investors, considerations include structuring the fund and investments in a manner that prevents investors from having direct exposure to U.S. net income taxes (and filing obligations) and minimizes U.S. tax on dispositions or other events (e.g., withholding taxes). Holding companies ("blockers") are often used and, in some cases, domestic statutory exceptions or tax treaties may shield non-U.S. investors from direct exposure to U.S. taxes.

For U.S. investors, considerations include minimizing a "double tax" on the income or gains and, in the case of non-corporate U.S. investors, qualifying for reduced tax rates or exemptions on certain dividend and long-term gains.

There is also a focus in transactions on maximizing tax basis in assets and deductibility of costs, expenses and interest on borrowings, as well as state and local income tax planning.

9.2 What are the key tax-efficient arrangements that are typically considered by management teams in private equity acquisitions (such as growth shares, incentive shares, deferred / vesting arrangements)?

Tax-efficient arrangements depend on portfolio company tax classification. For partnerships (including LLCs taxed as partnerships), profits interests can provide meaningful tax efficiencies for management. Profits interests are granted for no consideration and entitle holders to participate only in company appreciation (not capital), and provide holders with the possibility of reduced tax rates – under the current tax regime – on long-term capital gains (but do have certain complexities not present in less tax-efficient alternatives). Other types of economically similar arrangements (non-ISO stock options, restricted stock units and phantom equity) do not generally allow for this same capital gain treatment.

Profits interests are not available for corporations. In certain cases, the use of restricted stock that is subject to future vesting (together with the filing of an 83(b) election) can enable a holder – under the current tax regime – to benefit from reduced tax rates on long-term capital gains.

9.3 What are the key tax considerations for management teams that are selling and/or rolling-over part of their investment into a new acquisition structure?

Management investors selling their investment focus on qualifying for preferential tax rates or tax deferrals on income.

Management investors rolling part of their investment seek to roll in a tax-deferred manner, which may be available depending on the nature of the transaction and management's investment. In some cases (such as phantom or restricted stock unit plans), tax deferral is not achievable or may introduce significant complexity.

9.4 Have there been any significant changes in tax legislation or the practices of tax authorities (including in relation to tax rulings or clearances) impacting private equity investors, management teams or private equity transactions and are any anticipated?

There have been a number of significant changes in recent years. Significant changes to the tax audit process have become effective, and significant tax reform enacted in 2017, commonly referred to as the Tax Cuts and Jobs Act, resulted in many significant changes to the U.S. income tax system. Most recently, and related to the COVID-19 pandemic, there has been a series of tax legislation and non-legislative changes impacting the U.S. income tax system. This has included new rules that create or modify tax laws related to deductions for interest expense, use of carrybacks, and deductions for the expense of certain types of property, the extension of deadlines for tax payments and tax returns, payroll tax incentives including new refundable tax credits and payment deferrals. It is possible that further legislation or other initiatives relating to COVID-19 matters could be enacted.

These changes could impact the timing and amount of deductions and tax payments of portfolio companies, and therefore will be relevant to PE transactions involving U.S. companies.

Careful consideration and attention should be given to developments in this area. Future tax legislation and other initiatives could result in additional meaningful changes to the U.S. income tax system.

10 Legal and Regulatory Matters

10.1 Have there been any significant legal and/or regulatory developments over recent years impacting private equity investors or transactions and are any anticipated?

See question 1.3 for a discussion of certain government programs implemented in response to the COVID-19 pandemic. The Tax Cuts and Jobs Act was enacted in 2017 and, more recently, there have been legislative and other tax initiatives related to the COVID-19 pandemic. See section 9.

The enactment of FIRRMA in August 2018 and the implementation of related regulations that culminated in late 2020 has led to significant reforms to CFIUS. In particular, the scope of transactions that could be subject to CFIUS review has been expanded, certain filings are now mandatory, and there is an increased focus on particularly sensitive industries. These changes have led to increased timing delays for transactions that require CFIUS review and increased uncertainty as to whether CFIUS might seek to impose significant measures to mitigate potential national security concerns in a manner that might materially impact the structure of the transaction.

10.2 Are private equity investors or particular transactions subject to enhanced regulatory scrutiny in your jurisdiction (e.g. on national security grounds)?

There is enhanced scrutiny by CFIUS of transactions involving non-U.S. investors and U.S. businesses that operate in industries, or otherwise deal with technologies, that are deemed to be sensitive from a national security perspective. Transactions involving Chinese investors, in particular, continue to be subject to intense scrutiny by CFIUS. In addition, FIRRMA expanded CFIUS' jurisdiction to enable review not only of investments in which non-U.S. investors might be acquiring control over U.S. businesses (which have always been subject to CFIUS review), but also certain investments in which non-U.S. persons would gain certain rights involving appointment of directors, access to material non-public technical information, or other substantive decision-making board appointment rights even in the absence of control. Investments by non-U.S. entities that are partially or wholly owned by non-U.S. governments also are subject to heightened scrutiny and might trigger mandatory filing requirements. There are exceptions, however, for certain PE investments made through partnerships in which the general partner is a U.S. entity or is domiciled in an "excepted state" (which currently includes Australia, Canada, and the United Kingdom).

10.3 How detailed is the legal due diligence (including compliance) conducted by private equity investors prior to any acquisitions (e.g. typical timeframes, materiality, scope, etc.)?

The scope, timing and depth of legal due diligence conducted by PE sponsors in connection with acquisitions depends on, among other things, the transaction size, the nature and complexity of the target's business and the overall transaction timeline. Sponsors may conduct certain diligence in-house, but outside counsel typically handles the bulk of legal diligence. Specialized advisers may be retained to conduct diligence in areas that require particular expertise. PE sponsors have been increasing their focus on due diligence regarding ESG and data security.

10.4 Has anti-bribery or anti-corruption legislation impacted private equity investment and/or investors' approach to private equity transactions (e.g. diligence, contractual protection, etc.)?

PE buyers and counsel will evaluate the target's risk profile with respect to anti-bribery and anti-corruption legislation, including the Foreign Corrupt Practices Act ("FCPA"). The risk profile depends on, among other things, whether the target conducts foreign business and, if so, whether any of the business is conducted (i) in high-risk regions (e.g., China, India, Venezuela, Russia and other former Soviet countries and the Middle East), (ii) with foreign government customers, or (iii) in industries with increased risk for violations (e.g., defense, aerospace, energy and healthcare). Diligence will be conducted based on the risk profile. Possible violations identified need to be thoroughly evaluated and potentially self-reported to the relevant enforcement authorities.

The DOJ may impose successor liability and sanctions on PE buyers for a target's pre-closing FCPA violations. PE buyers typically obtain broad contractual representations from sellers regarding anti-bribery and anti-corruption matters and often insist on compliance enhancements to be implemented as a condition of investment.

10.5 Are there any circumstances in which: (i) a private equity investor may be held liable for the liabilities of the underlying portfolio companies (including due to breach of applicable laws by the portfolio companies); and (ii) one portfolio company may be held liable for the liabilities of another portfolio company?

Fundamentally, under U.S. law, businesses operated as legally recognized entities are separate and distinct from owners. Consequently, PE sponsors generally will not be liable for acts of portfolio companies. However, there are several theories under which "corporate" form will be disregarded. These include:

(i) Contractual liability arising to the extent the PE sponsor has agreed to guarantee or support the portfolio company.
(ii) Common law liability relating to: (a) veil piercing, alter ego and similar theories; (b) agency and breach of fiduciary duty; and (c) insolvency-related theories. Most often, this occurs when the corporate form has been misused to accomplish certain wrongful purposes or a court looks to achieve a certain equitable result under egregious circumstances.
(iii) Statutory control group liability relating to securities, employee benefit and labor laws, the FCPA and consolidated group rules under tax laws.

The two most common areas of concern relate to potential liabilities under U.S. environmental laws and employee benefit laws. The Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") can impose strict liability on owners and/or operators of a facility with respect to releases of hazardous substances at the facility owned or operated by the portfolio company. However, unless PE sponsors exercise actual and pervasive control of a portfolio company's facility by actually involving themselves in the portfolio company's daily operations at the facility or its environmental activities, they should not be exposed to liability as an operator of such facility. Parents also should not have indirect or derivative liability for the portfolio company's liability under CERCLA, unless there is a basis for veil piercing.

Under the Employee Retirement Income Security Act ("ERISA"), when a subsidiary employer terminates a qualified defined benefit pension plan, all members of the subsidiary control group become jointly liable. Control groups arise among affiliates upon "the ownership of stock possessing at least 80% of total combined voting power of all classes of stock entitled to vote or at least 80% of the total value of shares of all classes of stock of such corporation."

ERISA imposes joint and several liability on any person who, upon termination of a plan, is a contributing sponsor of the plan or a member of the person's controlled group. As a result, all affiliated companies (including the PE sponsor and other portfolio companies) may face liability when an inadequately funded plan terminates, provided that the 80% control test is satisfied.

11 Other Useful Facts

11.1 What other factors commonly give rise to concerns for private equity investors in your jurisdiction or should such investors otherwise be aware of in considering an investment in your jurisdiction?

Contract law in the United States embraces the freedom to contract. Absent public policy limits, PE sponsors in U.S. transactions are generally able to negotiate and agree upon a wide variety of transaction terms in acquisition documents that satisfy their underlying goals.

Transaction parties should expect increased regulation in the United States. In particular, new regulations should be expected in the arenas of cybersecurity and protection of personal data (both at the federal and state level) that will affect both how diligence is conducted and how portfolio companies operate. Taxes continue to be a key value driver in PE transactions, with IRRs and potential risks depending on tax considerations. See section 9.

Increased attention must be paid to potential CFIUS concerns, particularly given recent reforms and the political climate. Non-U.S. PE investors should be aware that investing in a U.S. business might trigger mandatory filing requirements. Even if a filing is not mandatory, it nonetheless may be advisable to submit a voluntary filing in order to avoid deal uncertainty, as CFIUS has the ability to open a review even after closing has occurred and could even require divestment. CFIUS considerations will remain a key issue for PE sponsors regarding foreign investments in 2021. See section 10.

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