Seyfarth

Middle Market M&A SurveyBook

2020 Survey of Key M&A Deal Terms

Introduction

Seyfarth Shaw LLP is pleased to present the 7th edition of its Middle Market M&A SurveyBook ("Survey") which analyzes key transaction terms from more than 100 middle market private target acquisition agreements signed in 2019.[1] The information presented is intended to serve as a guide to buyers, sellers, and deal professionals on "what's market" when negotiating these terms in private target acquisition agreements in 2020.

The Survey focuses on key deal terms, including those comprising the "indemnity package" included in almost all private target acquisition agreements to address a seller's potential post-closing liability to a buyer and to set the parameters of a buyer's ability to claw back purchase price from a seller. Each deal, of course, has unique facts and circumstances that affect the negotiation of the acquisition agreement, including, significantly, the relative leverage of the buyer and seller. It is nonetheless helpful when negotiating an acquisition agreement to have a strong understanding of where the terms of your "indemnity package" fall in the current market spectrum.

Given the substantial and continued growth in the use of representation and warranty ("R&W") insurance in private middle market M&A transactions, in this year's Survey, we have continued to track data from deals that included R&W insurance separately from deals where no R&W insurance was utilized. Approximately 55% of the transactions reviewed for the Survey included R&W insurance, compared to approximately 40% of the transactions in 2018. Buyers increasingly use R&W insurance in acquisition proposals to make their bids more competitive and attractive to sellers. Not surprisingly, the terms of the typical indemnity package differ substantially between transactions in which R&W insurance is utilized and non-R&W insurance deals. For example, the indemnity escrow amount and indemnity cap size are typically drastically lower in transactions that use R&W insurance as compared to transactions that do not use such insurance. Similar to 2018, in 2019 we saw a growing number of "no survival" private target acquisitions, in which the buyer's only recourse for breaches of representations and warranties was to the R&W insurance policy, or to an escrow related to the amount of the policy deductible, and then to the R&W insurance policy.

Again this year, the Survey also considers the number of private target acquisition agreements that included "fraud" exceptions to certain limitations on buyers' indemnification rights and remedies, such as caps and baskets, and whether and how "fraud" was defined across those transactions.

Looking through a broader lens, 2019 presented a slight drop in the number, and the aggregate value, of US deals compared to 2018. However, 2019 was historically the third best year in US deal making in the last two decades.[2] Despite a prolonged period of uncertainty related to the UK's Brexit plans, concerns about US interest rates, US-China trade tensions, and a growing consensus that after a bull run, markets and the economy were approaching the top of the cycle, the sustained high level of deal activity continued through 2019.[3]

These concerns, the characteristic ambiguity around the US presidential election, and now the unprecedented COVID-19 pandemic ("COVID-19") and its cataclysmic impact on global and US markets, will undoubtedly have at least a short-term negative impact on M&A activity in 2020. Prior to COVID-19, dealmakers were cautiously optimistic that steady economic growth, continued low interest rates, and record levels of capital would sustain the M&A momentum

through 2020,[4] [5] but the impact of COVID-19 has dampened any optimistic mood around M&A activity in the short-term and possibly longer.

As of the date of publication of this Survey, the length and depth of the long-term economic impact of COVID-19 on the US and global economies is highly uncertain and the full scale of the global supply chain disruptions is unknown. In addition, as a result of efforts to stop the spread of COVID-19, including "shelter in place" and "social distancing" initiatives, many segments of the economy have been shuttered entirely for a period of time which will result in a spike in the unemployment rate, among other adverse ramifications. The initial forecasts of many economists expect a significant contraction in the US economy through at least the second quarter of 2020, with the hope of a bounce back in the latter part of the year.[6] This sentiment ties to the optimism by some that dealmakers are merely pausing transactions during the current period of uncertainty.[7]

We hope that you find the information presented in this Survey valuable, and we welcome the opportunity to further discuss our findings with you.

What's Inside:

[1] For purposes of this Survey, "middle market" means transactions with a purchase price of less than $1 billion, and "purchase price" means the total cash consideration paid by the buyer in a transaction but does not include contingent purchase price payments (e.g., earnouts). This Survey does not include any transactions that involved the payment of consideration other than cash.

[2] *The State of the Deal, M&A Trends 2020*, Deloitte.

[3] *M&A in 2020*, Morgan Stanley.

[4] *2020 Global M&A Outlook,* J.P. Morgan; *M&A in 2020*, Morgan Stanley.

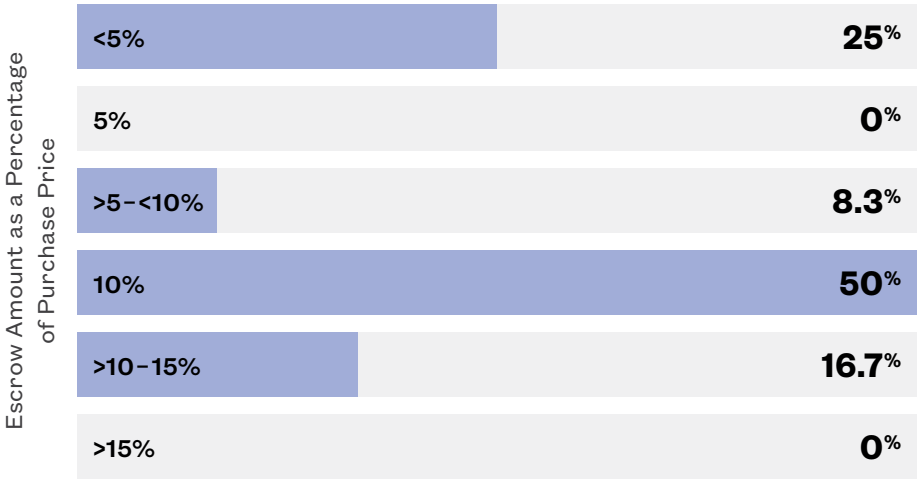
[5] *Year-End Review and 2020 Outlook*, PWC.

[6] *U.S. Braces for Sharp Economic Downturn as Coronavirus Bears Down*, The Wall Street Journal.

[7] *PE Clients See Opportunity Despite Coronavirus Effects*, Law360.

Indemnity Escrow Amount

NO R&W INSURANCE



Percentage of Deals Surveyed Providing for Indemnity Escrow

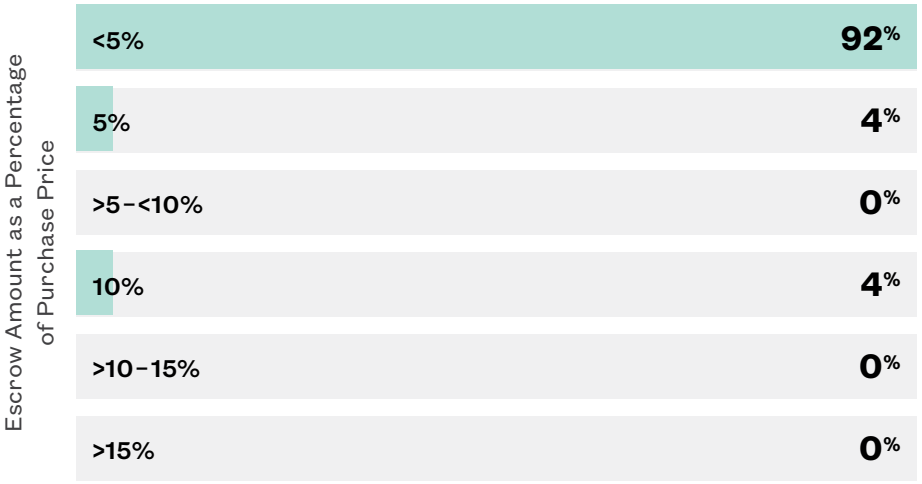
OBSERVATIONS

- Approximately 25% of the non-insured deals surveyed provided for an indemnity escrow (as compared to approximately 37.5% in 2018). The reduction in the number of deals providing for indemnity escrow is likely as a result of the increase in the number of "no survival" deals.
- The median escrow amount in 2019 for the non-insured deals surveyed was approximately 10% of the purchase price (consistent with 2018), with approximately 83% of the non-insured deals having an indemnity escrow amount of 10% or less but only approximately 25% of the non-insured deals having an indemnity escrow amount of 5% or less.

*__IMPORTANT NOTE:__ Data included under "no R&W insurance" sections reflects deals where no R&W insurance was utilized, or where we were unable to confirm whether R&W insurance was used based on a review of the acquisition, as confirmed by the acquisition agreement. Data included under "R&W insurance" sections reflects deals where R&W insurance was used.

Indemnity Escrow Amount

R&W INSURANCE



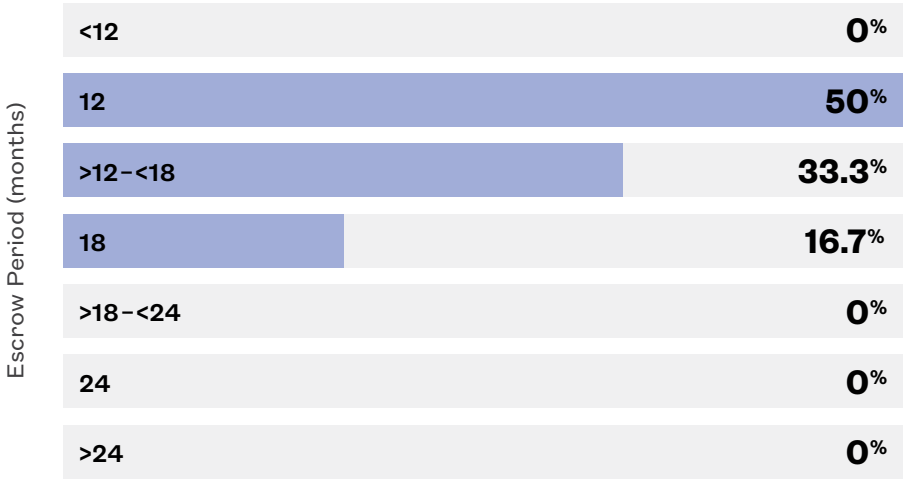
Percentage of Deals Surveyed Providing for Indemnity Escrow

OBSERVATIONS

- Approximately 43% of the insured deals surveyed provided for an indemnity escrow (as compared to approximately 55% in 2018). The reduction in the number of deals providing for indemnity escrow is likely as a result of the increase in the number of "no survival" deals.
- The median escrow amount in 2019 for the insured deals surveyed was approximately 0.6% of the purchase price (as compared to approximately 0.9% in 2018). It is plain to see the dramatic impact that R&W insurance has on the indemnity escrow amount (0.6% versus 10% for non-insured deals).
- The vast majority of insured deals had an indemnity escrow amount of less than 5% and, of those deals, approximately 91% had an escrow amount of 1% or less. This is consistent with the prevailing R&W insurance structure of including a retention (deductible) equal to approximately 1% of deal value. Depending on the negotiating leverage of the parties, the indemnity escrow will typically cover a portion or all of the retention under the R&W policy, and also act as the indemnity cap under the purchase agreement for breaches of representations and warranties.

Indemnity Escrow Period

NO R&W INSURANCE



Percentage of Deals Surveyed Providing for Indemnity Escrow

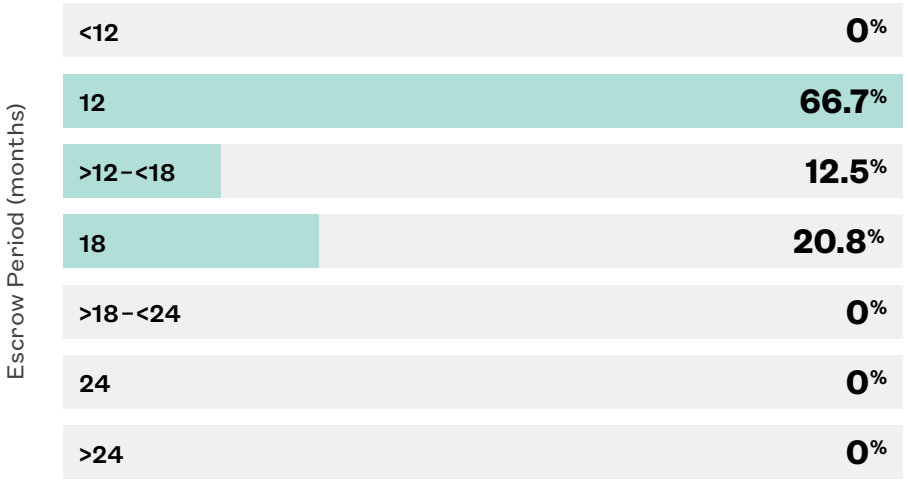
OBSERVATIONS

Of the non-insured deals surveyed which provided for an indemnity escrow:

- 100% had an indemnity escrow period of 12-18 months.
- The median indemnity escrow period was 13.5 months. This reflects a decrease from 2018 and shows a trend of continuing seller strength during 2019.

Indemnity Escrow Period*

R&W INSURANCE



Percentage of Deals Surveyed Providing for Indemnity Escrow

OBSERVATIONS

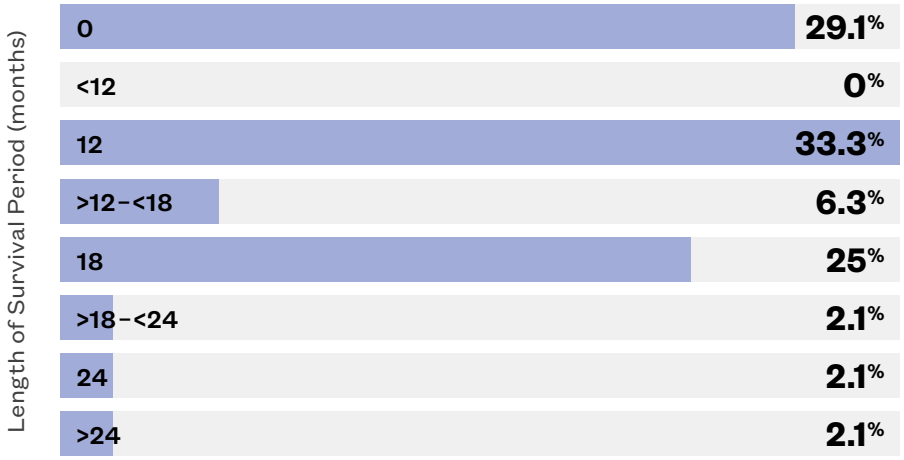
Of the insured deals surveyed which provided for an indemnity escrow:

- 100% had an indemnity escrow period of 12-18 months.
- The median indemnity escrow period was 12 months. This reflects a decrease from 2018 and shows a trend of continuing seller strength during 2019.

*__IMPORTANT NOTE:__ A limited number of the deals surveyed had escrow periods of 24 months or greater, and were not included for purposes of the calculations in this chart due to the deal specific nature of such transactions that caused the inclusion of extended escrow periods. This highlights that the specific facts and circumstances of each deal will often carry the day in deal negotiations even if "not market."

Representation & Warranty General Survival Period

NO R&W INSURANCE

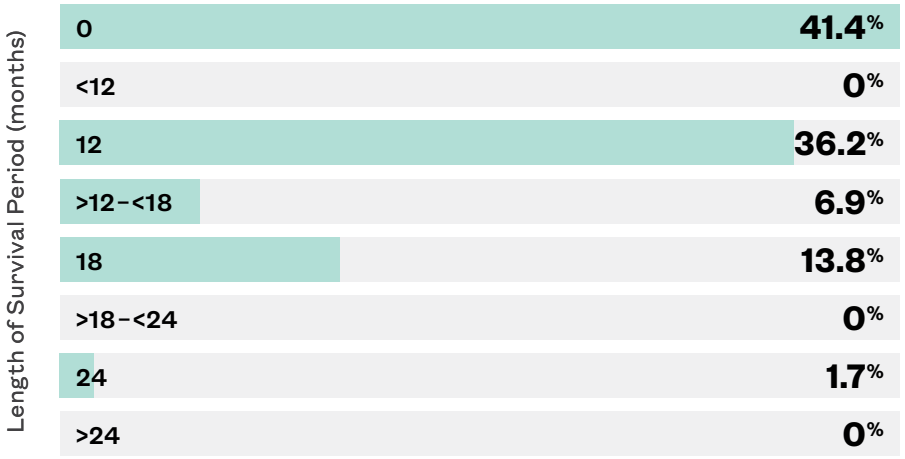


OBSERVATIONS

- The median general survival period for non-insured deals surveyed was 12 months. This reflects a decrease after having consistently remained at 15 months since 2013.
- Only approximately 6% of deals surveyed had survival periods of greater than 18 months, which is generally consistent with the results from prior years where such deals represented only a small percentage of the total number of deals surveyed.
- Note that the data above is somewhat skewed due to the increase in the number of "no survival" deals. Without taking such "no survival" deals into account, approximately 47% of the deals surveyed had a 12 month general survival period, approximately 9% had a survival period of more than 12 and less than 18 months, approximately 35% had a survival period of 18 months, and the median survival period would be 15 months, which is consistent with prior years.

Representation & Warranty General Survival Period

R&W INSURANCE

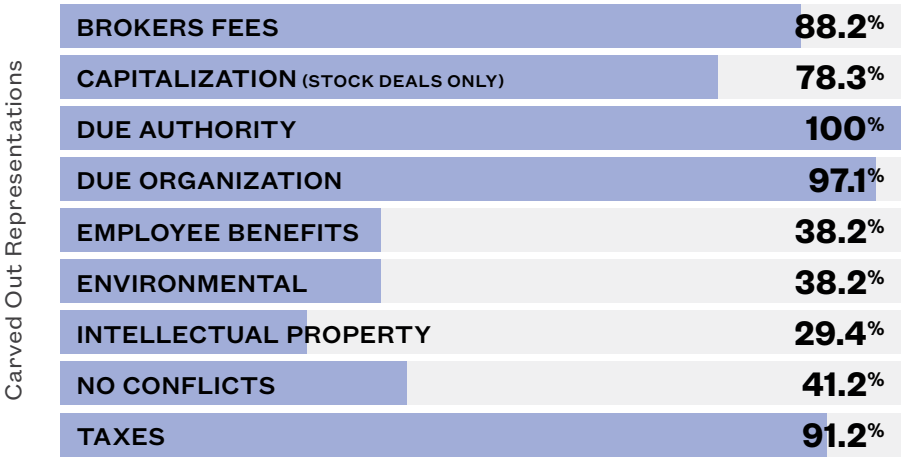


OBSERVATIONS

- The median general survival period for insured deals surveyed was 12 months, which is consistent with 2018 and 2017.
- Approximately 41% of insured deals were "no survival" deals in which the seller had no obligation to indemnify the buyer for breaches of the general representations and warranties. This represents an approximately 15% increase from 2018 in "no survival" deals. Of course, the R&W insurance policy makes a "no survival" framework more palatable for a buyer as the policy typically provides coverage for breach of general representations for three years. The continuing increase in "no survival" deals reflects an even greater reliance on R&W insurance as the primary remedy for buyers under purchase agreements for breaches of representations and warranties.
- Note that the data above is somewhat skewed due to the increase in the number of "no survival" deals. Without taking such "no survival" deals into account, approximately 59% of the deals surveyed had a 12 month general survival period, approximately 13% had a survival period of more than 12 and less than 18 months, approximately 25% had a survival period of 18 months, and the median survival period would be 12 months, which is consistent with prior years.

Carve Outs to General Survival Period*

NO R&W INSURANCE



Percentage of Deals Surveyed in Which Applicable Representation Was Carved Out

OBSERVATIONS

Employee Benefits

- The percentage of non-insured deals surveyed that carved out representations and warranties regarding employee benefits was approximately 38% in 2019.

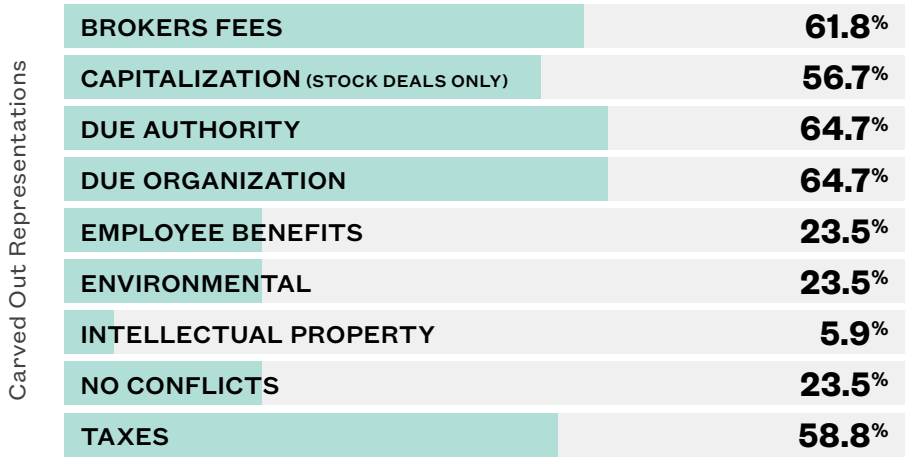
Environmental

- The percentage of non-insured deals surveyed that carved out representations and warranties regarding environmental matters was approximately 38% in 2019.

***IMPORTANT NOTE:** The calculations for the charts on pages 9 and 10 do not include no survival deals where representations and warranties do not survive as a general matter (as the concept of carve-outs to survival periods is not applicable to such deals).

Carve Outs to General Survival Period*

R&W INSURANCE



Percentage of Deals Surveyed in Which Applicable Representation Was Carved Out

OBSERVATIONS

Employee Benefits

- The percentage of insured deals surveyed that carved out representations and warranties regarding employee benefits was approximately 24% in 2019.

Environmental

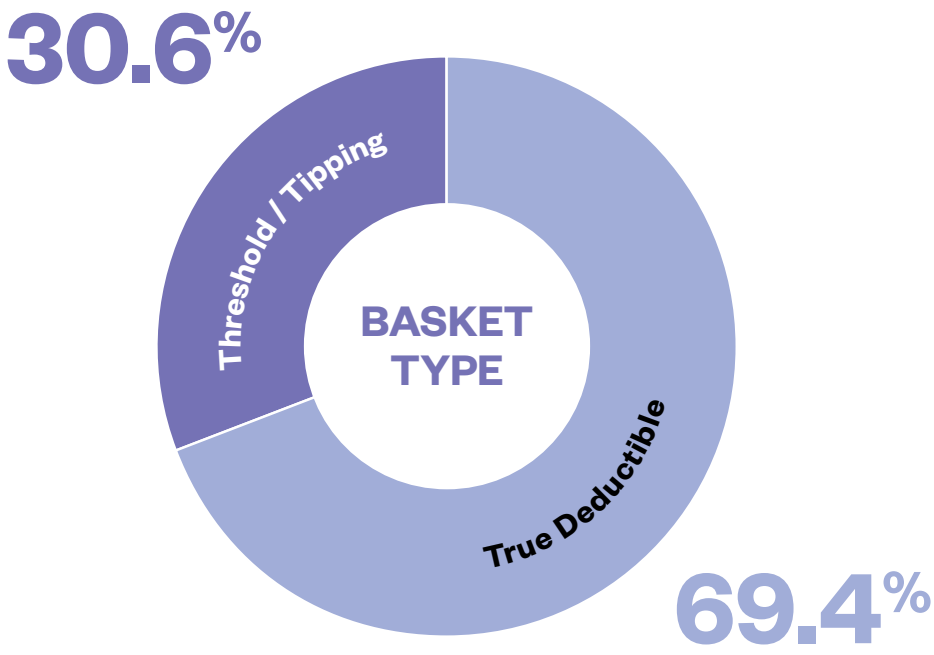
- The percentage of insured deals surveyed that carved out representations and warranties regarding environmental matters was approximately 24% in 2019.

Due Authority, Due Organization and Capitalization

- Approximately 65% of insured deals surveyed carved out representations and warranties regarding due authority and due organization, as compared to almost 100% of non-insured deals. Approximately 57% of insured deals surveyed carved out representations and warranties regarding capitalization (with respect to stock deals), as compared to approximately 78% of non-insured deals.
- In insured deals, the R&W policy generally provides six years of coverage for fundamental representations.

Indemnity Basket Type

NO R&W INSURANCE

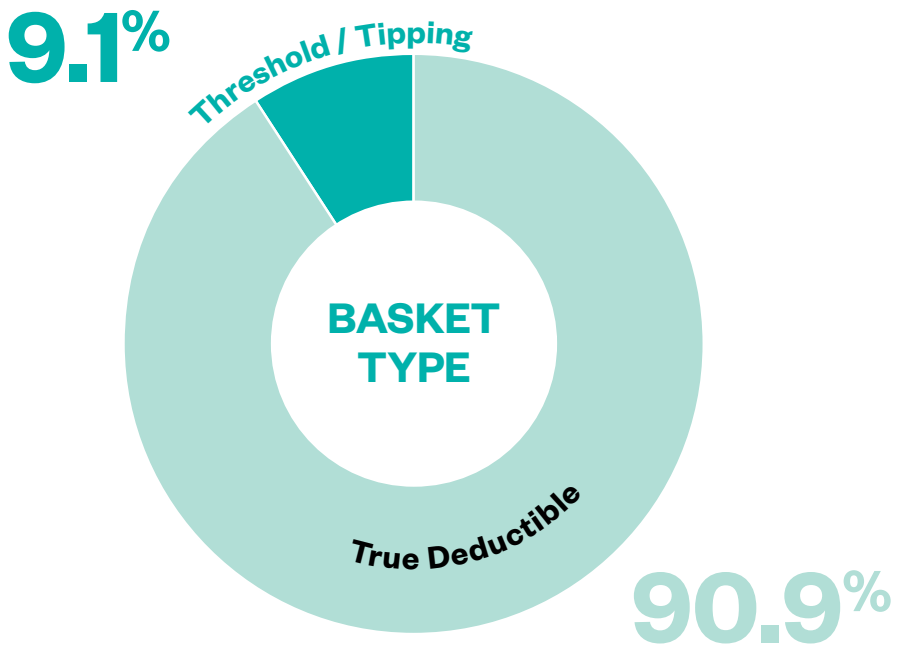


OBSERVATIONS

- Approximately 75% of non-insured deals surveyed provided for an indemnity basket, compared to approximately 90% in 2018, which is likely due to the larger number of "no survival" deals in 2019 deals surveyed. Taking out the "no survival" deals, approximately 97% provided for indemnity baskets.
- Of the non-insured deals providing for an indemnity basket, approximately 31% were structured as threshold/tipping baskets and approximately 69% were structured as a deductible, which is consistent with 2018.

Indemnity Basket Type

R&W INSURANCE

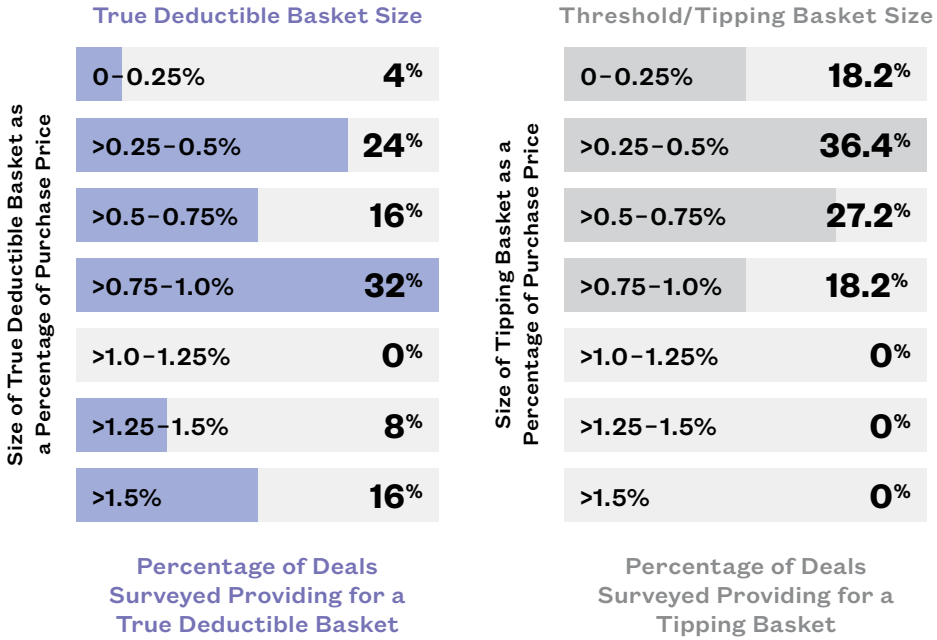


OBSERVATIONS

- Approximately 57% of insured deals surveyed provided for an indemnity basket, compared to approximately 73% in 2018, which is likely due to the larger number of "no-survival" deals in 2019 deals surveyed. Taking out the "no survival" deals, approximately 91% provided for indemnity baskets.
- Of the insured deals providing for an indemnity basket, approximately 9% were structured as threshold/tipping baskets and approximately 91% were structured as a deductible, which is consistent with 2018.

Indemnity Basket Size

NO R&W INSURANCE

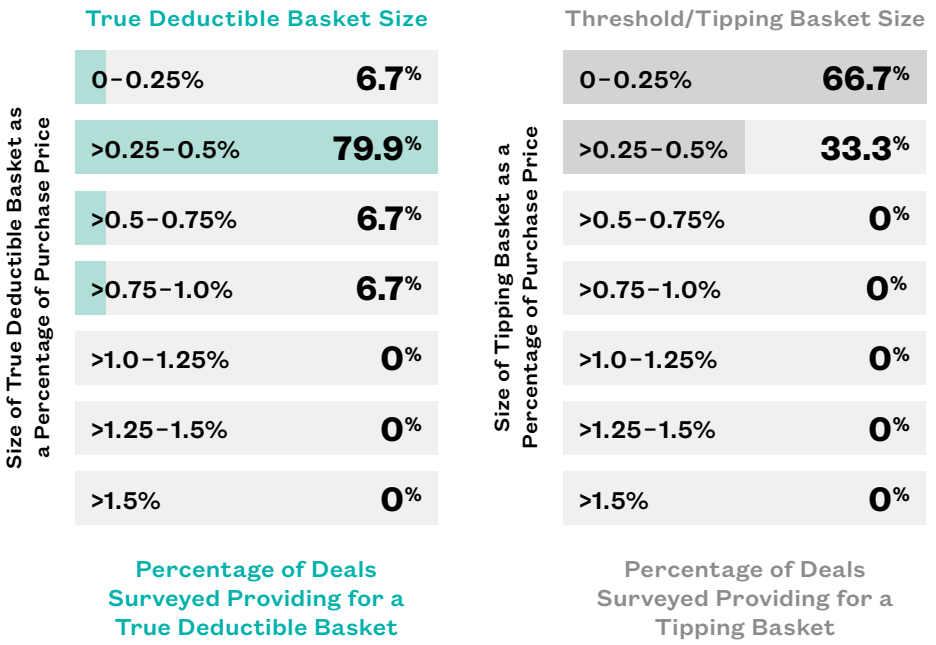


OBSERVATIONS

- The median basket size in non-insured deals surveyed in 2019 was 0.7% of the purchase price, which is consistent with 2018.
- Approximately 76% of deals with a deductible had a basket size of 1% or less, and approximately 44% had a deductible basket size of 0.75% or less.
- 100% of deals with a tipping basket had a basket size of 1% or less, and approximately 82% had a tipping basket size of 0.75% or less.

Indemnity Basket Size

R&W INSURANCE

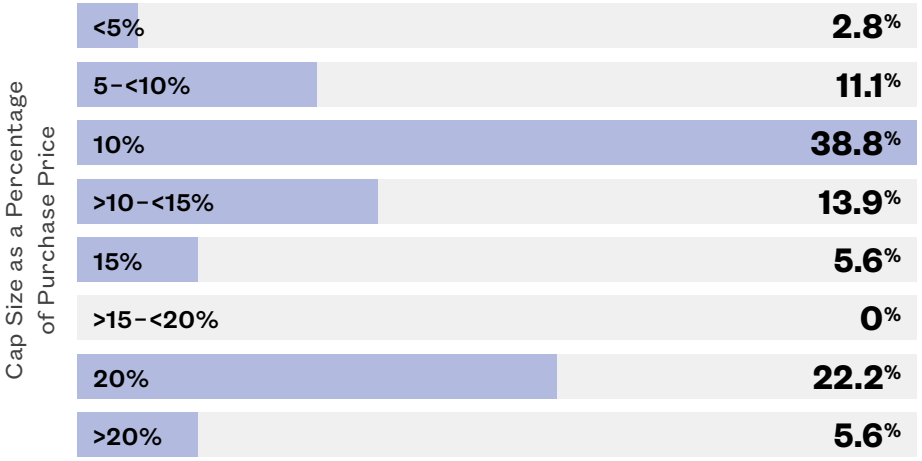


OBSERVATIONS

- The median basket size in insured deals surveyed in 2019 was 0.5% of the purchase price, which is consistent with 2018.
- Approximately 87% of deals with a deductible had a basket size of 0.5% or less, and approximately 93% had a deductible basket size of 0.75% or less.
- 100% of deals with a tipping basket had a basket size of 0.5% or less.

Indemnity Cap Size

NO R&W INSURANCE



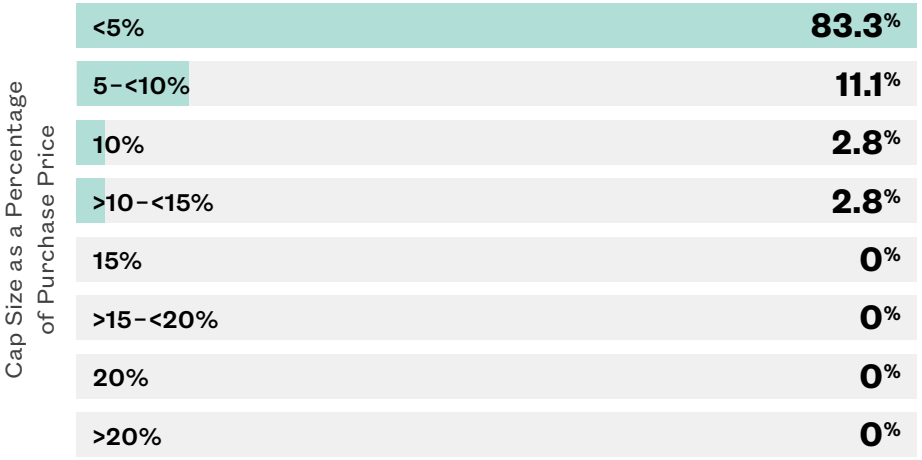
Percentage of Deals Surveyed Providing for Indemnity Cap

OBSERVATIONS

- Approximately 75% of non-insured deals surveyed had an indemnity cap, compared to approximately 90% in 2018. The decrease in number of deals with an indemnity cap was due to the increase in "no survival" deals, which removed the need for an indemnity cap related to representations and warranties. Without taking the "no survival" deals into account, approximately 97% provided for an indemnity cap.
- The median indemnity cap for non-insured deals surveyed was 10% in 2019, which is the same as 2018.
- Approximately 53% had an indemnity cap of 10% or less, and approximately 72% had an indemnity cap of 15% or less.

Indemnity Cap Size

R&W INSURANCE



Percentage of Deals Surveyed Providing for Indemnity Cap

OBSERVATIONS

- Approximately 62% of insured deals surveyed had an indemnity cap, compared to approximately 78% in 2018. The decrease in number of deals with an indemnity cap was due to the increase in "no survival" deals, which removed the need for an indemnity cap related to representations and warranties. Without taking the "no survival" deals into account, approximately 97% provided for an indemnity cap.
- The median indemnity cap for insured deals surveyed was 0.5% in 2019, which is the same as 2018.
- As is evident when compared to non-insured deals, the use of R&W insurance will typically greatly reduce the seller's indemnity cap under the purchase agreement (this is due to the fact that the buyer can seek recourse under the R&W insurance policy).

Fraud Exceptions and Definitions

Private target middle market acquisition agreements often include fraud exceptions to certain limitations on buyers' indemnification rights and remedies, such as caps and baskets. Unless "fraud" is carefully defined in the agreement, however, a seller may find itself subject to post-closing liability for more than intended by the fraud exception. In this year's Survey, we have continued to analyze the percentage of deals that included fraud carve outs to certain limitations on liability, and continued to track the percentage of deals that limited fraud to intentional acts, and the percentage of deals that limited fraud to the representations and warranties made in the acquisition agreement.

NO R&W INSURANCE	R&W INSURANCE
Fraud Exception	
Approximately 83% of non-insured deals surveyed in 2019 included fraud exceptions to certain indemnity provisions of the agreement. This is consistent with 2018.	Approximately 98% of insured deals surveyed in 2019 included fraud exceptions to certain indemnity provisions of the agreement. This is consistent with 2018.
Fraud Defined	
Of the non-insured deals that included a fraud exception, only approximately 31% of these deals defined the term "fraud," compared to approximately 37% in 2018.	Of the insured deals that included a fraud exception, approximately 60% of these deals defined the term "fraud," compared to approximately 65% in 2018.
Of the non-insured deals that defined the term "fraud," approximately 60% limited fraud to those representations and warranties contained in the agreement only, compared to approximately 39% in 2018.	Of the insured deals that defined the term "fraud," approximately 68% limited fraud to those representations and warranties contained in the agreement only, compared to approximately 67% in 2018.
Of the non-insured deals that defined the term "fraud," approximately 80% included an intent prong in the fraud definition, compared to approximately 81% in 2018.	Of the insured deals that defined the term "fraud," approximately 63% included an intent prong in the fraud definition, compared to approximately 77% in 2018.

Following are a few examples of fraud definitions based on the agreements reviewed for the Survey, ordered from most to least seller protective. Note that the most seller protective of the definitions also limits fraud to a particular universe of individuals with actual knowledge of the fraud.

- **"Actual Fraud"** means, with respect to any Person, the intentional (and not constructive) fraud of such Person effected by such Person making a representation or warranty contained in this Agreement with the actual (and not constructive) knowledge of such Person that such representation or warranty was false when made (as opposed to the making of a representation or warranty negligently, recklessly or without actual knowledge of its truthfulness) and which was made with the intention of inducing the Person to whom such representation or warranty was made to enter into or consummate the Transactions and upon which Recipient has reasonably relied to its detriment.

- **"Actual Fraud"** means actual and intentional fraud with respect to the representations and warranties expressly set forth in this Agreement that is committed by the party making such representations or warranties.

- **"Fraud"** means: (a) a false representation of a material fact by a Person; (b) made with knowledge or belief of its falsity; (c) with the intent of inducing another Person to act, or refrain from acting, to such other Person's detriment; and (d) upon which such other Person acted or did not act in reliance on the representation, with resulting Losses, and which shall expressly exclude any other claim of fraud that does not include the elements set forth in this definition, including constructive fraud, negligent misrepresentation or any similar theory.

- **"Fraud"** means actual common law fraud under applicable law.

Choice of Governing Law

The Survey results revealed that Delaware and New York are the most popular "governing law" choices.

NO R&W INSURANCE	R&W INSURANCE
Of the non-insured deals surveyed in 2019, the governing law for 50% was Delaware, 15% was New York, and 35% was "Other."	Of the insured deals surveyed in 2019, the governing law for 74% was Delaware, 10% was New York, and 16% was "Other."

MAE Provisions in the Wake of COVID-19

As a result of the recent unprecedented outbreak of the novel coronavirus ("COVID-19"), dealmakers and their advisors have yet another set of issues to address in connection with pending and future M&A transactions. While the outbreak and its impact is still evolving, it's clear that there will be at least short-term consequences for M&A transactions and the way they are approached.

MAE PROVISIONS

For a buyer in the midst of a pending M&A transaction, one of the first questions that comes to mind is its ability to walk away from a pending acquisition of a target that has suffered or may suffer potentially grave consequences caused by COVID-19; while sellers, on the contrary, are looking at ways to force nervous buyers to close. In their competing analysis, the first stop for parties in a pending M&A transaction will be to review closing conditions, termination rights, and the definition of "material adverse effect" ("MAE") included in their purchase agreement, including whether a pandemic or other health event is excluded from the determination of whether an MAE has occurred.

As a general matter, it is a very tall order for buyers to prove an MAE has occurred in any M&A transaction. Until the recent case of *Akorn, Inc. v. Fresenius Kabi A*G, the Delaware courts had never ruled that an MAE had occurred in an M&A transaction. In Akorn, the Delaware Court of Chancery confirmed that only a serious and substantial downturn in the business which is "durationally significant" could be deemed an MAE and a "short-term hiccup in earnings" will not qualify; such a perspective needs to be "measured in years rather than months." At this point, not enough time has passed yet to determine with any certainty whether the prevalence of the adverse impact resulting from COVID-19 will remain long enough to warrant finding an MAE. Of course, this could change over time depending on the staying power of the pandemic and its negative ramifications. It should be noted that buyers may also be able to look to the "impairment clause" (if any) of the MAE definition (i.e., whether a material adverse effect on the ability of the target to perform its obligations under the M&A agreement or to otherwise close the transaction has occurred) for relief as certain breaches by the target of its covenants under the M&A agreement could trigger this clause.

Given the current circumstances surrounding COVID-19, in negotiating future M&A deals, it would be prudent for sellers to push for express carve outs regarding pandemics and public health events from the definition of the MAE, and also from certain purchase agreement covenants, to make it completely clear that such events cannot be used as an "out" for buyers via an MAE or otherwise. Buyers, on the other hand, will contend that the long-term impact of COVID-19 and the possibility of other similar outbreaks remains unclear, and if there is a long period of time between signing and closing that they need the ability to analyze the ongoing and evolving impact of COVID-19 during the interim period and, at a minimum, buyers should require a disproportionate effects qualifier if they accept any such carve out to the MAE definition at all.

Read more in our Legal Update:
www.seyfarth.com/news-insights/manda-purchase-agreements-in-the-wake-of-covid-19.html

2020 Hart-Scott-Rodino Act Thresholds

The Hart-Scott-Rodino (HSR) Act requires that parties to transactions for the acquisition of voting securities or assets that exceed certain thresholds notify the Federal Trade Commission ("FTC") and U.S. Department of Justice ("DOJ") of the proposed transaction, pay the required fee, and observe a 30 day waiting period before closing so that the agencies can review the deal for potential anticompetitive effects. Effective February 27, 2020, transactions with a value greater than $376 million are generally reportable regardless of the annual net sales or the value of the total assets of the acquiring and acquired entities, while transactions with a value greater than $94 million but less than $376 million are generally reportable if one party to the transaction has annual net sales or total assets valued at $18.8 million or more and the other party has annual net sales or total assets valued at $188 million or more.

The HSR rules provide four additional reporting thresholds: in 2020, parties must report the acquisition of (A) voting securities valued at $188 million or greater but less than $940.1 million; (B) voting securities valued at $940.1 million or greater; (C) 25% of the voting securities of an issuer, if 25% (or any amount above 25% but less than 50%) is valued at greater than $1.88 billion; and (D) 50% of the voting securities of an issuer if valued at greater than $94 million. The filing fees associated with an HSR filing range between $45,000 and $280,000, depending on the size of the transaction, and the HSR reporting thresholds are adjusted annually and are tied to changes in the US gross domestic product.

Due to the COVID-19 pandemic, the FTC and DOJ suspended acceptance of HSR notification filings by hard copy or DVD effective March 16, 2020. On March 17, 2020, the FTC and DOJ established temporary e-filing systems to receive HSR filings. Parties to a proposed transaction typically can request an early termination of the 30 day statutory waiting period if the proposed transaction obviously presents no competitive issues. While the FTC/DOJ resumed the practice of granting early termination of the HSR Act's waiting periods following a temporary suspension, they indicated that it will continue to do so only as time and resources allow and expect early termination to be granted in fewer cases, and more slowly, than under normal circumstances.

Get to know Seyfarth's Antitrust & Competition team:
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Visit Seyfarth's COVID-19 Resource Center:
www.seyfarth.com/covid-19-resource-center.html

Navigating Immigration Compliance Due Diligence

Hidden, or often overlooked immigration issues can cause frustrating obstacles or even a "pencils down" directive from the client in an M&A deal. If the last year was any indication, the immigration compliance waters are likely to become even more difficult to navigate in 2020. In fact, the White House recently unveiled a $4.8 trillion budget which includes $49.8 billion in funding for a wide variety of Department of Homeland Security initiatives, including border security, cybersecurity, and immigration enforcement.

Any immigration misstep, in the context of an M&A transaction where the workforce is important, sizeable, or includes essential sponsored foreign workers, can be costly for the buyer and/or the seller. In addition to potential government fines, branding and reputational damage, there could be criminal penalties, especially where there is willful blindness or constructive knowledge of certain issues. Paperwork fines alone range from $230 to $2,292 per violation, and fines for the knowing hire of/continuing to employ an unlawful worker range from $573 to $22,927 per employee. Increasingly aware of these risks, the mindset of buyers has changed. In fact, parties on all sides of the deal are becoming more risk adverse, or more strategic in their approach of reviewing the immigration implications of a purchase (or sale). The increased use of representation and warranty insurance adds another layer of review, where the underwriters are now inquiring about issues that otherwise may have been left unaddressed.

Generally, when assessing target companies, or preparing companies for a sale, a review of the foreign national population (if any) should be considered along with immigration policies and related hiring practices, and the general state of current I-9 and E-Verify (if applicable) compliance. A diligence list should also include a request for prior I-9 related inspections and copies of Social Security Administration no match letters, as well as a specific request for the I-9s. In light of increasing data privacy concerns, this data should be safeguarded, especially if shared in the deal room.

A solid immigration review should ensure that the right questions are asked, and that even the more nuanced of the answers are quickly digested. Ultimately, if the diligence yields serious concerns, a qualified immigration team is critical to properly assess the risk discovered and to determine a path forward.

Get to know Seyfarth's Immigration Compliance & Enforcement team:
www.seyfarth.com/services/practices/advisory/immigration/immigration-compliance-and-enforcement.html

Pension Liabilities post-*Sun Capital*

Pension plan liabilities will remain an important focus point of diligence and a potential deal breaker for M&A transactions involving private equity funds ("PE Funds") seeking to acquire new portfolio companies with an ERISA pension plan following the First Circuit's Decision in *Sun Capital Partners III, LP v. New England Teamsters & Trucking Indus. Pension Fund*, No. 16-1376, 2019 WL 6243370 (1st Cir. Nov. 22, 2019).

Under ERISA, unfunded pension plan liabilities and unpaid contribution and withdrawal liability from multiemployer pension plans are joint and several liabilities of the employer sponsoring or contributing to the pension plan, as well as each trade or business under "common control" with such employer. Common control generally exists if there is individual or aggregate ownership of at least 80%.

In *Sun Capital*, the First Circuit found (reversing the lower court's decision) that a "partnership-in-fact" did not exist between the two Sun Capital PE Funds which owned, in the aggregate, more than 80% of a bankrupt portfolio company in question. As such, they were not liable for the portfolio company's $4.5 million withdrawal liability to a multiemployer pension plan.

However, the First Circuit's ruling is very fact specific and although it is a positive outcome for the Sun Capital PE Funds, it leaves open the possibility that other courts, applying the same partnership-in-fact test, could find PE Funds liable for pension and withdrawal liabilities of their portfolio companies under different facts.

In the M&A context, *Sun Capital* will have significant impact at the outset of any private equity transaction involving a target with pension plan obligations, including:

- Increased diligence on the pension plan obligations and controlled group liability;
- Heightened attention on the structure of the investment by PE Fund(s) and use of alternative structuring to minimize potential liability; and
- Inclusion of strong representations and indemnities surrounding pension obligations in transaction documents.

Following *Sun Capital*, private equity firms and their advisors should educate themselves on the ERISA controlled group and joint and several liability rules in order to assess the potential exposure of any assumed pension liabilities in an M&A transaction.

Get to know Seyfarth's Employee Benefits team:
www.seyfarth.com/services/practices/advisory/employee-benefits/index.html

California Consumer Privacy Act: A New Source of Risk

With the California Consumer Privacy Act ("CCPA") coming into force this year, businesses who are in the market to buy or be sold have a new risk component that needs to be added to the standard diligence process. What is the business doing to manage personal information about consumers and employees that are residents of the state of California?

The CCPA imposes on businesses a number of obligations (some old, some new) which can trigger regulatory and legal actions that have very real financial consequences on a business. As a result, participants in the M&A space now need to be able to understand how CCPA compliance can affect the value of a transaction. Does the target company come with a lawsuit waiting to happen? Is the acquiring company able to effectively use any of the consumer data which is being transferred as part of the sale? Is the transaction value diluted because there is a possible regulatory action which could result in administrative penalties in the tens of millions of dollars? These are all questions which arise as a result of the privacy and cybersecurity requirements of the CCPA.

Taken in two parts—security and privacy—any M&A transaction will now need to evaluate the risk associated with a business' obligations under the CCPA.

SECURITY

The general obligation to use reasonable security has been around for some time (and not just in California). The primary difference between previous attempts to recover for security breaches by private plaintiffs and the CCPA-era is that the CCPA now provides a statutory damages system that operates to overcome the damages challenges many of the previous breach suits faced. With damages being between $100 and $700 per consumer, it is easy to see how these damages can compound. This is especially true since most breaches don't impact ten or twenty individuals, but thousands.

Since many companies have been the target of a hacking event, it is important to understand what kind of exposure is present in the target with regard to possible class actions of this kind. While it may not stop a deal, it can definitely change the cost calculation for what an acquiring entity is willing to pay.

PRIVACY

While the CCPA does not provide for a private right of action, the potential administrative penalties available to the California Attorney General ("AG"), as well as the fact that such penalties go back to the AG, can have a similar influence on M&A activity as security breaches.

The primary difference between security and privacy is that security is something most companies want to do well. Privacy is often seen as a barrier to maximizing data as an asset. As such, the position of a target company around proper data handling practices may not be as inherently compliant as one would see in the security space.

Additionally, privacy compliance under the CCPA requires a number of operational infrastructures in order to ensure compliance. There is much more than just the provision of a privacy notice. CCPA requires businesses to know where their data is, how it is used, who has access to it, and whether or not it is being sold to third parties. Since the definition of "sale" is quite broad, as is the definition of "personal information", it is very possible that a target business is unaware that they are violating the CCPA because they are selling personal information to a third party without notice or an opportunity to opt-out.

These kinds of violations can generate between $2,500 and $7,500 in fines per violation. It is worth noting that the AG may well consider as a separate violation each impacted consumer who is denied the opportunity to opt-out. Like with security breaches, this number can become quite large quite quickly—and there is no cap.

CONCLUSION

All in all, as a result of the CCPA generating significant and material sources of liability for poor data handing practices, it is now very important for privacy and security issues to be evaluated as part of the M&A process the same way that other material sources of liability need to be considered. Otherwise an acquirer may well be paying too much for an expensive regulatory or class action.

Get to know Seyfarth's Privacy & Security team:
www.seyfarth.com/services/practices/advisory/privacy-and-security.html

Glossary

Indemnity Escrow Amount
The indemnity escrow amount is the portion of the purchase price held in escrow to serve as a fund to satisfy indemnification claims against the seller.

Indemnity Escrow Period
The indemnity escrow period is the length of time after the transaction closing date that the indemnity escrow amount is held before being released to the seller.

Representation & Warranty Survival Period
The survival period is the length of time after the transaction closing date during which a party may make claims for breaches of representations and warranties.

Carve Outs to General Survival Period
Certain specified representations and warranties may be carved out of the general survival period for representations and warranties and survive for a longer period of time.

Indemnity Basket
An indemnity basket requires a party to incur a certain amount of indemnifiable losses before it can seek indemnification from the other party. There are generally two types of baskets: true deductibles and threshold/tipping baskets. With a true deductible, the indemnifying party is only responsible for losses exceeding the basket amount. With a threshold/tipping basket, the indemnifying party is responsible for all losses from dollar one once a party's indemnifiable losses reach the basket amount. Indemnity baskets typically apply only to breaches of "general" representations and warranties.

Indemnity Cap
The indemnity cap limits a party's maximum liability under the indemnification provisions to a stated dollar amount. Indemnity caps typically only apply to breaches of "general" representations and warranties.

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> Seyfarth has "a very responsive, knowledgeable, lean practice, which has lawyers who are courteous and succinct."
> – Client quote, *The Legal 500*

> Seyfarth is "highly regarded for its deep knowledge of corporate law and M&A expertise."
> – Client quote, *The Legal 500*

> The Seyfarth team "works with clients to help them build their businesses in an efficient and high-quality manner."
> – Client quote, *The Legal 500*

> Seyfarth's "counsel during M&A procedures is consistently accurate and timely, and the team's knowledge and expertise proves invaluable."
> – Client quote, *The Legal 500*

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