# Private M&A 2020

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LEXOLOGY
Getting The Deal Through

Davis Polk

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Lexology Getting The Deal Through is delighted to publish the third edition of *Private M&A*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Sudan and the United Arab Emirates.

Lexology Getting The Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.lexology.com/gtdt.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, Will Pearce and John Bick of Davis Polk & Wardwell LLP, for their continued assistance with this volume.

LEXOLOGY
Getting The Deal Through

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# United States

**Harold Birnbaum, Lee Hochbaum, Brian Wolfe and Daniel Brass**

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## STRUCTURE AND PROCESS, LEGAL REGULATION AND CONSENTS

### Structure

**1 How are acquisitions and disposals of privately owned companies, businesses or assets structured in your jurisdiction? What might a typical transaction process involve and how long does it usually take?**

Typically, a contract, referred to as a purchase agreement, is executed between the relevant parties to acquire or dispose of privately owned companies, businesses or assets. A privately owned company can also be acquired through a merger pursuant to a merger agreement in accordance with the law of the state of incorporation of the company (see question 2).

The process of acquiring a company, business or assets will often turn on the complexity of the issues and number of parties involved, as well as whether the transaction involves a bilateral negotiation or a controlled auction process with multiple potential buyers.

An auction process in which interest from several buyers is solicited will typically involve:

- drafting an information memorandum as the basis of marketing the company, business or assets, and drafting a purchase agreement and other sale documents (approximately six to eight weeks);
- 'round one' expressions of interest from potential buyers who will then be permitted to undertake due diligence (approximately four weeks);
- 'round two' offers by potential buyers with mark ups of the transaction documentation (approximately four weeks); and
- negotiation of transaction documentation with one or more buyers until definitive terms are agreed with one party (up to two weeks).

The larger and more complex the target company, business or assets, the longer each phase of a process can take. Up to three months will often elapse between distribution of an information memorandum and execution of definitive transaction documents. A bilateral transaction can take longer to complete owing to the lack of competitive tension in the process.

### Legal regulation

**2 Which laws regulate private acquisitions and disposals in your jurisdiction? Must the acquisition of shares in a company, a business or assets be governed by local law?**

Parties to acquisitions and dispositions generally elect to have purchase agreements and other transaction documentation governed by Delaware or New York state law. Mergers are effected in accordance with the corporate laws of the states of incorporation of the constituent corporations. Under most states' corporate statutes, a company can be acquired by way of merging the buyer or one of its subsidiaries into the target resulting in the buyer becoming the owner of the target by operation of law once the statutory merger requirements have been satisfied and the target shareholders being entitled to the sale consideration for their former target shares. Usually, a merger can be effected with the approval and recommendation of the target company's board of directors and the approval of holders of a majority of the target's outstanding voting equity. There are also a range of federal and state statutes and regulations dealing with the transfer of employees, title to property, data protection, pensions and competition that are relevant to private acquisitions and disposals.

Although most sales of US companies will be governed by Delaware or New York law or the law of another US state, it is possible for acquisitions or dispositions to be governed by the law of a foreign jurisdiction. However, parties to a transaction will be required to comply with legal formalities applicable to the transfer of shares and assets and liabilities that are subject to local law.

### Legal title

**3 What legal title to shares in a company, a business or assets does a buyer acquire? Is this legal title prescribed by law or can the level of assurance be negotiated by a buyer? Does legal title to shares in a company, a business or assets transfer automatically by operation of law? Is there a difference between legal and beneficial title?**

The mechanism for transferring legal title to an asset in the US varies depending on the nature of the asset being sold and certain other factors. By way of example:

- title to certificated equity interests is often transferred pursuant to a simple transfer document and the physical transfer of any certificates representing those interests from seller to buyer. If equity interests are uncertificated, title can transfer in several different ways depending on the entity involved and its organisational documents. Specifically, for certain US companies, the transfer can be effected by book entry with the share registrar for the issuer, whereas in a sale of interests in a partnership or limited liability company, the transfer of title is often documented by an amendment to the underlying partnership or limited liability company agreement reflecting the updated capitalisation and ownership table pro forma for the sale transaction;
- if real estate is being sold, legal title is often transferred pursuant to a transfer document and the physical transfer of any deed or title to the relevant property from seller to buyer; and
- if personal assets are being sold, then transferring ownership of the property is often reflected in a transfer document along with the physical transfer of possession of those assets from seller to buyer. In the case of most personal assets, there is no title representing ownership of the property, but there are exceptions to this general principle (eg, vehicle sales).

Generally, the transfer of ownership is effected in the manner described above and does not occur by operation of law, except in the cases of acquisitions of companies by way of state law mergers (see question 2).

It can be possible for there to be a difference in the US between legal and beneficial title in certain instances, so buyers of assets in the US should be careful to document the acquisition of both legal and beneficial ownership of those assets accordingly.

**Multiple sellers**

4 Specifically in relation to the acquisition or disposal of shares in a company, where there are multiple sellers, must everyone agree to sell for the buyer to acquire all shares? If not, how can minority sellers that refuse to sell be squeezed out or dragged along by a buyer?

Generally, the sale of a US company is effected by way of either a direct purchase of the equity of the company from its shareholders (often called stock deal) or pursuant to a merger. If a US target company is owned by multiple sellers and the sale transaction is structured as a stock purchase, then the consent of all of the shareholders in the target would be required to sell the company. Often, buyers of US companies will seek to structure a transaction in this manner (particularly if there are not a large number of target shareholders), as a buyer will usually prefer to be in privity of contract directly with the selling parties. However, in transactions where the equity ownership of the target is widely dispersed, parties often structure the sale of a US company by way of a state law merger (see question 2). Any shareholders who object to the merger and otherwise follow the statutory requirements may be entitled to seek a judicial appraisal of their shares. Otherwise, the minority shareholders in a US company can be 'squeezed-out' in the merger with their shares converted into the right to receive the sale consideration prescribed by the merger agreement.

In addition to the above, in many private companies (particularly those with private equity or venture capital investors), it is fairly customary for the holder or holders of a majority or a specified percentage of the outstanding capital stock to have drag-along rights in any shareholders' agreement or organisational documents for the company. These rights entitle such holder or holders to compel minority shareholders to cooperate with, and vote in favour of, the sale of the company, and not to exercise any statutory appraisal rights to which a shareholder might otherwise be entitled.

**Exclusion of assets or liabilities**

5 Specifically in relation to the acquisition or disposal of a business, are there any assets or liabilities that cannot be excluded from the transaction by agreement between the parties? Are there any consents commonly required to be obtained or notifications to be made in order to effect the transfer of assets or liabilities in a business transfer?

As a matter of New York or Delaware contract law, a buyer can generally choose which assets and liabilities it will acquire in a transaction that is structured as an asset sale. However, the doctrine of 'successor liability' may result in liabilities of the seller transferring to the buyer by operation of law, even if the buyer and the seller have agreed between themselves that such liabilities will not transfer. Successor liability may be more likely to apply with respect to specific types of liabilities, such as environmental clean-up liabilities, products liability and employment liabilities. In circumstances where liabilities transfer to the buyer by operation of law, buyers may seek contractual indemnities from sellers for such liabilities.

The transfer of assets or liabilities often requires third-party consents, such as a landlord's consent to the assignment of a lease or a counterparty's consent to the assignment of a commercial contract. Governmental consents are typically not required, except for consents that are applicable to transactions regardless of structure (see question 6).

**Consents**

6 Are there any legal, regulatory or governmental restrictions on the transfer of shares in a company, a business or assets in your jurisdiction? Do transactions in particular industries require consent from specific regulators or a governmental body? Are transactions commonly subject to any public or national interest considerations?

Under the US antitrust laws, if the value of the transaction exceeds US$90 million, a filing will generally need to be made with the US antitrust authorities under the Hart–Scott–Rodino Antitrust Improvements Act of 1976 (HSR Act). The waiting period required under the HSR Act must expire or be terminated prior to completion of the transaction. The waiting period is generally 30 days from filing, but may be terminated earlier by the US antitrust authorities if requested by one or more parties, and may be extended substantially in circumstances where the antitrust authorities require additional information to complete their review of the transaction. The US antitrust authorities have the authority to require divestitures or other remedies to address any antitrust concerns, or to block the transaction altogether, subject to certain appeal rights of the parties.

Transactions in regulated industries (eg, banking, telecommunications and energy) must often comply with special regulatory regimes particular to transactions in these industries. Typically, approval of the relevant federal or state governmental agency is required before transactions in these industries may be completed.

In general, the US does not prohibit foreign investment in US companies, although statutes prescribe conditions for foreign direct investment in certain protected industries, including mining, marine transportation and communications. Moreover, the Committee on Foreign Investment in the United States (CFIUS or the Committee) has the authority to review acquisitions of US companies by non-US persons. Until legislative amendments in 2018, submission of a transaction for review by CFIUS was voluntary, with CFIUS retaining the power to initiate a review of any transaction not voluntarily submitted. The Foreign Investment Risk Review Modernization Act (FIRRMA), enacted In August 2018, imposes a legal requirement that certain categories of investment be submitted to CFIUS for review. Failure to notify CFIUS of a transaction subject to mandatory filing can result in civil penalties up to the value of the transaction. FIRRMA introduced the concept of an abbreviated 'declaration' in mandatory cases or, subject to regulations that have not been finalised as of this writing, in other circumstances. In addition, under FIRRMA, certain non-controlling investments in US companies are now subject to CFIUS review. CFIUS may, as a condition for clearing a transaction, require structural or behavioural remedies to mitigate national security concerns, including compelling divestitures or imposing extensive changes in corporate governance at the acquired entity. If CFIUS believes that the national security risks posed by a proposed transaction cannot be adequately mitigated, it may recommend that the US president prohibit the investment.

Private companies often have contractual arrangements in place among their stockholders that can impose meaningful additional restrictions on the transfer of their shares or the entry into transactions, such as consent or veto rights, rights of first refusal or first offer and tag-along rights. These restrictions vary considerably and are generally a focus of a buyer's diligence on a private company target.

### Third-party consents

7 | Are any other third-party consents commonly required?

In the purchase of the stock of a private company, each stockholder will need to agree to transfer its shares in the absence of contractual drag-along rights (see question 4). Thus, for a target company with multiple shareholders, buyers often prefer to use a merger structure (see questions 2 and 4). In addition, many states, such as Delaware and New York, require a shareholder approval if a significant portion (such as all or substantially all) of the assets of a company are sold.

Contractual counterparty (such as landlord) consents may be required in connection with assignments of contracts on an asset sale and, depending on the wording and governing law of the contract, can also be required in connection with a merger or other change of control transaction.

### Regulatory filings

8 | Must regulatory filings be made or registration (or other official) fees paid to acquire shares in a company, a business or assets in your jurisdiction?

See question 6 for details of governmental approvals and filings. In order to consummate a merger, a merger certificate will be required to be filed with the applicable secretary of state, and typically any unpaid franchise taxes will need to be paid prior to closing. The transfer of certain assets (eg, land) and licences or intellectual property (IP) rights may require formal recording, but this varies widely from state to state.

## ADVISERS, NEGOTIATION AND DOCUMENTATION

### Appointed advisers

9 | In addition to external lawyers, which advisers might a buyer or a seller customarily appoint to assist with a transaction? Are there any typical terms of appointment of such advisers?

Parties will often appoint a financial adviser to assist with a transaction, who will often actively manage the transaction process, provide strategic and valuation advice and, where appropriate, provide a fairness opinion regarding the transaction. Parties will often retain an accounting firm to assist with accounting and tax due diligence and structuring. In addition, subject matter specialist consultants may also be engaged to assist in due diligence. Public relations advisers are also often appointed to coordinate announcements and assist with messaging to key constituencies.

Most professional advisers have standard terms of engagement that are negotiated on a transaction-by-transaction basis. The level of fees for a financial adviser will typically depend on the monetary value of the deal, the complexity of the issues, the timetable for the transaction and the nature of any required work product. In aggregate, a party's advisory fees (including outside counsel) may amount to several percentage points of the monetary value of the deal.

### Duty of good faith

10 | Is there a duty to negotiate in good faith? Are the parties subject to any other duties when negotiating a transaction?

Neither Delaware nor New York law imposes a general duty to negotiate in good faith, and so parties to a transaction are permitted to pursue their own self-interest. However, in extreme circumstances a party can be liable to a potential counterparty for damages resulting from its fraudulent conduct during the course of negotiations, and can also be potentially liable for tortiously (meaning intentionally and without a legitimate business purposes) interfering with the rights of a third party during the course of negotiations. Once an agreement relating to a transaction is signed, including a letter of intent or other similar preliminary agreement, in addition to any express contractual obligations the parties will generally be subject to an implied covenant of good faith and fair dealing under applicable state law.

Directors of a US corporation generally have fiduciary duties to the company and its shareholders under the laws of state where the company is incorporated. While these duties vary from state to state, they generally consist of a duty of care, a duty of loyalty and a duty to act in good faith. Stockholders of the company being acquired may file litigation following the announcement of a transaction alleging, among other things, breaches of these fiduciary duties and seeking an injunction blocking the transaction or alternatively monetary damages. Litigation management is an important aspect of US transactional practice.

### Documentation

11 | What documentation do buyers and sellers customarily enter into when acquiring shares or a business or assets? Are there differences between the documents used for acquiring shares as opposed to a business or assets?

When acquiring shares, a business or assets, parties to a transaction will customarily enter into:

- a confidentiality agreement governing the exchange of confidential information relating to the transaction;
- a purchase agreement setting forth the terms of the transaction, which will be substantially similar whether shares, a business or assets are being acquired, except that in respect of a business or asset acquisition there will be detailed provisions defining the scope of the assets and liabilities that are to be transferred to the buyer;
- disclosure schedules in which general and specific disclosures are made by the seller qualifying the representations and warranties included in the purchase agreement;
- a transition services agreement pursuant to which the seller or its affiliates will provide certain services to the target company or business following completion of the transaction (or, in some circumstances, pursuant to which the target company or transferred business will also provide certain services to the seller or its affiliates); and
- documents to effect at the closing the transfer of the stock, assets or liabilities to be sold in the transaction, such as stock powers and assignment and assumption agreements (see question 3).

In addition:

- if the seller is running a process for the sale, a buyer will often deliver one or more offer or bid letters to the seller expressing its interest in the transaction and the terms upon which it would be willing to proceed;
- it is common for parties to negotiate a non-binding letter of intent or term sheet in an attempt to ensure that resources are not wasted evaluating a transaction before key terms are agreed;
- key members of target management may enter into new employment agreements to secure their continued employment following completion of the transaction (and, in some cases, will subscribe for equity in the buyer or resulting company); and
- depending on the scope of any post-closing indemnities and the creditworthiness of the seller, it is common to hold a portion of the purchase price in escrow pursuant to an escrow agreement, until releasing it after some specified period following closing.

### Formalities

12 | Are there formalities for executing documents? Are digital signatures enforceable?

The laws of the US state in which the seller or buyer is organised typically do not require that any special formalities be observed, other than ensuring that the transaction documents are executed by authorised persons. In this regard, it is typical for the board of directors (or similar constituent body) to adopt resolutions authorising one or more officers to execute the transaction documents. In certain limited circumstances, special formalities may need to be observed, such as notarising transaction documents effecting the transfer of real property.

Electronic signatures are generally enforceable in M&A transactions pursuant to overlapping state and federal law. Forty-seven states, plus Washington, DC, Puerto Rico and the Virgin Islands, have adopted the Universal Electronic Transactions Act (UETA), which provides that no contract or electronic signature can be considered unenforceable solely because of its electronic form. The statute defines signature very broadly and focuses on the intent of parties to be bound through the electronic format. New York and Illinois have not adopted UETA but maintain substantially similar statutes, while Washington has adopted a more unique approach.

On a federal level, the Electronic Signatures in Global and National Commerce Act (ESIGN) governs transactions in or affecting interstate and foreign commerce. It has a similar effect to UETA, stating that the electronic form of a contract or signature cannot by itself render a transaction unenforceable. Like UETA, it contains a broad definition of signature and focuses on the parties' intent. ESIGN pre-empts states' electronic transfer laws, except in states that have adopted UETA or a functional equivalent to UETA. Because both UETA and ESIGN validate the use of electronic signatures in contract formation, typical M&A transactions in the United States can be consummated with electronic signatures. Nonetheless, from a practice standpoint, the vast majority of M&A transactions still rely on handwritten rather than electronic signatures.

Finally, there are certain documents excluded from UETA and ESIGN, such as certain trusts and estates documents, powers of attorney and agreements completed pursuant to certain articles of the Uniform Commercial Code, which, while not typically implicated by M&A transactions, could be relevant depending on the facts and circumstances.

## DUE DILIGENCE AND DISCLOSURE

### Scope of due diligence

13 | What is the typical scope of due diligence in your jurisdiction? Do sellers usually provide due diligence reports to prospective buyers? Can buyers usually rely on due diligence reports produced for the seller?

Due diligence provides potential buyers with the opportunity to evaluate the legal, financial, tax and commercial position of a target company or business. The scope of legal due diligence in the US varies based on the situation, but as a general matter is typically fairly broad and will cover such areas as basic corporate information, material contracts, litigation matters, compliance with law, regulatory matters, title to assets, share capitalisation, IP and information technology, and employee arrangements.

It is very uncommon for sellers to provide due diligence reports to prospective buyers.

### Liability for statements

14 | Can a seller be liable for pre-contractual or misleading statements? Can any such liability be excluded by agreement between the parties?

A seller can be liable for pre-contractual misrepresentations, although purchase agreements usually limit a seller's liability to claims for breach of the express representations and warranties in the agreement and exclude liability for pre-contractual and misleading statements (sometimes with an exception for cases of fraud).

### Publicly available information

15 | What information is publicly available on private companies and their assets? What searches of such information might a buyer customarily carry out before entering into an agreement?

In the US, private companies are required to make only very limited filings that are publicly available. A company's certificate of incorporation (including any amendments thereto, and any certificate of designation containing the terms of its capital stock, including any series of preferred stock) will be filed and publicly available at the office of the secretary of state of the company's state of incorporation. However, the following are examples of information that are not required to be filed:

- financial statements;
- details of the board of directors or people with significant control over the company;
- any shareholder resolutions; or
- details of changes to the company's share capital.

Information on mortgages or liens on the company's assets can be obtained by undertaking a search for UCC-1 financing statements at the state level or a lien search at the local county level. Details of registered IP, such as patents and trademarks, can be obtained from the United States Patent and Trademark Office, United States Copyright Office and similar foreign offices.

A buyer of a company will typically carry out a search of information filed with the office of the secretary of state, including to confirm that no filing has been made to wind up or dissolve the company. Searches may also be performed in respect of liens and registered IP as noted above. A buyer could search litigation dockets in the locations in which the company is incorporated or principally does business, although such a search may not be exhaustive or reveal all pending claims.

Not all jurisdictions provide information on litigation dockets or lien searches in an online searchable format, so the nature of the search required and the confidence level can vary.

### Impact of deemed or actual knowledge

16 | What impact might a buyer's actual or deemed knowledge have on claims it may seek to bring against a seller relating to a transaction?

If a buyer is not explicitly precluded by the purchase agreement from claiming in respect of matters about which it has knowledge at the time of entering into the agreement, then a claim would not be expected to be automatically excluded (although the analysis can vary from state to state).

However, if a buyer has actual knowledge of a matter at the time of entering into a purchase agreement, the seller may seek to argue that, by closing under the agreement, the buyer accepted and waived any claim in respect of that matter. Accordingly, to achieve clarity, a purchase agreement would specify whether a buyer's actual, constructive or imputed knowledge of a matter will limit the buyer's right to make a claim post-closing in respect of that matter.

## PRICING, CONSIDERATION AND FINANCING

### Determining pricing

17 | How is pricing customarily determined? Is the use of closing accounts or a locked-box structure more common?

Pricing for private M&A transactions in the US is customarily determined via negotiations between the transacting parties. In coming to an agreement on price, the parties will consider a number of factors, including but not limited to financial analyses.

US private transactions typically include a purchase price adjustment that measures net cash and working capital of the target company as of the closing of the transaction against an agreed target amount of working capital, with any deficit or excess at closing against the target amount being for the seller's account. Depending on the industry and the specifics of the transaction, the purchase price adjustment may be based on alternative financial or operational metrics, rather than net cash and working capital.

Locked-box structures are used in some private M&A transactions, but they are far less common in the US than in other jurisdictions.

### Form of consideration

18 | What form does consideration normally take? Is there any overriding obligation to pay multiple sellers the same consideration?

Cash is the most common form of consideration in private M&A transactions, although other forms of consideration may also be used, particularly in strategic transactions or where tax considerations dictate. There is no overriding obligation to pay multiple sellers the same consideration in a private M&A transaction, although transactions where multiple sellers receive different forms of consideration may raise meaningful fiduciary duty issues (particularly where a controlling seller that is negotiating the deal is entitled to receive different consideration than minority shareholders) and may require special board or shareholder approval or otherwise be subject to enhanced judicial scrutiny.

### Earn-outs, deposits and escrows

19 | Are earn-outs, deposits and escrows used?

Earn-outs appear in transactions where parties are unable to agree on the valuation of the business to be acquired but, practically, are seen in a minority of transactions. Deposits may be used in highly unusual circumstances, for example if a buyer is based in a jurisdiction where there is a degree of uncertainty about its ability to complete the transaction or there are other significant doubts about buyer's ability to perform, although deposits are common in real estate transactions. Escrows are commonly used as security for indemnity claims by the buyer.

### Financing

20 | How are acquisitions financed? How is assurance provided that financing will be available?

Acquisition financing is a common feature of private M&A transactions. While buyers most commonly borrow from traditional commercial banks, there has been an increase in alternative finance providers such as business development companies and institutional investors. In acquisitions of a sufficient size of businesses with requisite financial statements, high-yield bond financing may be a financing component employed by a buyer. In limited circumstances, sellers sometimes agree to provide part of the financing by taking back deeply subordinated notes of the business being sold as part of the consideration.

There is no regulatory regime with respect to certainty of financing, and so documentation, conditionality and flexibility can vary significantly from deal to deal as it is driven by the outcome of commercial negotiations.

Where a newly incorporated entity is to be the buyer and requires capital, for example from a private equity fund, the seller will typically be provided with an equity commitment letter that will be conditional upon satisfaction of the conditions set out in the purchase agreement and any debt financing arrangements. An equity commitment letter will typically require the buyer to draw on any debt financing that has been negotiated, but the provider of equity capital to the buyer will not usually be required to increase its equity contribution in the event that a lender defaults on its commitment. In private equity acquisitions, it is common to have a reverse break-up fee that the buyer pays to the seller if the buyer cannot complete the transaction due to its failure to obtain debt financing (see question 26).

### Limitations on financing structure

21 | Are there any limitations that impact the financing structure? Is a seller restricted from giving financial assistance to a buyer in connection with a transaction?

US companies typically are not subject to statutory 'financial assistance' prohibitions akin to those applicable to the acquisition of shares of an English public limited company.

However, US solvency laws do limit the ability of a company to fund its own acquisition. In particular, affected creditors may have rights of recovery if the fair saleable value of the company's assets exceeds the value of the company's liabilities (including any new debt, other balance sheet liabilities and contingent liabilities); or the company is unable to pay its liabilities when due.

## CONDITIONS, PRE-CLOSING COVENANTS AND TERMINATION RIGHTS

### Closing conditions

22 | Are transactions normally subject to closing conditions? Describe those closing conditions that are customarily acceptable to a seller and any other conditions a buyer may seek to include in the agreement.

Signing and completion of transactions can occur simultaneously in the absence of legal or regulatory obligations to satisfy before completing the transfer of title to shares or assets. In that regard, antitrust filings and associated approvals or expiration of waiting periods is a common condition, as are conditions relating to CFIUS filings (if applicable). Similarly, the absence of any court order or law prohibiting the closing is a common condition.

Accuracy of representations and warranties (subject to negotiated materiality thresholds) and the absence of a material adverse effect are also typical conditions.

Conditions that appear with some frequency but are not typical include:

- obtaining contractual consents for contracts that are material to the transaction;
- the absence of litigation by a governmental agency challenging the transaction; and
- legal opinions (occasionally).

It is very unusual for US law-governed transactions to be subject to a financing condition. However, it is not unusual for private equity acquisitions (and other acquisitions where the buyer cannot pay the purchase price without financing) to provide, in effect, that if the buyer does not close the transaction due to committed financing not being funded, the buyer's liability is limited to payment of a reverse termination fee (see question 26). This is sometimes referred to as a 'synthetic' financing condition.

**Buyer and seller obligations**

23 What typical obligations are placed on a buyer or a seller to satisfy closing conditions? Does the strength of these obligations customarily vary depending on the subject matter of the condition?

Both buyer and seller will be required to commit to some level of efforts standard (eg, commercially reasonable efforts, reasonable best efforts) to satisfy closing conditions. Depending on the regulatory profile of a transaction, there may be specifically negotiated undertakings with respect to obtaining antitrust or other regulatory approvals. A seller will want a buyer to agree to do as much as possible to obtain antitrust or regulatory approvals, including agreeing to divesting assets, litigating with the government or taking other significant steps. On the other hand, a buyer will want to minimise its obligations.

**Pre-closing covenants**

24 Are pre-closing covenants normally agreed by parties? If so, what is the usual scope of those covenants and the remedy for any breach?

A seller will almost always agree to operate the target business in the ordinary course consistent with past practice and will commonly agree to specific pre-closing covenants including:

- not to amend the charter or by-laws;
- not to acquire or dispose of assets, enter into material agreements or commit to capital expenditure in excess of a specified value;
- not to create encumbrances;
- not to make distributions;
- not to issue or make changes to the outstanding shares;
- not to alter terms of employment or benefit entitlements or hire new employees on salaries, in each case in excess of a specified amount;
- not to settle litigation or waive any claims; and
- to grant access to the target company's books, records and premises.

A seller may also agree not to solicit competing proposals, and to notify the buyer of any unsolicited approaches in respect of the target company or business.

In addition, the parties typically undertake not to solicit senior employees, to maintain the confidentiality of the transaction and to make public announcements relating to the transaction only with the other party's consent. In some cases, a seller will agree to a non-compete with respect to the business being sold.

A breach of covenant will result in a claim for damages that is often uncapped. A court may grant specific performance with respect to a breach of covenant.

**Termination rights**

25 Can the parties typically terminate the transaction after signing? If so, in what circumstances?

It is customary for the purchase agreement in private transactions to provide each party the right to terminate the agreement before closing under certain circumstances. The most common of these is the right to terminate the agreement if the transaction has not closed by an agreed date. Other termination rights often include one or more of the following:

- the right to terminate if there is a permanent order or injunction prohibiting the transaction;
- the right to terminate if a required regulatory approval is denied and such denial is not subject to appeal; and
- the right to terminate if the other party is in breach of its representations and warranties or covenants in a manner that would cause the non-breaching party's conditions to closing not to be satisfied and the breaching party does not cure the breach within an agreed period.

**Break-up fees and reverse break-up fees**

26 Are break-up fees and reverse break-up fees common in your jurisdiction? If so, what are the typical terms? Are there any applicable restrictions on paying break-up fees?

Break-up fees are rare in private transactions. Reverse break-up fees are not common in private transactions but are included in certain types of transactions. For example, in private equity acquisitions, it is common to have a reverse break-up fee that the buyer pays to the seller if the buyer cannot complete the transaction due to its failure to obtain debt financing. This reverse break-up fee is usually guaranteed by the private equity sponsor and varies in size, with the common range being 4 to 8 per cent of the transaction size. Another example of transactions where reverse break-up fees are sometimes included are transactions with significant antitrust approval risk. In such transactions, the buyer will sometimes agree to pay a reverse break-up fee if antitrust approval is not obtained. In those circumstances, the amount of the fee can vary significantly (eg, examples can be found from 1 per cent of the equity value to over 10 per cent of the equity value). There are no restrictions generally applicable to the payment of reverse break-up fees.

## REPRESENTATIONS, WARRANTIES, INDEMNITIES AND POST-CLOSING COVENANTS

**Scope of representations, warranties and indemnities**

27 Does a seller typically give representations, warranties and indemnities to a buyer? If so, what is the usual scope of those representations, warranties and indemnities? Are there legal distinctions between representations, warranties and indemnities?

A seller will typically provide representations and warranties and, subject to the negotiating position of the parties and specific issues arising from due diligence, indemnities.

Representations and warranties provided by a seller typically address:

- the capacity and authority of the seller to enter into the purchase agreement;
- in respect of the acquisition of a company, the share capital of the target company and its direct and indirect shareholdings;
- the basis of preparation of the target's financial statements;
- the absence of changes to the condition of the business since the date of the financial statements;
- operational aspects of the business relating to employees, pensions and benefits, real property, financial commitments, commercial contracts, litigation and investigations, compliance with law, IP and information technology; and
- in respect of a business acquisition, the condition and adequacy of the assets to be acquired.

Where a company or business is sold in an auction process, a narrower scope of representations and warranties would be expected.

Subject to negotiation, the purchase agreement will typically include an indemnity providing the buyer with protection against breaches of representations and warranties or covenants. In some transactions, the seller does not provide any post-closing indemnification, or the buyer purchases representation and warranty insurance from a third party in lieu of a significant seller's indemnity (see question 29).

Known issues are generally disclosed against the representations and warranties (in a separate disclosure schedule that is attached to the purchase agreement) and generally may not be recovered under the general indemnity. However, specific risks identified through due diligence or disclosure may be the subject of specific indemnities. For example, specific indemnities may be given in respect of the outcome of ongoing litigation, the cost of remediating environmental damage prior to the buyer's acquisition or product liabilities in excess of an agreed level relating to the period prior to completion of the acquisition.

**Limitations on liability**

28 What are the customary limitations on a seller's liability under a sale and purchase agreement?

A seller's liability for general breaches of representations and warranties is typically contractually capped at an agreed percentage of the purchase price. Claims for breaches of representations and warranties are also often subject to a de minimis threshold as well as a deductible (ie, a threshold that aggregate damages must exceed before any damages are payable) or 'tipping point' (ie, no damages are recoverable until the aggregate amount of all damages exceeds a specified threshold, at which point all damages (even those below the threshold) are then recoverable). Fundamental representations and warranties (such as capacity and authority and title to shares being sold) are often outside these limitations, and liabilities for breaches of those representations and warranties may be capped at the purchase price. In many cases, the materiality qualifiers contained in the representations and warranties are disregarded for the purposes of determining whether a breach has occurred, the amount of damages resulting from a breach, or both.

The survival period for representations and warranties, which is the post-closing period during which claims for breaches may be brought, is often limited (eg, to a period of 12 to 36 months), with representations and warranties relating to certain subject matters (such as taxes, and environmental and employee issues), as well as fundamental representations, often subject to a longer survival period.

Liability for breaches of covenants is generally uncapped or capped at the purchase price.

In addition, more general limitations on a seller's liability may include:

- knowledge qualifications in representations and warranties, and materiality qualifications in representations, warranties and covenants;
- qualifying representations and warranties with disclosure contained in the disclosure schedules;
- provisions granting the indemnifying party the conduct of claims brought by third parties; and
- limiting the types of damages for which indemnity is available (eg, excluding consequential damages and punitive damages).

However, all of these points are subject to negotiation, and a broad range of outcomes is observed.

**Transaction insurance**

29 Is transaction insurance in respect of representation, warranty and indemnity claims common in your jurisdiction? If so, does a buyer or a seller customarily put the insurance in place and what are the customary terms?

Representation and warranty insurance has become much more prevalent over the past few years in private M&A transactions in the US, particularly with respect to divestitures by financial sponsors that are resistant to accepting meaningful post-closing exposure. It is also increasingly considered by strategic buyers as a way to make a competitive bid.

The insurance is intended to cover losses suffered by the policyholder where a successful claim can be made for breach of representations and warranties or a pre-closing tax indemnity. A policy will typically exclude:

- issues that are known to the policyholder, including issues that first arise and are discovered by the policyholder between signing and closing (it is possible, however, to negotiate insurance for known and specific contingent risks such as tax and environmental liabilities);
- purchase price adjustments;
- fines and penalties that are uninsurable by law;
- financial obligations resulting from pension underfunding and liabilities relating to the Fair Labor Standards Act and wage and hour claims;
- net operating losses and transfer pricing;
- liabilities relating to asbestos; and
- matters relating to 'heightened risks' that are specific to a transaction (product liability, data protection, broader environmental exclusions, etc).

The insurance is almost always a 'buyer-side' policy (as 'seller-side' policies have more limited recourse), but cost sharing is sometimes negotiated as part of the purchase agreement. Buyers often seek coverage for 5 to 20 per cent of the enterprise value of the target with a retention or deductible of 0.5 to 2 per cent of such enterprise value, and the policy costs approximately 2.5 to 4 per cent of the coverage limit. The policy can be put in place in approximately two working weeks.

**Post-closing covenants**

30 Do parties typically agree to post-closing covenants? If so, what is the usual scope of such covenants?

Most transactions will have customary post-closing covenants. Sellers often agree to preserve the confidentiality of the target's information. Buyers often seek restrictive covenants regarding non-solicitation of key employees or senior management and, with respect to sellers that are not financial investors, non-competition for two to five years post-closing. Buyers often agree to provide access to pre-closing information to sellers for financial reporting and regulatory purposes. In transactions structured as a merger, it has become common to obtain at signing separate 'support agreements' from a significant portion of the equity holders to ensure that such covenants are enforceable.

## TAX

### Transfer taxes

**31 Are transfer taxes payable on the transfers of shares in a company, a business or assets? If so, what is the rate of such transfer tax and which party customarily bears the cost?**

Typically, no federal transfer taxes are payable on the transfer of shares, a business or assets. Certain state and local jurisdictions impose a transfer tax on the transfer of assets (particularly real estate) and a few jurisdictions impose transfer taxes upon the transfer of shares in a company. The rate depends on the jurisdiction imposing the tax. Outside of pure real estate transactions, transfer taxes are customarily borne by the buyer or split equally.

### Corporate and other taxes

**32 Are corporate taxes or other taxes payable on transactions involving the transfers of shares in a company, a business or assets? If so, what is the rate of such transfer tax and which party customarily bears the cost?**

US taxpayers are generally subject to tax on all of their income, including gain arising from the sale of shares, a business or assets. For US corporate sellers, the gain is generally subject to a federal income tax at a 21 per cent rate. Under recent US tax reform legislation, however, significantly reduced rates of taxation may apply in the case of a disposition of shares of a non-US subsidiary corporation. For US individual sellers, the rate is typically 20 per cent if the property has been held for more than one year (recent US tax reform legislation has lengthened the holding period required to qualify for the 20 per cent rate to three years for certain private equity sellers) and typically 37 per cent in other cases. Individuals may also be subject to a 3.8 per cent 'medicare' tax. Further, gain from the sale of shares, a business or assets is generally subject to state and local taxes. Subject to certain exceptions (generally for transfers of interests in US real estate and for transfers of a trade or business not held in corporate form), non-US sellers generally are not subject to US federal income tax on the sale of shares or other assets.

## EMPLOYEES, PENSIONS AND BENEFITS

### Transfer of employees

**33 Are the employees of a target company automatically transferred when a buyer acquires the shares in the target company? Is the same true when a buyer acquires a business or assets from the target company?**

In the context of a share acquisition, the employees of the target company remain with the target company (and become the responsibility of the buyer) by operation of law. In the context of an asset acquisition, the employees of the target company do not automatically transfer to the buyer. Rather, the buyer will generally make offers of employment to all or some of the target company employees, and such offers of employment will be effective contingent upon the consummation of the transaction. The general terms and conditions of the offers of employment are often negotiated between the target and the buyer.

### Notification and consultation of employees

**34 Are there obligations to notify or consult with employees or employee representatives in connection with an acquisition of shares in a company, a business or assets?**

As a general matter, under US law, neither the target company nor the buyer has any obligation to notify or consult with employees or employee representatives (including labour unions or other similar organisations) solely as a result of an acquisition of the stock, business or assets of a target company. However, the specific terms of a collective bargaining or similar agreement with a labour union or similar organisation may provide for such obligations in connection with a transaction or other proposed actions affecting the covered employees (eg, planned changes to working hours and conditions or compensation and benefits).

In addition, in certain circumstances and subject to certain specified exceptions, if employees are terminated either before or after a transaction (whether as a result of a plant closing, reduction in force or otherwise) and the number of affected employees exceeds specified thresholds, the buyer, the target company, or both, may be required to comply with the US Worker Adjustment and Retraining Notification Act, as well as similar state statutes. Notably, terminations of employment that occur both pre-closing and post-closing may be aggregated together (to the extent they occur within a specified period) in determining whether the requisite thresholds triggering notice under these statutes have been exceeded.

### Transfer of pensions and benefits

**35 Do pensions and other benefits automatically transfer with the employees of a target company? Must filings be made or consent obtained relating to employee benefits where there is the acquisition of a company or business?**

In the context of a share acquisition, the employee benefit and retirement plans (and the assets and liabilities related thereto) maintained by the target company remain with the target company (and become the responsibility of the buyer) by operation of law. In the context of an asset acquisition, the target company and the buyer will negotiate and determine which employee benefit and retirement plans maintained by the target company (and the associated assets and liabilities) will transfer to and be assumed by the buyer. Notably, in the context of an acquisition in which a buyer purchases a business from a parent entity that owns other businesses that will remain with such parent entity, given that the employee benefit and retirement plans are often maintained at the parent level, a transaction in this context structured as a share acquisition will often be negotiated between the parties as if it were an asset acquisition, with the buyer assuming parent entity liabilities relating to employees of the acquired business.

Generally, there are no specific filings required to be made or consents obtained relating to employee benefit plans arising solely as a result of the acquisition of a company or business. However, there may be employee-related regulatory filings that are required to be made by the target company, the buyer, or both, in connection with a transaction depending on the facts and circumstances of the applicable parties and the acquisition. For example, if the target company or another member of its 'controlled group' sponsors a defined benefit pension plan, under the US Employment Retirement Income Security Act of 1974, the target company or such controlled group member may be required to provide the US Pension Benefit Guaranty Corporation written notice of certain 'reportable events' (including those related to the transaction) generally within a specified period after the date on which the reportable event occurs (but, in certain instances, prior to the date of such event).

## UPDATE AND TRENDS

### Key developments

36 What are the most significant legal, regulatory and market practice developments and trends in private M&A transactions during the past 12 months in your jurisdiction?

This year, for the first time, the Delaware courts permitted an acquirer to refuse to close an acquisition on the basis that a 'material adverse effect' on the target company had occurred. The decision provides guidance as to the determination of when a 'material adverse effect' has occurred, which may be helpful to practitioners in advising their clients. However, the determination was highly fact-specific, and it is not yet clear how Delaware courts will apply the decision to future transactions, particularly where the facts make it a closer call.

In addition, there continues to be an increase in the use of representation and warranty insurance in private M&A transactions (see question 29). Use of the insurance typically leads to negotiation of superior purchase agreement terms for the buyer, as the seller's exposure is either limited or eliminated altogether. Private equity sellers in particular often insist on 'no-seller indemnity' deals in which representations and warranties expire at closing and there is no ongoing exposure. In addition to the use of representation and warranty insurance, there continues to be a general increase in 'public company-style' deals, in which there is no post-closing indemnity liability for the sellers.

These developments are driven by the current seller-friendly market environment, which means that sellers have been able to negotiate aggressively many deal provisions, including those related to regulatory undertakings and reverse break-up fees.

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