

# THE INTERNATIONAL COMPARATIVE LEGAL GUIDE TO: PRIVATE EQUITY 2022

8TH EDITION

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## 1 Overview

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

U.S. private equity (“PE”) deal activity surged to record-setting levels in 2021, with both deal volume and deal values reaching unprecedented highs. Performance in 2021 was fueled by continued access to significant levels of dry powder, robust fundraising, easy access to debt at attractive rates and strong economic headwinds. Deal activity in the first half of 2022 has been tepid in comparison to 2021. Macroeconomic and geopolitical factors have created a more challenging environment for M&A and injected uncertainty into the outlook for 2022. Fundraising activity has continued in the first half of 2022, but at lower levels than the same period in 2021, and the market is crowded. A significant number of PE firms have been raising capital and competing for investments from large institutional allocators, many of whom committed their entire allocation for 2022 early in the year.

The frothy, competitive deal environment that characterized the past several years resulted in a continued focus on portfolio company add-ons and alternative transactions, such as carve-outs, strategic partnering transactions, minority investments, club deals, growth investments, structured equity investments, private investments in public equity (“PIPEs”) and take-private transactions. The changing landscape in 2022 is slowing traditional PE investing and is expected to increase hold periods, but opportunities remain for take-privates, co-investments and opportunistic transactions, and continuation funds and GP-led secondaries are on the rise. Additionally, some funds may be well-positioned to take advantage of opportunities in the current market.

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

Over the last few years, M&A activity was characterized by extremely competitive auctions, which resulted in historically high selling multiples, seller-favorable terms and intense pressure on certainty and speed to closing. While dry powder is still at a record high, parties are now faced with a less attractive environment for deal-making, with high inflation, rising interest rates and market volatility increasing the cost of borrowing, which in turn is pushing down valuations and increasing the proportion of equity-to-debt for many new deals. The war in Ukraine, supply chain disruptions, labor shortages and exploding energy

prices have also had an impact. These factors are beginning to shift the market away from the seller-favorable terms that dominated the last several years, and that trend is expected to continue in the near term.

The regulatory environment has also become more challenging for PE transactions. The U.S. Federal Trade Commission (“FTC”) and Department of Justice (“DOJ”) have increased the level of scrutiny applied to acquisitions by PE firms. In addition, recent regulatory reforms involving the Committee on Foreign Investment in the United States (“CFIUS”) have led to increased timing delays and deal uncertainty for transactions involving non-U.S. investors that might raise U.S. national security issues.

### 1.3 Have you observed any long-term effects for private equity in your jurisdiction as a result of the COVID-19 pandemic? If there has been government intervention in the economy, how has that influenced private equity activity?

COVID-19 has not had significant long-term effects on the U.S. PE industry. However, one noteworthy trend is that parties have developed an increased level of comfort with conducting processes in a virtual or partially virtual setting, including fundraising, and this trend is expected to continue.

The U.S. government intervened in the economy in response to the COVID-19 pandemic in a number of ways, including with loan programs targeted at small businesses, such as Paycheck Protection Program (“PPP”) loans, payroll tax deferrals and payroll tax credits under the CARES Act, and temporary modifications of certain aspects of the Tax Cut and Jobs Act of 2017. Stimulus was not aimed at PE, although PE funds and their portfolio companies were able to take advantage of certain benefits. At this point, few PPP loans remain outstanding, and any remaining deferred payroll taxes need to be paid by December 31, 2022. However, purchase agreements continue to address the risks associated with PPP loans and other stimulus obtained by target companies.

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

Over the past several years, the concentration of capital in large, multi-strategy asset managers has increased, leading to a corresponding increase in the number of deals consummated by such managers. We expect this trend to continue, as these funds are

outperforming in fundraising and may be better positioned to take advantage of opportunities in the current market.

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

## 2 Structuring Matters

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

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

Historically, most PE sponsors have prioritized control investments; however, in recent years there has been an increased focus on alternative investment structures, including structured equity.

### 2.2 What are the main drivers for these acquisition structures?

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

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

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

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

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

U.S. PE returns typically arise from management fees and returns on equity investments. Equity structuring varies depending on the PE sponsor involved, the portfolio company risk profile and the IRR sought. Equity most often consists of preferred and/or common equity interests held by the PE sponsor. Often, some or each type of equity is offered to existing, or "rollover," target investors. Preferred equity can be used to set minimum returns

and incentivize common or other junior security holders to drive portfolio company performance. PE funds often offer portfolio company management equity-based incentive compensation in the form of stock options, restricted stock, phantom or other synthetic equity or profits interests, each of which is subject to vesting requirements. Carried interest is typically found at the fund level and does not directly relate to the structuring of the equity investment at the portfolio company level.

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

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

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

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

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

Management equity is typically subject to time- and/or performance-based vesting. Time-based awards vest in specified increments over several years (typically four to five years (in the Eastern United States) and sometimes less (in the Western United States)), subject to the holder's continued employment. Performance-based awards vest upon achieving performance goals, often based on the PE sponsor achieving a certain IRR or multiple on invested capital upon exit, which in some instances is subject to minimum return hurdles. Time-based awards typically accelerate upon the PE sponsor's exit. Forfeiture of both vested and unvested equity in the event of a termination for cause is common.

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

The proportion of equity allocated to management (as well as the allocation among executives) varies by PE fund and the capital

structure of the portfolio company, but management equity pools for portfolio companies typically range from 7.5–15% of equity on a fully diluted basis, with the higher end of that range being more typical with smaller equity investments and equity structures where the PE sponsor holds more preferred equity.

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

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

## 3 Governance Matters

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

PE sponsors generally form new buyer entities (most often corporations or tax pass-through entities such as limited liability companies (“LLCs”) or limited partnerships (“LPs”)) through which they complete acquisitions and maintain their ownership interest in underlying portfolio companies. Governance arrangements are typically articulated at the level in the portfolio company’s ownership structure where management investors will hold their equity interests post-acquisition. For control investments, PE sponsors will often control the manager and/or the board of the buyer, any parent companies above the buyer entity, and the portfolio company.

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

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

For control investments, PE sponsors will often control the portfolio company through their right to appoint the manager or a majority of the directors. As a result, major corporate actions are ultimately indirectly controlled by the PE sponsor. If a PE sponsor takes a minority position, veto rights will generally not

be included in underlying governance arrangements unless the sponsor owns a substantial minority position. See question 2.4.

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

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

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

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

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

Delaware is frequently chosen as the state of organization in PE transactions due to its well-developed business law and sophisticated judiciary. Under Delaware law, the primary fiduciary duties owed to the shareholders by the controlling shareholder (and by the board of directors) are the duties of care and loyalty, along with ancillary duties such as those arising under the corporate opportunity doctrine. The duty of care requires directors to make informed and deliberate business decisions. The duty of loyalty requires that decisions be made in the best interests of the company and its shareholders and not based on personal interests or self-dealing.

Under Delaware law, corporate entities can (and usually do) exculpate breaches of the duty of care, but the duty of loyalty cannot be waived in corporate organizational documents. However, the Delaware Court of Chancery recently suggested that it would be open to permitting contractual waivers of the duty of loyalty by the shareholders themselves if done in clear and unambiguous language.

By contrast with the corporate statute, the Delaware statutes for alternative entities like LLCs and LPs allow the parties to waive the duty of loyalty. For this reason, among others, PE sponsors frequently organize their investment vehicles as LLCs or LPs in Delaware and include in the LLC or LP agreement an express waiver of fiduciary duties owed to minority investors. Absent an express waiver, however, courts will apply traditional corporate-like fiduciary duties to the board and the controller’s conduct. In addition, shareholders’, LLC and LP agreements often include express acknowledgments that the PE sponsor actively engages in investing and has no obligation to share

information or opportunities with the portfolio company. These agreements also typically provide that the portfolio company (and not PE sources) serve as the first source of indemnification for claims against PE sponsor employees serving on the portfolio company's board.

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

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

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

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

There are no meaningful legal restrictions applicable to PE investors nominating directors to private company boards, other than restrictions under applicable antitrust laws. For example, the Clayton Act generally prohibits a person from serving as an officer or director of two competing corporations. In 2019, the U.S. Department of Justice ("DOJ") expressed a desire to extend the scope of these restrictions on interlocking directorships to non-corporate entities and entities that appoint directors to competing entities as representatives or "deputies" of the same investor. If the Clayton Act is expanded in such a manner, PE funds may need to reevaluate their existing corporate governance arrangements with their portfolio companies. More recently in 2022, DOJ officials have said they are "ramping up efforts" to identify interlocking director violations and they are "committed to taking aggressive action" against PE investments in competitors that lead to interlocking boards.

PE investors should also be aware that some U.S. states have been enacting gender diversity requirements for the boards of companies organized and/or headquartered in the applicable state, and NASDAQ has enacted new listing rules regarding board diversity and related disclosure.

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

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

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

## 4 Transaction Terms: General

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

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

Antitrust clearance is the most common regulatory clearance faced. Only persons and entities that meet regulatory thresholds are required to make filings under the Hart-Scott-Rodino Act ("HSR"). The most significant threshold in determining reportability is the minimum size of transaction threshold (2022: US\$101 million). In most transactions, the HSR filing is submitted after the parties have signed a definitive purchase agreement. Once both parties have filed, they must observe a statutory waiting period, which typically lasts 30 days (15 days for certain transactions) and must be observed before the transaction can close. Parties can expedite review by filing based on executed letters of intent or, historically, by requesting early termination of the waiting period; however, the FTC and the DOJ issued a suspension of early terminations in early 2021 that was still in effect at the end of Q2 2022.

Transactions raising anticompetitive concerns may receive a "second request" from the reviewing agency, resulting in a significantly more extended review period. Recently, the FTC and DOJ have increased their review of PE-led deals and signaled that PE funds and their roll-up strategies will face greater scrutiny.

In addition, parties to transactions potentially affecting national security may seek regulatory clearance from CFIUS. Given recent political developments, regulatory changes, and increased resources available to CFIUS, buyers should expect enhanced scrutiny by the U.S. government of certain foreign investments in the United States, particularly in the technology and defense-related industries. Recent CFIUS reforms that have been implemented pursuant to the Foreign Investment Risk Review Modernization Act of 2018 (“FIRRMA”) have expanded CFIUS’ powers and also now require mandatory submissions to CFIUS for certain types of transactions that are more likely to raise U.S. national security concerns – previously, CFIUS was typically a voluntary process. Prudent buyers seek CFIUS approval to forestall forced divestiture orders.

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

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

In recent years, competitive auctions have been the preferred method for exits by PE sponsors and other sellers in the United States. As a result of these competitive auctions, the scarcity of viable targets and the abundant availability of equity financing and debt financing prior to 2022, transaction terms shifted strongly in favor of sellers, including the limiting of conditionality and post-closing indemnification obligations. Transactions are commonly consummated with “public”-style closing conditions (i.e., representations subject to MAE bring-down), financing conditions have disappeared, and reverse break fees are common. The use of representations and warranties (“R&W”) insurance has been implemented across transactions of all sizes and is now used equally by PE and strategic buyers. Transactions are being structured more frequently as walk-away deals, with the R&W insurance carrier being responsible for most breaches of representations between the retention (which refers to the self-insured deductible) and insured limit under the policy. It also is becoming more common to include terms regarding CFIUS in transactions involving non-U.S. investors.

Although the current market for M&A has softened in comparison to 2021, which may result in some transaction terms becoming less seller-favorable over the coming months, many of these trends are expected to continue for the foreseeable future.

## 5 Transaction Terms: Public Acquisitions

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

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

A public company acquisition will require either consummation of a tender offer combined with a back-end merger or target shareholder approval at a special shareholder meeting. In either case, there will be a significant delay between signing and closing that must be reflected in sponsor financing commitments, with a

minimum of six weeks for a tender offer (which must remain open for 20 business days) and two to three months for a merger that requires a special meeting.

Absent unusual circumstances, there will be no ability to seek indemnification or other recourse for breaches of target representations or covenants, but R&W insurance may be obtained. Public company transactions also present unique challenges for the use of creative financing methods such as earn-outs and seller financing.

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

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

## 6 Transaction Terms: Private Acquisitions

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

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

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

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

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

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

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

Historically, U.S. PE sellers typically have not agreed to non-competition covenants, and restrictive covenants were limited to employee non-solicitation covenants. Conversely, selling management investors and certain co-investors typically agree to non-competition and other restrictive covenants. In recent years, limited non-competition covenants by PE sellers have become somewhat more common given the high valuations paid by buyers. However, these covenants, if present, are typically very narrow and may be limited to restrictions on purchasing enumerated target companies. Restrictive covenants by PE sellers tend to be intensely negotiated, and the terms, including the length of the restrictions, any exceptions and their applicability to PE fund affiliates, depend on the parties' negotiating strength and the nature of the PE seller (including fiduciary duties owed to its LPs) and the business being sold.

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

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

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

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

Despite competition among R&W insurers, consistent with other insurance markets, pricing of R&W insurance policies has tightened, with premiums and broker fees commonly around 3–5% of the policy limit, and underwriting due diligence fees of US\$30,000–US\$50,000. In addition, the premium is subject to taxation under state law.

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

For transactions with indemnification, representations and warranties typically survive for 12–24 months post-closing, with 12 months being more common, although certain specified representations may survive longer. For example, tax, employee benefit and fundamental representations often survive for several years or until expiration of the applicable statute of limitations. Fundamental representations typically include due organization, enforceability, ownership/capitalization, subsidiaries and brokers

and may also include affiliate transactions. For walk-away R&W insurance transactions, representations and warranties typically do not survive the closing.

For transactions without R&W insurance, indemnification caps typically range from 5–20% of the purchase price, whereas a significantly lower cap (e.g., 0.5%) is typically negotiated when the buyer is obtaining R&W insurance. Liability for breaches of fundamental representations, breaches of covenants and fraud is often uncapped or capped at the purchase price. Although dollar-one thresholds are sometimes used, sellers will often only be responsible for damages above a deductible amount.

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

With the prevalence of R&W insurance across the market, escrows and holdbacks to cover indemnification for representation breaches are less common. However, for transactions with R&W insurance that are not walk-away deals, sellers generally place 50% of the retention under the R&W insurance policy in escrow. Escrows for post-closing purchase price adjustments remain common, as do special escrows to address issues identified during due diligence.

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

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

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

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

In the current market, closings are rarely, if ever, conditioned on the availability of a buyer's financing. In certain circumstances, PE buyers may accept the risk that they could be forced to close the transaction by funding the full purchase price with equity. However, buyers seeking to limit such exposure typically negotiate for a reverse break fee, which allows termination of the transaction in exchange for payment of a pre-determined fee if certain conditions are satisfied. Depending on the terms, reverse break fees may also be triggered under other circumstances, such as a failure to obtain HSR approval. Typical reverse break fees range from around 4–10% of the target's equity value, with an average of around 5–7%, and may be tiered based on different triggering events. Where triggered, reverse break fees typically serve as a seller's sole and exclusive remedy against a buyer.

Given that PE buyers typically have no assets prior to equity funding at closing, sellers commonly require PE sponsors to provide limited guarantees of reverse break fees.

## 7 Transaction Terms: IPOs

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

Exits through IPOs will often be at higher multiples and more readily apparent market prices than exits through third-party sale transactions. However, exits through IPOs are subject to volatile market conditions and present other significant considerations. IPOs accomplished through acquisitions by special purpose acquisition companies (“SPACs”) (i.e., de-SPAC transactions) have decreased in popularity recently, given heightened regulatory scrutiny, performance of recent de-SPAC transactions, decreased public company valuations and general uncertainty in the public markets.

Unlike third-party sales, PE sponsors continue to own significant amounts of portfolio companies’ equity following an IPO or de-SPAC transaction. As a result, PE sponsors’ ownership interests and rights and the nature of any affiliate transactions with portfolio companies will be subject to public disclosure and scrutiny. PE sponsor management and monitoring agreements commonly terminate in connection with IPOs.

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

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

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

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

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

Depending on market conditions, PE sponsors may simultaneously pursue exit transactions through IPOs and private auction

sales. Dual-track transactions can help maximize the price obtained by sellers (through higher IPO multiples or increased pricing pressure on buyers), lead to more favorable transaction terms and provide sellers with greater execution certainty. The path pursued will depend on the particular circumstances of the process, but ultimate exits through private auction sales remain the most common, particularly as decreased public company valuations have made IPOs (including de-SPAC transactions) significantly less attractive.

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

### 7.4 Do private equity sellers seek potential mergers with SPAC entities as an alternative to an IPO exit? What are the potential market and legal challenges when considering a “de-SPAC” transaction?

While de-SPAC transactions can present a quicker, easier path to a public listing than a traditional IPO, the SPAC boom in the U.S. has cooled, and neither SPACs nor traditional IPOs are attractive alternatives to a private transaction in the current market. See question 7.3. Some of the challenges presented in a de-SPAC transaction are the same as would be present in a traditional IPO. The portfolio company will need financial statements that are audited in accordance with SEC and PCAOB standards and may need to build out its finance function in order to be able to comply with financial reporting requirements and implement necessary controls over financial reporting. De-SPAC transactions also depend on the presence of a robust PIPE market.

## 8 Financing

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

The most common sources of debt financing used to fund private equity transactions are bank loans and high-yield bonds. Bank loans can be provided by traditional banks or direct lending institutions and can be syndicated (typically when arranged by traditional banks) or non-syndicated (i.e., a single-lender or club deal with a smaller group of lenders, typically when provided by direct lending institutions). Private equity sponsors generally fund their acquisitions with bank loans and then look to obtain high-yield bonds or a combination of both as the size of the deal gets larger.

Direct lending institutions continue to be the key players in private equity transactions due to their competitive advantage over traditional banks, including an ability to take on higher leverage, unconstrained by the bank regulations, and provide faster execution of the deal and certainty of terms with no “market flex” risk. The notable difference in the recent market has been the size of the deals in which direct lending institutions are participating – direct lending institutions used to fund smaller, middle-market deals in prior years, but an increasing number of PE sponsors,



including the so-called “mega funds,” have been turning to direct lending institutions to fund their large-cap transactions.

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

Traditional banks continue to be governed by capital requirement guidelines and regulations affecting highly leveraged loans, which have faced increasing criticism. Some of these regulations have been loosened in recent years in an effort to infuse capital and support the market during the COVID-19 pandemic. It remains to be seen whether similar guidelines and/or regulations will be imposed on direct lending institutions, as their role in the debt financing market has been ever increasing.

Stricter enforcement of sanctions has also been a key area of focus in the debt financing market since the wake of the Russian-Ukrainian war, which has resulted in a number of PE funds and their portfolio companies having to navigate ways to manage relationships and/or cut ties with Russian investors.

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

Due to the uncertainty caused by higher interest rates and inflation, the debt-financing market for PE transactions has slowed in the first half of 2022 from its peak activity level in 2021. However, private credit funds continue to actively raise capital, which translates into more funds to be deployed in PE transactions, and the level of add-on acquisitions by corporate borrowers and portfolio companies has remained high. Another recent trend has been the increasing number of amendments being executed in the debt-financing market to, among other things: (1) convert LIBOR loans into SOFR loans, as most bank or other lending institutions now require any new loans be made as SOFR loans as an internal policy matter; or (2) modify the EBITDA definition and/or the financial covenants as many corporate borrowers and portfolio companies continue to deal with the aftermath of the COVID-19 pandemic, such as decreased EBITDA or other liquidity issues resulting from labor shortages or supply chain issues.

## 9 Tax Matters

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

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

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

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

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

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

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

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

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

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

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

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

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

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

## 10 Legal and Regulatory Matters

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

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

The Chair of the FTC and the Assistant Attorney General for DOJ's Antitrust Division have recently expressed strong concerns that certain types of PE transactions, including roll-up transactions, may harm consumers, workers, and marginalized communities. Antitrust officials have also identified PE acquisitions in the health care industry as particularly troublesome, as PE firms may be "focused on short-term gains and aggressive cost-cutting" that "can lead to disastrous patient outcomes and, depending on the facts, may create competition concerns." These concerns may lead to extended investigations, stronger consent agreements, or blocked deals. Stronger consent agreements include requiring PE firms to obtain prior approval before acquiring additional entities in the same market for 10 years.

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

The California Consumer Privacy Act of 2018 ("CCPA") represented a paradigm shift in U.S. privacy law. The California Privacy Rights Act, which aligns even more closely with the General Data Protection Regulation ("GDPR"), will replace the CCPA on January 1, 2023. Numerous other state-specific privacy laws will also take effect in 2023. This state-level activity, the Chair of the FTC's focus on tech and privacy practices, and the potential for a federal privacy law have created a complex legal environment for PE buyers who need to gauge privacy risks associated with the data-driven companies they seek to acquire and with targets who are looking to present robust privacy compliance programs.

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

There is enhanced scrutiny by CFIUS of transactions involving non-U.S. investors and U.S. businesses that operate in industries, or otherwise deal with technologies or personal data, that are deemed to be sensitive from a national security perspective. Transactions involving Chinese investors, in particular, continue to be subject to intense scrutiny by CFIUS. In addition, FIRRMA expanded CFIUS' jurisdiction to enable review not only of investments in which non-U.S. investors might be acquiring control over U.S. businesses (which have always been subject to CFIUS review), but also certain investments in which non-U.S. persons would gain certain rights involving appointment of directors, access to material non-public technical information, or other substantive

decision-making board appointment rights even in the absence of control. Investments by non-U.S. entities that are partially or wholly owned by non-U.S. governments also are subject to heightened scrutiny and might trigger mandatory filing requirements. There are exceptions, however, for certain PE investments made through partnerships in which the general partner is a U.S. entity or is domiciled in an "excepted state" (which currently includes Australia, Canada, and the United Kingdom).

In addition, the FTC and DOJ have increased their review of PE transactions. See question 10.1.

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

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

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

PE buyers and counsel will evaluate the target's risk profile with respect to anti-bribery and anti-corruption legislation, including the Foreign Corrupt Practices Act ("FCPA"). The risk profile depends on, among other things, whether the target conducts foreign business and, if so, whether any of the business is conducted (i) in high-risk regions (e.g., China, India, Venezuela, Russia and other former Soviet countries and the Middle East), (ii) with foreign government customers, or (iii) in industries with increased risk for violations (e.g., defense, aerospace, energy and healthcare). Diligence will be conducted based on the risk profile and possible violations identified need to be thoroughly evaluated and potentially self-reported to the relevant enforcement authorities. In particular, the imposition of numerous sanctions and export controls against Russia in 2022 has led to intense scrutiny of a target's operations in, or connection to, Russia, to identify potential violations or impacts on revenue derived from Russia, among other issues.

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

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

Fundamentally, under U.S. law, businesses operated as legally recognized entities are separate and distinct from owners.

Consequently, PE sponsors generally will not be liable for acts of portfolio companies. However, there are several theories under which “corporate” form will be disregarded. These include:

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

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

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

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

## 11 Other Useful Facts

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

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

Transaction parties should expect increased regulation in the United States. In particular, new regulations should be expected in the arenas of cybersecurity and protection of personal data (both at the federal and state level) that will affect both how diligence is conducted and how portfolio companies operate. See question 10.1. Tax continues to be a key value driver in PE transactions, with IRRs and potential risks depending on tax considerations. See section 9.

Increased attention must be paid to potential CFIUS concerns, particularly given recent reforms and the political climate. Non-U.S. PE investors should be aware that investing in a U.S. business might trigger mandatory filing requirements. Even if a filing is not mandatory, it nonetheless may be advisable to submit a voluntary filing in order to avoid deal uncertainty, as CFIUS has the ability to open a review even after closing has occurred and could even require divestment. CFIUS considerations will remain a key issue for PE sponsors regarding foreign investments in 2022. See section 10.

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