

From the Editors

The private equity industry is indeed living through interesting times, as it simultaneously contends with changes at the intersection of trade policy and national security, accelerating AI developments, new Delaware law covering deals with conflicted directors and controlling stockholders, the greater use of continuation vehicles and secondaries and more. The Spring 2025 *Private Equity Review* provides an analysis of several of these market-shaping trends.

Recent SEC Actions Signal a Positive Shift for Expanding Retail Access to Private Market Strategies

Recent SEC updates to longstanding regulatory positions applicable to business development companies and closed-end funds are likely to give sponsors of these vehicles greater flexibility to offer retail investors broader access to private market investment strategies, while preserving key investor protections.

What Do Storm Clouds Portend for Private Credit?

In a near-zero interest rate environment, private credit enjoyed robust growth. Current conditions, however, may bring increased restructuring—and introduce the specter of lender-on-lender violence to this relationship-driven asset class.

Key Executive Compensation Issues for PE Sponsors in Take-Private Transactions

Take-privates have become an increasingly common PE strategy, but they require navigating numerous executive compensation considerations, including potential severance liability, “golden parachute” tax issues, disclosure obligations and a shift in compensation philosophy and mechanics.

The Secondaries Market: Dealmaking Trends

As the market for continuation vehicles continues to evolve with further specialization, in larger vehicles and in more innovative ways we share our insights on current trends.

The Secondaries Market: Financing Trends

The secondaries market grew 40% in 2024—growth that has been accompanied by a greater use of leverage through use of innovative financing structures and techniques.

Updated SEC Guidelines Bring Welcome Regulatory Clarity

Expanded and updated SEC guidance concerning draft registration statements, M&A transactions and tender offers bring private equity firms increased flexibility and clarity in three key areas.



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Trump's America First Investment Policy: Implications for Private Equity

The administration's recent investment policy accelerates the trend of defining "national security" to include trade and technology policy, with important implications for inbound and outbound private equity investment.

Eight Principles of Effective and Strategic M&A Legal Due Diligence

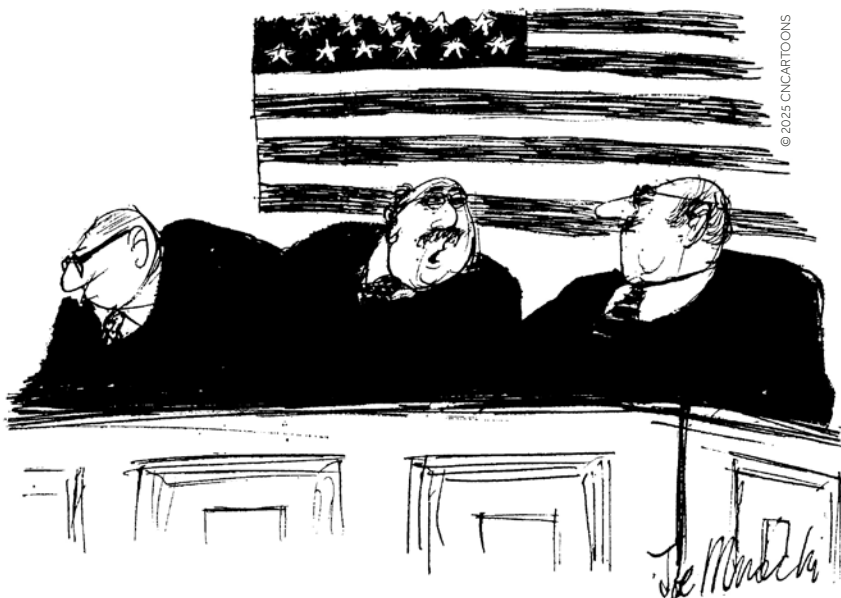
If performed with the appropriate level of thought and planning, legal due diligence conducted in the course of a potential acquisition can provide a sponsor with valuable strategic insight, while being efficient and effective.

Five Reasons to Use Generative AI (and Five Reasons Not To)

As interest in enterprise use of artificial intelligence continues to grow, private equity firms and portfolio companies are increasingly experimenting with large-scale generative AI projects. We offer tips on finding high-value/low-risk AI use cases that can help increase the odds of success.

Delaware's Reformed Transaction Law Unlikely to Stem the Flow of Plaintiff Suits

Delaware's S.B. 21 brings welcome change to that state's law governing transactions involving conflicted transactions and the safe harbors protections available. But plaintiffs will continue to have avenues to challenge such transactions, including through creative allegations around "non-ratable benefits."



"Do you ever have one of those days when everything seems unconstitutional?"



Spring 2025 Issue Editors



Rafael Kariyev
rkariyev@debevoise.com



Patricia Volhard
pvolhard@debevoise.com

Editorial Board

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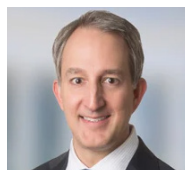
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Recent SEC Actions Signal a Positive Shift for Expanding Retail Access to Private Market Strategies



Vadim Avdeychik
Partner



Marc Ponchione
Partner

Regulated Funds, including business development companies (BDCs) and closed-end funds (CEFs), have played a pivotal role in providing retail investors with access to alternative asset classes, including private credit and private equity. However, their operational frameworks were often hamstrung by legacy regulations, procedural rigidity, and regulatory limitations that made them less agile compared to their private fund peers. The SEC's willingness over the last three months to review and update some of these historical regulatory positions comes as a welcome development.

The SEC's most recent updates indicate the possibility of increased operational flexibility, broader fundraising pathways, and reduced compliance burdens in the future that could unlock significant opportunities for retail investors and fund sponsors. As discussed in more detail below, these recent updates include: (i) simplified co-investment exemptive relief, (ii) multi-share class exemptive relief for privately offered BDCs, and (iii) potential for broader capital raising enabled by updated Rule 506(c) guidance.

Modernization of Co-Investment Exemptive Relief

On April 29, 2025, the SEC issued an order granting an application for more flexible co-investment exemptive relief for Regulated Funds.¹ Under the Investment Company Act, Regulated Funds are generally restricted from jointly negotiating or participating in certain investments alongside affiliates, unless they obtain SEC exemptive relief.² The process for obtaining that relief can be complex and can come with conditions that impose operational and administrative burdens. However, the new, more flexible co-investment relief should ease some of these burdens.

- **Streamlined Allocation Processes:** Under the updated co-investment relief, advisers will be able to utilize their existing, customary allocation policies for co-investments, provided the adviser adopts and implements policies and procedures reasonably designed to ensure that: (i) opportunities to participate

1. FS Credit Opportunities Corp., et al., SEC Rel. No. IC-35561 (Apr. 29, 2025) (the "order"), available [here](#). See also FS Credit Opportunities Fund et al., SEC Rel. No. IC-35520 (Apr. 3, 2025) (the "notice"), available [here](#). See also FS Credit Opportunities Corp., et al., File No. 812-15706 (Feb. 21, 2025) (the "application"), available [here](#).

2. Section 17(d) and 57(a)(4) of the Investment Company Act generally prohibit Regulated Funds from participating in joint transactions, including co-investment transactions, with their affiliates.

in co-investment transactions are allocated in a manner that is fair and equitable to every Regulated Fund; and (ii) the adviser negotiating the co-investment transaction considers the interest in the transaction of any participating Regulated Fund. This departs from the historical approach that required that an investment opportunity be shared with a Regulated Fund if the investment opportunity fell within the fund's

relief, a Regulated Fund will be able to participate in such investment if the transaction is approved in advance by the "required majority" of the Regulated Fund's board,³ on the basis of the determinations set forth in Section 57(f) of the Investment Company Act.⁴ The removal of this restriction is expected to broaden the range of co-investment opportunities available to Regulated Funds, particularly

Regulated Fund already holds the same security as the affiliated entity; and (ii) the Regulated Fund and each affiliated entity that are participating in the transaction are doing so pro-rata; or (iii) the disposition is a sale of a "tradable security." This revision is especially relevant for newly launched funds, late entrants to an investment, and funds purchasing in the secondary market.

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investment objective and any board-established criteria. Enabling investment advisers to rely on their existing allocation policies should streamline internal workflows relating to co-investment transactions.

- **Removal of the "Propping Up" Restriction:** Historically, a Regulated Fund has been barred from making an investment in an issuer in which it did not already hold an interest if any affiliate of the Regulated Fund already held an interest in that issuer. Under the new, streamlined co-investment

in light of the expansive and interconnected nature of modern asset management businesses.

- **Expanded Participation in Follow-on Deals:** Under the new streamlined co-investment relief, participation in follow-ons alongside affiliates will be subject to the same conditions as any other co-investment; i.e., a Regulated Fund will be able to participate in a follow-on investment even if it did not join the original transaction, as long as the "required majority" of the Regulated Fund's board provides the required pre-approval, unless the

- **Reduced Board Approval**

Thresholds: Under prior exemptive relief, board approval was required for every new co-investment by a Regulated Fund and any follow-on investments and dispositions by a Regulated Fund, unless the transaction was allocated "pro rata" or limited to "tradeable securities." Under the new exemptive relief, board approval is only required where a follow-on transaction is not effected pro rata based on current holdings, or an affiliated entity is an existing investor in the issuer and the Regulated Fund is not an existing investor in the same class of issuer's securities, as discussed above. New co-investments, pro-rata dispositions, and pro-rata follow-on acquisitions where an affiliated entity and a Regulated Fund are existing investors in

3. Section 57(o) of the Investment Company Act defines "required majority" as both (i) a majority of a Regulated Fund's board members who have no financial interest in such transaction, plan, or arrangement and (ii) a majority of the board members who are not interested persons of such company.

4. Section 57(f) of the Investment Company Act permits certain transactions if the "required majority" approves the transaction on the basis that: (i) the terms of the transaction, including the consideration to be paid or received, are reasonable and fair to the shareholders of the BDC and do not involve overreaching of the BDC or its shareholders on the part of any person concerned; (ii) the proposed transaction is consistent with the interests of the BDC's shareholders and the BDC's policy as recited in filings made by the BDC with the Commission and the BDC's reports to shareholders; and (iii) the BDC's directors record in their minutes and preserve in their records a description of the transaction, their findings, the information or materials upon which their findings were based, and the basis for their findings.

the same security of an issuer and participate in the follow-on acquisition on a pro-rata basis, will no longer require board approval.

- This narrowing in the scope of situations requiring formal board sign-off will reduce friction and potential delays in deal execution.
- **Broader Definition of Eligible Affiliates:** Historical co-investment relief extended only to investments alongside affiliated entities that were exempt from the Investment Company Act under Sections 3(c)(1), 3(c)(5)(C) or 3(c)(7). The new exemptive relief will broaden the scope of affiliated entities covered to include all entities that would be an investment company but for Section 3(c) of the Investment Company Act and Rule 3a-7, as well as Regulated Fund joint venture subsidiaries, among others. This expansion of entities that will be able to co-invest with Regulated Funds will also include collective investment trusts, which typically rely on an Investment Company Act Section 3(c)(11) exemption. As a result, this expansion should

also be taken into account when considering expanding private markets access in the defined contribution space.⁵

- **Streamlined Compliance and Reporting:** Adviser compliance teams will benefit from a leaner reporting model under the new, streamlined, co-investment relief. Instead of prescriptive documentation for each co-investment transaction, the new co-investment relief will require periodic board summaries and an annual compliance overview highlighting any material changes or notable exceptions.

There is hope in the industry that the SEC may in the future address other pain points in this space that remain unresolved. For example, the industry would greatly benefit from: (1) the adoption of a safe harbor or other relief from the requirement of same terms, same price, same class, and same security condition; (2) principal transaction relief involving portfolio companies that are classified as downstream affiliates; and (3) expansion of co-investment relief to open-ended funds.

Multi-Share Class Exemptive Relief: A New Frontier for BDC Distribution

In April 2025, the SEC took another step forward by granting⁶ multi-share class relief to private BDCs.⁷ This expansion of the multi-share class relief will allow, for the first time, a private BDC to offer multiple share classes featuring differentiated distribution and servicing fees tailored to specific distribution channels, such as registered investment advisers, broker-dealers, and institutional investors.

This shift will bring several advantages:

- **Market Reach Expansion:** Private BDCs will be able to reach a broader investor audience and distribution networks, which is expected to increase AUM growth. Historically, private BDCs were limited to issuing only one share class and, as a result, were unable to offer share classes based on specific distribution needs.
- **Alignment with Industry Norms:** Multi-share class capability brings private BDCs closer to distribution parity with other retail vehicles.

5. Collective investment trusts are primarily available to qualified retirement plans, including retirement plans that qualify under Section 401(k) of the Internal Revenue Code.

6. The SEC issued this order in response to seven distinct applications for relief in this area: Ares Core Infrastructure Fund, et al., SEC Rel. No. IC-35523 (Apr. 8, 2025), available [here](#); Antares Strategic Credit Fund, et al., SEC Rel. No. IC-35528 (Apr. 9, 2025), available [here](#); Jefferies Credit Management LLC and Jefferies Credit Partners BDC Inc., SEC Rel. No. IC-35527 (Apr. 9, 2025), available [here](#); Carlyle Global Credit Investment Management L.L.C., et al., SEC Rel. No. IC-35534 (Apr. 14, 2025), available [here](#); Barings LLC and Barings Private Credit Corporation, SEC Rel. No. IC-35535 (Apr. 15, 2025), available [here](#); Goldman Sachs Private Credit Corp. and Goldman Sachs Asset Management, L.P., SEC Rel. No. IC-35536 (Apr. 15, 2025), available [here](#); and North Haven Private Income Fund LLC, et al., SEC Rel. No. IC-35537 (Apr. 15, 2025), available [here](#) (collectively, the “order”). For a sample requested relief application, see: Ares Core Infrastructure Fund, et al., File No. 812-15687 (Feb. 28, 2025), available [here](#).

7. Like private funds, private BDCs offer their shares pursuant to exemptions from registration under Section 4(a)(2) of the Securities Act. As a result, private BDCs generally limit investors to those that satisfy the definition of “accredited investor” under Regulation D of the Securities Act.

By removing outdated constraints, simplifying compliance, and enhancing flexibility, the SEC is signaling regulatory innovation and design in the Regulated Fund space while maintaining focus on core investor protections.

- **Operational Efficiency:** By offering multiple share classes within a private BDC structure, BDC sponsors can avoid the unpredictable, and often Kafkaesque state-level approval process associated with launching a non-traded BDC.⁸

Minimum Investment-Based Accredited Investor Verification: A New Fundraising Opportunity

On March 12, 2025, the SEC Staff issued interpretive guidance⁹ confirming that the following minimum investment thresholds can satisfy “accredited investor” verification requirements for Rule 506(c) offerings:

- \$1,000,000 for entity investors and
- \$200,000 for natural person investors.

This much-needed guidance should increase the ability of a fund (including a privately offered Regulated Fund) to raise additional capital from investors that many fund sponsors previously had

difficulty accessing due to onerous verification steps that they and fund intermediaries were reluctant to undertake. The interpretive guidance also confirms that investment minimums are not the only methods that may be used to satisfy Rule 506(c); issuers may continue to use other reasonable methods.

While this recent SEC guidance is a welcome addition to the fundraising tool kit, industry participants continue to hope for future expansion of the “accredited investor” definition to further promote capital formation.

Implications and Outlook

Together, these updates reflect a significant recalibration of the SEC’s posture toward revising its regulatory positions in response to marketplace modernizations. By removing outdated constraints, simplifying compliance, and enhancing flexibility, the SEC is signaling regulatory innovation and design in the Regulated Fund

space while maintaining focus on core investor protections. And while certain challenges remain, the current direction is promising. With further expansion and broader application, these and future updates could significantly bolster growth and competitiveness in the asset management space by attracting new asset management entrants to the retail market.

8. Historically, non-traded BDCs are the only BDCs that have been granted the ability to offer multiple share classes. Prior to being offered publicly to investors, shares of non-traded BDCs must be approved by each state in which solicitations will occur pursuant to the applicable blue sky laws. Blue sky laws are state-specific regulations that require certain issuers, including non-traded BDCs, to register their offerings in applicable states and to comply with the “Omnibus Guidelines” of the North American Securities Administrators Association.

9. Latham & Watkins, LLP, SEC Staff No-Action Letter (Mar. 12, 2025), available [here](#); Letter from Latham & Watkins LLP to Div. of Corp. Fin., Request for Rule 506(c) Interpretative Guidance (Mar. 6, 2025), available [here](#). For additional insights into this development, see also our prior Debevoise Update available [here](#).

What Do Storm Clouds Portend for Private Credit?



Erica S. Weisgerber
Partner



Molly Baltimore Maass
Associate

Once a relatively niche asset class, private credit has, over the past few years, become a buzzword in corporate finance. Fueled by a favorable interest rate environment, tighter bank lending constraints, and expanding private credit strategies, the private credit market in 2024 grew to reach almost \$2 trillion in assets under management. With a rapidly increasing number of new entrants, a broadening investor base, and heightened competition, private credit has moved deeper into the mainstream, bringing with it a range of more diverse and creative solutions, such as asset-based lending and specialty loans.

Much of private credit's growth occurred during a time in which interest rates stayed close to zero. As a result, it is widely believed that private credit has yet to experience a "real" credit cycle. That may soon change, however, as signs of distress within the private credit arena are beginning to emerge. If a downturn does begin to take hold, a key question will be whether the contentious liability management transactions that have become prevalent in broadly syndicated loan structures will become more prevalent in private credit, an asset class known for being relatively tight-knit and relationship-driven.

Signs of Distress

There are numerous signs of distress. In February 2025, the default rate in U.S. private credit rose to 5.7%—up from 4.7% at the end of 2024, 5.3% at the end of 2023, and 0% in 2022, according to Fitch Ratings. More pointedly, some private credit deals have ended up as restructurings, both in- and out-of-court. Four recent examples are International Data Group, Alacrity Solutions, Pluralsight, and Zips Car Wash—each of which involved lenders taking the keys from the companies' private-equity sponsors:

Just in the past few weeks, a group of private lenders to **International Data Group**, a market intelligence company, agreed to convert some of their debt to equity in order to provide the company with runway. The deal involved adjusting part of the loan to allow payment-in-kind, which allows the borrower to defer cash interest payments.

In February 2025, **Alacrity Solutions**, which manages insurance claims through a network of adjusters, entered into an out-of-court restructuring that involved the sponsor relinquishing control to Alacrity's direct lenders. Following the transaction, the go-forward entity's capital structure will consist of a \$450 million term loan and approximately \$250 million in preferred equity. In addition to converting approximately half of their loans into equity, Alacrity's lenders contributed roughly \$175 million in new money, split between a \$75 million revolver and a \$100 million delayed-draw term loan.

Last summer, **Pluralsight**, an online education company, engaged in a drop-down transaction involving its sponsor, in which the company moved certain intellectual property into a new restricted subsidiary. The sponsor provided a \$50 million loan to the new entity that was secured by a lien on the IP, the proceeds of

the company's repayment of 75% of their loans. Zips entered bankruptcy with \$654 million in debt and \$1 million cash on hand, and its lenders agreed to loan an additional \$30 million to fund the restructuring. Zips' filing has been described as "one of the biggest bankruptcies ever in the private credit space."

If a downturn does begin to take hold, a key question will be whether the contentious liability management transactions that have become prevalent in broadly syndicated loan structures will become more prevalent in private credit, an asset class known for being relatively tight-knit and relationship-driven.

which were transferred to Pluralsight and used to fund an interest payment to its existing lenders. The deal proved unsuccessful in bridging Pluralsight through a turnaround plan, so the sponsor eventually agreed to relinquish control of the company to its lenders in an out-of-court recapitalization. Unlike many liability management exercises, the Pluralsight drop-down—while viewed as the first liability management exercise in private credit—was not challenged by any of its lenders. This may have been due, at least in part, to the fact that Pluralsight did not take the more aggressive step of moving collateral outside of the restricted group and that the parties were able to reach agreement on a consensual restructuring.

In February 2025, **Zips Car Wash** filed for chapter 11 with a pre-negotiated agreement that its private-equity sponsor would hand over the keys to Zips' lenders in exchange for

Many blame rising interest rates for the increase in liquidity issues, though remain hopeful that the recent decline in rates will stave off the need for more widespread and substantial restructurings.

"Lender-on-Lender Violence" in Private Credit?

Although these signs of distress have raised the question as to whether liability-management exercises and so-called lender-on-lender violence will become more commonplace in private credit, there are several reasons to think things may not unfold in this way:

- Deals in the private credit market are traditionally built on relationships, which makes sponsors less inclined to take aggressive maneuvers against lenders.
- Private credit deals often have more bespoke, closely negotiated credit agreements with stronger protections for lenders than broadly syndicated

loans, which typically contain more flexible, standardized language.

- To mitigate the transaction costs, litigation risk, and business disruption that accompany complex liability-management exercises involving some or all lenders, observers expect private credit lenders to opt for change-of-control or balance-sheet restructurings.
- The perception of ratings agencies or public markets is not a factor in private credit, alleviating some pressure to engage in creative liability-management exercises when a borrower is in trouble.
- The lack of secondary market in private credit limits the ability of third parties to acquire controlling positions in a company's debt and then aggressively pursue their own investment thesis.

At the same time, there are countervailing factors to the above: increased competition in the private credit arena may erode some of its relationship-driven quality and, additionally, lead lenders to accept looser terms, making agreements less bespoke. Further, increased distress may tempt increasingly desperate market players to adopt creative maneuvers. So, while there may be numerous reasons why private credit will be spared the adversarial dynamics that now frequently characterize syndicated loan structures, the bottom line is that both the level of distress in the market and how private credit payers react to it remain to be seen.

Key Executive Compensation Issues for PE Sponsors in Take-Private Transactions



Simone S. Hicks
Partner



Jonathan F. Lewis
Partner



J. Michael Snypes, Jr.
Partner



Alison E. Buckley-Serfass
Counsel

Over the past several years, private equity sponsors have increasingly pursued take-private transactions. A combination of factors has driven this trend: substantial amounts of dry powder awaiting deployment by PE firms, ongoing market volatility, perceived undervaluation of some public companies relative to their long-term prospects and the rise of private debt financing as a means to facilitate these deals. More recently, heightened macroeconomic and geopolitical uncertainties—including trade tensions and disruptions to global supply chains—have contributed to a more volatile environment, yet these same pressures may also create opportunities for sponsors to capitalize on market dislocations.

One area in which a take-private transaction introduces complex considerations for the PE sponsor is that of executive compensation. Careful planning is needed across a range of issues, from potential severance liabilities to implementing a new compensation philosophy, to avoid surprises that may disrupt management stability at a key inflection point in the company's trajectory. Below, we outline some of the key U.S. executive compensation issues relevant to PE sponsors in take-private deals.

Potential "Good Reason" Severance Exposure

Public company executives frequently have employment agreements or change-in-control severance plans entitling them to severance or benefits if they resign for "good reason" following a change in control. Common triggers include material reductions in salary or benefits; a substantial diminishment of the executive's title, authority, duties or responsibilities; or requirements to relocate beyond a set distance. Severance at public companies is typically generous and pegged to levels higher than private companies.

Changes at a target company that naturally occur as a result of a take-private transaction may provide C-suite executives with the ammunition they need to invoke their "good reason" clause. For example, a CFO losing public company financial reporting and investor relations duties might point to a perception of diminished responsibility as a basis to resign and collect severance. Even when such claims are not ultimately valid, the mere assertion of those claims can be disruptive and potentially expensive to resolve.

PE buyers can mitigate this risk by reviewing and renegotiating "good reason" provisions before closing. Executives may be asked to waive any potential triggers tied solely to the shift from public to private status so that it is clear the transaction itself does not automatically allow an executive to walk away

with severance. These discussions will often occur in connection with the negotiation of post-closing equity and other compensation arrangements, subject to the timing and disclosure considerations discussed below.

Section 280G Golden Parachute Tax

U.S. tax law adds another layer of complexity for the PE sponsor in a take-private transaction. Certain senior executives and highly compensated employees face a potential 20% federal excise tax on “excess” parachute

deduction on any excess amounts, it is quite common and typically less controversial and less punitive to the executive than a full cutback.

Private companies can often circumvent this tax exposure—avoiding the excise tax and lost deduction—through the shareholder approval exception, wherein the executive waives any excess amount and at least 75% of the remaining shareholders approve. However, this exception is not available for public companies, including in a take-private transaction. The parties to the

amounts, accelerated equity, retention bonuses and other deal-related payments. In addition, a separate “say on parachute” shareholder vote (albeit nonbinding and advisory) on the golden parachute arrangements between the soliciting target company and the named executive officers is required under Section 14A(b) of the Securities Act.

The SEC disclosure rules cover agreements and “understandings,” whether written or unwritten, involving the named executive officers of the target, whether such agreements are with the target company or the acquiring PE sponsor. Further, the merger proxy rules separately require disclosure of any substantial interest held by a director or executive officer in the proposed transaction, which can include new entitlements to compensation in connection with the proposed take-private transaction. As a result, any new arrangements between the PE sponsor and the executive officers of the target may be disclosable and in the public spotlight.

Pre-closing discussions with management can be complicated by additional enhanced disclosure rules that are intended to address potential management conflict-of-interest concerns. Pre-signing discussions about post-closing employment, retention programs or equity arrangements may raise claims of conflicted transaction negotiations, and the public company board and the PE sponsor may each have incentives (though not perfectly aligned) to limit access to management prior to closing. This limited access can

Careful planning is needed across a range of issues, from potential severance liabilities to implementing a new compensation philosophy, to avoid surprises that may disrupt management stability at a key inflection point in the company's trajectory.

payments triggered by a change in control, and the corporation may lose its federal tax deductions for such payments. The excise tax on parachute payments generally is triggered when severance, retention payments, accelerated equity vesting or other change-in-control payments exceed three times the executive's historical average compensation.

Gross-ups for this tax liability were once common, but institutional shareholder backlash has made such provisions increasingly rare. Instead, executives more typically have “better off” cutback provisions that reduce parachute payments to an amount that does not trigger the excise tax unless the executive is better off receiving full payment and paying the taxes themselves. Although this approach may still forfeit the corporate

transaction often must model out the potential costs, factor them into the transaction negotiations and consider strategies to mitigate the tax exposure (e.g., accelerating bonuses into a year prior to closing to increase base amounts or recharacterizing a portion of the change-in-control payments as consideration for a noncompete).

Compensation Disclosure Obligations

Because the target company is public at the time the transaction is signed, it must comply with SEC disclosure requirements regarding merger-related compensation for its named executive officers. Under Item 402(t) of Regulation S-K, the merger proxy or tender offer statement must disclose tables and narratives detailing the various elements of the executives' golden parachutes, including severance

complicate—or, from a timing perspective, compress—critical discussions involving management equity, rollover and other important closing matters. Navigating these sensitive issues is often a critical feature of management negotiations in take-private transactions.

Management Equity

Outstanding Public Company

Awards. The existing equity plan documents and terms of the merger agreement generally govern how public company equity awards held by management are treated in a take-private transaction. In most cases, in-the-money stock options are cashed out at closing for their spread value, while time-based restricted stock and restricted stock units (RSUs) may either be cashed out or assumed and replaced with an equivalent-value award (equity or cash-based) under the new private structure. Performance awards typically vest at a level specified by the plan or the compensation committee—often target or actual performance (potentially prorated for the truncated performance period)—and are then either cashed out or converted into replacement awards, like the time-based RSUs. These decisions are heavily negotiated, and in practice, cashing out awards for cash consideration at closing is simplest and common in public-to-private deals.

Management Equity Under Private

Ownership. After the closing, private equity sponsors usually offer a combination of co-investment and

incentive equity (often in the form of options or profits interests) to ensure the leadership team has “skin in the game” for the next chapter.

substantial equity grant at the time of acquisition, intended to cover multiple years within the sponsor’s typical investment horizon.

The parties to the transaction often must model out the potential costs, factor them into the transaction negotiations and consider strategies to mitigate the tax exposure.

Co-investment, in this context, is generally made by the executive in cash on an after-tax basis—using transaction proceeds or other capital—rather than through a rollover of executives’ public company shares because the availability of a tax-free rollover is limited. With respect to the incentive equity, because public company employees may be used to liquid public markets and annual grants of full-value awards, sponsors should clearly communicate the mechanics of different private equity pay structures:

- **Shift to appreciation awards:** Executives accustomed to full-value awards (like RSUs) will typically receive stock options or profits interests in the PE portfolio company. These instruments carry potentially high upside but can become worthless if the investment underperforms. Profits interests, though increasingly prevalent, can be more complex than options from a tax and operational perspective, thereby requiring detailed explanation to management.
- **Front-loaded grants:** Rather than annual equity grants, PE sponsors commonly provide one

- **Illiquidity and extended time frames:** Because PE equity awards rarely have an active market, executives should expect a multi-year holding period until the sponsor exits. These awards also may be subject to call rights if the executive’s employment terminates. While vesting may accelerate upon a future sale of the company, day-to-day trading is not an option.
- **Targeted participation:** Although some sponsors extend equity opportunities to broader employee populations, it is more common for PE firms to limit direct equity participation to a narrower group of key contributors. Cash-based bonus programs typically fill the gap for the broader workforce.

Taking a public company private with PE backing gives rise to a broad spectrum of executive compensation issues, each of which must be carefully addressed. The time and effort invested in doing so, however, will help align the interests of the sponsor and management, minimize uncertainty and provide a firm foundation for the company’s next chapter.

The Secondaries Market: Dealmaking Trends



Gavin Anderson
Partner



Benjamin Amos
Counsel

Continuation vehicles (CVs) have been on a hot streak. Last year, more than \$70 billion of GP-led secondaries closed,¹ setting a new record. The market is evolving rapidly, with plentiful pools of secondary capital to soak up investor demand, including new sources such as '40 Act funds. In this article, we look at some of the current trends and where they might lead.

Single- vs. Multi-Asset CVs

The last few years have seen a fairly steady mix of both single- and multi-asset CVs. A single-asset CV may be the ideal showcase for a sponsor's "crown jewel," allowing the asset to show its full potential with a bespoke vehicle and potentially a deeper diligence process for investors. Some fund sponsors have even raised funds dedicated to investing in single-asset CVs. Yet, multi-asset CVs also have their advantages. From the sponsor side, they can help to achieve critical mass and/or synergies and can be an effective way to clean up end-of-life funds. For investors, they provide natural diversification, which may appeal to a different investor base, and they result in netted economics, so that carry is only payable if the portfolio as a whole performs well. We expect both types to remain prominent.

Sector Specialization

Credit

Although we have worked on some large and notable credit CVs, they still represent a relatively small slice of the market. Following the recent surge in fundraising for credit funds—and the appetite for the steady returns they can bring—we expect credit CVs to be a growth area. Pricing can present a challenge, however, given that the anticipated returns from credit instruments are lower, and there may be less scope for the kind of compelling story that can be told about some buyout CVs (*e.g.*, more capital for accretive bolt-on transactions or more runway to reach full exit velocity). Furthermore, given the self-executing nature of the assets, existing investors may be more likely to "roll" compared to some other types of CVs, which may result in a less attractive proposition for potential buyers.

VC and Growth

Growth and venture capital CVs are also less common than buyout vehicles. Although they do have more market share than credit strategies, they remain nascent, and pricing is often at a significant discount. On the face of it, these assets may look appealing for CVs, as they offer the potential for outsize

1. Lazard's Secondary Market Report 2024.

returns. But dangers lurk for precisely those reasons. Accurate valuations are notoriously difficult. The smaller size of VC and growth deals can make it harder to assemble a portfolio that is large enough to justify a CV, and the lack of control compared to a buyout vehicle may hamper sponsors' ability to proactively add value. For U.S. sponsors that are not registered with the SEC, there can also be regulatory hurdles to navigate, including structuring the CV to maintain the sponsor's venture capital fund adviser exemption. There will be some great opportunities, but they are perhaps not for the faint of heart.

Infrastructure

Perhaps more adjacent to traditional buyout CVs, we have seen a number of infrastructure CVs and also a few funds dedicated to infrastructure secondaries (while other sponsors may invest in such deals from a mainstream secondary fund). These assets are often long term by nature, and may require significant capital, so they are in many ways a natural fit for a CV structure. They offer steadier and potentially inflation-resistant returns that can be reassuring in uncertain times, albeit typically lower than a buyout CV target return, which may be to the detriment of the upside story.

CV Ouroboros

What happens when a CV runs out of road? One option is to rinse and repeat: raise a CV for the CV. As more and more CVs are reaching the ends of their terms, and some of them

have not yet found a path to exit, we are increasingly seeing these "CV squared" structures in the market. They may face more skepticism from investors regarding the business plan (including the eventual path to exit), but if the asset is attractive, and the story is compelling, then a CV squared could make sense for the same reasons that the original CV did—to provide liquidity and optionality to existing investors while allowing new investors to buy in and provide top-up dry powder if needed. Also, the investor base for the first CV is likely dominated by secondary investors, who will be familiar with CV technology and dynamics, making for an easier and more sophisticated conversation the second time around. At some point, this could even start to look more like a "private IPO."

Disintermediation?

Financial advisors are a standard part of the process for most CV transactions. As well as sourcing investors and running auctions, they also provide strategic advice and market intelligence, and they help to manage a complex and fast-moving process. However, we have seen some CVs put together with a limited role, or no role, for a financial advisor. In some cases, these are large and sophisticated managers with the in-house expertise and resources to run such transactions effectively. In other cases, they may be small managers who are comfortable with a more ad hoc approach, and who may feel that the limited size of their CV does

not justify additional costs. Looking forward, we anticipate that some of the largest managers may want to bring some CV-related workstreams in-house, especially if they are regularly raising CVs, but most likely around the margins. Another consideration is that LPs often take comfort from the involvement of an experienced and sophisticated third-party advisor, given the conflicted nature of these transactions.

The More the Merrier

Many CV transactions involve not just a CV but also a third-party buyer or sponsor flagship fund on the buy side. This is often a feature of larger deals, and we are seeing a number of outsize CVs coming to the market in 2025, supported by ever-larger secondary fundraisings. Such additional parties can help to validate pricing (in the case of a third-party buyer) and to show strong alignment and conviction (in the case of a sponsor flagship fund).

Conclusion

The CV market has come a long way in a short space of time and will continue to innovate in interesting ways. We expect further specialization, ever-larger CVs, and increasingly creative solutions for channeling secondary capital into attractive assets.

The Secondaries Market: Financing Trends



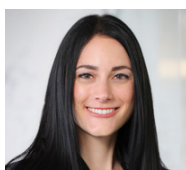
Ramya S. Tiller
Partner



Michael P. McGuigan
Counsel



Ann Stillman
Associate



Ines Tulic
Associate

The secondaries market has grown from strength to strength in recent years; the transaction volume of \$165 billion in 2024 represented a 40% increase over the prior year. While recent market turmoil may make the short-term outlook hard to predict, over the long term, both transaction volume and fundraising are expected to increase. This growth has been accompanied by a greater use of leverage by secondaries funds. Indeed, the slowdown in M&A activity and related reduction of distributions from the underlying portfolio is likely to spur funds to incur more leverage, including to cover liquidity needs and to return capital to investors. While the nuts and bolts of a secondaries net asset value (NAV) financing are not new, the growth in volume has attracted new entrants and resulted in innovation in the market.

Deferral Security and NAV Financings

Liquidity needs are not the only factor driving the significant growth in the secondaries market—plenty of sponsors engage in secondary transactions for purposes of, among other things, rebalancing their portfolio allocations or de-risking their fund. As a result, sellers in recent deals have been more willing to defer a significant portion (50% or more) of the purchase price in exchange for a meaningfully higher headline price (3–4% in recent experience) and a more robust guarantee and security package, which may include parent guarantees, pledges of equity interests in the SPV holding the portfolio, pledges of bank accounts into which distributions from the portfolio will flow and/or a pledge of the unfunded capital commitments of the investors. Buyers, on the other hand, often want to obtain a NAV facility whose proceeds can be utilized to make the closing date purchase price payments or to return capital more quickly to investors.

The competing obligations—deferral owed to sellers and NAV loans to lenders of the buyer—can create a complicated structuring and deal dynamic as sellers push for deferral security to come ahead and buyers push for NAV loans to come ahead to preserve maximum financing flexibility. Often, sellers are willing to agree to have the NAV facility come ahead in respect of the underlying portfolio investments so long as the buyers have provided guarantees from well-capitalized entities above the NAV structure.

Insurance Investors

Another notable trend is the prevalence of insurance investors in NAV financings. The terms of these facilities often blur the line between a

While secondaries NAV financings are by no means a new product in the fund finance space, the growth in secondaries fundraising and deal activity has spurred innovation in structures and terms.

secondaries NAV financing and a securitization or collateralized fund obligation (CFO) transaction. Key features of insurance financings include the following:

- **Tenor:** These loans often have a tenor of 10 years as compared to three to five years for those provided by other lenders.
- **Cash Flow Sweeps:** Given the long tenor, insurance investors may be willing to provide for a longer cash sweep holiday, thus allowing the borrower to make more distributions to its investors in the initial years of the facility.
- **Rating:** These loans include either a requirement to obtain a rating prior to the closing of the facility or, if not obtained at closing, a covenant to use commercially reasonable efforts to obtain a rating within a specified period. Failure to obtain a specified investment grade rating can result in an interest rate step-up or accelerated cash sweeps.
- **LTV Financial Covenant:** In borrower-favorable deals, there might not be a financial covenant to maintain a loan-to-value ratio

(LTV) below a specified threshold. Instead, when LTV exceeds specified thresholds, the result is a 100% sweep of distributions from the portfolio rather than a default.

Financings for Evergreen Funds

We have seen semi-liquid open-ended secondaries funds (also known as evergreen funds) gain in popularity in recent years, and more lenders are providing financing to these funds with the following key features:

- **Blind Pool Revolvers:** Lenders are willing to provide revolving facilities without approval rights over specific assets in the borrowing base so long as such assets are consistent with the fund's investment strategy and meet certain minimum diversity requirements.
- **Unsecured v. Secured:** These facilities can be obtained either on a secured or on an unsecured basis. If unsecured, there will be a soft commitment from the entity receiving subscription funds to transfer amounts to a borrower collateral account in the case of an event of default or LTV breach.

Rated Feeders/CFOs

We have seen rated feeders and CFO transactions for secondaries funds or stakes come back in focus given that recent developments have provided greater regulatory certainty for U.S. insurers. We expect secondaries funds to take more advantage of these products, either as a fundraising tool or as a means of obtaining needed leverage.

Expectations for the Future

While secondaries NAV financings are by no means a new product in the fund finance space, the growth in secondaries fundraising and deal activity has spurred innovation in structures and terms. We expect this to continue, with market participants using more bespoke structures, and terms evolving on a deal-by-deal basis.

Updated SEC Guidelines Concerning Draft Registration Statements, M&A Transactions and Tender Offers



Morgan J. Hayes
Partner



Eric T. Juergens
Partner



Benjamin R. Pedersen
Partner

In early March 2025, the staff of the Division of Corporation Finance of the Securities and Exchange Commission expanded and updated guidance with potential implications for the private equity industry. These changes include expanded accommodations for issuers to submit draft registration statements for nonpublic review, greater flexibility in written consents and “lock-up” agreements in M&A transactions, and new clarifications to materiality thresholds in tender offers.

A summary of each of these key changes, along with takeaways for clients in the private equity industry, are provided below. More detailed information can be found in our Debrief on the registration statement review process and our Update on the new Compliance and Disclosure Interpretations (C&DIs) regarding sign-and-consent structures and tender offers.

Broadened Accommodations for Draft Registration Statement Review.

Enhanced Accommodations. Beginning in 2012, the SEC permitted confidential submission and review of draft registration statements for initial public offerings of Emerging Growth Companies (EGCs). The SEC then expanded this process to include all IPO issuers, as well as, in limited circumstances, other issuers. On March 3, 2025, the SEC further expanded this guidance through the following key changes:

- **Expanding the initial registration statements eligible.** The SEC will now permit issuers to submit for nonpublic review initial registration statements on Form 10, 20-F or 40-F under Exchange Act Section 12(g).
- **Removing time constraints on review of subsequent draft registration statements.** The SEC has removed the 12-month time limit and will now permit nonpublic review of subsequent draft registration statements for Securities Act offerings or registration of securities under either Section 12(b) or Section 12(g) of the Exchange Act regardless of when the issuer filed an initial registration statement. Issuers submitting subsequent draft registration statements for nonpublic review must publicly file their registration statement and nonpublic draft submission at least two days preceding the requested effective time and date. The SEC will continue to limit its nonpublic review of subsequent draft registration statements to the initial submission and not to any amendments.

- **Expanding review to include de-SPAC transactions.** The SEC will allow issuers to submit for nonpublic review registration statements in connection with de-SPAC transactions as if such registration statements were an initial Securities Act registration statement where the SPAC is the surviving entity, provided the co-registrant target would otherwise be independently eligible to submit a draft registration statement.
- **Special considerations for Foreign Private Issuers.** In addition to their options under the new accommodations, Foreign Private Issuers may, if they so qualify, choose to follow the procedures available to EGCs, or they can follow the alternative guidance issued in the SEC's [2012 statement](#).
- **Allowing issuers to omit underwriter(s) from initial draft registration statements.** The SEC will permit issuers to omit the underwriter name(s) from initial registration statements where such information would otherwise be required, provided such information is later supplied in subsequent submissions and public filings.

The SEC's expanded review process allows more companies to benefit from confidentiality during their initial registration review process, offering companies greater agency over their messaging to the market and greater ability to control the timing of their transactions based on market conditions. These changes provide flexibility benefitting private equity sponsors in connection with liquidity

events, including follow-on sales after an IPO and public exits via a de-SPAC business combination transaction.

the acquiring company's securities on Form S-4 (or Form F-4) when a sign-and-consent structure has

Changes include expanded accommodations for issuers to submit draft registration statements for nonpublic review, greater flexibility in written consents and "lock-up" agreements in M&A transactions, and new clarifications to materiality thresholds in tender offers.

Expanded Flexibility for M&A Sign-and-Consent Structures and Lock-Up Agreements.

Background

In business combination transactions involving target companies with a majority stockholder, an acquiror often requests that such stockholder delivers a written consent immediately after the signing of the transaction agreement. This "sign-and-consent" structure eliminates the need for a stockholder meeting to approve the transaction, accelerates the closing timeline and enhances acquiror's deal certainty. Absent a written consent, acquirors will seek voting agreements where management and principal security holders commit to vote in favor of the transaction at the stockholders meeting, referred to as "lock-up agreements."

Though not enforced in recent years, the SEC historically objected to sign-and-consent structures in transactions where the target company stockholders were to receive public (i.e., unrestricted) stock of the acquiring company as consideration.

Updated Guidance

Sign-and-Consent Structures

The SEC now formally permits registration of offers and sales of

been implemented, provided: (1) the insiders of the target company, who provided written consents, are offered and sold acquiring company securities only in an offering validly exempt from the Securities Act, and (2) the registered securities (on either Form S-4 or F-4) are offered and sold only to security holders who did not sign on to such written consent.

This means that the SEC staff will allow stock-for-stock mergers that involve a combination of exempt offerings for target company insiders who executed consents in favor of the transaction and a registered offering for other target company stockholders. The SEC's updated guidance offers additional flexibility for companies with significant stockholders (such as a private equity sponsor) to structure their business combination transactions to avail themselves of the benefits of a sign-and-consent arrangement.

Lock-Up Agreements

The SEC also clarifies its guidance on transactions involving voting agreements with significant stockholders in lieu of a sign-and-consent structure. Four conditions must be satisfied to ensure the non-objection

of SEC staff to the registration of offers and sales when significant stockholders (such as a private equity sponsor) sign lock-up agreements:

- the lock-up agreement involves only target company insiders, including executive officers, directors, affiliates, founders and their family members and holders of 5% or more of the voting equity securities of the target company;
- those signing the lock-up agreement own, in the aggregate, less than 100% of the target company's voting equity securities;
- votes are solicited from the target company's stockholders who have not signed lock-up agreements if required to approve the transaction under state or foreign law; and
- the acquiring company must deliver a prospectus to all target company security holders entitled to vote on the transaction.

New Guidance on Materiality Thresholds in Tender Offers.

New Guidance

The SEC also provided new guidance relating to tender offers, relevant to private equity sponsors and their portfolio companies engaging in liability management exercises or take-private transactions structured as a tender offer. The SEC's new Compliance and Disclosure Interpretations (C&DIs) relating to tender offers provide greater insight into how the SEC views materiality thresholds, thus removing certain ambiguities regarding tender offer

disclosures and allowing companies and private equity sponsors to more thoughtfully contract with lenders. The SEC's relaxing of the five-business day requirement for all-cash tender offers allows companies and private equity sponsors additional flexibility and certainty in structuring offers, including in the take-private context.

We summarize the new C&DIs as follows:

- **Question 101.17:** The SEC acknowledges that its "general rule" requiring all-cash tender offers remain open at least five business days following the initial disclosure date of material changes may not always be practical. A shorter time frame may be acceptable, provided security holders have sufficient time to consider the material information disclosed when contemplating whether to tender, withdraw, sell or hold. The relative materiality of the information matters.
- **Question 101.18:** When an offeror announces a partly financed or unfinanced tender offer subject to Regulation 14D and discloses the lack of sufficient funds in its offer, the offeror's subsequent securing of funding is a material change requiring prompt disclosure and dissemination of updated disclosure. Offerors may consider extending the offer to allow shareholders adequate time to consider the change. This C&DI applies to both third-party tender offers and issuer tender offers.
- **Question 101.19:** The SEC clarifies that binding commitment letters from lenders constitute a fully

financed transaction. However, "highly confident" letters from lenders are not fully financed.

- **Question 101.20:** Where an offeror discloses that it has received a binding commitment letter from a lender but also discloses that it may purchase the securities via an alternative funding source, if the offeror does utilize the alternative funding (including cash), the substitution does not constitute a material change. The offeror should still consider whether the offer materials should be updated to reflect the change.
- **Question 101.21:** This C&DI applies to an all-cash tender offer subject to Regulation 14D, where the offeror obtains a binding commitment letter from a lender but conditions the purchase of the tendered shares on receiving the funds from the lender. If the lender provides the funds—or if the lender does not provide the funds, but the offeror waives the condition and utilizes alternative funding—there is no material change. However, if the lender does not fulfill its obligation, but the offeror waives the funding condition without any alternative funding source, the offeror's waiver is a material change requiring prompt disclosure. Further, offerors should consider whether they can satisfy the prompt payment requirement imposed by Rule 14e-1(c). This C&DI applies to third-party tender offers, as well as issuer tender offers subject to Rule 13e-4 and its comparable requirements.

Trump's America First Investment Policy: Implications for Private Equity



Rick Sofield
Partner



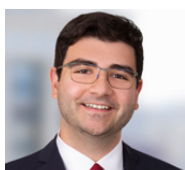
Robert T. Dura
Counsel



Jordan Corrente Beck
Associate



John M. Satira
Associate



John Sullivan Baker
Associate

On February 21, 2025, President Trump issued his *America First Investment Policy* memorandum, which details measures intended to “make the United States the world’s greatest destination for investment dollars” by facilitating investment by U.S. allies while countering “new and evolving threats” associated with investments from and into countries considered foreign adversaries, principally China.¹ These threats include China’s efforts to “direct and facilitate” inbound U.S. investments in order to acquire critical technology, obtain intellectual property, and gain leverage in strategic industries. The memorandum also highlights continuing U.S. concerns that China is leveraging U.S. investment in certain ostensibly civilian Chinese companies to strengthen its military and intelligence apparatuses. Along with focusing on the national security threats posed by inbound and outbound foreign investment, the investment policy also promotes more streamlined review of, and lower barriers to investment from, countries allied with the United States.

The Trump administration’s investment policy reflects U.S. officials’ changing understanding of national security, which has expanded beyond intelligence and military defense to include matters of trade, technology, and energy policy. While this trend has been underway for some time, it has accelerated under the current administration. In this shifting landscape, it is more important than ever for private equity firms to stay abreast of national security policy developments and consult proactively with counsel regarding approaches to compliance.

Inbound Investment

A key pillar of the policy put forth in the memorandum is that “restrictions on foreign investors’ access to United States assets will ease in proportion to their verifiable distance and independence from the predatory investment and technology-acquisition practices” of foreign adversaries. As part of this approach, the administration intends to create an expedited review process for investments that will include the launch of a “Known Investor Portal” that will allow CFIUS to collect information from foreign investors in advance of a filing. CFIUS intends to conduct a pilot of this fast-track process and build from it over time, but it will presumably involve judging whether foreign investors are sufficiently distant from foreign adversaries.

1. “Foreign adversaries” under the memorandum are the PRC, including the Hong Kong Special Administrative Region and the Macau Special Administrative Region; the Republic of Cuba; the Islamic Republic of Iran; the Democratic People’s Republic of Korea; the Russian Federation; and the regime of Venezuelan politician Nicolás Maduro.

Accordingly, in order for private equity firms to gain the benefits of this fast-track process, they may need to first distance themselves from the PRC and other geopolitical rivals of the United States. While it may be challenging for firms to pare back rights or interests from PRC-affiliated investors in investment fund vehicles, any associated costs should be weighed against the possible benefits of fast-track review. Firms should also consider steps to render foreign

foundational technologies within CFIUS's jurisdiction. When investing in industries or targets that can involve these areas, firms should be prepared for potential scrutiny of such investments for national security concerns.

In addition, the administration intends to cease entering into what it considers "overly bureaucratic, complex, and open-ended" mitigation agreements with investors from foreign adversary countries and

what rights and interests such foreign investors have acquired. In doing so, it will be able to exercise its broad authority to request information from firms, including information regarding limited partners that would otherwise be confidential. Accordingly, if private equity funds include investors affiliated with foreign adversary countries, or foreign investors that otherwise present national security concerns, CFIUS has the means to uncover such information. And if CFIUS believes such an investor presents a national security concern within the context of a particular transaction, CFIUS has the authority to mitigate or block an investment where that foreign investor will receive an indirect interest in a U.S. business.

Private equity will likely be a key target of CFIUS's expanding enforcement. CFIUS appears poised to continue scrutinizing private equity structures to determine whether they include foreign investors, and if so, what rights and interests such foreign investors have acquired.

investors passive where appropriate, as passive investments from foreign investors are explicitly welcomed and encouraged in the memorandum.

Further, firms should note the administration's intent to expand CFIUS review and enforcement in certain strategic areas. The memorandum states that the administration intends to, in consultation with Congress, protect real estate and farmland near sensitive sites, strengthen CFIUS authority over greenfield investments, limit foreign adversary access to U.S. talent and operations in sensitive technologies (especially those related to artificial intelligence), and expand the range of emerging and

instead seek agreements mandating "concrete actions that companies can complete within a specific time." While investors from allied countries have grown frustrated with lengthy CFIUS reviews and burdensome mitigation agreements, they may find this provision to be a limited remedy, given that it explicitly relates to investments from foreign *adversaries*, which are more likely to be prohibited outright—rather than permitted with complex mitigation in place.

Private equity will likely be a key target of CFIUS's expanding enforcement. CFIUS appears poised to continue scrutinizing private equity structures to determine whether they include foreign investors, and if so,

Outbound Investment

The *America First Investment Policy* also proposes expanding the existing Outbound Investment Rule, a Biden-era regulation that restricts U.S. persons' investment in certain sensitive industries if there is a nexus to China. For a covered transaction, the rule imposes either a notice requirement or an outright prohibition, and the current targets are China-related companies engaged in the development or production of certain semiconductor, AI, and quantum technologies. The rule's requirements are triggered by a U.S. person's knowledge of these China-related technology touchpoints, including both actual knowledge as well as information that could have been obtained through a reasonable

The America First Investment Policy has significant implications for the private equity industry. Not only does the memorandum call for restrictions that specifically target private equity, but the policy also targets the U.S. institutional investors that form the core LP base for many private equity firms, including pension funds and university endowments.

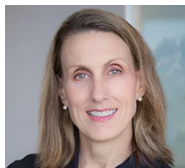
and diligent inquiry. Accordingly, reasonable diligence regarding investment activities, including related recordkeeping, is now advisable for many fund investments.

The *America First Investment Policy* memorandum—as well as an April trade policy report delivered to the President—indicates that new and expanded investment restrictions may be imposed in the coming months, including controls targeting China-related companies engaged in biotechnology, hypersonics, aerospace, advanced manufacturing, or directed energy technology development.

The *America First Investment Policy* has significant implications for the

private equity industry. Not only does the memorandum call for restrictions that specifically target private equity, but the policy also targets the U.S. institutional investors that form the core LP base for many private equity firms, including pension funds and university endowments. Although private equity investments are already covered by the rule—which restricts all U.S.-person investors equally—these explicit references suggest that the administration may single out private equity for extra scrutiny as it considers when and how to enforce the rule.

Eight Principles of Effective and Strategic M&A Legal Due Diligence



Molly F. Stockley
Counsel

Legal due diligence is a standard component of the larger due diligence investigation that sponsors conduct on potential targets. But legal due diligence can vary greatly in how efficient it is and in whether it generates real strategic value or is just a rote exercise. Effective and strategic M&A legal due diligence has three objectives:

- to obtain information regarding the assets and liabilities of the target so that an informed investment decision can be made;
- to identify problem areas or obstacles for making the deal work or getting the deal done; and
- to mitigate or address those issues.

This article discusses eight guiding principles for optimizing legal due diligence practices for sponsor acquisitions.

1. Build the due diligence strategy around the deal's rationale and key risk areas.

Legal due diligence should be more than a risk mitigation exercise. Done properly, it can provide significant insight into valuation, identify potential impediments to closing early on, and refine post-close priorities. Achieving these benefits, however, requires that the due diligence strategy be shaped by the deal's specific business thesis and value drivers, the contexts around the target, its market and its industry, and the sponsor's plans for the target. There may be a specific plan for the target business (such as renegotiating all of the customer contracts, entering into a new geographic area, or expanding through M&A) or perhaps a particular litigation exposure or regulatory risk, which will be important to the valuation. Deal counsel should avoid approaching legal due diligence with a one-size-fits-all template and take the time at the beginning of the process to identify the value drivers.

2. Prepare due diligence work plans.

The legal due diligence strategy can then be translated into a detailed work plan that sets out the key risk areas for the target and the specific documents or categories of documents or issues to be reviewed, as well as the substance of the analysis (such as provisions to be captured or concerns to be addressed). In addition to providing a roadmap for the due diligence process, a work plan helps ensure that due diligence is conducted in a resource-efficient

manner, establishing a coordination framework for junior deal counsel who are reviewing the documents, and for senior deal counsel who are determining staffing needs and priorities. Often, a target will provide a large volume of contracts or other information that is not material, and materiality thresholds are important elements of most due diligence work

the target's approach to evaluating and managing the risks facing its business and its perception of areas that do and do not require buyer attention provide a strong foundation for structuring an effective due diligence process. It is difficult to obtain this information solely through written Q&A without interaction in real time. A call also provides the opportunity

that the request list be coordinated across the entire working group (including advisors beyond the legal teams) to avoid duplicative requests.

If timing allows, there can be some benefit to waiting to submit a due diligence request list until after the initial legal due diligence call, since potential lines of inquiry frequently can be addressed and eliminated on the call. As a result, the due diligence request list will be shorter and even more focused.

Legal due diligence should be more than a risk mitigation exercise. Done properly, it can provide significant insight into valuation, identify potential impediments to closing early on, and refine post-close priorities.

5. Adopt a thoughtful approach to due diligence reporting.

Legal due diligence reports can vary greatly in length and detail (from long-form comprehensive reports to short-form "red flag" issue lists). The format chosen should take into account the expected use of the report among the deal team as well as by third parties such as lenders or representation and warranty insurers. While we see a trend toward shorter reports that focus on issues analysis rather than extensive document summaries, there are some situations (such as a target that has customer agreements with specific pricing formulas that are material to the business) where details may be important for the sponsor's financial modeling purposes. In these situations, summary charts that capture these key economic provisions can be attached to the report. Obviously, material issues should be conveyed as soon as they are identified.

plans. Sampling methodologies can be used to avoid reviewing large numbers of similar ordinary-course contracts. It is often efficient to structure due diligence work in phases, so that areas most likely to result in "red flag" issues with a go/no-go outcome are tackled first, with confirmatory due diligence on other issues to follow after there is greater deal certainty.

for the sponsor to demonstrate at an early stage that it and its advisors are commercial and pragmatic. This initial call can be followed by conversations with relevant specialists and, if needed, a deeper dive into issues identified in documentary due diligence.

4. Create customized due diligence request lists.

The due diligence request list should be closely tailored to the target and the target's industry. It should reflect deal counsel's review of the target's data room (if already open), any marketing materials received from the target, and counsel's own research and familiarity with similar transactions. The list should be designed to elicit the necessary information to meet the objectives of the legal due diligence process without creating burdensome busywork for the target. It is important

3. When possible, establish early communication with the target.

When the sales process permits, we are advocates of a kick-off call with target personnel at the beginning of the due diligence investigation, before document review has begun in earnest, to discuss the transaction and core risk areas. An early call sets the foundation for a focused, results-oriented investigation. Understanding

Whatever form they take, all reports should include an executive summary of material value items and legal issues (such as regulatory approvals) that will affect the timeline to closing for use in purchase agreement negotiations. The summary should also include concrete recommendations for next steps, assessments of implications, and any mitigating factors. The executive summary is the most important section of the report and the most challenging to write, requiring the application of general “deal sense” and experience from similar transactions to the facts, findings, and conclusions that have been identified or developed in the due diligence investigation in a specific transaction. It is thus important for deal counsel to involve seasoned dealmakers in the preparation of the executive summary.

6. Maintain a tight connection between due diligence review and the purchase agreement and other deal documentation.

The goal of legal due diligence is to identify obstacles to deal execution or ongoing risks so they can be mitigated or addressed in the deal documentation. Examples of these obstacles include required consents, contingent liabilities, change of control triggers in employee benefits documents, non-competition agreements and other restrictions on doing business, and, in carve-outs, shared assets and liabilities. Methods to mitigate or address obstacles include requiring pre-signing or pre-

closing cleanup of issues, modifying the economics of the deal (such as identifying debt-like items that will be deducted from the purchase price), shifting risk in accordance with findings (such as adding specific representations and warranties or negotiating indemnification rights) and changing the structure of the transaction.

Regular communication between the due diligence and purchase agreement teams at both the business and legal levels ensures that due diligence findings are appropriately reflected in the deal documentation.

Regular communication between the due diligence and purchase agreement teams at both the business and legal levels ensures that due diligence findings are appropriately reflected in the deal documentation. Due diligence teams should also be involved in disclosure schedule review to leverage knowledge of the target’s business that was obtained during document review and management interviews.

7. Provide close supervision and guidance of junior lawyers performing due diligence.

An experienced attorney on the deal counsel team should be designated to coordinate legal due diligence efforts across all practice areas, supervise general corporate (non-specialist) due diligence, and assume primary responsibility for the due diligence report. The requisite experience level of the coordinator

will depend on the complexity of the deal and the overall timeline.

Quality control of the due diligence input is one of the most important functions of the coordinator. It is not possible to produce a due diligence analysis that will achieve the overall goals of the process without accurate and complete due diligence findings.

In other words, “garbage in, garbage out” or, for a more positive spin on this aphorism, “excellence in, excellence out.” For that reason, it is critical to ensure that the team of junior attorneys who are reviewing the documents understand the business expectations and desired final work product, are fully briefed on the due diligence work plan and deal structure, and maintain an open dialogue with more senior lawyers and the deal team on areas where it may be appropriate to modify the plan based on ongoing due diligence findings.

8. Commit internal resources to foster excellence and efficiency in due diligence practice.

Beyond the best practices for the legal due diligence of a given deal, we recommend that regular deal counsel make a commitment to broader knowledge management and training

by appointing a senior attorney to develop due diligence best practices, including approaches to data room review and management and disclosure schedules, and use of technology when cost efficiencies can be demonstrated. Ideally, the senior attorney will also work directly with junior attorneys in the trenches on transactions where doing so is justified by the complexity

diligence review forms and due diligence reports). We have found that the most useful materials are industry- or transaction-type-specific that differentiate between private and public company targets.

These efforts require an up-front investment, but they pay off by allowing more junior attorneys to handle key diligence tasks efficiently

These efforts require an up-front investment, but they pay off by allowing more junior attorneys to handle key diligence tasks efficiently and at a higher level of quality than would otherwise be the case—ultimately saving the sponsor time and money.

of the due diligence exercise, the pacing of the transaction, or both. In our view, the most useful models and organizational systems are derived from actual deal experience. The senior attorney should also be tasked with disseminating best practices to attorneys involved in the due diligence process through formal presentations, consultations on live transactions, and informal, on-the-job training.

The end product for legal due diligence knowledge management should be an extensive library of models, precedents, and practice guides (including sponsor-specific due diligence work plans, due diligence request lists, legal call agendas, due

and at a higher level of quality than would otherwise be the case—ultimately saving the sponsor time and money.

By following the above eight guiding principles, deal counsel's M&A legal due diligence process will be a targeted, results-oriented investigation that is tailored to the sponsor's business objectives and documented in a useful format. In addition, the due diligence process will enable the dealmakers to make an informed investment decision, to identify and mitigate or address problem areas or obstacles, and to successfully execute the acquisition.

Five Reasons to Use Generative AI (and Five Reasons Not To)



Charu A. Chandrasekhar
Partner



Avi Gesser
Partner



Matt Kelly
Counsel



Andreas Constantine
Pavlou
Associate

As interest in enterprise use of artificial intelligence continues to build, private equity firms and their portfolio companies are increasingly experimenting with large-scale generative AI projects in an effort to save time, cut costs, improve processes, and gain a strategic advantage over competitors. However, despite significant improvement in the reliability and capabilities of generative AI tools over the last year, there are still many tasks that are not well suited for generative AI integration. To assist firms in finding high-value/low-risk AI use cases, we offer five circumstances that, based on our experience, favor generative AI adoption and five counterexamples in which using generative AI, at least in the near term, may not be worth the associated costs and risks.

Five Circumstances Favoring Generative AI Use

1. When you are just getting started.

Example: Brainstorming on new investment opportunities.

Generative AI tools can be very helpful for devising new ideas and for kickstarting a complicated project. While the probabilistic nature of these tools can lead them to hallucinate, in the brainstorming process they can be, on balance, valuable sources of ideas and approaches that otherwise might not have been considered.

2. When you are almost finished.

Example: Reviewing a near-final draft of an investor report.

Many firms are now using generative AI as a final check before finalizing reports. In addition to checking facts, these tools are very good at catching grammatical errors, inconsistent use of capitalization and defined terms, unnecessary repetition, and overly complicated sentence constructions.

3. When the AI can do something well that you cannot do well without it.

Example: An auto insurer using AI to process weather and geographic data to generate text messages warning customers of impending hailstorms in their neighborhood so that customers can shelter their cars.

If a company cannot do a particular task well at scale—or at all—the benefits of having generative AI complete that task are obvious, and there can be a higher tolerance for small errors because no viable alternative exists.

4. When there is a fit-for-purpose tool that is being used by peer firms.

Example: A firm using a tool that is specifically designed to translate financial services documents and communications between English and Japanese that is being widely used in the industry.

Using an AI tool that is designed for a specific purpose and provided by a vendor allows a firm to pool the risks associated with confidentiality, privacy, cybersecurity, IP rights, and overall regulatory compliance with the vendor and the other users.

5. When there is sufficient time and a method to properly test the AI tool before deployment.

Example: An asset manager has designed a lengthy pilot program to test different AI tools for accuracy, consistency, and completeness, with specific benchmarks that need to be met before moving into production.

Some AI use cases initially achieve acceptable results but involve risks (such as model drift or loss of skills) that only present themselves gradually over time. In those circumstances, the AI tools can achieve acceptable results for several days or even weeks before problems arise. Staying in the pilot phase for longer can provide the time needed to identify and mitigate these risks so that they don't arise after the model is in production.

Five Circumstances That Disfavor Generative AI Use

1. When the acceptable error rate is essentially zero.

Example: A law firm using AI to draft the legal briefs to be presented in an important court filing.

The error rates for generative AI tools have dropped significantly over the last year, but these tools still make mistakes, and those mistakes are getting harder

Despite significant improvement in the reliability and capabilities of generative AI tools over the last year, there are still many tasks that are not well suited for generative AI integration.

to find through human review. This small-but-irreducible error rate may be prohibitive for some use cases. When submitting a brief in court, for example, there is no tolerance for fabricated cases, regulations, or quotations. The need to carefully double-check AI-generated content for accuracy, completeness, and applicability may erase any efficiencies gained from the use of generative AI.

2. When a basic automation tool will achieve the same results.

Example: Using AI to generate one of 10 possible NDA contracts when a simple automation decision tree can achieve the same results without any risk of hallucinations, drift, or bias.

Many problems for which generative AI is currently being used can be solved using traditional AI or automation algorithms, methods which often are less expensive, are better understood, garner less attention, carry fewer risks, and are more reliable. It can be helpful to think of generative AI as a last-resort solution, when all other solutions are unable to achieve the desired scale or efficiency.

3. When learning the subject is as important as the content being created.

Example: A compliance associate using AI to draft an internal analysis of an important new SEC regulation.

Generative AI is increasingly able to handle complex tasks with speed and efficiency. But doing tasks slowly and inefficiently at first can sometimes be an important part of risk management and professional growth. For example, it can be crucial for professionals to digest the intricacies of a new development so that they can better understand the nuances of its application and limitations. Asking a large language model to summarize the development and reviewing the results often will not produce the same level of understanding or strategic analysis.

4. When human authenticity is important or when use of the AI may seem "icky."

Example: Using AI to replace the internal monthly video address from the CEO with a deepfake video of the CEO that is customized for each office location.

While AI can tackle many corporate tasks, there are some interactions that still benefit from human-to-human connection and a sense of authenticity. Likewise, some AI use cases have a high "ick" factor as well as more concrete risks. For instance, using AI to watch a job interview and determine whether a candidate is trustworthy or has leadership skills based on their body language would carry regulatory and reputational risks that likely outweighs any benefits.

5. When the false positive rate is too high.

Example: Using AI to identify investment professionals who may be involved in illegal trading activity when the AI is not very good at separating legitimate conduct or communications from potentially improper activities.

a loss of confidence in the output of the tool that the hits simply may not be reviewed at all.

Conclusion

We expect generative AI adoption to continue to accelerate, but how it does will be different for different firms.

Carefully choosing which projects to tackle can stack the odds in your favor and build firm-wide momentum for AI adoption.

For AI systems involved in making classification decisions, the accuracy and precision of the systems must be sufficient to justify their costs. If the use case produces enough false positives, there is a risk that either (a) any efficiencies gained will be outweighed by the need to review and confirm that the false positives are not true hits, or (b) there will be such

Attempting to use generative AI tools for less-appropriate tasks or without implementing proper safeguards can lead to project failures that in turn result in setbacks for the firm's overall AI program. Carefully choosing which projects to tackle can stack the odds in your favor and build firm-wide momentum for AI adoption.

Delaware's Reformed Transaction Law Unlikely to Stem the Flow of Plaintiff Suits



Zachary H. Saltzman
Partner



Shannon Rose Selden
Partner



Adam Aukland-Peck
Associate



David J. Hotelling
Associate

In response to what has become known as “DEXit”—the departure of a number of major companies from Delaware and the threat of further such moves—Delaware’s Senate Bill 21 was signed into law on March 26, 2025.¹ The new law made significant changes and welcome additions to the safe harbor protections available to deals involving conflicted directors and controlling stockholders. However, for all its improvements, S.B. 21 is not likely to spell the end of challenges to controller transactions. Plaintiffs have successfully—and lucratively—challenged such transactions for years, and it is likely that they will continue to look for opportunities to do so. Below we give a high-level overview of S.B. 21 and discuss one aspect of S.B. 21 that plaintiffs may seek to exploit.

Overview of S.B. 21

At a high level, S.B. 21 makes more readily available safe harbors for controlling stockholder and conflicted director transactions, allowing those deals (except going-private controller transactions) to be immune from equitable relief and damages if approved by either a special committee of disinterested directors or a majority of disinterested stockholders. Going-private transactions involving a controller can similarly achieve these safe harbor protections by satisfying both prerequisites. S.B. 21 also both sharpens the definition of disinterested director and limits who can be counted as a controlling stockholder by setting a minimum stockholding requirement below which a stockholder cannot be deemed a controller. While *M & F Worldwide Corp* established special committee and disinterested stockholder vote protections for a decade prior to S.B. 21,² those procedures have been revised under the new law in order to extend their benefits and add more certainty to dealmaking. (For a more detailed discussion of S.B. 21, please see our article [here](#).)

However, these extended safe harbors do not block all paths by which a plaintiff could challenge a controller transaction. An obvious route for a plaintiff would be to argue that stockholders or directors were not fully informed when voting for a transaction. But there are also less obvious paths. One such path is to challenge a transaction that was not viewed as conflicted by the transaction parties—who thus saw no reason to implement S.B. 21’s safe harbors—by arguing that the transaction was in fact a conflicted one.

1. Senate Substitute No. 1 for Senate Bill No. 21, available [here](#).

2. See, e.g., *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).

The new law made significant changes and welcome additions to the safe harbor protections available to deals involving conflicted directors and controlling stockholders.

To see how a plaintiff may argue this, you need only turn to the text of S.B. 21. For a transaction to count as a “controlling stockholder transaction” and be subject to potential liability in the first place, the controller must have some sort of conflict. Prior to the passage of S.B. 21, to be conflicted, the controller must either have (i) stood on both sides of the transaction or (ii) received a “non-ratable benefit,” i.e., a financial benefit unique to the controlling stockholder. S.B. 21 maintains both these concepts, but plaintiffs will likely argue that it expands the concept of a non-ratable benefit: A controller is conflicted if it receives “a financial **or other benefit** not shared with the corporation’s stockholders generally.”³

S.B. 21 did not construct guardrails around the term “financial or other benefit.” Even before S.B. 21, plaintiffs were focused on expanding the scope of “non-ratable benefits,” and we expect them to push even harder on the meaning of “financial or other benefit.” In particular, plaintiffs may argue that the statute’s use of “or other benefit” invites the Chancery Court to broadly include as a non-ratable benefit all manner of non-financial benefits.

Below, we analyze two recent “non-ratable benefits” cases from the pre-S.B. 21 era that will be relevant to upcoming decisions applying S.B. 21’s “financial or other benefit” formulation.

Does the Potential to Wind Down a Fund Constitute a “Financial or Other Benefit” to a Private Equity Firm?

The Delaware Chancery Court’s post-trial opinion in *Manti Holdings, LLC v. Carlyle Group, Inc.*, 2025 WL 39810 (Del. Ch. Jan. 7, 2025), examined whether the sale of a portfolio company at the end of a private equity fund’s life counted as a “non-ratable benefit.” In 2008, a Carlyle fund acquired a majority of the outstanding shares of Authentix, an authentication technologies company. Nearly 10 years later, in 2017, Authentix was sold to BWE, and Authentix stockholders received \$77.7 million plus potential earnouts; the sale of Authentix was alleged to have coincided with the planned end of the Carlyle fund. Plaintiffs sued and claimed Carlyle forced a “fire sale” of Authentix in order to wind down its fund in a timely manner and, in so doing, secured an unfair, non-ratable benefit for itself.

The court denied Carlyle’s early attempt to exit the litigation, finding on Carlyle’s motion to dismiss that plaintiffs adequately pled that Carlyle had acted to achieve a unique benefit, plausibly rendering it conflicted.⁴ For this, the court pointed to statements that emphasized Carlyle’s urgent need to sell Authentix and close out the fund in order to return money to investors. After trial, the court decided there was no unique benefit, applied the business judgment rule, and found for Carlyle. However, the court did not reject the principle that a unique liquidity benefit could have existed but rather held, based on a highly specific set of facts, that Carlyle had no need to quickly sell Authentix and therefore had not received a unique liquidity benefit.

Post-S.B. 21, plaintiffs may look for other “unique” non-ratable benefits, citing *Manti Holdings*. It would not be surprising if plaintiffs argue that the timing of future fund wind-downs—or other unique benefits to a PE fund—constitutes an “other benefit,” making a seemingly non-conflicted controller transaction a conflicted controller transaction.⁵ Given the uncertainty, PE funds should think creatively about how a plaintiff might argue that a non-ratable benefit was received. If an argument for such a benefit exists, the PE fund may want to consider setting up safe harbors.

3. S.B. 21 § 144(e)(3).

4. *Manti Holdings, LLC v. Carlyle Grp. Inc.*, 2022 WL 1815759 (Del. Ch. June 3, 2022).

5. For example, the court in *Firefighters' Pension Sys. of City of Kansas City, Missouri Tr. v. Presidio, Inc.* noted that finding a “liquidity-driven conflict can be difficult,” 251 A.3d 212, 255-56 (Del. Ch. 2021), but given the changes in S.B. 21, plaintiffs will push on this issue further, and courts may be more receptive.

Is a Tax Receivable Agreement a Source of Non-Ratable Benefit?

Umbrella Partnership Corporations, or “Up-C” transactions, have been an increasingly popular mechanism for private investors to take portfolio companies public while retaining some of the tax benefits of a traditional partnership model through a Tax Receivable Agreement (TRA), which allocates a majority of the tax savings (typically 85%) to the original investor. Of course, popularity breeds scrutiny, and the plaintiffs’ bar has not been shy in targeting companies with Up-C structures.⁶ In particular, plaintiffs have argued that early acceleration of the TRA as part of a change in control transaction is a “financial benefit” for purposes of the conflicted transaction analysis—and this question was squarely at issue in the Delaware Chancery Court’s motion to dismiss opinion in *Firefighters’ Pension System v. Foundation Building Materials, Inc.*, 318 A.3d 1105 (Del. Ch. May 31, 2024).

The sponsor of Foundation Building Material (FBM) executed an Up-C IPO in early 2017 and retained control of FBM. As part of that transaction, FBM and the sponsor executed a TRA. In the event of a change in control, the sponsor could terminate the TRA and receive an early termination payment (ETP) equal to the present value of payments it would have received over the full life of the TRA. In early 2018, FBM began to explore a sale, ultimately leading to a merger that allowed the sponsor to terminate

the TRA. Plaintiffs claimed, among other things, that the ETP diverted merger consideration to the sponsor in a manner that was unfair to the public shareholders and that the sponsor’s decision to sell FBM was influenced by the desire to terminate the TRA and receive the ETP.

In this new environment, it will be critically important for the private equity industry to strategically anticipate how plaintiffs might argue that a fund received a unique benefit as the result of what have previously been considered an unremarkable element of a transaction.

As a threshold matter, the court ruled that the sponsor did not divert merger consideration from the minority shareholders by terminating the TRA. While it would receive a disproportionate share of the value, it was entitled to stand on its contractual right to that payment under the TRA and did not breach any fiduciary duty in doing so.

However, the court nonetheless found that the TRA payment constituted a non-ratable benefit to the controlling stockholder, who was therefore conflicted in choosing whether to hold or sell—meaning the entire fairness standard applied to that decision. In short, although both the sponsor and minority shareholders received the same merger consideration in the deal, only the sponsor received the ETP—and therefore received a non-ratable benefit. Investors should therefore

consider whether future transactions involve acceleration of a TRA (or any other contract that benefits the controller more than the unaffiliated stockholders) and discuss with counsel whether, under the circumstances, it constitutes a “financial or other benefit” under S.B. 21.

Conclusion

S.B. 21 introduces significant changes regarding controllers and conflicted transactions. By both limiting what counts as a controlling stake and improving safe harbors, the bill would seem to narrow the opportunities for a plaintiff to challenge a transaction as conflicted. We expect, however, that plaintiffs will merely become more resourceful in asserting such claims. One such approach will be to leverage the revised definition of non-ratable benefit to argue that more transactions should be viewed as conflicted. In this new environment, it will be critically important for the private equity industry to strategically anticipate how plaintiffs might argue that a fund received a unique benefit as the result of what have previously been considered an unremarkable element of a transaction.

6. *The Up-C Goes to Court: Managing the Emerging Risks of an Advantageous Tax Structure*, available [here](#).

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