



Middle Market
M&A
SurveyBook

2023 Survey of Key M&A Deal Terms

Introduction

Seyfarth Shaw LLP is pleased to present the 9th edition of its Middle Market M&A SurveyBook (“2022/2023 Survey”) which analyzes key transaction terms from more than 105 middle market private target acquisition agreements signed in 2022 and the first half of 2023.^{1,2} The information presented is intended to serve as a guide to buyers, sellers, and deal professionals on “what’s market” when negotiating these terms in private target acquisition agreements.

The 2022/2023 Survey focuses on key deal terms, including those comprising the “indemnity package” found in most private target acquisition agreements to address a seller’s potential post-closing liability to a buyer and to set the parameters of a buyer’s ability to claw back purchase price from a seller. Each deal, of course, has unique facts and circumstances that affect the negotiation of the acquisition agreement, including, significantly, the relative leverage of the buyer and seller. It is nonetheless helpful when negotiating an acquisition agreement to have a strong understanding of where the terms of your “indemnity package” fall in the current market spectrum.

Given the continued growth in the use of representation and warranty (“R&W”) insurance in private middle market M&A transactions, in this 2022/2023 Survey, we have continued to track data from deals that included R&W insurance separately from deals where no R&W insurance was utilized. Approximately 58% of the transactions reviewed for the 2022/2023 Survey included R&W insurance, compared to approximately 59% of the transactions in 2020/2021. Buyers consistently use R&W insurance in acquisition proposals to make their bids more competitive and attractive to sellers. Not surprisingly, the terms of the typical indemnity package differ substantially between transactions in which R&W insurance is utilized and non-R&W insurance deals. For example, the indemnity escrow amount and indemnity cap size are typically drastically lower in transactions that use R&W insurance as compared to transactions that do not use such insurance. With respect to “no survival” private target acquisitions, in which, similar to public company M&A transactions, the representations and warranties of the seller terminate at closing, the 2022/2023 Survey demonstrated continued growth in “no survival” deals when R&W insurance is used but the opposite was found when R&W insurance is not obtained by buyers. Relatedly, the 2022/2023 Survey also showed the continued trend of decreased use of an indemnity escrow when R&W insurance is in play but increased indemnity escrow usage when R&W insurance is not involved. In the scenario of a “no survival” deal, recourse to a R&W insurance policy is typically a buyer’s primary (or exclusive) remedy.

Again this year, the 2022/2023 Survey considers the number of private target acquisition agreements that included “fraud” exceptions to certain limitations on buyers’ indemnification rights and remedies, such as caps and baskets, and whether and how “fraud” was defined across those transactions.

As expected, US M&A activity in 2022 did not come close to reaching 2021 levels (which represented the highest level of M&A deal activity in modern history). However, deal volumes in 2022 nonetheless remained above pre-pandemic levels,³ with North America middle

market M&A activity generating 18,576 deals for a combined value of \$2.2 trillion, but M&A activity in the first half of 2023 failed to even reach comparative 2022 levels.⁴ Some of the drivers tapering or otherwise impacting M&A deal activity included (i) increasing interest rates and inflation; (ii) bank failures and capital availability; and (iii) renewed commitment to comprehensive due diligence and an emphasis on ensuring the deal thesis values are realized.^{5,6}

Nevertheless, private equity sponsors continued to deploy their capital amidst a challenging financing environment by focusing on add-on acquisitions rather than large platform buyouts. For example, in 2022, add-ons accounted for a record 71.9% of buyout deals, which given their smaller size and ability to rely on their larger acquirer's credit, made them easier to finance.⁷ This is further reflected in the fact that the number of deals over \$1 billion declined much more than deals under \$1 billion during the period between the second half of 2022 and the first half of 2023.⁸

While most M&A professionals are certainly not expecting the record-breaking levels of M&A activity seen in 2021, there are indications that the second half of 2023 and driving into 2024 will be a reasonably resilient period for middle market M&A activity. The reasons for the positive outlook for this period include an increase in strategic divestitures by larger companies, the lasting prevalence of small to midsize deals, the continued high amount of uninvested capital or "dry powder" in the market available for deal making, a more stable interest rate environment, taming of inflation, and increased technology adoption and innovation in M&A.⁹ In addition, small and mid-market companies in the US have historically outperformed their larger counterparts through both inflation and rising interest rates, which, if history repeats itself, could result in increased middle market M&A activity in 2024.¹⁰

We hope that you find the information presented in our 2022/2023 Survey valuable, and we welcome the opportunity to further discuss our findings with you.

¹ This edition surveys deals signed in both 2022 and the first half of 2023 and compares those deals against deals signed in 2020 and 2021.

² For purposes of this survey, "middle market" means transactions with a purchase price of less than \$1 billion, and "purchase price" means the total cash consideration paid by the buyer in a transaction but does not include contingent purchase price payments (e.g., earnouts). This survey does not include any transactions that involved the payment of consideration other than cash.

³ Kreischer Miller. Expectations for Middle Market M&A in 2023

⁴ Pitchbook. 2022 Annual Global M&A Report

⁵ PWC. Global M&A Industry Trends: 2023 Mid-Year Update

⁶ The American Lawyer. M&A Activity is Down, but Opportunities Still Abound

⁷ See footnote 4

⁸ See footnote 5

⁹ MarketWatch. Middle-market M&A players expect conditions to stabilize in 2023; Deloitte. Navigating Uncertainty 2023 M&A Trends Survey; BMO. Middle Market M&A Update: Q2 2023

¹⁰ Forbes. Why Mergers And Acquisitions Activity In The Middle Market Remains Hot

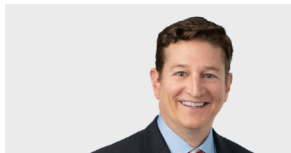
What's Inside

Resources for More Information	Page 4
Key Indemnity Deal Terms Surveyed	Page 5
Trends in Indemnity Escrow Usage and No Survival Deals	Page 9
Fraud Exceptions and Definitions	Page 21
Choice of Governing Law	Page 23
Earnouts	Page 23
Seller Retains Attorney-Client Privilege	Page 24
Bring-Down	Page 24
Claims Insight from Aon	Page 25
2023 Hart-Scott-Rodino Act Thresholds	Page 28
Key Indemnity Deal Terms Glossary	Page 29
Seyfarth's Leading Middle Market M&A Practice	Page 30

Resources for More Information



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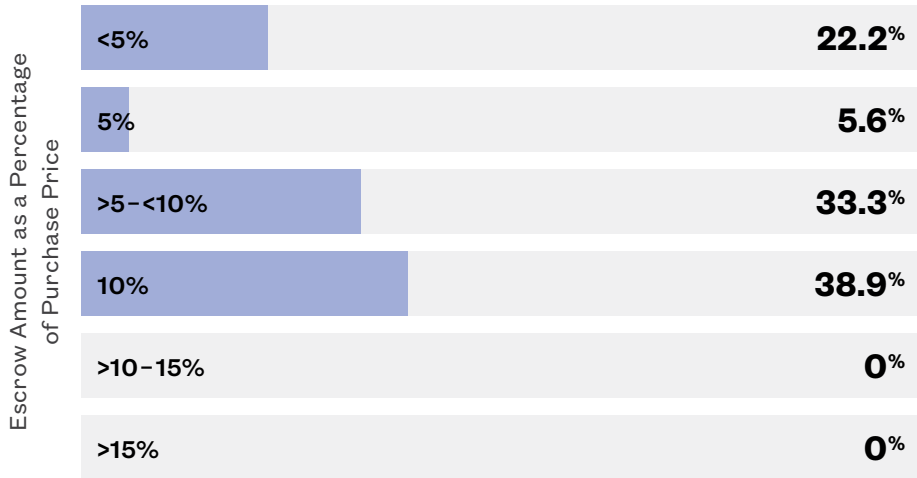
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Indemnity Escrow Amount

NO R&W INSURANCE



Percentage of Deals Surveyed Providing for Indemnity Escrow

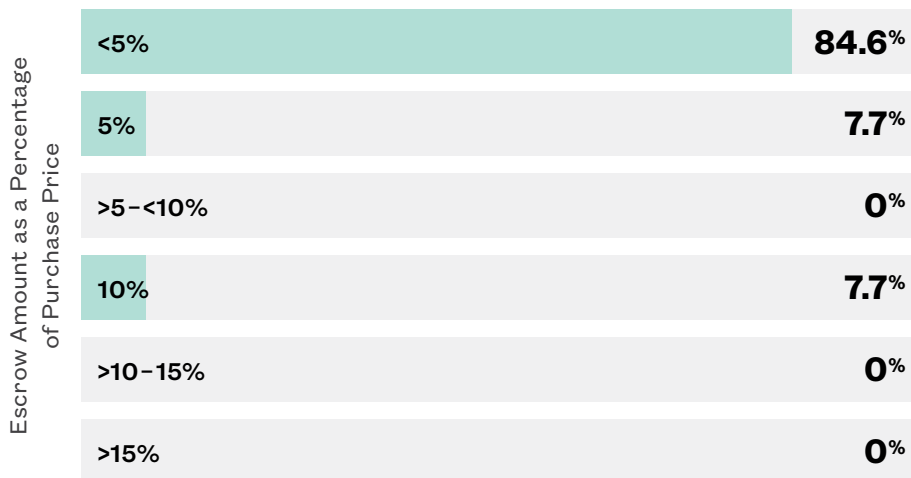
OBSERVATIONS

- The median indemnity escrow amount during the period of 2022 and first half of 2023 (“2022/2023”) for the non-insured deals surveyed was approximately 8% of the purchase price (which is generally unchanged as compared to the period of 2020 and 2021 (“2020/2021”).
- 100% of non-insured deals had an indemnity escrow amount of 10% or less (as compared to approximately 91% in 2020/2021), with approximately 28% of non-insured deals having an indemnity escrow amount of 5% or less (as compared to approximately 26% in 2020/2021). The increase in smaller escrow amounts show that the seller favorable market appears to have remained intact with regard to this deal term in 2022/2023.

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

Indemnity Escrow Amount

R&W INSURANCE



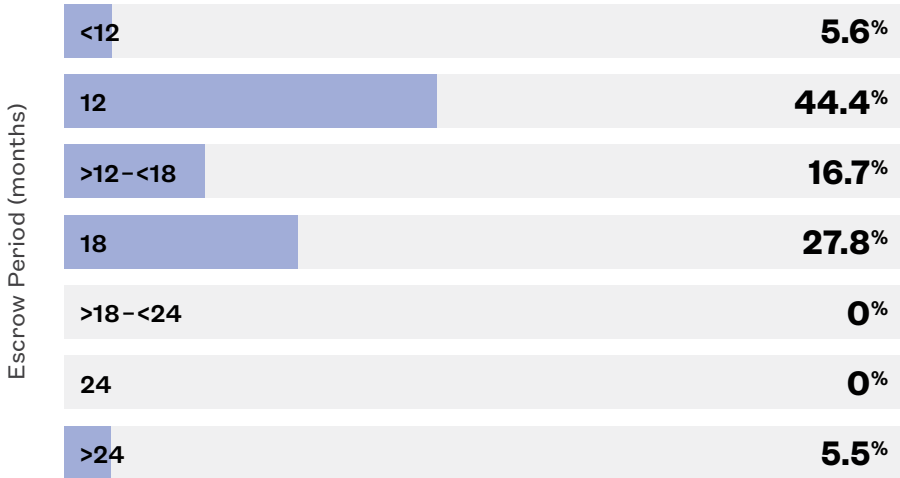
Percentage of Deals Surveyed Providing for Indemnity Escrow

OBSERVATIONS

- The median indemnity escrow amount in 2022/2023 for the insured deals surveyed was approximately 1% of the purchase price (as compared to approximately 0.5% in 2020/2021). It is plain to see the dramatic impact that R&W insurance has on the indemnity escrow amount (approximately 1% for insured deals, as compared to approximately 8% for non-insured deals).
- The vast majority (approximately 85%) of insured deals had an indemnity escrow amount of less than 5%, and of those deals, approximately 82% had an indemnity escrow amount of 1% or less (as compared to 89% in 2020/2021). This is consistent with the prevailing R&W insurance structure of including a retention (deductible) equal to approximately 1% of deal value.

Indemnity Escrow Period

NO R&W INSURANCE



Percentage of Deals Surveyed Providing for Indemnity Escrow

OBSERVATIONS

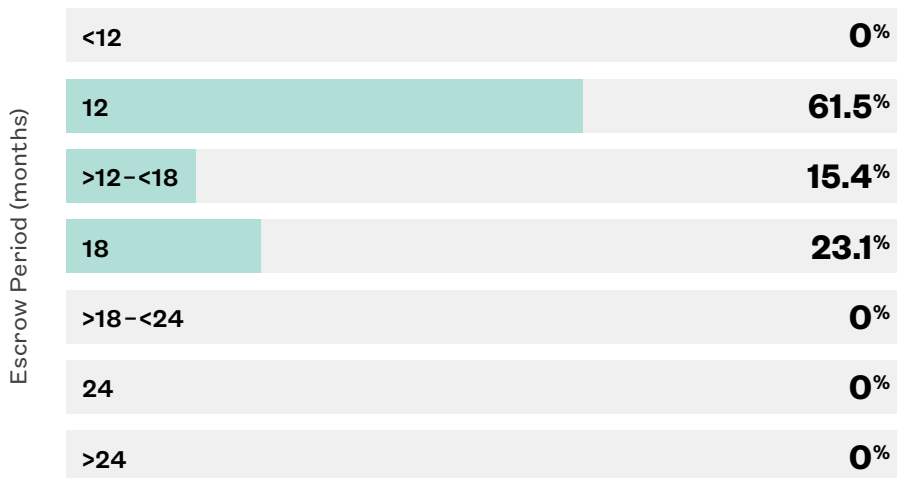
Of the non-insured deals surveyed which provided for an indemnity escrow:

- Approximately 89% of such deals had an indemnity escrow period of 12-18 months. However, without taking the Unique Deals (as defined below) into account, 100% of such deals had an indemnity escrow period of 12-18 months, which is consistent with 2020/2021.
- Approximately 6% of such deals had an indemnity escrow period of less than 12 months. However, without taking the Unique Deals into account, none of such deals had an indemnity escrow period of less than 12 months, which is consistent with 2020/2021.
- The median indemnity escrow period of such deals was 13.5 months. This reflects a decrease from 18 months during 2020/2021, showing a trend of continuing seller strength during 2022/2023 with respect to this deal term.

IMPORTANT NOTE: A limited number of the deals surveyed had indemnity escrow periods of either (i) less than 12 months or (ii) 24 months or greater due to unique facts applicable to such deals (the “Unique Deals”). This highlights that the specific facts and circumstances of each deal will often carry the day in deal negotiations even if “not market”.

Indemnity Escrow Period

R&W INSURANCE



Percentage of Deals Surveyed Providing for Indemnity Escrow

OBSERVATIONS

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

- 100% of such deals had an indemnity escrow period of 12-18 months.
- None of the deals had an indemnity escrow period of less than 12 months, which is consistent with 2020/2021.
- The median indemnity escrow period of such deals was 12 months. This is consistent with 2020/2021, showing a trend of continuing seller strength during 2022/2023 with respect to this deal term.

Trends in Indemnity Escrow Usage and No Survival Deals

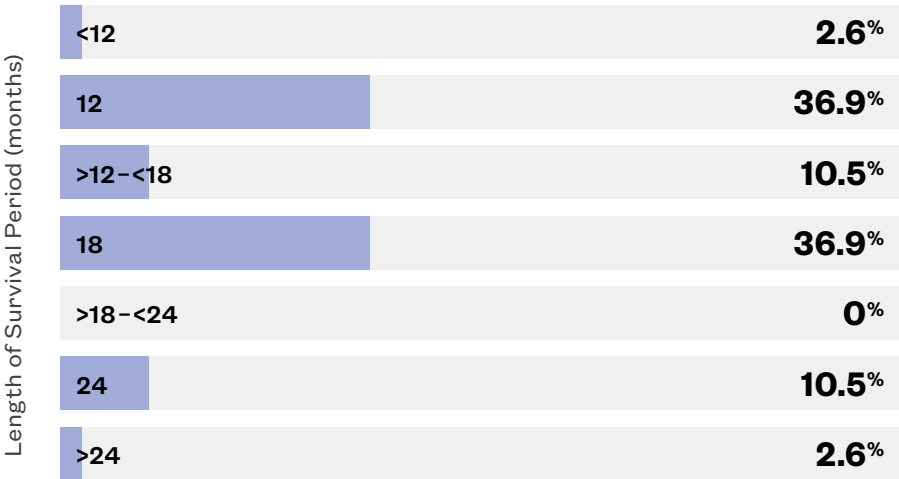
Over the last five years, our surveys have identified trends pointing to fewer deals involving an indemnity escrow and more deals involving no survival of the general representations and warranties. These trends appear to be particularly the case in deals utilizing R&W insurance. However, for deals in 2022/2023 not utilizing R&W insurance, there was an uptick in indemnity escrow usage and a decrease in “no survival” deals. In looking to analyze these trends further, we partnered with SRS Acquiom (“SRS”), a provider of seamless M&A solutions, to provide the below data with respect to the usage of indemnity escrows and the general application of “no survival” deals in transactions surveyed by SRS.

	YEAR	INDEMNITY ESCROW	NO INDEMNITY ESCROW
All Deals	2019	76%	24%
	2020	68%	32%
	2021	65%	35%
	2022-1H 2023	67%	33%
No R&W Insurance Identified	2019	78%	22%
	2020	75%	25%
	2021	70%	30%
	2022-1H 2023	80%	20%
R&W Insurance Identified	2019	73%	27%
	2020	59%	41%
	2021	59%	41%
	2022-1H 2023	47%	53%

	YEAR	REPS SURVIVE	NO SURVIVAL
All Deals	2019	83%	17%
	2020	78%	22%
	2021	74%	26%
	2022-1H 2023	75%	25%
No R&W Insurance Identified	2019	86%	14%
	2020	88%	12%
	2021	83%	17%
	2022-1H 2023	90%	10%
R&W Insurance Identified	2019	79%	21%
	2020	64%	36%
	2021	63%	37%
	2022-1H 2023	52%	48%

Representation & Warranty General Survival Period

NO R&W INSURANCE



Percentage of Deals Surveyed

OBSERVATIONS

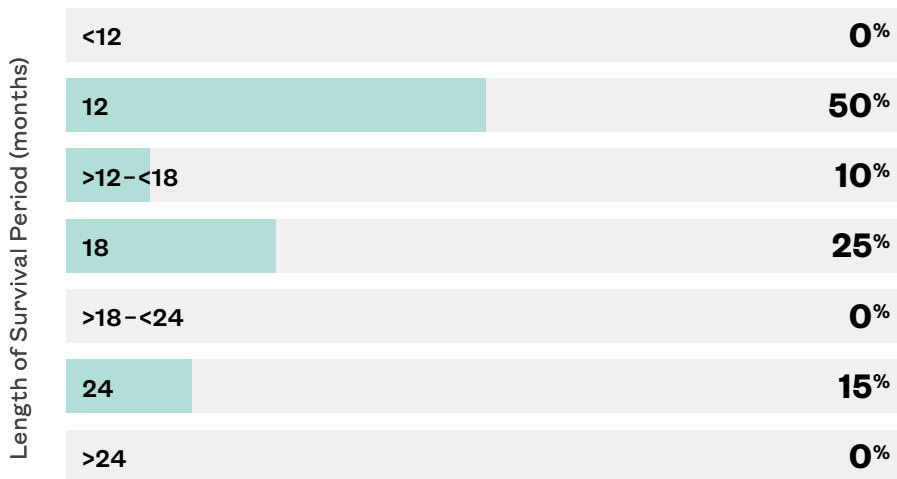
- The median general survival period for non-insured deals was 16.5 months which is less than 2020/2021. The vast majority (approximately 84%) of non-insured deals surveyed had a survival period of 12-18 months in 2022/2023, which is consistent with the length of the indemnity escrow period in 2022/2023.
- Approximately 13% of non-insured deals surveyed had survival periods of greater than 18 months, which is consistent with 2020/2021. This is also generally consistent with the results from prior years where such deals represented only a small percentage of the total number of deals surveyed.

IMPORTANT NOTE: The calculations for the charts on pages 11 and 12 do not include “no survival” deals, which would have a significant impact on the data regarding general survival periods.

Representation & Warranty

General Survival Period

R&W INSURANCE



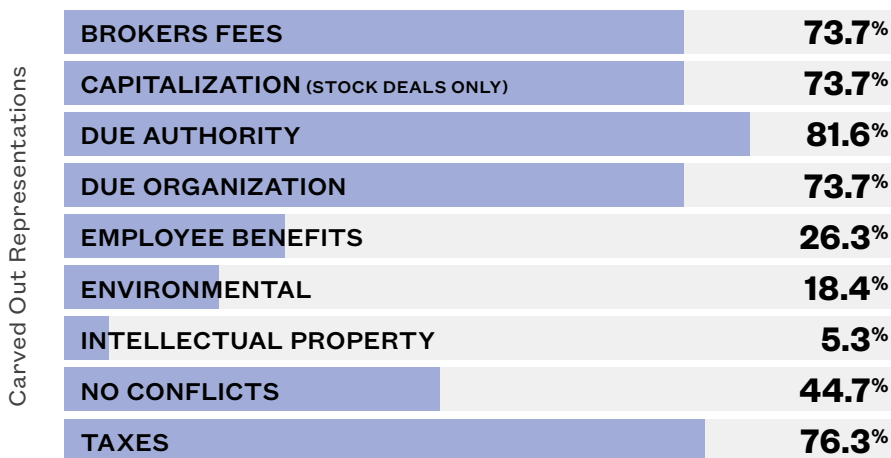
Percentage of Deals Surveyed

OBSERVATIONS

- The median general survival period for insured deals surveyed was 14 months, which is a slight increase from 12 months in 2020/2021. In addition, this is a slight increase from the median indemnity escrow period of 12 months for insured deals in 2022/2023. The vast majority (approximately 85%) of insured deals surveyed had a survival period of 12-18 months in 2022/2023, which is consistent with the length of the indemnity escrow period in 2022/2023.
- Approximately 15% of insured deals surveyed had survival periods of greater than 18 months, which is approximately 10% greater than 2020/2021 but, without taking into account Unique Deals, the results are consistent where such deals represented only a small percentage of the total number of deals surveyed.

Carve Outs to General Survival Period

NO R&W INSURANCE



Percentage of Deals Surveyed in Which Applicable Representation Was Carved Out

OBSERVATIONS

Employee Benefits

- The percentage of non-insured deals surveyed that carved out representations and warranties regarding employee benefits was approximately 26% in 2022/2023. This represents an increase from approximately 15% in 2020/2021.

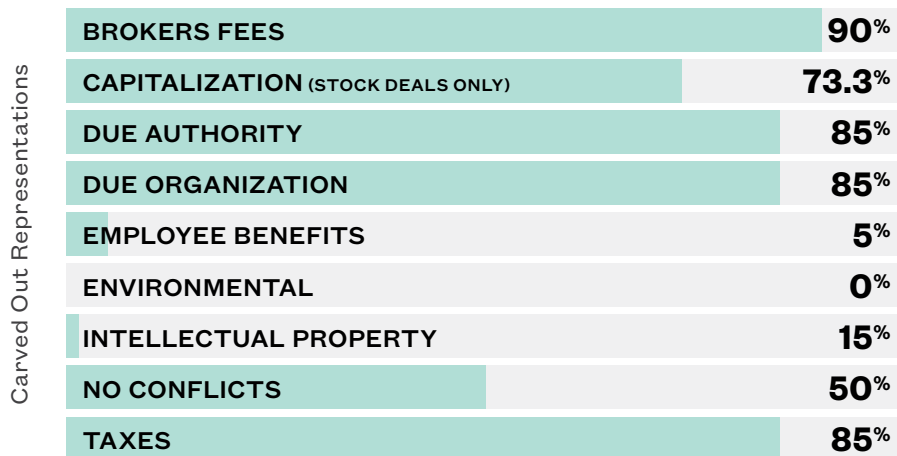
Environmental

- The percentage of non-insured deals that carved out representations and warranties regarding environmental matters was approximately 18% in 2022/2023. This demonstrates a trend of decreasing carve outs for environmental representations over the last few years (approximately 26% in 2020/2021 and approximately 38% in 2019).

IMPORTANT NOTE: The calculations on pages 13 and 14 do not include “no survival” deals where representations and warranties do not survive as a general matter (as the concept of carve outs to survival periods is not applicable to such deals).

Carve Outs to General Survival Period

R&W INSURANCE



Percentage of Deals Surveyed in Which Applicable Representation Was Carved Out

OBSERVATIONS

Taxes

- The percentage of insured deals surveyed that carved out representations and warranties regarding taxes was approximately 85% in 2022/2023. This represents an increase from approximately 73% in 2020/2021.

No Conflicts

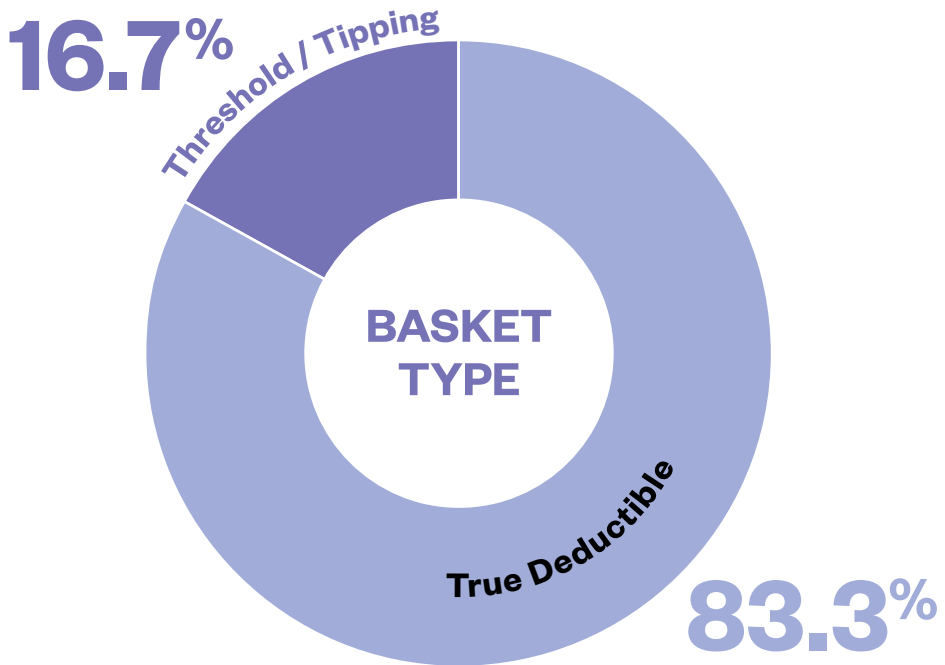
- The percentage of insured deals surveyed that carved out representations and warranties regarding no conflicts was approximately 50% in 2022/2023. This represents an increase from approximately 35% in 2020/2021.

R&W Insurance Policy Coverage of Fundamental Representations

- As compared to prior years, the frequency of carve outs in insured deals increased in 2022/2023. This may reflect a greater leniency by R&W insurance carriers to treat more representations and warranties as “fundamental,” prompting buyers to seek increased use of carve outs in their purchase agreements thereby taking advantage of R&W insurance policy expansion of fundamental representations.
- In insured deals, the R&W insurance policy generally provides 6 years of coverage for fundamental representations and warranties (as opposed to 3 years for general representations and warranties).

Indemnity Basket Type

NO R&W INSURANCE



OBSERVATIONS

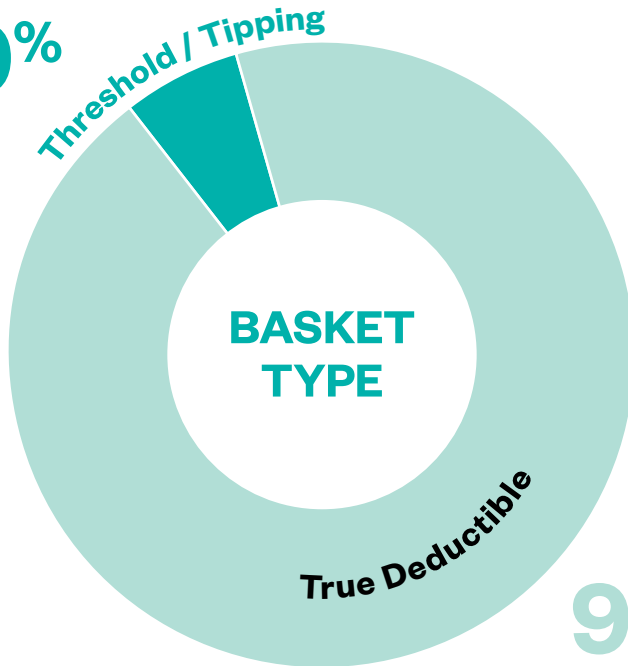
- Approximately 95% of non-insured deals surveyed provided for an indemnity basket, which high percentage is consistent with 2020/2021 (approximately 98%).
- Of the non-insured deals providing for an indemnity basket, approximately 17% were structured as threshold/tipping baskets (as compared to approximately 29% in 2020/2021) which is a decrease from prior years, and approximately 83% were structured as deductible baskets (as compared to approximately 71% in 2020/2021), which is an increase from prior years. The higher percentage of non-insured deals providing for a deductible basket, rather than a threshold/tipping basket, is a seller-friendly deal term.

IMPORTANT NOTE: The calculations on pages 15 and 16 only include deals with indemnity baskets that limit indemnity obligations for breaches of general representations and warranties, and therefore do not include “no survival” deals where general representations and warranties do not survive the closing.

Indemnity Basket Type

R&W INSURANCE

5.9%



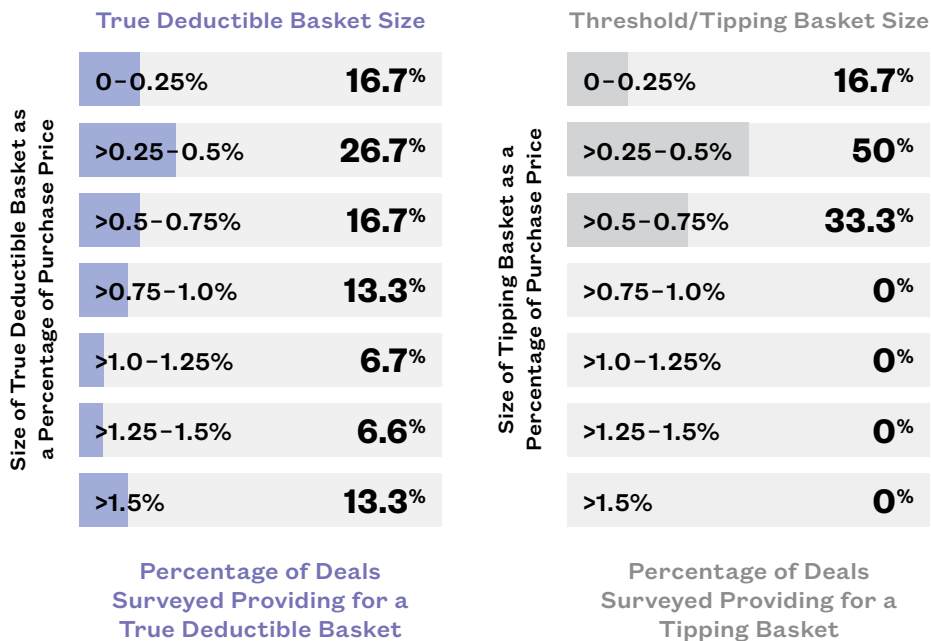
94.1%

OBSERVATIONS

- Approximately 85% of insured deals provided for an indemnity basket, which is a decrease from 2020/2021 (when approximately 94% provided for an indemnity basket).
- Of the insured deals providing for an indemnity basket, approximately 6% were structured as threshold/tipping baskets (as compared to approximately 12% in 2020/2021) which is a decrease from prior years, and approximately 94% were structured as deductible baskets (as compared to approximately 88% in 2020/2021), which high percentage is generally consistent with prior years. The higher percentage of insured deals providing for a deductible basket, rather than a threshold/tipping basket, is a seller-friendly deal term.

Indemnity Basket Size

NO R&W INSURANCE



OBSERVATIONS

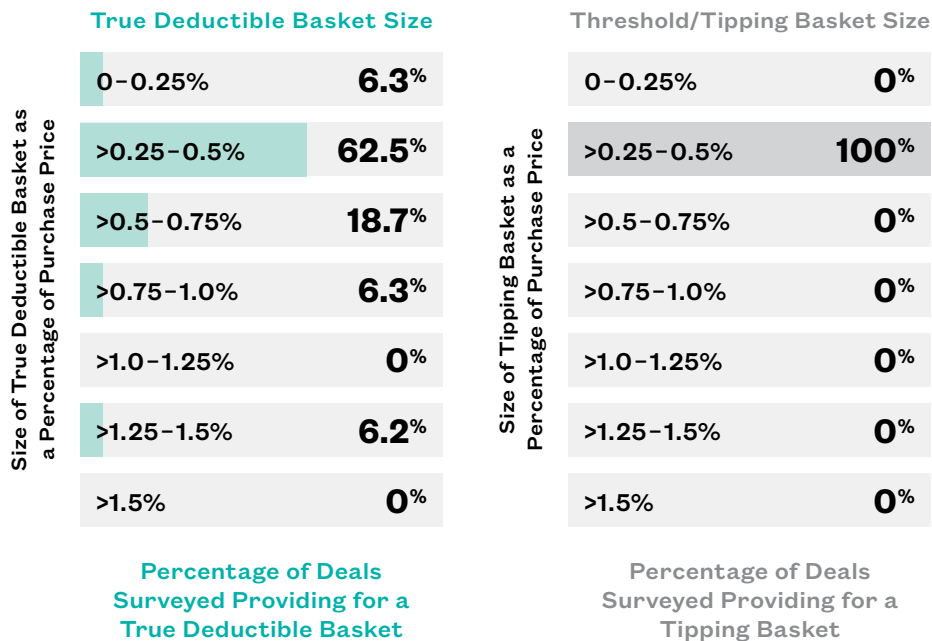
- The median basket size in non-insured deals surveyed in 2022/2023 was 0.5% of the purchase price, which is consistent with prior years.
- Approximately 87% of non-insured deals with a deductible had a basket size of 1.5% or less (as compared to approximately 87% in 2020/2021) and approximately 60% had a deductible basket of 0.75% or less (as compared to approximately 51% in 2020/2021).
- 100% of non-insured deals with a tipping basket had a basket size of 1% or less (as compared to approximately 87% in 2020/2021).

IMPORTANT NOTES: The calculations on pages 17 and 18 only include deals with indemnity baskets that limit indemnity obligations for breaches of general representations and warranties, and therefore do not include “no survival” deals where general representations and warranties do not survive the closing.

A limited number of the deals surveyed, which such deals are included in the calculations on pages 17 and 18, had a true deductible basket size in excess of 1.25% of the purchase price. These deals were subject to unique facts and included certain terms that vary from the “market” terms in the other deals surveyed. Again, the specific facts and circumstances of each deal will often carry the day in deal negotiations even if “not market.”

Indemnity Basket Size

R&W INSURANCE

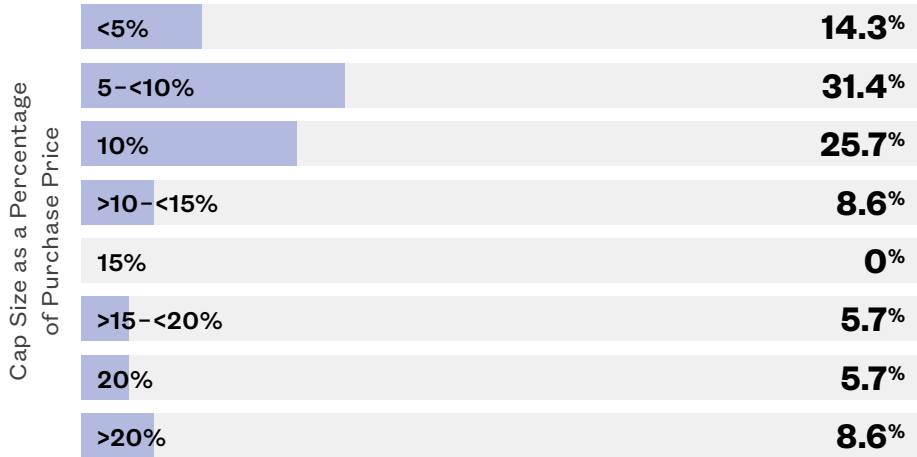


OBSERVATIONS

- The median basket size in insured deals surveyed in 2022/2023 was 0.5% of the purchase price, which is consistent with prior years.
- Almost all (94%) insured deals surveyed with a deductible had a basket size of 1% or less, which is consistent with 2020/2021.

Indemnity Cap Size

NO R&W INSURANCE



Percentage of Deals Surveyed Providing for Indemnity Cap

OBSERVATIONS

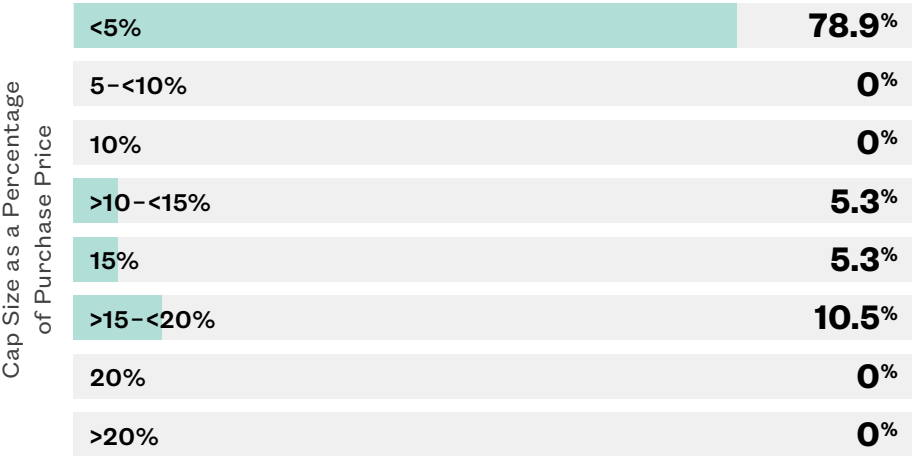
- Approximately 92% of non-insured deals surveyed provided for an indemnity cap, which is consistent with prior years.
- The median indemnity cap for non-insured deals surveyed was approximately 10%, which is consistent with prior years.
- Approximately 71% of non-insured deals surveyed had an indemnity cap of 10% or less (as compared to approximately 72% in 2020/2021), and approximately 80% had an indemnity cap of 15% or less (as compared to approximately 91% in 2020/2021).

IMPORTANT NOTES: The calculations on pages 19 and 20 only include deals with indemnity caps that limit indemnity obligations for breaches of general representations and warranties, and therefore do not include “no survival” deals where general representations and warranties do not survive the closing.

A limited number of the deals surveyed, which such deals are included in the calculations on page 19, had an indemnity cap greater than 20% of the purchase price. These deals were subject to unique facts and included certain terms that vary from the “market” terms in the other deals surveyed. Again, the specific facts and circumstances of each deal will often carry the day in deal negotiations even if “not market.”

Indemnity Cap Size

R&W INSURANCE



Percentage of Deals Surveyed Providing for Indemnity Cap

OBSERVATIONS

- Approximately 95% of insured deals surveyed provided for an indemnity cap, which is consistent with prior years.
- The median indemnity cap for insured deals surveyed was 0.5%, which is consistent with prior years.
- As is evident when compared to non-insured deals, the use of R&W insurance will typically greatly reduce the seller's indemnity cap (median cap of 0.5% for insured deals, as compared to 10% for non-insured deals) under the purchase agreement, which is due to the fact that the buyer can seek recourse under the R&W policy.

Fraud Exceptions and Definitions

Private target middle market acquisition agreements often include fraud exceptions to certain limitations on buyers' indemnification rights and remedies, such as caps and baskets. Unless "fraud" is carefully defined in the agreement, however, a seller may find itself subject to post-closing liability for more than intended by the fraud exception. In the 2022/2023 Survey, we have continued to analyze the percentage of deals that included fraud carve outs to certain limitations on liability, and continued to track the percentage of deals that limited fraud to intentional acts with actual knowledge (as opposed to constructive knowledge and/or recklessness), and the percentage of deals that limited fraud to the representations and warranties made in the acquisition agreement.

NO R&W INSURANCE	R&W INSURANCE
Fraud Exception	
<p>Approximately 85% of non-insured deals surveyed in 2022/2023 included fraud exceptions to certain indemnity provisions of the agreement, as compared to approximately 92% in 2020/2021.</p>	<p>100% of insured deals surveyed in 2022/2023 included fraud exceptions to certain indemnity provisions of the agreement, as compared to approximately 97% in 2020/2021.</p>
Fraud Defined	
<p>Of the non-insured deals that included a fraud exception, approximately 60% of such deals defined the term "fraud," as compared to approximately 48% in 2020/2021.</p>	<p>Of the insured deals that included a fraud exception, approximately 90% of such deals defined the term "fraud," as compared to approximately 89% in 2020/2021.</p>
<p>Of the non-insured deals that defined the term "fraud," approximately 82% of such deals limited fraud to those representations and warranties contained in the agreement only, as compared to approximately 55% in 2020/2021.</p>	<p>Of the insured deals that defined the term "fraud," approximately 73% of such deals limited fraud to those representations and warranties contained in the agreement only, as compared to approximately 69% in 2020/2021.</p>
<p>Of the non-insured deals that defined the term "fraud," approximately 88% of such deals included a requirement of actual knowledge of falsity (as opposed to constructive knowledge) and/or expressly excluded fraud based on recklessness or similar fraud in the fraud definition, as compared to approximately 76% in 2020/2021.</p>	<p>Of the insured deals that defined the term "fraud," approximately 92% of such deals included a requirement of actual knowledge of falsity (as opposed to constructive knowledge) and/or expressly excluded fraud based on recklessness or similar fraud in the fraud definition, as compared to approximately 79% in 2020/2021.</p>

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

- **“Fraud”** means, an act committed in the making of any representation or warranty set forth in this Agreement with the intent to deceive another party, or to induce it to enter into this Agreement and requires: (a) a false representation of material fact made by such party herein; (b) with actual knowledge (as opposed to imputed or constructive knowledge) of a Person set forth on Schedule 1.01 hereto that such representation is false; (c) with an intention to induce the party to whom such representation is made to act or refrain from acting in reliance upon it; (d) causing that party, in justifiable reliance upon such false representation and with ignorance to the falsity of such representation, to take or refrain from taking action; and (e) causing such party to suffer damages because of such reliance. For the avoidance of doubt, for purposes of this Agreement, “Fraud” shall exclude equitable fraud, constructive fraud, promissory fraud, unfair dealings fraud and any fraud claim based on negligence or recklessness.
- **“Fraud”** means, with respect to a Party, an actual intentional fraud against the other Party, with the specific intent to deceive or mislead the other Party with respect to the representations and warranties set forth in this Agreement and the other Party must have relied on and suffered reasonably foreseeable losses as a result.
- **“Fraud”** means common law fraud under the Laws of the State of Delaware (excluding constructive fraud, recklessness or negligent fraud) brought against a party hereto based on the making of a representation or warranty of such party in connection with the transactions contemplated by this Agreement, which misrepresentation is made for the purpose of inducing any other party to act and upon which such other party justifiably relies on.
- **“Fraud”** shall mean common law fraud determined in accordance with the Laws of the State of Delaware.

Choice of Governing Law

The 2022/2023 Survey results revealed that Delaware law continues to be the most popular “governing law” choice.

NO R&W INSURANCE

Of the non-insured deals surveyed in 2022/2023, the governing law for 69% of such deals was Delaware (as compared to 66% in 2020/2021), 2% was New York (as compared to 7% in 2020/2021), and 29% was a jurisdiction other than Delaware or New York (as compared to 27% in 2020/2021).

R&W INSURANCE

Of the insured deals surveyed in 2022/2023, the governing law for 95% of such deals was Delaware (as compared to 86% in 2020/2021), 2% was New York (as compared to 10% in 2020/2021), and 3% was a jurisdiction other than Delaware or New York (as compared to 4% in 2020/2021).

Earnouts

Of the deals surveyed in 2022/2023, approximately 17% included earnouts, as compared to 15% in 2020/2021.

In addition, of the deals surveyed in 2022/2023 with earnouts:

- Approximately 78% of such deals provided for earnout amounts in excess of 10% of the purchase price.
- Approximately 11% of such deals provided for earnout amounts less than 5% of the purchase price.

Seller Retains Attorney-Client Privilege

NO R&W INSURANCE

Of the non-insured deals surveyed in 2022/2023, approximately 69% of such deals provided for the seller retaining attorney-client privilege after the closing of the transaction.

R&W INSURANCE

Of the insured deals surveyed in 2022/2023, approximately 88% of such deals provided for the seller retaining attorney-client privilege after the closing of the transaction.

IMPORTANT NOTE: This deal term is only applicable for equity transactions.

Bring-Down

Of the deals surveyed in 2022/2023:

- Approximately 81% used a “Material Adverse Effect” qualifier for the representations and warranties bring-down closing condition, as compared to approximately 76% in 2020/2021.
- Approximately 13% used an “in all material respects” qualifier for the representations and warranties bring-down closing condition, as compared to approximately 24% in 2020/2021.

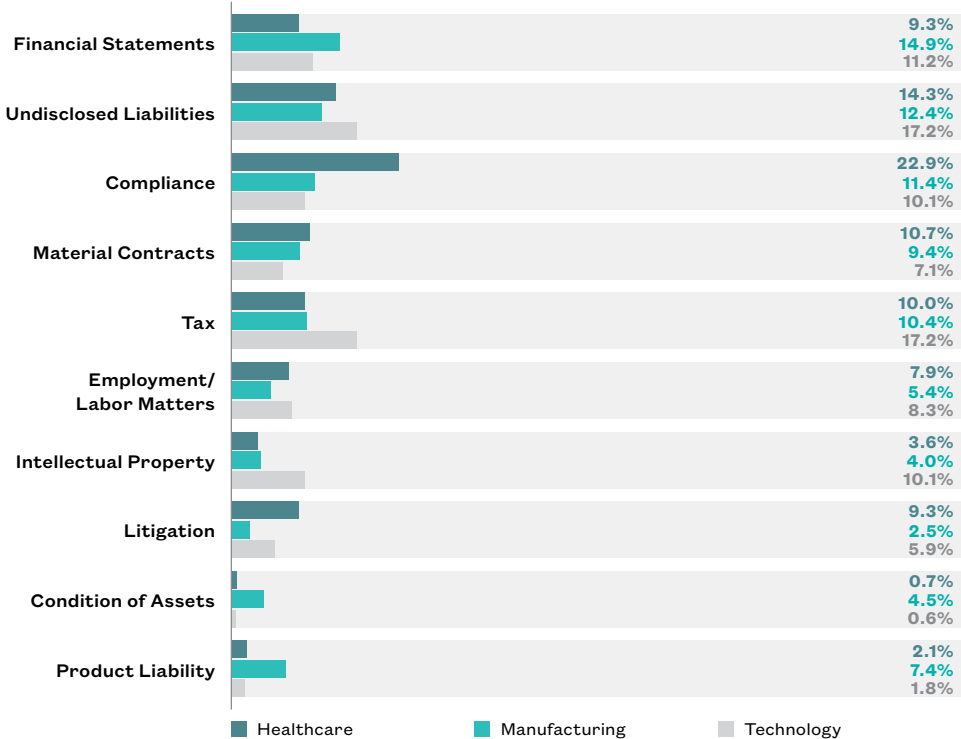
The higher percentage of deals using the “Material Adverse Effect” qualifier for the representations and warranties bring-down closing condition is a seller-friendly term which increases certainty of closing for sellers.

Claims Insight from AON

As insurer claims handling becomes more important to buyers of R&W insurance, Aon continues to track data on all claims made on Aon-brokered policies. To date, Aon has seen more than 900 claims on North American R&W insurance policies since 2013. Insurers have recognized over \$1.3 billion in total loss (including retentions) and paid over \$900 million above the policy retention to Aon clients. Moreover, only 10 claims have sought dispute resolution, with seven claims having gone to arbitration and three resulting in litigation.

In North America in 2022, the raw volume of new claims was higher than in 2021. However, the early data indicates that the average claim rate on R&W policies may be slightly lower in recent years, as the average claim rate between 2015-2021 sits at 18% compared to the historical average of 20%. While claim frequency is slightly down, Aon is not seeing this impact the frequency of significant claims, defined here as claims with the insured's initial loss calculation exceeding the policy retention, which has remained constant over the life of the product.

Breach Type by Industry



The chart on page 25 illustrates Aon's North American claims data with respect to breach frequency using the industry of the target company as the key variable. The analysis specifically focuses on three industries in particular: (i) healthcare and pharmaceutical; (ii) manufacturing; and (iii) technology.

The data suggests that companies in the healthcare and pharmaceutical industries are more likely to report a claim arising out of a breach of the compliance with laws representation, in comparison to companies in the technology and manufacturing industries. These companies reported a breach of compliance with laws in 23% of the claims they filed, while manufacturing companies reported it 11% of the time and tech companies reported this breach 10% of the time. This trend is likely driven by the nature of the legal and regulatory framework that governs healthcare and pharmaceutical companies.

Manufacturing companies are more than twice as likely to cite a breach of the condition of assets representation when compared to companies in the technology and healthcare industries. This is also true when looking at the percentage of claims submitted by manufacturing companies citing a breach of the product liability representation.

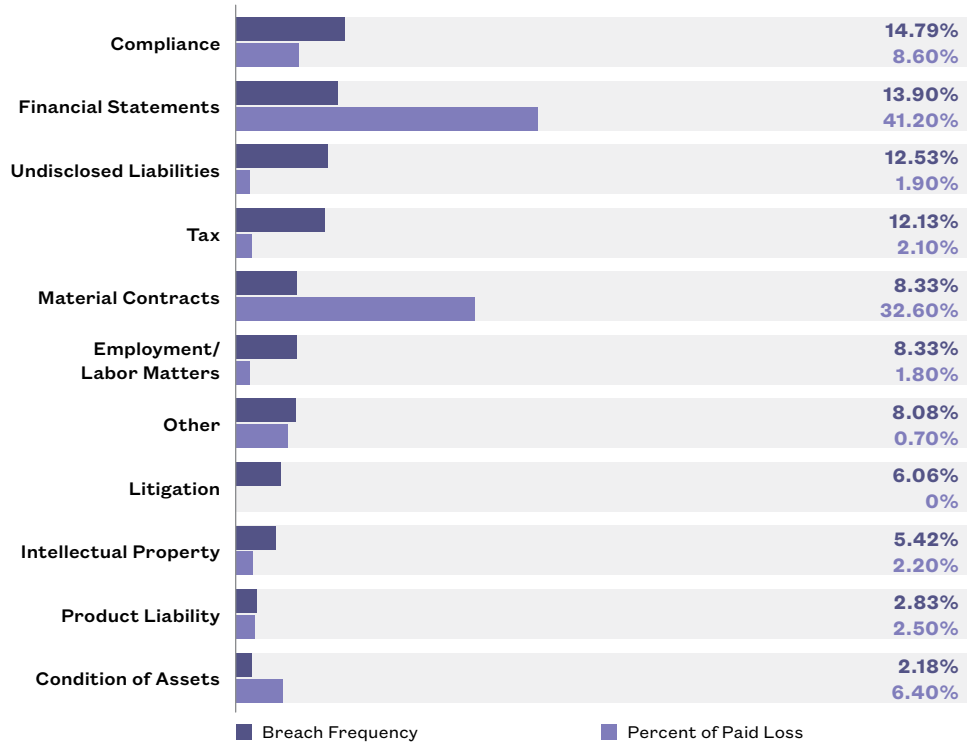
For companies in the technology industry, Aon's data suggests that they are much more likely to cite a breach of the intellectual property representation. This was cited by technology companies in R&W claim notices 10% of the time, as opposed to 4% of the claims made by companies in the manufacturing industry and 3.6% of the claims made by companies in healthcare.

Another interesting trend borne out by the data is that companies in the technology industry are more likely to file a claim citing unknown pre-closing tax exposures than companies in the manufacturing or healthcare industry. It is not uncommon for technology companies that are the target of an acquisition to be expanding quickly prior to the deal with respect to the location of both employees and clients. This may explain the higher percentage of pre-closing tax claims, as quick expansion can lead to new sales and use taxes or employee related tax exposures to which the company is not familiar with navigating.

The Aon data shows that risks can vary across industries and it would be prudent for dealmakers to pay attention to those breach types which tend to be the drivers of claims.

Claims Insight from AON

Frequency by Type of Breach versus Percentage of Total Paid Loss Attributable to Each Breach



Analyzing the data from 2015-2022, the most common breach type reported by Aon clients, as illustrated above, is the compliance with laws representation, followed by financial statements, undisclosed liabilities, tax, and material contracts. This is the first year where the Aon data shows compliance with laws as the most frequent breach category, surpassing financial statements which historically had been the most-cited breach.

When looking at the amount of loss paid by breach type, Aon continues to see claims alleging a financial statements breach as the main driver of loss followed closely by material contracts claims. Financial statements breaches comprise 14% of all claims but have accounted for 41% of all recovery, while material contracts breaches comprise 8% of all claims but have accounted for 32% of all amounts recovered. The reason for the outsized impact of these two breach types is the frequency with which clients seek damages beyond a simple dollar for dollar calculation.

2023 Hart-Scott-Rodino Act Thresholds

The Hart-Scott-Rodino (“HSR”) Act requires that parties to transactions for the acquisition of voting securities or assets that exceed certain thresholds notify the Federal Trade Commission (“FTC”) and US Department of Justice (“DOJ”) of the proposed transaction; pay the required HSR filing fee; and observe a 30-day waiting period before closing so that the agencies can review the deal for potential anticompetitive effects. Effective February 27, 2023, transactions with a value greater than \$445.5 million are generally reportable regardless of the annual net sales or the value of the total assets of the acquiring and acquired entities, while transactions with a value greater than \$111.4 million but less than \$445.5 million are generally reportable if one party to the transaction has annual net sales or total assets valued at \$22.3 million or more and the other party has annual net sales or total assets valued at \$22.7 million or more. HSR reporting thresholds are adjusted annually and are tied to changes in the US gross national product.

The HSR rules provide four additional reporting thresholds: in 2023, parties must report the acquisition of (a) voting securities valued at \$222.7 million or greater but less than \$1.137 billion; (b) voting securities valued at \$1.137 billion or greater; (c) 25% of the voting securities of an issuer, if 25% (or any amount above 25% but less than 50%) is valued at greater than \$2.2274 billion; and (d) 50% of the voting securities of an issuer if valued at greater than \$111.4 million. As required by the Merger Filing Fee Modernization Act of 2022, the FTC revised the HSR filing fee thresholds in 2023, so that HSR filing fees are now assessed on a six-tier range between \$45,000 (for transactions valued at less than \$161.5 million) and \$2.25 million (for transactions valued at \$5 billion or more) depending on the size of the transaction.

On June 27, 2023, the FTC published in the Federal Register proposed changes to the HSR premerger notification form and rules that would require parties to provide greater detail about proposed transactions and their potential impact. Following closure of the public comment period on September 27, 2023, it is likely these proposed rule changes will be adopted in the final quarter of 2023.

Glossary

Indemnity Escrow Amount

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

Indemnity Escrow Period

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

Representation & Warranty Survival Period

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

Carve Outs to General Survival Period

Certain specified representations and warranties may be carved out of the general survival period for representations and warranties and survive for a longer period of time.

Indemnity Basket

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

Indemnity Cap

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

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