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Letter from the Editors

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The first half of 2020 has, of course, been dominated by the pandemic. Public markets have been up and down, M&A activity dramatically slowed, and the outlook for new fundraisings is less clear than it has been for many years. As we report in this edition of *Private Equity Report's Mid Year Review and Outlook*, sponsors have been focused on supporting the liquidity and business requirements of portfolio companies. During the second half of the year, we expect some innovative refinancing transactions alongside an uptick in restructuring activity. At the same time, many dealmakers have been creative, with take-privates and strategic investments in public companies seeing something of a resurgence in Asia and the United States respectively.

It is not yet certain what the longer-term implications of the crisis will be, but some are already becoming clear. The many episodes of racial violence and injustice over the last few months are a sharp reminder to us all of continuing racial inequalities, while the pandemic itself highlighted many social issues that are often hidden from view. Private equity firms and their portfolio companies have been among those in the business community responding positively to these events. As highlighted in this edition, we believe that this focus on business integrity will continue in the years ahead —as policy-makers and asset-owners continue to demand more deliberate attention to the social, environmental and governance agenda from all quarters of the investment community.

We hope that you find the insights that follow to be helpful as we all navigate the new terrain. To this end, we are also pleased to inform you that Debevoise's Private Equity Group has launched a new digital channel—the *Private Equity Report Webcast Briefing* series. This is a supplement to our quarterly *Debevoise & Plimpton Private Equity Report*, now approaching its 20th year of publication. This new platform provides timely insights into developing legal issues that impact our private equity sponsor and portfolio company clients. We hope you join us for these webcasts, and we encourage you to access the on-demand recordings provided on our website.

In the meantime, we wish you and your families a safe, healthy and rapid return to the "new normal!"

Fundraising

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Despite considerable disruption caused by the global COVID-19 pandemic, the amount of capital raised globally in the first quarter of 2020 surpassed the amounts raised in the first quarter of 2019. However, the significant decrease in the number of funds closed in the first quarter of 2020 (as compared to the first quarter of 2019) indicates that much of the first quarter growth can be attributed to established sponsors raising megafunds. It is also likely that many of these funds were in the market before the onset of the pandemic and it remains to be seen whether current fundraising levels will continue through the remainder of 2020 and into 2021 or begin to decelerate as new products are marketed in the current economic environment.

We have seen established sponsors and investors across the spectrum adapt quickly to remote meetings and other investment processes necessitated by the global pandemic. At the same time, for newer fund managers, attracting first time investors has become uniquely difficult, as most business travel and in-person due diligence remains inadvisable, leading investors to seek out sponsors with established track records. We expect these trends to continue for the remainder of the year.

With respect to new products being marketed, there has been a meaningful increase in credit-focused funds, as well as pooled funds and separate account mandates that can be launched on an expedited basis, which favors sponsors with established track records and relationships with institutional investors able to execute quickly. In addition to fundraising efforts with new strategies, another trend we are seeing is increased sponsor appetite to (i) help existing portfolio companies weather short-term liquidity issues and (ii) take advantage of market dislocation, much of which is achieved through fund-level financing sources as well as amendments to existing fund documents expanding the ability of a fund to borrow, recycle or make follow-on investments.

Finally, we are seeing a notable build-up of dry powder in the private markets space, while at the same time deal volume has declined throughout the first half of 2020 (from the record 2019 pace). This change seems to be particularly impactful in the venture capital market, due to the unprecedented economic uncertainty in the market and difficulty assessing COVID-19's impact on valuations without reliable market data. As sponsors begin to better understand the economic impact of COVID-19 on valuations, we expect an increasing rate of deal volume in the second half of 2020.

Leveraged Finance and Fund Financing

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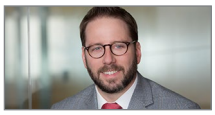

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Until the widespread impact of COVID-19 became clear, activity in the leveraged financing markets started 2020 at a brisk pace. There was a significant uptick in volume, as the outflows of 2019 were replaced by considerable inflows, allowing even lower-quality credits to return to the market. All this came to an abrupt halt in March. The COVID-19 crisis caused arrangers to hold off on syndicating previously committed deals, funding them from their balance sheets instead, while many M&A deals that had been close to signing were shelved. PE sponsors went into crisis management mode, evaluating the potential impact of the pandemic-related shutdowns on their portfolio companies' liquidity, performance and ability to continue as going concerns.

An overwhelming number of borrowers drew down on their revolving credit facilities to guarantee available liquidity as lockdown arrived. Revolving draws did not represent the only path to liquidity, as the high-yield market reopened by April, leading to record levels of issuance since then. Notably, similar to the market recovery following the financial crisis, secured notes have been the primary source of new deal volume, as borrowers look to shore up the liquidity on their balance sheets; secured notes have also allowed a limited number of leveraged buyouts to be completed, including CD&R's acquisition of Radio Systems Corporation, [See Leveraged Finance Outlook: The Rise of Secured Bonds in M&A Deals (Feb 2019)]. In addition, some borrowers have engaged in liability management transactions either to increase liquidity or to reduce debt load or both, including some that have been judged controversial by creditors, such as the priming transaction for Serta. [See NY State Court Refuses to Enjoin Serta's Priming Credit Agreement Amendment (Jun 2020)]

As the negative impact of COVID-19 on some borrowers' performance continues, we expect to see the increased stress reflected in their liquidity position, potential non-compliance with financial covenants, ability to address near term-maturities and possible going concern qualifications in the next audit season. In this context, we also expect to see disagreements between borrowers and lenders over EBITDA addbacks, requests for covenant relief and/or additional out-of-court and in-court restructurings.

The focus on access to liquidity also extended to fund level financings, as sponsors sought to close ongoing fund-finance transactions quickly and efficiently to minimize any execution risk. Many sponsors raised new liquidity at fund level not only as a defensive move in light of the pandemic but also for the purposes of taking advantage of market dislocation. Although some lenders retrenched and terms shifted somewhat in favor of lenders, the fund finance market remains robust as others have sought to expand their market position. The fund finance market is also looking to the future in respect of ESG-linked financings. Debevoise recently acted on a EUR 2.3 bn (USD 2.6 billion) ESG-focused subscription line facility, which was the first of its size and kind in the fund finance market. The search for new sources of liquidity has also led to growth in the market for financings against non-diversified portfolio assets (*i.e.*, concentrated net asset value facilities) of buyout funds, providing fund level leverage to sponsors where this was previously not possible. [See Recent Developments in Fund Level Financings (Jul 2020)].

M&A (U.S.)

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2020 began with a brisk PE M&A deal market, as the decade-long combination of vast amounts of dry powder and an abundance of debt financing continued to fuel buyout activity. But then, as the first quarter drew to a close, the severity of the coronavirus pandemic transformed all of our lives overnight. Debt markets unsurprisingly seized up and M&A sale processes were put on hold. It seemed as though 2020 was going to be the year that the PE deal market came to a temporary halt.

But the private equity community is nothing if not resilient. As the world adjusted to due diligence sessions conducted via Zoom calls, much of the focus of sponsors in Q2 shifted to PIPE (Private Investment in Public Equity) investments, with at least 27 PE-led PIPE transactions announced since the start of the pandemic. Few of these transactions involved debt financing (other than occasional back-leverage), and many came together in days, not weeks, and competition among sponsors was intense. Not surprisingly, many of the PIPE deals of 2020 featured more issuer-friendly terms (including conversion terms and lock up, standstill and voting obligations) than appeared in PIPES in recent years. In fact, in a number of situations, sponsors agreed to close prior to HSR approval, taking non-voting shares pending filings made post-closing.

Prospects for M&A deal activity in the second half of the year feel as uncertain as in recent memory. The recent resurgence of COVID-19 cases in the U.S., and the related delays in the reopening of the debt markets—as well as the looming presidential election —are all contributing to the medium-term caution. There has been anecdotal talk of sellers looking to accelerate sale processes in an effort to close prior to potential changes to tax rates following November's election, but those processes would need to be in full swing relatively quickly and, for now, it seems many sellers are still taking a wait-and-see approach.

In this time of uncertainty, we expect to continue to see a significant volume of deals that require less, or no, debt financing. For example, minority equity investments in portfolio companies owned by an existing sponsor, allowing the existing sponsor some liquidity. Portfolio company add-ons will continue to be plentiful, particularly to the extent the portfolio company can finance the deal from its balance sheet or additional sponsor equity. And, obviously, the credit and distress arms of PE sponsors will continue to review opportunities, including in so-called "363 sales" out of bankruptcy. In short, the traditional large-scale LBO may not be as frequent, but we expect that PE M&A lawyers will continue to be quite active as their clients pivot to bespoke opportunities resulting from the current economic disruption.

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The pandemic and ensuing uncertainty has, of course, also had a freezing effect on M&A activity in Europe. Many projects have been put on hold or continue on an extended timetable, with deal volumes trending downwards after a strong start to 2020.

It is not clear when the uptick will come, but buyers and sellers are busy getting ready for it. They are spending more time preparing for M&A processes (average "build times" for transactions are estimated to have increased by up to 50%), from structuring through to diligence, with a strong focus being placed on execution risks from both sides of transactions.

European governments continue to introduce measures to mitigate the effects of the pandemic, with dealmakers having to navigate new and varying regulatory controls on the private sector that have been implemented on an accelerated basis. In March, the European Commission issued guidelines to ensure a strong EU-wide approach to the screening of foreign direct investments (FDI) aimed at protecting key infrastructure and mitigating risks that foreign ownership may pose to public security and order. In response, many European countries have introduced new FDI laws which offer protection to key industries in the national interest; the scope and implementation of these laws has not been uniform, and so seeking advice early on in processes will be important in order to navigate these new laws efficiently.

Market volatility has of course created uncertainty in valuations. One effect of this is an increasing consideration of purchase price mechanisms that provide for adjustments based on future performance, including elements of deferred compensation (such as earn-outs), as well as clawbacks and escrows that seek to compensate sellers for a lack of up-front agreement on price as well as to mitigate impacts of unpredictable financial modelling.

We anticipate the remainder of 2020 will see an increase in sales of noncore assets in order to provide liquidity and working capital in the short and medium term, as well as an uptick in distressed sales, providing opportunities for financial sponsors and strategic investors alike.

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Meanwhile, in Asia, the tumbling stock market has created opportunities to take publicly listed companies private. According to Dealogic, there were 23 take-private transactions in the Asia-Pacific region worth a total of USD 14.6 billion in the first quarter of 2020, a fiftyfold increase from the same period in 2019. This trend is expected to continue through 2020, especially for cash-rich companies in the property, retail and energy sectors that are trading below their book values. In Hong Kong, Wheelock & Co. and Li & Fung are the latest examples of formerly blue chip companies engaging in privatization transactions. Certain Mainland Chinese companies may also delist from Hong Kong if the China A-share market is perceived to offer better long-term valuation —for example, China Huadian Corporation, a PRC electricity generator, recently announced its take-private offer.

Following the announcement by Luckin Coffee in April 2020 that its chief operating officer had fabricated the company's 2019 sales figures, and its suspension from trading

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M&A (Asia)

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and expected delisting by NASDAQ, investors' confidence in U.S.-listed Chinese companies has been shaken again. Furthermore, proposed changes to U.S. listing rules as well as the possible passage of new U.S. legislation on non-U.S. company listings have raised the specter of another wave of de-listings and/or privatization transactions involving U.S.-listed Chinese companies. In the last take private wave in 2015, as many as 25 U.S.-listed Chinese companies received take-private offers due to valuation gaps with their Chinese-listed peers. It remains to be seen whether similar valuation gaps would emerge that will present similar opportunities. As of July 10, 2020, NYSE-listed Jumei International, Bitauto Holding and 58.com, as well as NASDAQ-listed Changyou.com, have engaged in take private transactions. Certain other U.S.-listed Chinese companies, the highest-profile of which being Sina Corporation, have received take-private offers. In addition, Baidu Inc. reportedly is considering de-listing from NASDAQ and moving to an exchange closer to home, while JD.com and NetEase have conducted secondary listings in Hong Kong.

U.S. Capital Markets

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As the markets suffered the quickest decline for U.S. stocks on record, the SEC, the Federal Reserve, and stock exchanges reacted by providing a mixture of regulatory relief, liquidity support, and guidance to help companies cope with the myriad of economic concerns raised by COVID-19 and its impact on business.

In March, the SEC issued an order granting exemptions from certain reporting and proxy delivery requirements for public companies. The SEC supplemented this relief in April with guidance providing relief for difficulties in preparing proxy materials for shareholder meetings.

The SEC also provided a series of guidance to companies describing how to address the risks of COVID-19 in reports publicly filed with the SEC. The SEC stressed the need to honestly assess COVID-19's effect on the company in preparing or considering financial disclosures, including whether the effects should be addressed in the company's MD&A (Management's Discussion and Analysis of Financial Position and Results of Operations), risk factors, or elsewhere. Disclosures were also addressed in an April and June statement.

In April, the NYSE made it easier to raise capital in private offerings by matching current NASDAQ rules. Then, in May, both the NYSE and NASDAQ released temporary rules that exempted public companies from requiring shareholder approval requirements for issuances of equity securities to insiders or that constitute more than 20% of the issuer's outstanding common stock or voting power under specific circumstances. Both rules expired on June 30th, 2020 and have not been renewed as of the date hereof; however, the NYSE's April relief has been extended through September 30, 2020.

The Federal Reserve, in some cases using funds from the CARES Act, established a series of facilities and programs to inject liquidity into the financial system and keep businesses afloat during the COVID-19 crisis. Many of these facilities were aimed at

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U.S. Capital Markets

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stabilizing markets, such as the PMCCF (Primary Market Corporate Credit Facility), which was authorized to purchase qualifying bonds and portions of syndicated loans directly from eligible issuers and the SMCCF (Secondary Market Corporate Credit Facility), which was authorized to purchase eligible bonds and eligible corporate bond portfolios in the form of ETFs from eligible sellers, including primary dealers. Additional Federal Reserve facilities were aimed at supporting programs that help businesses impacted by the crisis, such as the Main Street Lending Program and the Paycheck Protection Program Lending Facility.

The capital markets had a roller coaster ride during this period. In March, investors withdrew record amounts from investment grade debt funds, and risk premiums on investment grade bonds reached 2008 financial crisis levels. However, after the Federal Reserve announced the PMCCF, SMCCF, and other facilities, the investment-grade bond market quickly recovered. In April, the Federal Reserve expanded the scope of the bonds it would purchase to include "fallen angels" (issuers whose bonds fell below investment-grade during the crisis), and made limited purchases of ETFs tracking high-yield corporate bonds.

New bond issuances also increased significantly following the implementation of these facilities. Despite a year-over-year decrease in high-yield debt issuances in March, the market quickly rebounded with $34.8 billion in new high-yield debt issued in April, compared to $16 billion in April 2019, and as of mid-June, high-yield volume for 2020 was 65% ahead of 2019. Issuances of investment grade bonds saw even greater increases, with March 2020 doubling that of March 2019 and continuing into April. By the end of the first half of 2020, companies with investment-grade credit ratings had issued a record $840 billion in bonds.

As discussed above [in our M&A section], many companies also began to take a renewed interest in PIPEs as a means of raising capital and many sponsors focused on these opportunities. They were assisted by temporary changes to the NYSE and NASDAQ's rules, which made it easier to complete these transactions without the delays and uncertainty caused by shareholder approval requirements.

Outside of funding concerns, many reporting companies are also reacting to the economic uncertainty of the crisis by suspending or withdrawing earnings guidance. In April, more than 80 S&P 500 companies suspended their earnings guidance and, as of June, nearly 40% of the S&P 500 had withdrawn their guidance, citing COVID-19.

As the crisis continues, companies should pay close attention to the market and further regulatory responses in considering how to fund and disclose their operations.

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To many sponsors and investors in U.S. real estate, the arrival of the pandemic in the United States in March promised to usher in a long-awaited market adjustment. Many firms rapidly shifted fundraising efforts toward an opportunistic strategy, with the expectation that widespread distress among property owners would translate into a glut of properties trading at steep discounts.

The predictions of distress have proven true, especially for hospitality and already ailing retail properties, many of which experienced a nearly complete collapse of property revenues amidst government-mandated closures and "stay at home" guidance. While office landlords have largely kept their buildings open and operating, many are confronting reduced collections from financially struggling tenants, pushback from businesses whose personnel are working remotely to paying full rent on unused space and a sharp decline in new leasing activity. Multifamily operators have generally reported lower-than-expected tenant delinquencies but increases in vacancy and tenant concessions. (On a bright note, distribution/logistics and other industrial properties have continued to flourish, benefitting from the expansion of e-commerce.)

As yet, however, the predicted surge of transactions has not materialized. Almost the opposite, commercial real estate (aside from the industrial sector) experienced something closer to a standstill in the second quarter of 2020, with much of the meager deal volume consisting of completion of transactions already in progress (although, in a few notable instances, buyers have opted to litigate rather than close on pre-COVID purchase agreements).

Several factors help to explain the state of affairs at mid-year. First, COVID and its collateral effects have complicated and, to some extent, curtailed the physical aspects of real estate due diligence—from site tours to surveys.

Second, few lenders have rushed to exercise default remedies, generally preferring workouts and, where necessary, providing short-term forbearance, rather than foreclosing or pushing owners to sell into a weak market (in many jurisdictions, legislation and court closures have limited or prohibited foreclosure actions, and in several recent New York cases courts have looked askance at lenders' efforts to use workarounds, such as acquiring control of a property by foreclosing on a pledge of equity interests in the borrower).

Third, and perhaps most significantly, ongoing uncertainty across a variety of factors continues to pose a challenge to determining asset value and pricing, as models are sensitive, in the near term, to the likely duration and severity of the pandemic and, in the mid- to long-term, to the economic outlook and changes in how people live, work, shop and travel.

An uptick in deal activity in recent weeks suggests cautious optimism, at least for certain types of assets in specific markets. Still, industry opinion remains mixed as to the dominant theme of the second half of 2020: more of the same, with virus flare ups and renewed lockdowns dampening investor confidence; a gradual rebound, with relatively modest re-pricing; or the onset of a more dramatic market re-set, particularly in the hospitality, retail and office sectors.

U.S. Tax

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In response to the economic downturn triggered by the pandemic, Congress enacted the Coronavirus Aid, Relief, and Economic Security Act on March 27, 2020 (the "CARES Act"). The CARES Act was intended to provide a rapid infusion of cash into the economy through loan programs, individual rebate checks and tax relief. Summarized below are some of the tax relief provisions of particular interest for private equity firms and their portfolio companies. For a more fulsome discussion of the CARES Act provisions, see CARES Act—Fiscal Response to COVID-19 and our Coronavirus Resource Center.

In order to increase liquidity and incentivize companies to retain employees, the CARES Act provides for a refundable tax credit against wages paid to employees. The tax credit equals 50% of employee wages of up to $10,000 paid after March 12, 2020 and before January 1, 2021, for a credit of up to $5,000 per employee. To qualify for the credit, an employer must either be subject to a government-mandated suspension of operations or experience a decrease in gross receipts of greater than 50% compared to the same calendar quarter in the prior year. For employers with more than 100 full-time employees, wages count only if they are paid to employees that are not providing services as a result of one of these two causes. However, the credit is not available to any employer who receives a Paycheck Protection Program loan (a "PPP Loan") issued by the Small Business Administration under a separate provision of the CARES Act.

An important point for private equity firms is that all entities under common control are treated as a single employer for purposes of the payroll tax credit under the CARES Act. For example, a holding company and its wholly owned subsidiaries are treated as a single employer in determining whether the stricter 100-employee rule applies, whether the gross-receipts test for the credit is met and whether the credit is unavailable as a result of one of the subsidiaries receiving a PPP Loan. However, it is not clear whether a private equity fund that owns multiple portfolio companies causes them all to be aggregated as a single employer.

The CARES Act provides for a deferral of the employer's portion of the Social Security payroll tax for the period from March 27, 2020 until the end of the calendar year. Fifty percent of the deferred amount will be due on December 31, 2021 and the remaining 50% will be due a year later, on December 31, 2022. The deferral benefit ends if any PPP Loan is forgiven.

The CARES Act also made taxpayer-favorable changes to the use of net operating losses ("NOLs") and interest expense. As background, the Tax Cuts and Jobs Act of 2017 (the "TCJA") limited NOL carryforwards and eliminated NOL carrybacks, and limited interest expense to 30% of EBITDA. The CARES Act removed the limitations for NOLs arising in 2018 through 2020 and generally increased the EBITDA cap on interest expense for 2019 and 2020 to 50% (and allows taxpayers to use 2019 EBITDA (if higher) for 2020). These measures should enable companies to generate cash rebates for taxes paid in prior years.

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U.S. Tax

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Separately, the crisis has revived a tax issue that may affect many sponsors closing deals in the current circumstances. Buyers in M&A transactions often are required to bid with no finance conditions. To protect themselves against this risk, PE buyers often negotiate with a bank to provide a committed loan of last resort, referred to as a bridge loan. In normal market conditions, these bridge loans are typically not funded as the borrower is usually able to secure other, cheaper, financing. However, in a down market, replacement debt is frequently not readily available. Therefore, bridges are often funded but the loan documents provide "market flex" provisions or securities demands that allow the lender to modify the terms (typically, the yield or interest rate) of the loan in order to syndicate it. These modifications may be viewed as significant and give rise to a "deemed exchange" for tax purposes. A deemed exchange results in the borrower being viewed as paying off the "old loan" for the fair market value of the "new loan." If the syndicated price that the bank is able to sell at after exercising the market flex or securities demand is below the original amount received by the borrower, the borrower will have cancellation of indebtedness income ("CODI") on the old loan that is taxable upon the exchange and an offsetting amount of original issue discount ("OID") on the new loan that the borrower may deduct over the life of the new loan. Because OID may be subject to deferral or disallowance, these rules need to be thought about in advance and navigated with care.

Relatedly, in the last economic downturn, many portfolio companies had debt that was trading at significant discounts and many of the private equity funds that owned these portfolio companies believed that the debt was undervalued and wished to purchase the debt. Unfortunately, similar to the discussion above regarding significant modifications, an acquisition of debt by a person related to a borrower is generally treated as a purchase by the borrower at the price paid by the related party followed by a new issuance to the related party. If the debt is trading at a significant discount, this has the effect of causing the portfolio company to recognize CODI upon the exchange with offsetting OID expense over the term of the debt, the deductibility of which may be subject to deferral or disallowance. If market conditions continue to deteriorate, it is likely that this issue will arise more frequently and tax professionals will need to consider ways to mitigate this unfortunate result (including through use of special vehicles that can navigate the related party rules with proper structuring).

UK Tax

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Not surprisingly, the European tax landscape has recently been dominated by authorities' reactions to COVID-19. Unhelpfully for private equity firms that do a significant amount of cross-border business involving EU jurisdictions, tax authorities' inconsistent reactions have created further opportunities for missteps during an already challenging time.

In June, the European Council permitted EU member states to delay reporting under the EU's significant new tax disclosure regime, "DAC 6", by six months in light of COVID-19. This means that, with some exceptions (discussed below), private equity firms, their legal and accountancy advisers and their investors have until next year, rather than as soon as next month, to review and report any relevant transactions. (See here for our high-level introduction to DAC 6, written when the UK first published its draft rules.)

The majority of EU member states, including the UK, France and Luxembourg, have taken advantage of this option to delay. However, Austria and Finland have not while, as of today, it is uncertain whether Germany will; there are rumours of conflict between federal and state authorities in Germany over which approach to take. Unfortunately for those in the private equity industry who have offices, investments or investors in Germany, if Germany were to decide not to delay, the timeline for complying with DAC 6 would be significantly accelerated, with penalties potentially payable by those firms and advisers who are not able to spring into action. Private equity firms are advised to watch this space closely!

Establishing the tax residence of companies has also been more difficult since March. Among the millions of overseas trips cancelled as a result of the pandemic were those planned by directors of portfolio companies (or other companies within a fund structure) to attend board meetings in foreign jurisdictions. Regular physical attendance at these meetings (rather than virtual attendance) and actually carrying out relevant duties in the jurisdiction in which the company is resident (rather than the jurisdiction(s) in which the directors are resident) are key in many EU member states for ensuring that a company's profits are not taxed in more than one jurisdiction; these actions relate to the concepts of corporate residence and permanent establishment, respectively.

Tax authorities in many EU member states, including Luxembourg and Ireland, have issued clear and helpful guidance in situations where the directors or employees of normally nonresident companies are forced to manage those companies or carry on their business in Luxembourg or Ireland, respectively. However, the approach of the UK tax authority, HMRC, to directors and employees who have been grounded in the UK has been more ambivalent, arguing that its existing application of the UK rules regarding corporate residence and permanent establishment is sufficient to avoid unjust results during lockdown.

The UK's approach creates some uncertainty; for example, relatively recently incorporated non-UK resident companies that have several UK-resident grounded directors may struggle to demonstrate that, looked at as a whole, they are managed, and habitually conduct their business, outside the UK. Equally, longer-established non-UK resident portfolio companies may struggle to demonstrate the same thing if lockdowns return next year and they are once again unable to travel. Private equity firms should aim to identify those non-UK portfolio (and other) companies with significant directors or employees trapped in the UK and consider whether preventative measures can be taken to reduce such companies' UK footprint during

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UK Tax

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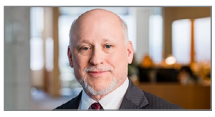
lockdown. It is important to note that, while the focus has been on corporate residence and permanent establishment, personnel being confined to the UK could result in wider tax issues, including in relation to VAT or employment taxes, depending upon the circumstances.

Unrelated to COVID-19, and a 'good news' item for the private equity industry, the UK government is conducting a wide-ranging review of the UK's tax regime for holding companies to ensure its competitiveness and sustainability. This involves consultations relating to simplifying the VAT on fund management fees, the suitability of UK holding companies for making and exiting investments, and addressing any unintended adverse consequences of the UK anti-hybrid rules.

In each of the areas under review, Luxembourg's tax regime has a head-start on the UK; for example, a VAT exemption on management fees, flexible and efficient mechanisms for repatriating partial exit proceeds in capital form, and provisions that clarify the application of anti-hybrids rules in the context of widely held funds. The UK will need to move in this direction if it is to enjoy the success as a private equity holding company jurisdiction currently enjoyed by Luxembourg. Debevoise intends to play its part in encouraging the UK government along these lines. Our most recent understanding is that HMRC is taking this review seriously and is open to engagement.

U.S. Regulatory



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While the Securities and Exchange Commission (SEC) continues to focus on protecting retail investors and assessing market-wide risks, in January 2020, the SEC's Office of Compliance Inspections and Examinations (OCIE) specifically identified private funds as an examination priority. OCIE noted that it will focus on, among other things, private equity advisers that have a greater impact on retail investors, private equity funds with emerging investment strategies (such as those incorporating ESG criteria), the full and fair disclosure of conflicts relating to fees and expenses and compensation arrangements, and compliance risks, including controls to prevent the misuse of material, non-public information (MNPI). OCIE further emphasized these priorities in June 2020 in its risk alert on observed deficiencies by advisers to private funds. While the June 2020 risk alert did not identify new risks or findings that have not been previously identified by the SEC in, primarily, SEC enforcement actions or speeches by SEC staff, it reinforces the SEC's focus on private fund advisers and the need by private fund advisers to review and update practices and compliance policies and procedures. Finally, the June 2020 risk alert draws attention to the potential misuse of MNPI, an area which has separately been the subject of recent enforcement cases as further discussed in [the SEC Enforcement section] below.

At the same time, the SEC focused on supporting market participants during the COVID-19 pandemic by issuing exemptive relief under the Advisers Act and providing guidance on how to comply with various regulatory obligations. The Division of Investment Management updated its Frequently Asked Questions on completing and amending Form ADV and complying with obligations under the Custody Rule (Rule 206(4)-2) to provide guidance related to, among other things, a firm's reliance on remote working conditions and inability to access mail and deliveries, maintain physical certificates with qualified custodians and complete surprise examinations. The SEC also reminded firms that receive Paycheck

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U.S. Regulatory

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Protection Program (PPP) loans that they may have related regulatory reporting obligations to their clients. Finally, the SEC issued extensions for certain Form ADV and Form PF reporting and filing obligations by registered investment advisers and exempt reporting advisers.

While OCIE stated that it would not consider an adviser's reliance on exemptive relief as a risk factor in deciding to begin an examination, it may request further information on the implementation and effectiveness of such adviser's business continuity plans. We are aware that OCIE is beginning to incorporate into its routine examinations specific requests with respect to private fund advisers' preparedness and disclosures prior to the pandemic, responses to changing circumstances (including changes to their compliance program generally and specifically with respect to business continuity plans), disclosures and communications to investors over the course of the pandemic, and overall health and safety. We expect OCIE (and the SEC generally) to continue with this focus in the near- to medium-term.

Following a 2019 concept release on the harmonization of exempt offerings, the SEC proposed amendments to the exempt offering framework, which seek to harmonize certain of the offering exemptions and provide increased flexibility and certainty to issuers. Perhaps most notable is a proposal to modify from six months to 30 days the current "cooling off" period found in the existing offering integration safe harbors. Shortening this safe-harbor time period, outside of which other offerings would be considered to be integrated or part of the same offering, would enhance market flexibility in accessing capital.

The SEC also proposed an expansion of the "accredited investor" definition under the Securities Act of 1933. Where the current definition primarily relies on quantitative measures, the proposal includes qualitative categories that would allow a person to qualify as an accredited investor based on such person's status as a "knowledgeable employee" of a fund or based on a natural person's possession of certain professional certifications and designations or other credentials issued by an accredited educational institution.

At the same time, the SEC engaged with the industry on its various proposals. We continue (and are aware of others' effort to continue) to discuss with the SEC and its staff, for example, the 2019 proposals to modernize the advertising and cash solicitation rules. In light of the upcoming election and uncertainty of SEC leadership composition in 2021, we expect the SEC to focus on finalizing these proposed rule amendments before the end of the year.

Finally, as very widely reported, the Department of Labor issued an informational letter providing a roadmap for including private equity investments as an investment option for participant-directed individual account plans (such as 401(k) plans) in a manner that complies with the requirements of Title I of ERISA. The letter notes that, in order to better diversify portfolios or align investment horizons, a fiduciary that follows an objective, thorough, and analytical process can, consistent with its ERISA fiduciary duties, offer 401(k) plan participants the opportunity to invest in private equity. The letter includes a number of considerations for such a process as well as practical solutions on managing the liquidity constraints. While none of the structures considered would permit plan participants and beneficiaries to invest directly into private equity investments on a stand-alone basis, the letter suggests potential paths for such investments, including through separately managed accounts or fund-of-fund structures.

SEC Enforcement

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In a March statement emphasizing the importance of market integrity, the SEC's Division of Enforcement focused on corporate insiders' access to, use of, and protection of material non-public information (MNPI), noting that holding such MNPI may have greater value now in light of the unprecedented market and economic conditions. *Ares Management LLC* provides an example of the kind of MNPI violations that the SEC is focused on. Primarily an enforcement case about policies and procedures, the SEC found that the firm failed to implement and enforce its policies and procedures designed to prevent misuse of MNPI while a member of its deal team sat on a portfolio company's board and while it was subject to confidentiality provisions in a loan agreement with the portfolio company. The SEC found that Ares' compliance policies were insufficient as they provided compliance staff with wide discretion in implementing policies and did not require them to contact all employees with potential access to MNPI. The SEC also found that Ares failed to sufficiently document instances where compliance staff inquired with deal teams as to whether anyone had received MPNI and whether, to the extent any documentation existed, it lacked consistency and detail.

At the same time, the Division of Enforcement continues to focus on the timely and accurate disclosure of conflicts of interests, especially as they relate to firm-specific practices concerning the allocation of fees and expenses. In *Monomoy Capital Management, L.P.*, the SEC found that Monomoy charged the portfolio companies owned by a private fund Monomoy managed for the services of Monomoy's in-house Operations Group but failed to provide full and fair disclosure of this practice and the associated conflicts of interests in the private fund's operating documents. In particular, prior to 2014, Monomoy did not disclose that the Operations Group would provide billable services to the funds' portfolio companies, or that Monomoy would receive, or had received, reimbursement from portfolio companies to cover the cost of such services. Later, in March 2014, Monomoy amended its Form ADV to state that "under specific circumstances, certain Monomoy operating professionals may provide services to portfolio companies that typically would otherwise be performed by third parties," and that "Monomoy may be reimbursed" for costs related to such services. This disclosure, however, did not accurately describe the practice and was not identified as a material change in the "Summary of Material Changes." *Monomoy* presents yet another example of a "may" disclosure that was found to be inadequate where a practice is in fact occurring. The SEC also expressed concern that the disclosure did not make clear that the rates charged to portfolio companies were intended to recoup most of the total cost of maintaining the Operations Group. *Monomoy* reflects the SEC's continuing skepticism of private equity managers that charge investors for employee-related expenses outside the management fee in the absence of crisp, detailed disclosures. More generally, it is also an important reminder that fund documentation must clearly and accurately reflect a firm's practice regarding how expenses (*e.g.*, salaries of adviser personnel, compliance, regulatory filings, and office expenses) are allocated.

The compliance issues raised in both *Ares* and *Monomoy* are examples of the specific deficiencies that OCIE noted in the June 2020 risk alert discussed above [in the U.S. Regulatory section].

Meanwhile, the U.S. Supreme Court restricted the SEC's power to seek "disgorgement" from firms. In June, the Court held that the SEC has the ability to seek disgorgement as long as

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SEC Enforcement

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the disgorgement award does not exceed a wrongdoer's net profits and is awarded to victims of the violation. While the Court held that a "disgorgement award that does not exceed a wrongdoer's net profits and is awarded for victims" is equitable relief permissible under the statute, it nevertheless suggested that the SEC may exceed its authority to seek disgorgement if it: (i) requires that defendant's gains be deposited with the U.S. Treasury instead of returned to victims, (ii) imposes joint-and-several liability under certain circumstances, or (iii) declines to deduct legitimate business expenses from the award. It remains to be seen, however, whether Congress will enact legislation that would overturn this decision. Legislation has been proposed that would give the SEC the ability to generally seek disgorgement for five years after the violative conduct that gives rise to the claim and extend such statute of limitation to ten years for violations of antifraud provisions of the federal securities laws that require a defendant to have acted intentionally or recklessly. Current proposals in Congress do not seem poised to address the limitations on disgorgement imposed by the Court. Without legislative change, the SEC's ability to obtain disgorgement (and the amount of any such awards) in certain types of cases could be substantially affected.

European Regulatory

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Despite the disruption caused by COVID-19, the UK has held fast to its "Brexit" commitment to end the direct application of EU law in the UK at the end of December 2020, with the UK government announcing in June 2020 that the UK will not extend the current transition period beyond that date. The "onshoring" of virtually all existing EU laws means that there will be no dramatic change to UK law overnight, although there will be divergence over time, and cross-border services will be disrupted immediately because UK firms will lose passported access to those based in the EU. That will be a significant change for many UK-based private equity firms, especially those in the middle of fundraising.

On financial services, focus has turned to the conditions in various EU Directives that allow non-EU firms to access EU customers, which generally depend on a determination that non-EU regulatory regimes are of an "equivalent" standard to that of the EU. Acceptance of this route as a viable means for UK firms to access EU customers will depend on the European Commission making equivalence determinations relating to UK law and regulation, which is certainly not guaranteed. In any event, such a determination would be of little value to many UK-based firms, because there is no operative equivalence-based access for alternative investment funds, and such firms will therefore have to use an alternative approach unless and until there is. Such approaches include the establishment of an EU structure, often in Luxembourg, and we are seeing many clients take that path.

In Luxembourg, where Debevoise opened an office in June, the financial regulator, the CSSF, recently published a circular that provides some helpful guidance on the provision of investment services by non-EEA investment firms and also introduced a national transitional regime for third country equivalence under the Markets in Financial Instruments Regulation (MiFIR). Both announcements are of particular significance for the continuity of services provided by UK investment firms post-Brexit.

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European Regulatory

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Brexit aside, the EU's law-makers have made progress on a new regime on the disclosure of environmental, social and governance factors. All affected firms, including many private equity fund managers, will be required to make certain disclosures about their approach to sustainability risks, and the consistency of their remuneration policy with that approach. In addition, firms will be asked to say whether they take account of the "principal adverse impacts" of their investment decisions on sustainability factors—a broader and more demanding standard—and, if they do, to make extensive public and investor disclosure. Most private equity firms will be able to explain why they do not apply this additional standard if they feel it is disproportionate or unrealistic, although larger asset managers will have no choice but to disclose how they comply with the obligation to take these factors into account in decision-making. More detail on the obligations will emerge later this year. It seems that non-EU fund managers marketing under the national private placement regimes in EU member states will also be subject to disclosure requirements, but the precise application of the regime to non-EU fund managers marketing in the EU—and, indeed, to those regulated in the UK—remains unclear.

In a similar vein, the European Commission will also make changes to the governance, risk management and control framework for private fund managers authorised under the EU Alternative Investment Fund Managers Directive ("AIFMD") to seek to ensure that sustainability issues are adequately considered. In addition, the Commission's Technical Expert Group published its final report on the taxonomy for sustainable economic activities in March 2020, focusing on climate change mitigation and climate change adaptation, a milestone in its work to establish common criteria to determine whether an economic activity is environmentally sustainable.

Firms will also have to prepare for the EU's (and the UK's) new prudential framework for investment firms, which applies from June 2021. This will apply to private equity sponsors in the UK or the EU which are structured as "adviser-arrangers" under the EU Markets in Financial Instruments Directive (MiFID), as well as EU alternative investment fund managers with additional MiFID permissions. The regime brings with it a highly structured framework for requirements on regulatory capital, risk management, governance and staff remuneration—in some ways disproportionate to the risks generated by private equity sponsors' activities.

CFIUS Reform

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On February 13, 2020, the Committee on Foreign Investment in the United States (CFIUS) regulations that implement the Foreign Investment Risk Review Modernization (FIRRMA) became effective. Although FIRRMA and the regulations significantly expand CFIUS jurisdiction to include certain types of non-controlling investments by foreign persons in U.S. businesses, there is some good news for private equity sponsors.

Most importantly, for U.S.-based sponsors operating in the United States, lingering questions as to CFIUS's jurisdiction over investments by their foreign-organized funds (*e.g.*, in the Cayman Islands) have now largely been put to bed. The regulations (final version published July 28) confirm long-standing understandings that an entity, regardless of where it is organized, that has its "principal place of business" in the United States is not a foreign person, which, for a fund, means the place where its activities (inclusive of investments) are "primarily directed, controlled, or coordinated" by the GP. In this respect, CFIUS noted that it essentially adopted a "nerve center" test." A cautionary note: if the fund's most recent filing with a U.S. or foreign government states that its principal place of business is ex-U.S., that will control. But, as has been the case, notwithstanding its principal place of business, a foreign-organized entity in which U.S. nationals hold the majority of the equity is not a foreign person. As before, non-U.S. sponsors and U.S. entities controlled by foreign persons are themselves foreign persons and, as such, they will still need to pay attention to whether their investment in a U.S. business is subject to CFIUS jurisdiction.

The regulations implement FIRRMA expansion of CFIUS jurisdiction beyond control transactions (CFIUS's historic jurisdiction) to encompass "covered investments;" that is, a non-controlling investment (of any size) by a foreign person in a "U.S. T[echnology] I[infrastructure] D[ata] business" *if* that foreign person is accorded any one of three "trigger rights:" (i) access to material non-public technical information; (ii) a board or board observer seat; or (iii) or involvement in substantive decision-making regarding the U.S. business.

A U.S. TID business includes a U.S. business that produces, designs, tests, manufactures, fabricates or develops a "critical technology" (defined, in most relevant part, by whether the technology is subject to U.S. export controls); performs certain functions with respect to "critical infrastructure" (the regulations list the types); or maintains or collects "sensitive personal information" of U.S. citizens. Sensitive personal data includes insurance-, financial- or health-related data, but, in general, only if the data of a million persons is collected or maintained during a 12-month period.

In theory, expanding CFIUS's jurisdiction to covered investments could sweep in any foreign LP's equity stake in a U.S. fund. Ordinarily, however, LPs are not accorded one of the three trigger rights with respect to portfolio companies, so, in that case, their investments will not be "covered." In addition, FIRRMA (and the regulations) provide

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CFIUS Reform

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a further "safe harbor," in which a foreign LP in an investment fund that a U.S. GP manages does not make a covered investment in the fund's portfolio company if the LP is passive, and has no decision-making rights with respect to the fund or its investments.

The regulations, as authorized by FIRRMA, also establish a new category—"excepted investors"—who enjoy favorable treatment, to the effect that a non-controlling investment by them in a U.S. TID business is outside the definition of "covered investment." Excepted investors are persons who are nationals of, or are entities organized in, based in and substantially connected to, "excepted foreign states" and the U.S., including with respect to their directors, 10% equity holders or controlling persons, and 80% of its equity (for non-public companies). CFIUS announced that the excepted foreign states are Australia, Canada and the United Kingdom, and starting in February 2022, the Government is expected to identify more excepted foreign states.

Filings with CFIUS always have been and remain, for the most part, voluntary. Filings are now mandatory in two circumstances. First, parties to a control transaction or covered investment must file if the investment involves a "critical technology" TID U.S. business, where the relevant technology is used or designed for use in one of 27 specified industries; this largely carries forward the Pilot Program that CFIUS launched in the fall of 2018, although CFIUS is now proposing further change. CFIUS now has proposed to replace the 27 industries test with one that looks at whether a U.S. export license would be required to export the technology in question to any of the countries where the buyer and its parents (and any holders of 25% voting interests in entities in the ownership chain) are located. Second, a filing is mandatory where a foreign government is acquiring a "substantial interest" in a U.S. business. This may be of limited concern for the majority of private equity sponsors because, where a partnership is making the investment, the regulations define a substantial interest as a 49% or greater interest in the GP itself. Nonetheless, careful review of whether a filing is mandatory is warranted because the parties must make such a filing by no later than 30 days before closing. CFIUS has the power to impose a penalty on the parties if they fail to make that filing; the penalty can be up to the transaction value.

Under the new regulations, parties can file shorter-form declarations (including where filings are mandatory) instead of full-blown notices. CFIUS will respond to a declaration within 30 days, so the timing advantages to filing a declaration can be significant. Any timing consideration, however, should account for one possible response by CFIUS: the parties should file a notice. Under FIRRMA, a notice is subject to an initial 45-day review period—once CFIUS accepts the notice for filing—and the review can then spill over into a second, 45-investigation period, subject to a 15-day extension in extraordinary circumstances. CFIUS also has implemented regulations that empower it to charge a filing fee. The fee for $750 million plus transactions is $300,000.

U.S. Asset Management Litigation

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In PE-related U.S. litigation, 2020 has been the year of the "contractual out." As lockdown began and the global pandemic disrupted all manner of business expectations, parties questioned whether their contracts were enforceable, or could be modified or set aside. The doctrines that govern those questions are rarely tested. This year, they have drawn an unprecedented level of focus and litigation. Three doctrines may provide a basis for temporarily or permanently excusing performance of contractual obligations: force majeure clauses, material adverse events/change clauses and frustration of contract. For each of these doctrines, changes in the economy are usually not enough to avoid performance, nor are these doctrines meant to buffer against the normal risks of contracting. The implications of these doctrines for any particular contract or transaction will depend on the applicable law, the specific terms of the agreements and the governing facts. New York and Delaware courts look to precedent when resolving contract disputes—and there is none to guide them here.

Force Majeure

Force majeure clauses in contracts allocate risk by excusing one party's non-performance when its reasonable expectations have been frustrated due to circumstances beyond its control and, therefore, are applied narrowly. *Force majeure* clauses that specifically excuse non-performance due to outbreaks, epidemics, pandemics, quarantines, travel restrictions and the like provide a stronger basis to argue that the current coronavirus outbreak constitutes a *force majeure* event than those that do not.

Typically, a party seeking to avoid performance due to a *force majeure* event must demonstrate that performance (i) has become objectively impossible, or (ii) occurred as as a result of an event that could not have been foreseen, unless such event is specifically enumerated in the clause or is otherwise captured by a catch-all provision. Orders imposed by a government may excuse performance if it would be impossible both to comply with the order and to perform under the contract. To be a *force majeure*, an event must have an effect beyond the contract or parties at issue: a party's duty to perform is not discharged if the event that rendered it unable to perform would not likewise have prevented others from performing. The non-performing party may also have to demonstrate that it made an effort to perform notwithstanding the *force majeure*, and its performance may only be excused for so long as those conditions persist and prevent performance.

Material Adverse Effect/Material Adverse Change

A Material Adverse Effect (MAE) or Material Adverse Change (MAC) clause contemplates a change in circumstances that significantly reduces the value of an enterprise, transaction or venture, because of which buyers or investors may be able to avoid completing a transaction. MAE clauses are often heavily negotiated and, accordingly, their applicability may depend on the language of the specific MAE clause at issue.

Absent specific controlling language, courts set a high bar when asked to consider whether a circumstance constitutes an MAE. Most courts have imposed two requirements: (i) the change in circumstances must be an event that will cause a significant effect, viewed over a long duration of years (not months); and (ii) the change must pose a substantial threat to the overall financial health of a target or a venture.

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Since the inception of the pandemic, multiple parties have filed complaints alleging MAEs due to COVID-19. The ongoing litigation in *Forescout Technologies, Inc. v. Ferrari Group Holdings, L.P.*, may provide the first court decision considering the impact of the COVID-19 pandemic on contracts containing MAE provisions.

Contract Frustration

In the absence of a contractual provision directly addressing the consequences of unanticipated risks, parties may seek to avoid contractual obligations based on the common law doctrine of frustration of contract (or frustration of purpose). Such frustration can occur when both parties are literally able to perform but, as a result of unforeseeable events, performance by one party would no longer give the other the benefit that induced that party to make the bargain in the first place. Courts analyzing frustration claims typically consider the foreseeability of the allegedly frustrating event's occurrence, the fault of the non-performing party in causing or not providing protection against the event's occurrence, the severity of the harm and other circumstances affecting the just allocation of the risk. Frustration of contract is very difficult to invoke and is limited to instances where a virtually cataclysmic, wholly unforeseeable event renders the contract valueless to one party.

U.S. Restructuring

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The U.S. COVID-19 outbreak in mid-March raised concerns that capital, which had until then been readily available on favorable terms, would dry up. This caused an abrupt second-quarter shift, with an immediate focus on preserving and building liquidity—whether by drawing on revolver facilities, reaching agreements to defer payment of interest and rent, seeking new debt or equity funding, or otherwise—sponsors were able to review their portfolios and assess the company-by-company impact of the pandemic.

As the second half of 2020 comes into focus, with new COVID-19 cases multiplying and states pausing or even reversing their reopenings, the outlook is more challenging. Even borrowers who are not facing near-term maturities and had a once-manageable debt load—those who would not ordinarily have experienced any financial distress—may be forced to address the prospect of covenant defaults caused by revenue shortfalls, and a resulting inability to meet financial thresholds or deliver unqualified going concern audit opinions. Also, short-term liquidity bridges may have been consumed in the first months of COVID, requiring a new, more comprehensive cash flow solution. In short, sponsors and portfolio companies now must refocus their analysis, with potentially more activist solutions required.

In general, we believe lenders and the capital markets will continue to be accommodating for companies that were previously healthy, whose businesses will allow for a reasonable level of modified operations in a COVID landscape, or who have unencumbered assets that can facilitate new financing on creative and advantageous terms. Indeed, as mentioned above in our Leveraged Finance and Fund Financing section, in recent cases such as Revlon

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and Travelport, portfolio companies have utilized "investment" capacity under their loan agreements to remove existing liens from valuable intellectual property and then borrow new money secured by that same IP. By contrast, for companies that were already stressed or fully leveraged, particularly those that are in heavily impacted industries such as travel, in-person entertainment, education and others, a refinancing or amendment solution appears less likely and sponsors will face the choice of defending their investment through self-help funding initiatives, which may be unpalatable, monetizing the value of the business through a sale, or pursuing a holistic capital structure adjustment.

In this context, if sponsors opt to pursue balance sheet alternatives, we see with increasing frequency that they will seek to engage with a select group of lenders who hold a majority of the debt (or certain key tranches of debt). By limiting the number of lenders who participate in a liability management transaction, the sponsors can provide each of those lenders with more attractive recovery as an inducement to transact—thereby achieving a needed amendment or liquidity raise that extends runway to allow the sponsor to shore up operations and improve the business, or ride out the impacts of COVID. By way of example, the currency offered to participating majority lenders can include non-pro rata repayments of loans at par, changes to the payment waterfall that grant priority to the majority lenders, backstop and financing opportunities, and fees. Serta Simmons Bedding recently pursued this approach, in a transaction where a majority of first- and second-lien secured lenders voted to amend their credit agreement to create three new tranches of debt higher in priority than the existing first lien loans, allowing the participating lenders to improve their position in the capital structure while exchanging at values below par, thereby reducing the company's debt load and injecting new financing to provide needed liquidity. Non-participating lenders sought unsuccessfully to block the transaction in court, and were forced to settle for a junior position in the new capital structure, while Serta and its sponsor were able to move forward with new cash and a reduced debt load, to try to weather the COVID storm. We expect a trend toward similar types of transactions as portfolio companies continue to utilize available provisions in finance documents and applicable law to provide needed balance sheet relief.

Not every portfolio company will be able to find a new-liquidity solution, however. Where sponsors are not willing or able to defend their investment, or where lenders are not willing to accommodate new borrowing or other needed amendments, we expect to see an increased wave of control-change transactions, including an uptick in distressed M&A and debt-for-equity swaps. These instances are most likely to occur where sponsors conclude that certain investments in companies cannot be salvaged, and their best option is to achieve an outcome that minimizes loss to creditors, protects directors and management teams, and enables the sponsors to obtain releases. To that end, we have already begun to see a number of pre-arranged or pre-packaged restructurings in Chapter 11 that turn control of troubled companies over to lenders or put operating assets up for auction, and we expect that trend to continue in the next year.

U.S. Intellectual Property

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Among the key I.P. developments in recent months is an influx of trademark disputes regarding the names of private equity and other private investment funds. A few years ago, we represented Highline Capital Management, a New York-based hedge fund, in a trademark infringement lawsuit against High Line Venture Partners, a captive venture capital firm owned by Barry Diller. That case was successfully resolved on the eve of trial. Today, we are representing a UK-based private equity firm in a lawsuit in California against a private investment firm using the exact same name as our client that focuses on early stage tech investments. We also are advising two other private equity firms on trademark disputes related to their names that have not yet reached litigation. In one, our client identified the infringing use as soon as it began; by moving quickly, we hope to nip it in the bud. In the second case, the name has been in use for some time, which is making resolution of the dispute more challenging. To prevent such complications, it is important to monitor the marketplace and enforce your trademark rights as soon as potential infringements arise. We can help private equity firms set up monitoring programs to check for use of similar names in trademark and domain name applications, and use in the marketplace. It also is important to register your name as a trademark. Trademark registration offers important protections, such as a spot on the Trademark Register, which notifies third parties of the existence of your rights, nationwide protection, and a presumption of validity of the trademark should you need to challenge a third party's infringing use.

Another trend we have seen is an attempt by plaintiffs to hold private equity funds liable for the alleged intellectual property infringement of their portfolio companies. A recent example was a trade dress and design patent case we handled for Clayton, Dubilier & Rice in which Jenny Yoo, a maker of bridal gowns, attempted to hold CD&R liable for the allegedly infringing sale of bridesmaids dresses by its portfolio company, David's Bridal. We were successful in having the case voluntarily dismissed against CD&R. To adequately state a claim for relief for this type of liability, a plaintiff would have to plausibly allege that the private equity fund actively participated in the infringement. Mere participation of the private equity fund on the portfolio company's Board of Directors, or even in a dual role in management of the investment, should not be enough. The less "control" allegations that a plaintiff can make, the stronger a private equity fund's motion to dismiss will be.

Over the last year, we have also seen a flurry of activity related to trademarks at the Supreme Court level. It is clear that the Court is more active than ever in ensuring the protection of intellectual property rights. Two particularly important decisions that may be relevant to private equity firms are summarized below.

United States Patent and Trademark Office v. Booking.com B.V.

In June, the Supreme Court held that Booking.com B.V. could register as a trademark its eponymous domain name, BOOKING.COM. The U.S. Patent and Trademark Office ("USPTO") originally refused to register Booking.com's trademark because it believed that any generic term, when combined with the .com top level domain, is automatically generic. We were co-counsel to Booking.com in its appeal to the Supreme Court, where we

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argued that the USPTO rule failed to respect the primacy of consumers' perception when deciding whether a term is generic (*i.e.*, the name of a category, like travel websites), or a brand name (*e.g.*, Travelocity). Because the evidence overwhelmingly showed that consumers understand BOOKING.COM to be a brand name, the Court ruled in our client's favor and held that BOOKING.COM is entitled to trademark protection. The decision is significant because it recognizes that a domain name has the ability to function as more than simply a web address and can serve as a brand name if consumers understand it in that way.

Romag Fasteners, Inc. v. Fossil Group, Inc.

In April, the Supreme Court held that the Lanham Act—the Act which governs trademark infringement claims under federal law—does not require a showing of willful infringement before a court may order a trademark infringer's profits to be disgorged. Such awards can be significant—for example, in a dispute over the trademark BACKYARD GRILL for barbecue grills, Wal-Mart was ordered to disgorge $50 million of its profits from the sale of those grills even though the plaintiff could not show that it lost any sales. This decision is important because it means that, going forward, Lanham Act plaintiffs may obtain a defendant's profits at the trial court's discretion, subject only to "principles of equity." This may make settlement harder to achieve in Lanham Act litigation.

U.S. Business Integrity

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Recent market trends reflect that U.S.-based private equity firms are increasingly interested in analyzing Environmental, Social and Governance ("ESG") issues. This evolution flows in part from the increasing number of limited partners seeking analyses of such issues. In addition, more sponsors are concluding that a company committed to ESG principles offers additional value, which will benefit the sponsor upon the sale of the business or an exit to public markets. Of course, many sponsors also support ESG principles because they can help a company avoid various legal and reputational risks.

In particular, an increasing number of U.S.-based private equity firms are relying on counsel and other external advisors to evaluate ESG issues associated with their acquisitions. This review includes assessing a target company's ESG risks, including in areas such as carbon emissions, worker safety, data privacy and diversity. Such an assessment also typically includes recommending actions to help mitigate ESG risks and identify opportunities to create further value.

Given recent events, certain issues are receiving greater scrutiny in the ESG assessments being prepared for private equity firms. For example, ESG assessments may now encompass issues associated with COVID-19, such as whether a company is adequately protecting its employees from exposure to the virus. They may also consider whether a company has avoided layoffs, supported flexible working arrangements and repurposed production facilities to manufacture personal protective equipment during the pandemic. Other considerations include assessing data privacy and security concerns resulting from employees working from home.

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U.S. Business Integrity

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In addition, the May 2020 killing of George Floyd by a Minneapolis police officer and other racially motivated incidents have highlighted racial inequality issues. Relatedly, ESG assessments may evaluate company efforts to increase racial diversity, including initiatives designed to help promote minority employees to management positions.

Although the role of ESG consultants is growing, certain critical ESG-related information is often best obtained by a sponsor's counsel. For example, ESG issues such as bribery and corruption often raise issues for which sponsors need specialized legal advice. Given the legal intricacies surrounding these issues, sponsors properly benefit from the attorney-client privilege applicable to such advice.

Looking ahead to the November 2020 election, if Joe Biden wins the presidential election and Democrats control both houses of Congress, certain ESG-related initiatives may yield new laws. For example, a Biden administration is expected to impose certain restrictions on emissions of greenhouse gases. Private equity firms will want to evaluate the impact of such laws on the companies they acquire, in addition to monitoring and addressing other evolving ESG risks.

Europe Business Integrity

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Over the last year we have seen an increased push for mandatory due diligence of human rights and environmental impacts in Europe. In the wake of the pandemic and the provision of government assistance packages, there has been a renewed and increased focus on responsibilities of business to society at large. This focus comes as risks of adverse impacts have shifted and proliferated: for example, health and safety risks for workers and the vulnerabilities linked to mass unemployment, such as child labor, trafficking and other forms of exploitation. In April 2020, the European Union's Commissioner for Justice, Didier Reynders, announced a new legislative initiative to be expected in 2021 that will require businesses to conduct due diligence on potential human rights and environmental impacts of their operations and supply chains. Commissioner Reynders explained that voluntary action had not brought about sufficient change.

The call is for a regulation that is cross-sectoral and is not limited to large companies or companies that are EU domiciled. While the scope and content of the proposed legislation will be subject to consultation, Commissioner Reynders indicated a preference for cross-sectoral legislation that contained enforcement mechanisms and sanctions for non-compliance. In June 2020, a report by a Directorate General of the European Parliament also recommended that any human rights due diligence legislation not limit its scope to large companies, but differentiate the requirements depending on size, leverage and the nature of any potential impacts. Further, it recommended that the law should apply to any companies placing products or offering services in the EU, and that the scope of diligence extend beyond first-tier suppliers in line with business relations and influence in the value chain. It therefore seems likely that many private equity-backed companies will be in scope.

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Businesses report a lack of legal certainty in the current landscape surrounding due diligence requirements. Commissioner Reynders' comments followed a study commissioned by the European Commission, which surveyed business and general respondents. Just over a third of business respondents reported conducting due diligence into human rights and environmental impacts, and another third stated that they conducted due diligence into limited areas. The majority of all survey respondents stated that the current legal landscape did not provide them with sufficient legal certainty regarding due diligence obligations. A "complementary" study into directors' duties and sustainable corporate governance was launched last year (findings pending), and the studies and resulting proposals will contribute to the EU Commission's Sustainable Corporate Governance Initiative 2021.

The push for mandatory due diligence is also coming from international investors. Commissioner Reynders' announcement also came less than a week after more than 100 international investors representing USD 4.2 trillion in assets under management called on governments to require companies to conduct human rights due diligence. The statement reiterated that investors themselves have a responsibility to respect human rights and may be connected to adverse impacts on human rights by funding companies or projects linked to abuses. As a result, companies must have robust processes in place for investors to conduct their own diligence.

All of these developments sit alongside increasing emphasis on transparency surrounding investment portfolios. The European Commission's Communication on the European Green Deal emphasized the need to improve disclosure of non-financial information—in this context, a consultation on extension of the EU's Non-Financial Reporting Directive closed on June 11, 2020. There are other relevant reporting initiatives on the table—we have already reported on the EU's Taxonomy Regulation and the Sustainable Finance Disclosure Regulation, which will have significant consequences in the financial sector and beyond—and further initiatives are to come—the EU's current consultation on a Renewed Sustainable Finance Strategy and the UK's Green Finance Strategy set ambitious and wide ranging objectives.

At the same time, certain European governments are considering the effectiveness of their national regimes, including the UK Modern Slavery Act ("MSA"), that are relevant to most private equity firms and/or their portfolio companies. A 2018 review into the effectiveness of certain provisions of the MSA included recommendations to improve the operation of section 54, which requires larger companies to issue an MSA statement. The statement must cover steps taken by the company (if any) to combat modern slavery and trafficking in its business and its supply chain. In response to the review's recommendations, the UK government conducted a public consultation on strengthening the transparency requirements, including on the content of MSA statements. It also accepted certain recommendations which will result in changes to its official guidance, including encouraging more specificity in reporting. In June 2019, the Prime Minister also announced the creation of a central registry of modern slavery statements.

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