

M&A, Supply Chains, Contracts, and the Cloud: The Latest 'Must-Knows' for the Corporate Generalist

2023 New Legal Risks Symposium

SEPTEMBER 20, 2023

www.gtlaw.com

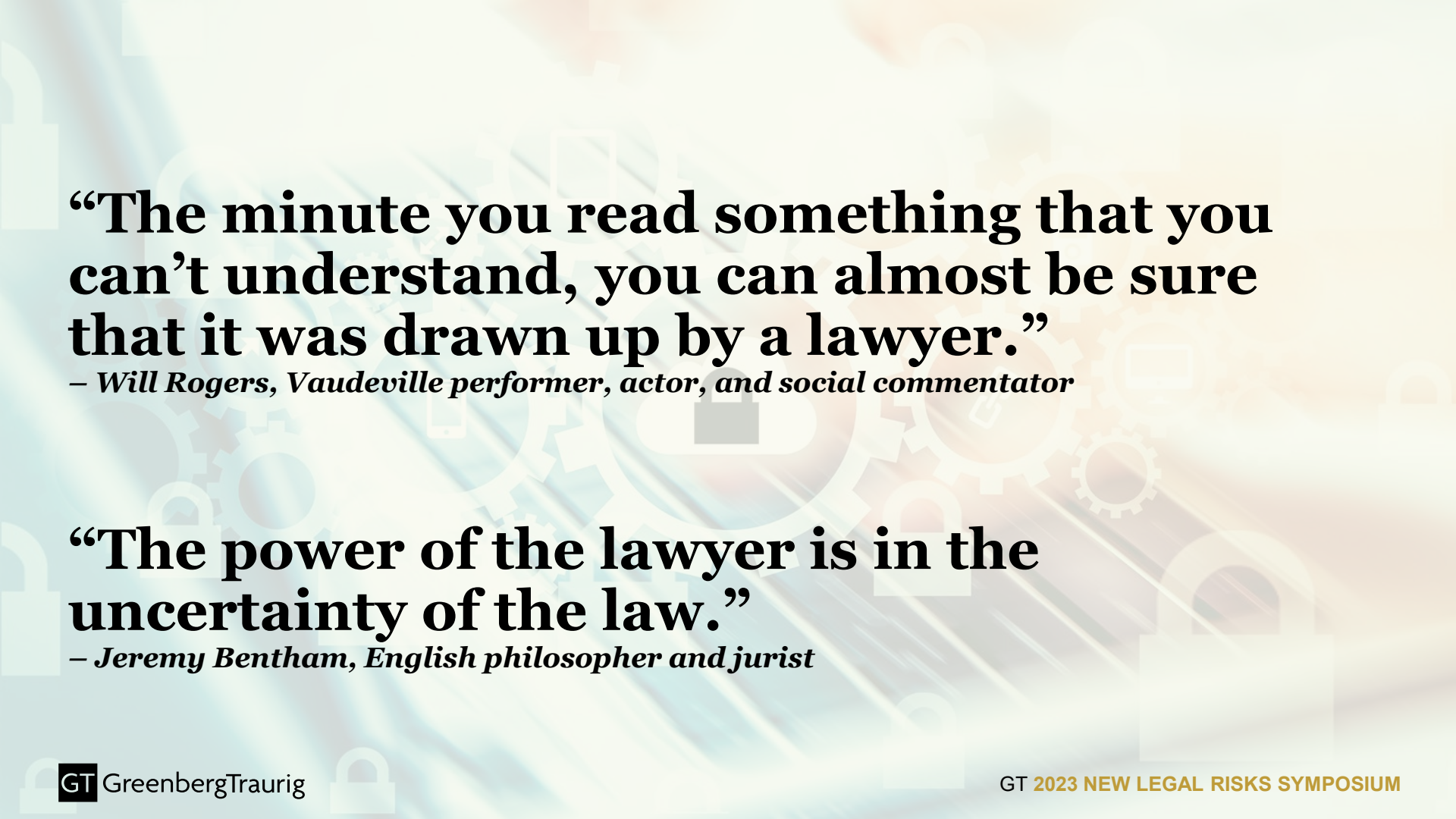
Today's Speakers



Shawn McIntee
Shareholder
Greenberg Traurig, LLP
shawn.mcintee@gtlaw.com



Shauro Bagchi
Shareholder
Greenberg Traurig, LLP
shauro.bagchi@gtlaw.com



“The minute you read something that you can’t understand, you can almost be sure that it was drawn up by a lawyer.”

– Will Rogers, Vaudeville performer, actor, and social commentator

“The power of the lawyer is in the uncertainty of the law.”

– Jeremy Bentham, English philosopher and jurist

Approach

- **Scope & Assumptions:**

- Covering many (relevant) topics at a high level for the in-house generalist.
- Spotting issues and trends; many driven by market conditions and post-pandemic business challenges.
- Combination of legal and business issues at play; goal is to help you...to help the business units that you support identify, allocate, and mitigate risk.

- **Out of Scope:**

- In-depth treatment of regulatory developments; we have subject matter experts who can help with that.

Topics

- Corporate & M&A
- Supply Chain & Logistics
- Cloud & Technology Agreements

Corporate & M&A Topics

- New Antitrust Rules
- Hart-Scott Rodino (HSR)
- Earnout Trends
- Representations & Warranties Insurance
- New MN Noncompete Law & Effect on M&A

M&A – New Antitrust Guidance

- On July 19, 2023, the FTC and DOJ released for public comment draft updated Merger Guidelines. Not binding law but reflects how the FTC intends to analyze M&A transactions.
- Reactive Rulemaking – Perception that previous administrations have been overly permissive leading to excessive concentration.
- Increased focus on enforcement on digital platforms, incremental “roll-up” strategies, and the impact of M&A on wages and benefits.

M&A – New Antitrust Guidance (Cont.)

13 Guiding Principles:

- 1) Mergers Should Not Significantly Increase Concentration in Highly Concentrated Markets.
- 2) Mergers Should Not Eliminate Substantial Competition Between Firms.
- 3) Mergers Should Not Increase the Risk of Coordination.
- 4) Mergers Should Not Eliminate a Potential Entrant in a Concentrated Market.
- 5) Mergers Should Not Substantially Lessen Competition by Creating a Firm That Controls Products or Services That Its Rivals May Use to Compete.
- 6) Vertical Mergers Should Not Create Market Structures That Foreclose Competition.
- 7) Mergers Should Not Entrench or Extend a Dominant Position.

M&A – New Antitrust Guidance (Cont.)

- 8) Mergers Should Not Further a Trend Toward Concentration.
- 9) When a Merger Is Part of a Series of Multiple Acquisitions, the Agencies May Examine the Whole Series.
- 10) When a Merger Involves a Multi-Sided Platform, the Agencies Examine Competition Between Platforms, on a Platform, or to Displace a Platform.
- 11) When a Merger Involves Competing Buyers, the Agencies Examine Whether It May Substantially Lessen Competition for Workers or Other Sellers.
- 12) When an Acquisition Involves Partial Ownership or Minority Interests, the Agencies Examine Its Impact on Competition.
- 13) Mergers Should Not Otherwise Substantially Lessen Competition or Tend to Create a Monopoly.

M&A – New Antitrust Guidance (Cont.)

- **Key Takeaways:**

- Material change from prior FTC/DOJ approach; reflects categorical suspicion of M&A activity and tightening of merger enforcement.
- Agencies willing to adopt economic theories not previously used in antitrust rulemaking—lower deal size; non-traditional evidence; not focused on the “market” but on potential competition/harm to competitors; target “platforms” and “roll-ups;” focus on labor markets and deceptive practices.
- Antitrust scrutiny will become relevant earlier in the deal process and more deals will be subject to antitrust scrutiny.

M&A – Proposed HSR Changes

- Hart-Scott-Rodino Antitrust Improvements Act of 1976 – Current requirements:
 - Parties to larger transactions (based on the size of the parties and size of the transaction) must:
 - report basic information about the transaction and their businesses to both the Federal Trade Commission and the U.S. Department of Justice Antitrust Division.
 - Wait a specified period before they can close.
 - During the waiting period, one of the U.S. antitrust agencies reviews the transaction to make sure it is not likely to substantially harm competition. Transaction can be permitted to proceed, or the applicable agency will seek to enjoin the transaction. The matter can also be “settled” in a manner that satisfies the regulator—e.g., by requiring a divestiture of a line of business.

M&A – Proposed HSR Changes (Cont.)

- Set forth in a “Notice of Proposed Rulemaking (NPRM)” on June 29, 2023. Comment period ends September 27, 2023.
- Parties to a transaction would be required to disclose:
 - Business/strategic rationale for the transaction and information regarding dates and closing conditions.
 - Description of the market overlaps between the parties to the transaction.
 - Underlying structure of funds and special purpose vehicles, etc. Could result in private funds having to disclose sensitive internal information.
 - Investment holdings (including minority stakes).
 - Market research and other documents (in addition to the basic transaction documents that previously needed to be disclosed).
 - Details regarding prior (including non-reportable) transactions.

M&A – Proposed HSR Changes (Cont.)

- Information about officers, directors, and board observers of the buyer.
- Data/analysis regarding the effect of the transaction on employees (and the labor market in the industry).
- Disclosure of prior penalties assessed against the filing parties by *other* unrelated federal agencies (e.g., NLRB and OSHA matters, which are more than likely unrelated to the subject transaction, would need to be disclosed).
- Disclosure/analysis of product overlaps for nascent/upcoming products (as between the parties) for products expected to generate annual revenue totaling more than \$1 million within two years.

M&A – Proposed HSR Changes (Cont.)

- **Key Takeaways:**

- Significant additions to the HSR form's requirements and very few deletions.
- If adopted (which is likely) the new reporting data and information framework will add significant time and cost burdens to all deals, including those having no substantive competitive impact.
- The Agencies themselves estimate a four-fold increase in HSR Form preparation time, and many HSR experts forecast an exponentially greater burden when considering the full scope of efforts required to fully comply with the additional requirements, especially those that are novel.
- While the Agencies have updated the HSR Form numerous times over the years, the new rules represent the most comprehensive overhaul and expansion of HSR Form requirements.
- Lengthens deal (and pre-deal) process – Parties may need to restructure in advance of the deal (to try and avoid certain disclosures); Agencies will receive more applications → longer review time → longer period between signing and closing.

M&A – Earnout Trends

- Earnout – The seller must “earn” a portion of the consideration based on the performance of the as-sold business after closing.
 - Can be very complex
 - Prone to post-closing disputes

M&A – Earnout Trends (Cont.)

- Showing up more in deals, especially private deals
 - SRS Acquiom study reported earnouts in 21% of deals announced in 2022, the highest percentage since 2017.
 - Likely due to market conditions and financing challenges, i.e., higher cost of capital makes earnouts comparatively more attractive for buyers *and sellers*.
 - Economic uncertainty creating post-closing insecurity.
- Prevalence of disputes on the rise

M&A – Earnout Trends (Cont.)

- EBITDA metrics
 - Combinations of revenue and earnings
- Longer performance periods – median of 24 months in 2022
- Virtually no deals with a buyer covenant to run the business in a way that maximizes the earnout
- Appearing in industries where earnouts were very rare (e.g., sports franchise sales)

M&A – Earnout Trends (Cont.)

- **Key Takeaways:**

- Earnouts have become more “market,” which may make it more acceptable to sellers (and sellers may not have any other options—no longer a “seller’s market” like 2021).
- Given that earnouts are heavily litigated, consider whether the “juice is worth the squeeze.” Exchanging financing and valuation issues now for potential disputes in the future.
- Crucial to draft tight earnout provisions where success or failure can be objectively measured.
- Consider if broader/more robust ADR provisions should be included in anticipation of earnout disputes.

M&A – Representations & Warranties Insurance (RWI)

- Protects a party to an M&A transaction from losses suffered as a result of the other party's breach of its representations and warranties. Usually, buyer obtains the policy to insure against seller rep./warranty breaches.
- Breaches of "10b-5" and "Full Disclosure" seller representations are typically not covered by RWI policies.
- Indemnification escrow sizes have remained steady (deals with RWI have median escrow of 0.5% and without RWI have 10% escrows). The low escrow for RWI deals usually tied to the amount of RWI policy retention for which sellers may be responsible.
- RWI deals more likely to include "Non-Reliance" and "No Other Representations" reps. Continues to be highly negotiated notwithstanding other deal trends in 2022/23.

M&A – RWI (Cont.)

- Continuation of seller favorable “walk away” deals *in certain industries* (where reps./warranties don’t survive closing but buyer may have recourse through the RWI policy). But this trend is the result of multiple factors, not just RWI.
- RWI deals less likely to include materiality scrapes, but, overall, scrapes are prevailing practice. Most scrapes in RWI deals are double scrapes, likely mirroring the double scrape approach in most RWI policies.
- In RWI deals, sellers’ indemnification obligations are more often structured as true deductibles than first dollar (tipping) baskets. Might be for purposes of matching the RWI policy. Almost 25% of RWI deals did not include a basket.

M&A – RWI (Cont.)

- Purchase price escrows (for post-closing adjustment) on the rise across all deals. Per SRS Acquiom, 85% of deals with RWI included separate purchase price escrow vs. 73% of all deals and 42% of deals without RWI. Might be a product of deal size as well.
- **Key Takeaways:**
 - Continues to move “down market” (used in more deals than 5 or 10 years ago). May become even more prevalent if only the “best deals” are getting done (and overall M&A activity continues to slump). I.e., easier to underwrite top-tier sellers’ reps/warranties. Conversely, may become less prevalent if buyers want to reduce deal costs. Uncertain.
 - As of now, no marked decrease (as a percentage of deals) notwithstanding overall deal activity is down.
 - May not affect deal timing (see above re: antitrust and HSR rules).

New MN Noncompete Law

Minn. Stat. Section 181.988 renders void and unenforceable any covenant not to compete (i.e., noncompete agreement) with an employee or independent contractor, unless the noncompete agreement was:

- Agreed to by partners, members, or shareholders selling or dissolving a business;
- Restricts them from carrying on a similar business; and
- Within a reasonable geographic area and for a reasonable length of time.

New MN Noncompete Law (Cont.)

- A “covenant not to compete” means an agreement between an employee and employer that restricts the employee, after termination of the employment, from performing:
 - Work for another employer for a specified period of time;
 - Work in a specified geographical area; or
 - Work for another employer in a capacity that is similar to the employee’s work for the employer that is party to the agreement.
- Definition of non-compete expressly excludes non-disclosure agreements, agreements designed to protect trade secrets, agreements to protect confidential information, agreements restricting the ability to use client or contact lists, and non-solicitation agreements, including soliciting customers of the employer.

New MN Noncompete Law (Cont.)

- The new law is only effective for agreements entered into after July 1, 2023; not retroactive.
- It only renders void and unenforceable non-compete covenants; the balance of an otherwise enforceable agreement is not affected.
- Contains choice-of-law and venue provisions prohibiting an employer from requiring an employee who primarily resides and works in Minnesota, as condition of employment, to agree to a provision that would require a claim or controversy arising in Minnesota: (1) to be adjudicated (including litigation and arbitration) outside of Minnesota; or (2) which deprives the employee of the substantive protections of Minnesota law.
- In addition to injunctive relief and other remedies, a court may award reasonable attorneys' fees to an employee who sues to enforce the employee's rights under the law.

New MN Noncompete Law (Cont.)

- **Key Takeaways:**

- Viewed as one of the more extreme noncompete laws (as it categorically prohibits noncompete agreements in the employment context, even for upper management and key personnel).
- Need to use other mechanisms to ensure protection of IP and proprietary/sensitive information.

Cloud

- “Hosted application” model or “software-on-demand” model of providing end-user access via the applicable UI to information technology applications via the Internet is becoming ubiquitous.
- Became critical during CV-19 pandemic (and valuations soared).
- SaaS adoption continues to increase.
- There are still gaps and missed opportunities.

Cloud – Trends/Key Negotiations

- Defining “the Service” and ability to reduce subscription without termination
- IP Ownership and scope of “customer’s” work product
- Monetizing data
- Fees and payment terms/term and termination
- Indemnification and limitation of liability

Supply Chain & Logistics

- Bubbled to the forefront as a result of CV-19. Continues to have significant ripple effects. Companies are approaching commercial contracts differently as a result.
- **Primary Topics:**
 - Force Majeure
 - Commercial Impracticability
 - Frustration of Purpose

Supply Chain & Logistics – Force Majeure

- Force Majeure - French for “superior force.” Common law concept that requires an express contractual provision to be operative, i.e., does not apply “as a matter of law.”
- Force majeure clauses set forth the circumstances in which a party owing a duty under the contract (the obligor) is excused from all or partial performance of that obligation, typically due to circumstances beyond the obligor’s reasonable control.
- If an event could have been prevented by the impacted party, or if the impacted party did not do everything it could do to avoid the event, it may not constitute a condition excusing performance under the force majeure clause.

Supply Chain & Logistics – Force Majeure (Cont.)

- **Legal Themes:**

- Narrowly interpreted to give effect solely to the specific force majeure “events” included in the contract (including MN courts). E.g., MLB/MN Twins Case.
- If the force majeure event is not listed or is expressly excluded, however, courts are likely to find that the risk of that event should remain with the obligor.
- A party must prove that the listed FM event proximately caused its failure to perform under the agreement.
- New FM clauses have a very long list of items, many of which are controllable.

Supply Chain & Logistics – Force Majeure (Cont.)

- Consider example provision:
- ““Force Majeure Event” means the occurrence of any event or circumstance (or any combination of events and/or circumstances) that is: (a) beyond the reasonable control of a Party; and (b) partly or wholly prevents, hinders or delays due performance by that Party of its obligations under the Contract (other than an obligation to pay money) (“Affected Obligations”) and, provided that the above conditions are satisfied, includes but is not limited to:
 - (i) fire, explosion or accident;
 - (ii) cyclone, earthquake, fog, frost, tidal wave, flood, storm, lightning, hurricane, tempest, perils of the sea or other acts of God;
 - (iii) acts of public enemies, war (declared or undeclared), civil war, piracy, terrorist activities, embargo, blockade, hostilities, revolution, political disturbance, sabotage, explosion, riot, insurrection, mobilization, civil commotion;
 - (iv) strikes, lockout, labor disputes or other form of industrial action or industrial disturbances, stoppages of workmen or tugboat men or any other hands essential to the working, carriage, Delivery and shipment of the Product whether partial or general;

Supply Chain & Logistics – Force Majeure (Cont.)

- (v) acts, legislation, decrees, orders, regulations or restrictions of government or of local authorities (including interruptions caused by such acts, legislation, decrees, orders, regulations or restrictions) or of any court, or of any regulatory body or authority having jurisdiction over either Party or its group, or controls on exports;
- (vi) plague, epidemic, pandemic, outbreaks of infectious disease or any other public health crisis or quarantine or other restrictions arising out of these events; and
- (vii) any circumstance or event which affects the Seller's or, any of the Seller's suppliers, ability to produce, transport or Deliver the Product including without limitation: (A) the events listed in (i) to (vi) above; (B) blockages or congestion in the navigation channels or approaches (at sea or on land) to the Loading Port; (C) the unavailability of any infrastructure necessary to transport the Product; or (D), loss of, damage to, failure, accidents or breakdowns of any of the Seller's or the Seller's suppliers' facilities necessary to the production, transportation or Delivery of the Product (including roof shaft collapse).

The existence of the COVID-19 pandemic and its effects or possible effects at the time the Contract is entered into shall not prevent the Affected Party from relying on the rights granted under Clause 4 (Force Majeure)."

Supply Chain & Logistics – Force Majeure (Cont.)

- FM clause should have an express obligation to circumvent or resolve the FM clause as soon as possible.
- Should specify a maximum period of time in which the party that cannot perform has to resolve the matter, and if not so resolved, the party not affected by the FM event has the right to terminate the contract to seek other suppliers. Otherwise, the non-affected party could be waiting for some time for the other party to perform.
- Recently, we have seen provisions in which the party experiencing the FM event has the right to terminate the contract after a certain period of time. Unusual approach.
- A FM clause should impose a duty on the affected (non-performing) party to mitigate. State law interpretation of this duty, however, varies from state to state:
 - In some states, the duty arises only when mitigation can be done at minimal or reasonable expense or effort.
 - In states that do not have any case law regarding mitigation of damages in the force majeure context, courts generally hold parties to the same general standard of mitigation used in breach of contract cases.

Supply Chain & Logistics – Force Majeure (Cont.)

- **Key Takeaways - Negotiation and Drafting:**

- When negotiating a force majeure provision, the party bearing most of the principal non-payment obligations of the agreement typically is the main beneficiary of the force majeure clause, i.e., “payment of fees” is a common carveout to the definition of FM.
- However, a buyer in a sale of goods agreement generally wants:
 - To exclude a FM clause or, at a minimum, draft the force majeure provision as narrowly as possible and limit the definition of force majeure events to those events that are genuinely outside the seller’s control.
 - The ability to terminate the contract if a force majeure event continues for a certain length of time.
- The contract’s choice of law and dispute resolution clauses will affect the outcome of any FM dispute.

Supply Chain & Logistics – Commercial Impracticability

- Common law doctrine for the purchase and sale of services and UCC-based for the sale of goods (in MN, see Minn. Stat. Ann. § 336.2-615(a)).
- Elements: To prevail on a claim under UCC § 2-615(a), a party must generally show:
 - An unforeseen event occurred (the “contingency”);
 - The contingency made performance impracticable; and
 - The nonoccurrence of that contingency was not foreseeable at the time of contracting.
- Underlying Rationale – The circumstance causing the breach has rendered performance so critically different from what was anticipated, that the contract cannot be reasonably thought to govern the scenario.

Supply Chain & Logistics – Commercial Impracticability (Cont.)

- Gap filler; does not alter risk allocation in agreements.
- Contrast with other states that use “impossibility” instead of impracticability.
- If the cause of impracticability only partly impairs a supplier’s ability to deliver goods, then the party must allocate production and deliveries among customers and reasonably notify such customers of the estimated quota made available to the customer. In allocating production and deliveries, the non-performing party may include regular customers not then under contract and the party’s own requirements for further manufacture, so long as the allocation is fair and reasonable. Can attempt to modify this via contract.

Supply Chain & Logistics – Commercial Impracticability (Cont.)

Key Takeaways:

- Open question is whether or not a party can contract for allocation of supply in advance of an impracticable event.
- Courts have not found commercial impracticability if the price of the subject goods rose even with other compounding factors (e.g., production cost increases). Price increases generally do not make contracts “impossible” or “impracticable” to perform.
- Might benefit suppliers and customers to build in contract mechanisms to mitigate the effect of price increases, e.g., price adjustment provisions, alternative sourcing, overriding ability to allocate production across customers.

Supply Chain & Logistics – Frustration of Purpose

- Excuses performance when the cessation or nonexistence of some particular condition or state of things has rendered performance impossible and the object of the contract frustrated.
- Must be clear from the contract and surrounding context that the parties obviously assumed a particular condition or state of circumstances would continue to exist.
 - Subject to the foregoing premise, if the applicable condition or state ceases to exist, only then may a court may find that the entire purpose of the contract is frustrated.

Supply Chain & Logistics – Frustration of Purpose (Cont.)

Key Takeaways:

- Unlike force majeure and impracticability, which focus on the ability of the obligor (e.g., supplier) to perform, frustration of purpose focuses primarily on the obligee's (e.g., customer) ability to enjoy the benefits of the bargain.
- The Restatement (Second) of Contracts § 265 provides that frustration of purpose may excuse performance when, so long as the language or circumstances do not indicate the contrary: (1) a party's principal purpose is substantially frustrated; (2) such party is not at fault; and (3) the contract was made on the basic assumption that the cause of the frustration would not occur.
- The doctrine is generally given a narrow construction to be applied sparingly.
- MN recognizes the doctrine of Frustration of purpose and will apply it even if the parties have a FM clause.

Artificial Intelligence (AI)

- Definition – “Artificial intelligence is a machine’s ability to perform the cognitive functions we usually associate with human mind.” – *McKinsey*, “*What is AI*,” April 24, 2023.
- Regulation is still in its nascent stages.
- No comprehensive federal legislation dedicated solely to AI regulation.

AI (Cont.)

- The European Commission proposed the “AI Act” in April of 2021. Risk-based regulations that classify the level of regulation based on the perceived risk:
 - High Risk – (1) Human safety and fundamental rights—e.g., toys, aviation, cars, medical devices (and other products subject to the most stringent EU regulation) and (2) systems in the following categories (requiring EU registration): biometrics, critical infrastructure, education, employment, essential services, law enforcement, migration/border control *and “assistance in legal interpretation and application of the law.”*
 - Lower Risk – Generative AI (e.g., ChatGPT). Comply with robust transparency requirements.
 - Limited risk – AI systems that generate or manipulate image, audio or video content (e.g., “deepfakes”). Comply with minimal transparency requirements.

AI (Cont.)

- Current and proposed U.S. laws focusing on:
 - Limitations on data retention, sharing and use of PII.
 - Allowing natural persons to “opt out” of AI-based decisions/profiling.
 - Preventing AI from making “decisions” using factors that otherwise cannot be used to make the applicable decisions, e.g., using protected traits to determine employment, insurance coverage, interest rates, issue loans, etc.
 - Limitation of use for certain “public goods” (e.g., Ballot processing in AZ).
 - Protecting children or vulnerable populations (including from advertisement).
 - Monitoring/reporting outcomes from AI-based decisions.
 - May have industry-specific effects, e.g., insurance, lending, etc.

AI (Cont.)

- **Key Takeaways:**

- Uncertain legal landscape; novel legislation and legal issues.
- Rulemaking is (and will likely continue to be) data-focused legislation. As expected, most regulations are attempting to piggyback off other regulations relating to sensitive data (and parallel/adapt those laws to “fit” with AI).
- When evaluating AI programs and agreements, consider the same factors that legislators are considering:
 - What data is being obtained or generated; who is processing/storing the data and for what purposes (and in what form) is the data being used.
 - Will the product be used in an otherwise highly regulated industry (e.g., healthcare, insurance, lending) or in connection with otherwise highly regulated activities (e.g., employment).
 - Can the data subjects elect to opt out? Are the data subjects likely to be part of a protected or highly regulated class?
 - How is the AI product monitored, modified, or shut off, and what role do humans play in mitigating the key legal risks?

Questions?

Presenter Information:

Shawn McIntee, Shareholder

Phone: 612-259-9678

Email: Shawn.McIntee@gtlaw.com

Shauro Bagchi, Shareholder

Phone: 612-259-9673

Email: Shauro.Bagchi@gtlaw.com